

# AIECE General Report presentation

## For the Autumn 2015 General Meeting

Brussels  
November 5-6, 2015



# Agenda

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1 European economic outlook

2 Monetary policy

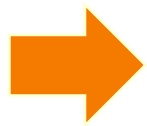
3 Fiscal policy

4 Institutional environment

# World business cycle: Key insights

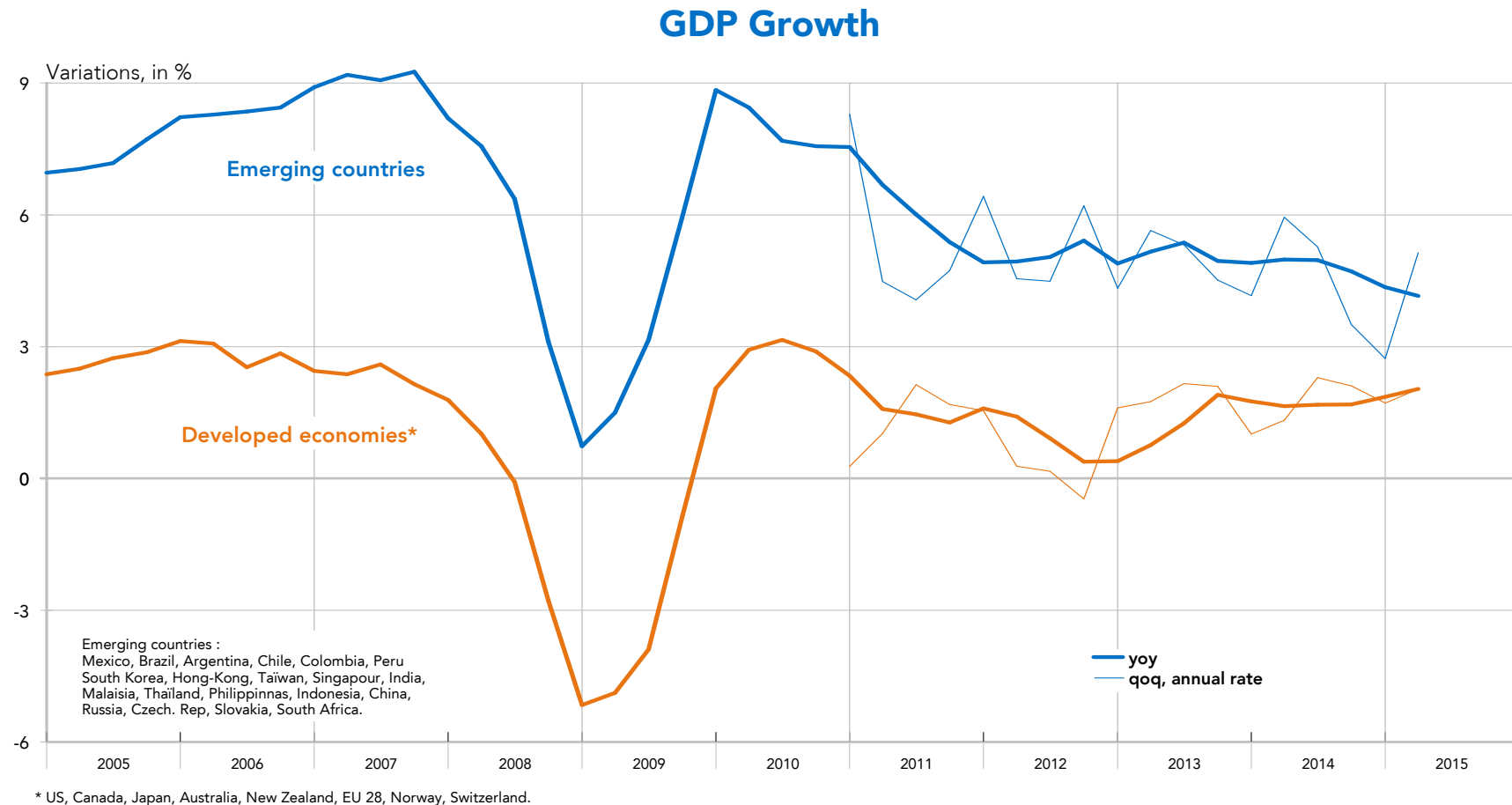
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- **A transitory and inconspicuous « favorable alignment of stars »**  
The smallest rate of world economic growth since 2001 (excl. 2008-09) in 2015 in spite of decrease in raw material prices and extraordinary low levels of interest rates.
- **Long lasting slowdown in emerging countries, resilience of developed economies**  
Activity in the United States is not at the end of the cycle. Russian and Brazilian recessions, Chinese still soft landing
- **Euro Area rediscovers both growth and risks**  
Positive news for activity, inflation close to zero  
Resurgence of risks.



**Downward revision of growth prospects for 2015 and onwards  
No clear acceleration anywhere in 2016 apart from the expected  
milder recession for Russia and Brazil**

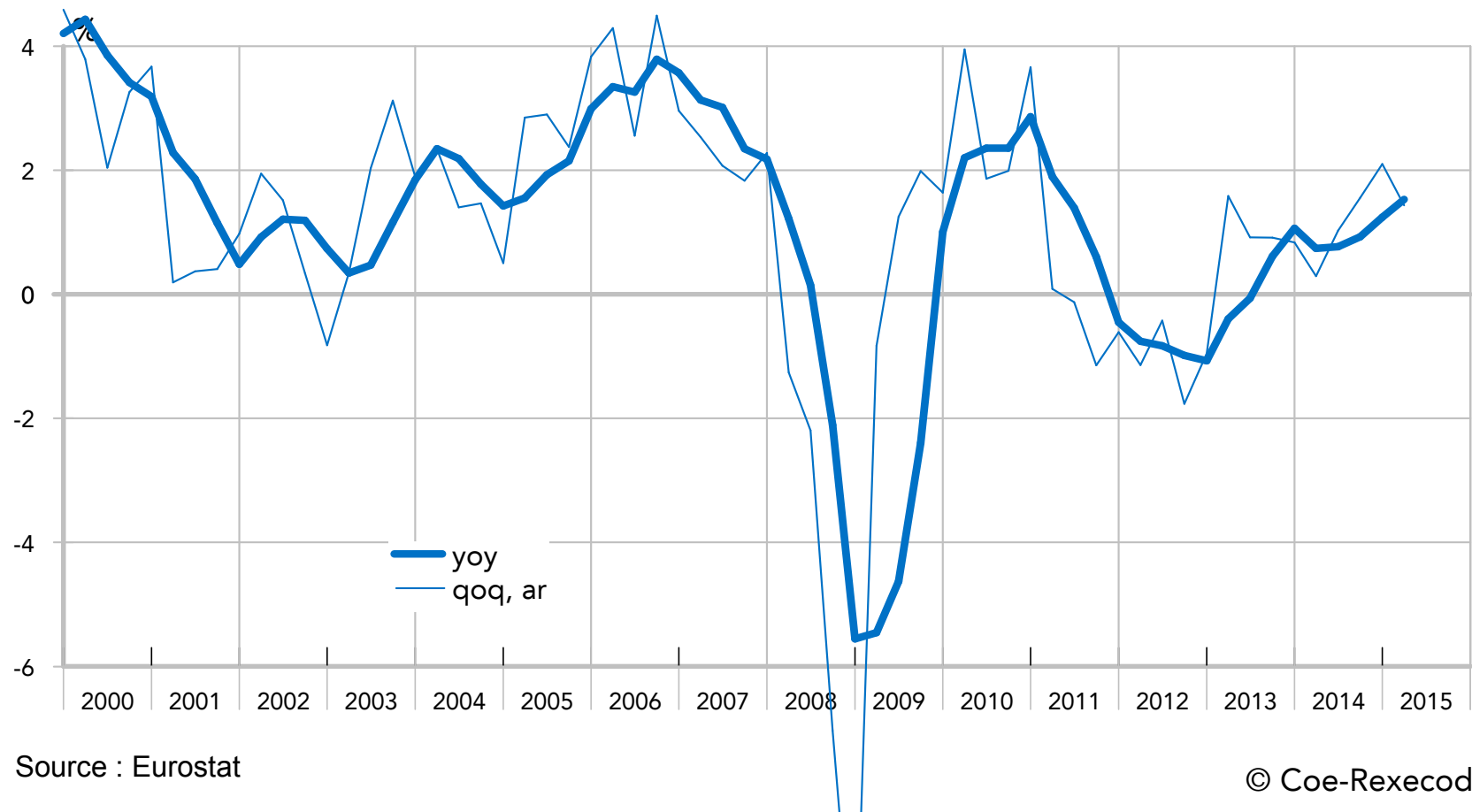
# 2015 will see the narrowest gap in GDP growth between emerging and developed economies for 15 years



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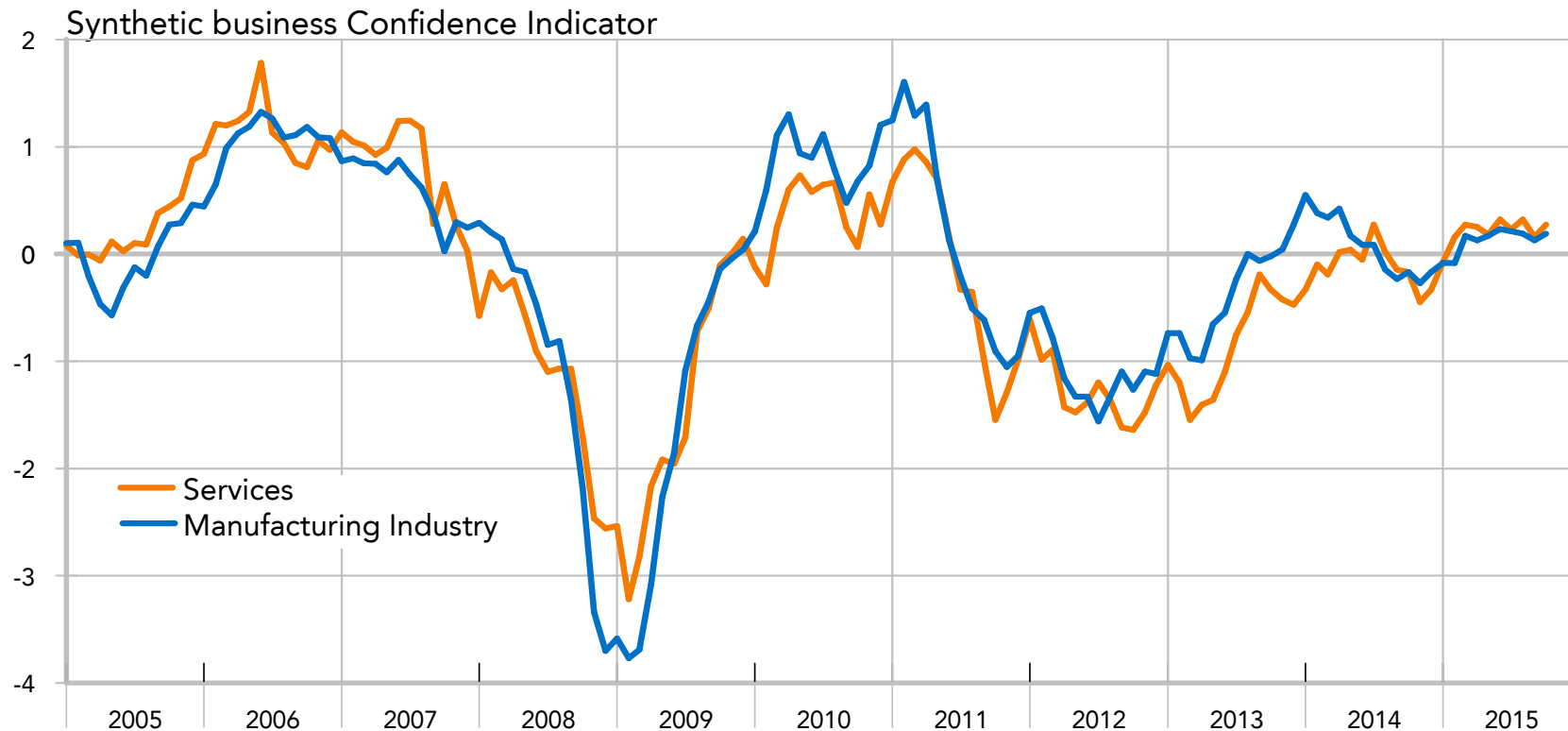
## 9 consecutive quarters of positive although subdued growth

Euro Area : GDP in constant terms



# A still soft patch for euro area economic growth

## Euro Area : Purchasing Managers Index



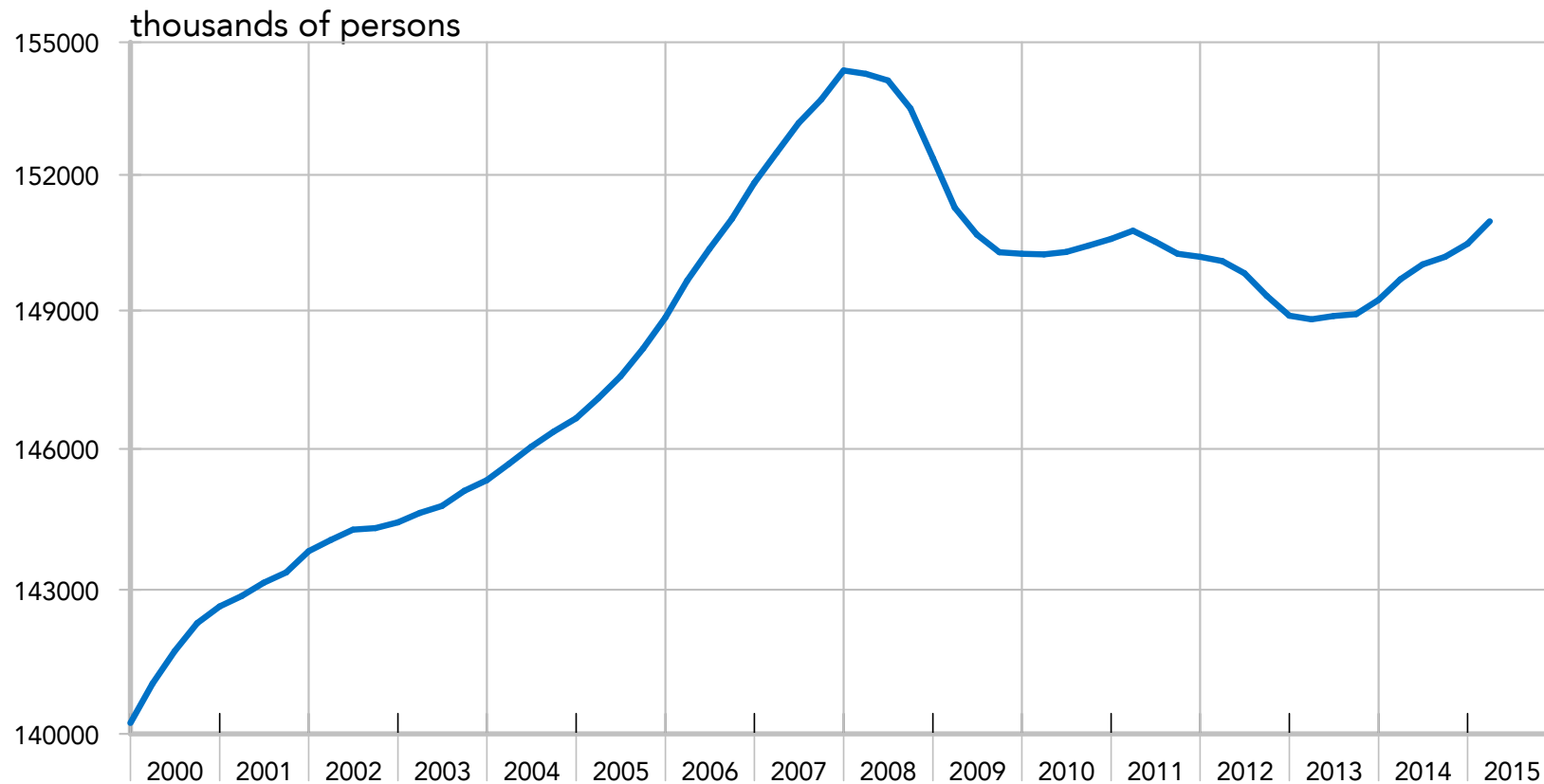
Source : PMI survey (Markit)

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# A clear recovery of employment. Still a long way to go to return to pre-crisis levels

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## Euro area : Total employment

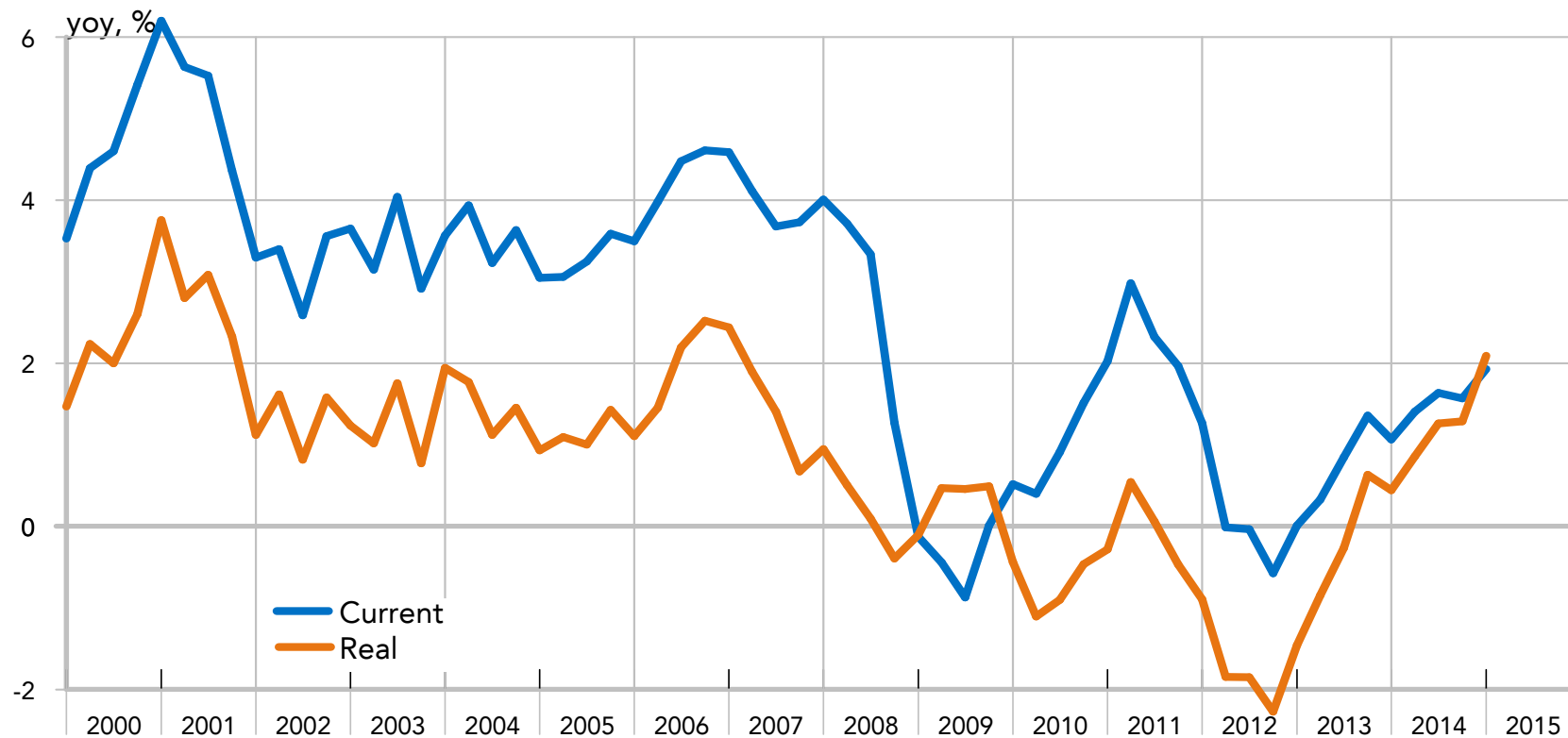


Source : Eurostat

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# The households real GDI has reached the 2 % growth line, thanks to the drop in inflation and energy prices

## Euro Area : Households Gross Disposable Income



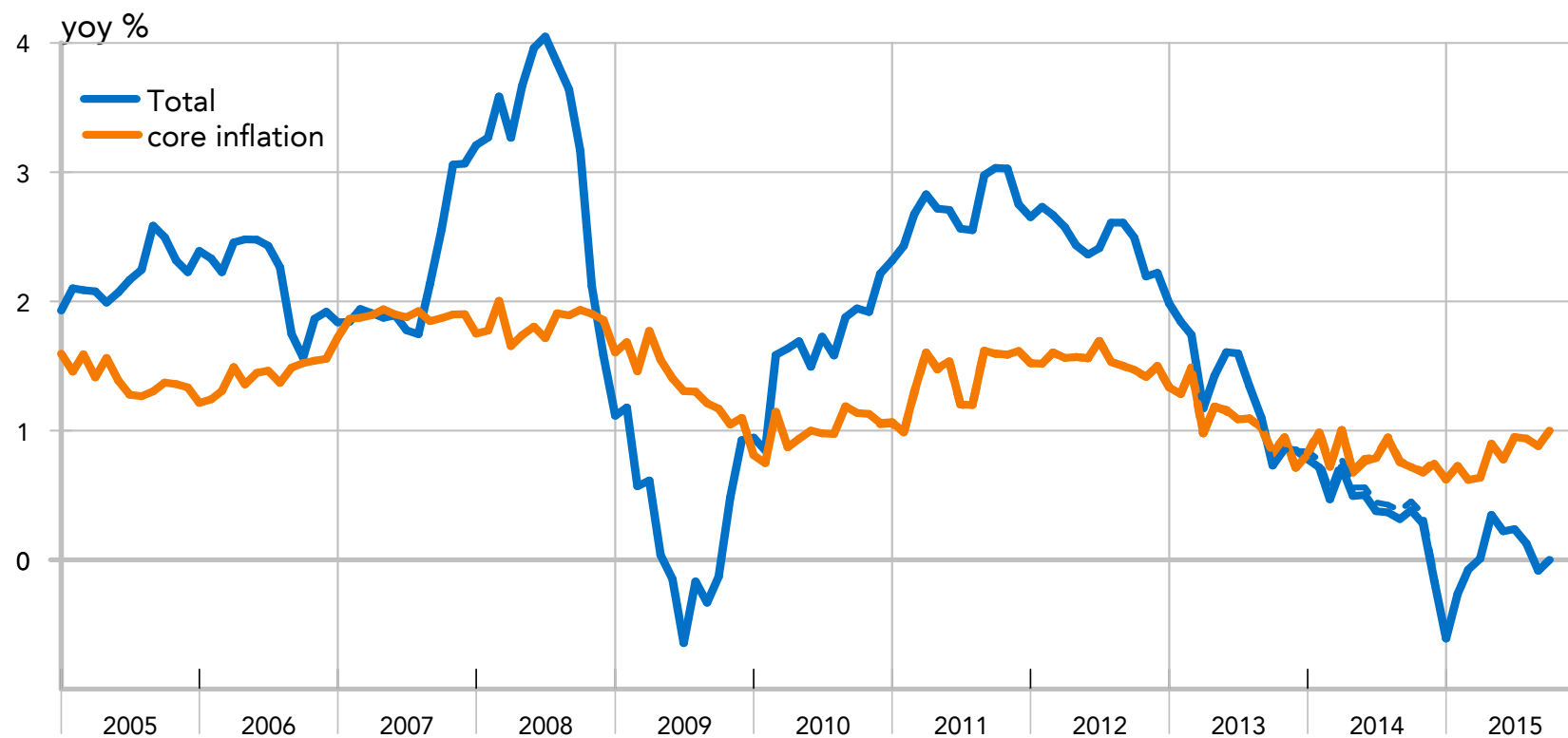
Source : Eurostat

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# The end of the disinflation process?

## Euro Area : Inflation rates

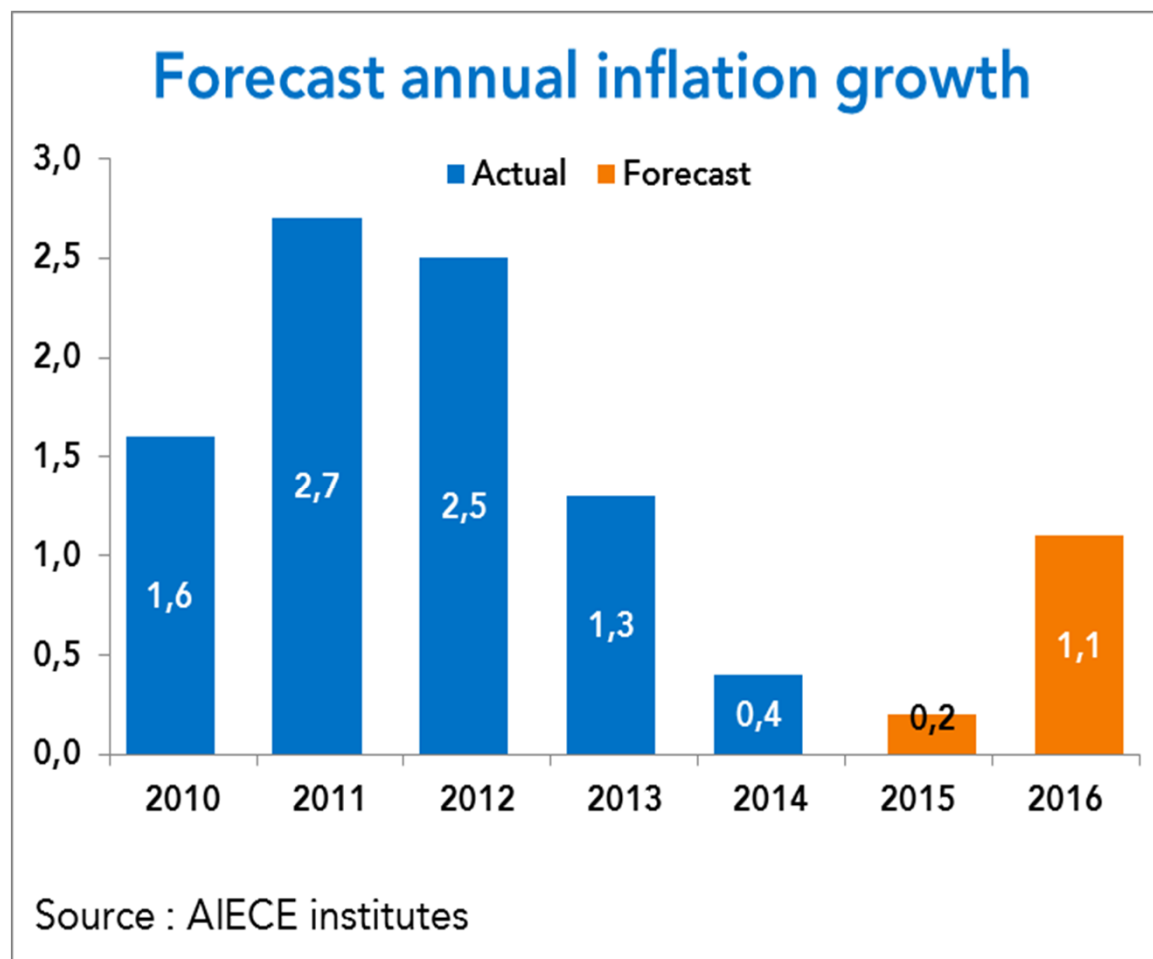


Source : Eurostat,

© Coe-Rexecode

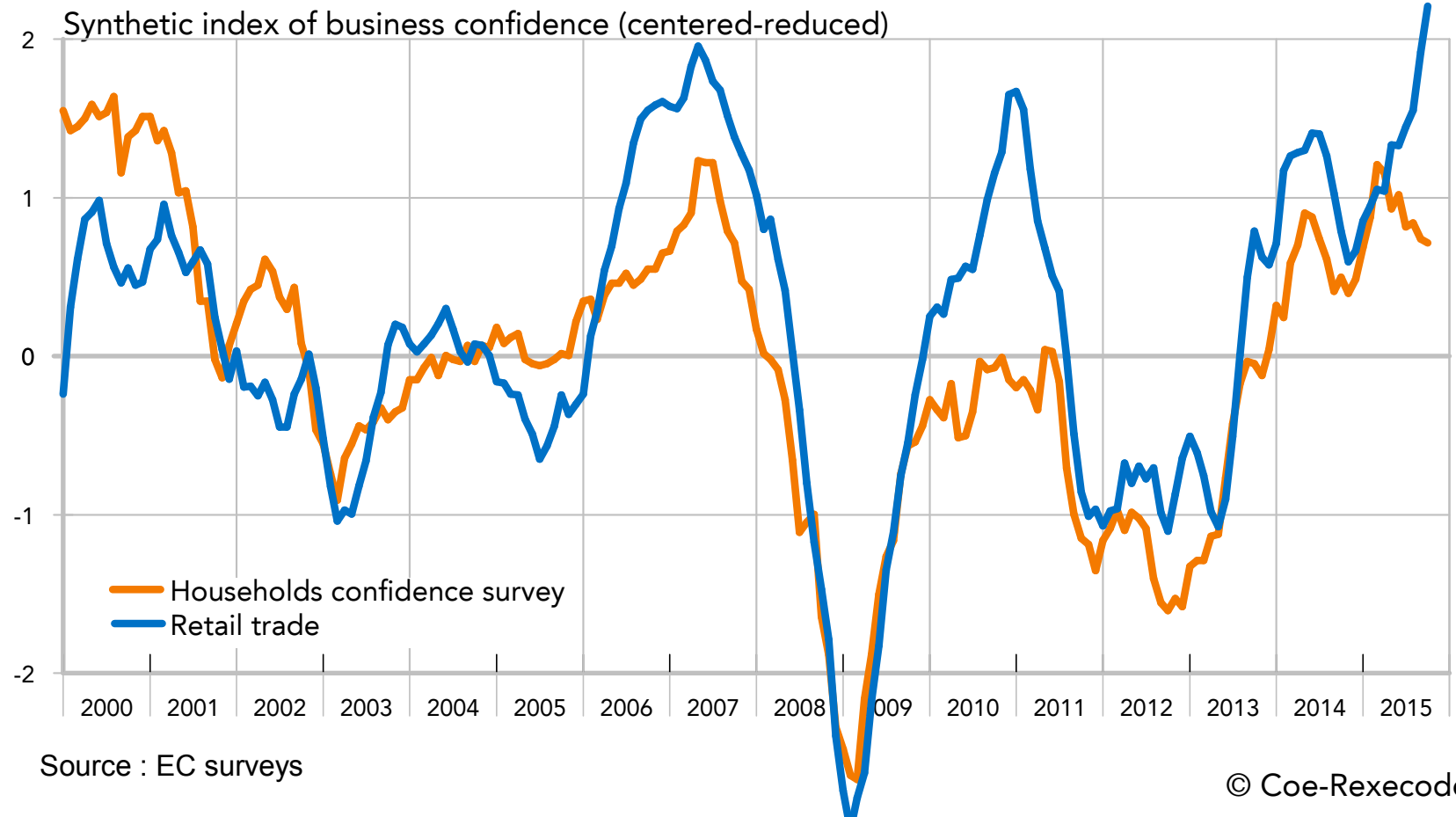
## Inflation will still be far from the 2 % target in 2016 according to AIECE forecasts.

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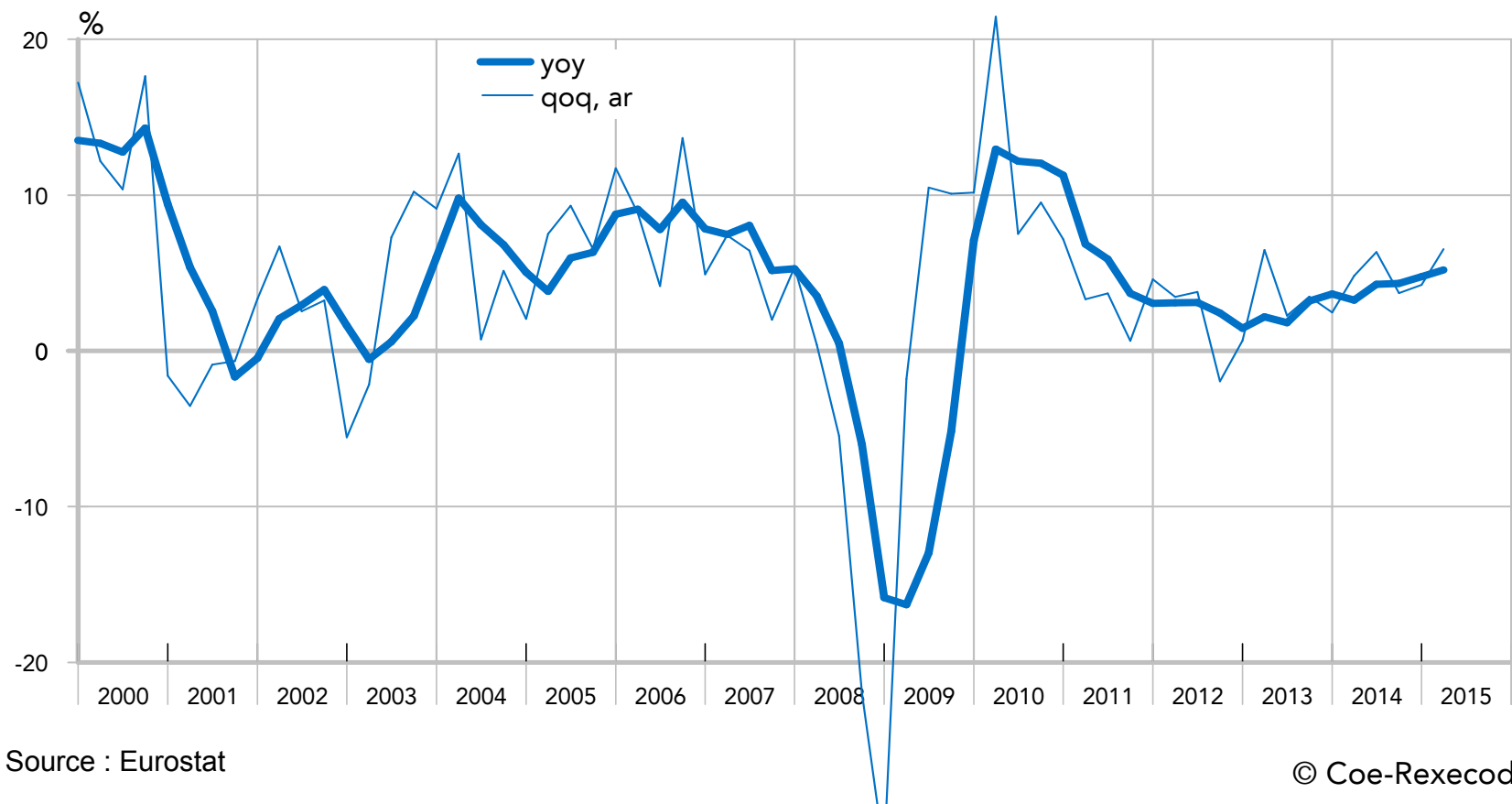
# Mixed signals concerning the evolution of consumption

## European Union : Retail trade and households survey



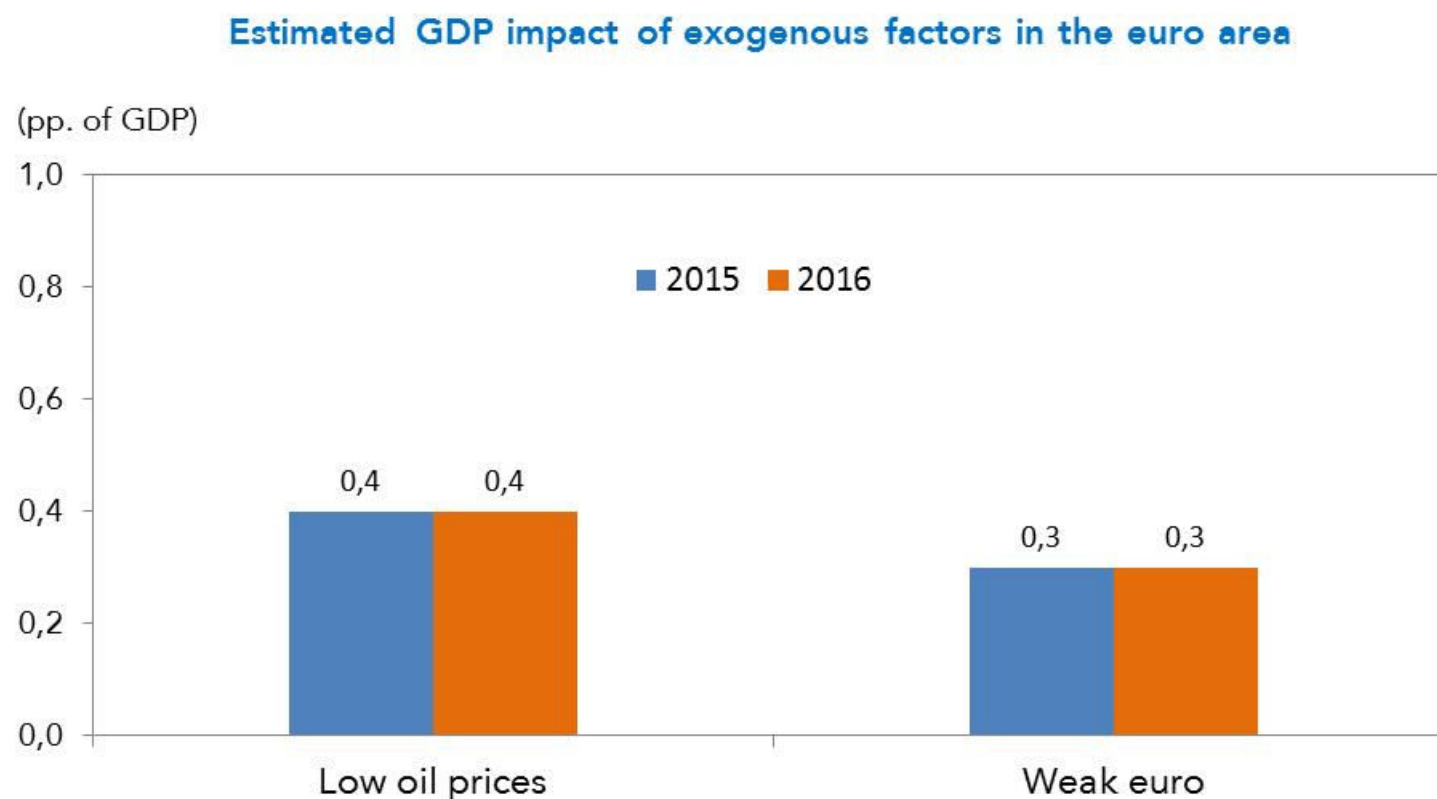
# Export growth has recovered even in a decelerating world trade context

Euro Area : Exports of goods and services, constant terms



# Low oil prices and weak euro exchange rate are deemed to contribute to about half of euro area growth

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Source : AIECE institutes

# Can European growth stay resilient to the weakening of emerging economies and the reversal in exogenous factors?

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## ➤ Households consumption has accelerated

Decline in oil prices has implied a direct support for households purchasing power of about 0,4 % in 2015 (acc. to AIECE institutes). But AIECE institutes do not expect any new drop in oil prices.

Will the « oil effect » still produce such an impact next year ?

## ➤ Increase in world market share (in volume terms)

Exports growth was above world demand growth. But euro effective exchange rate has been on the rise for 6 months in a row and AIECE institutes are expecting a stabilisation of €/.\$.

Is there still new gains in export market share to come ?

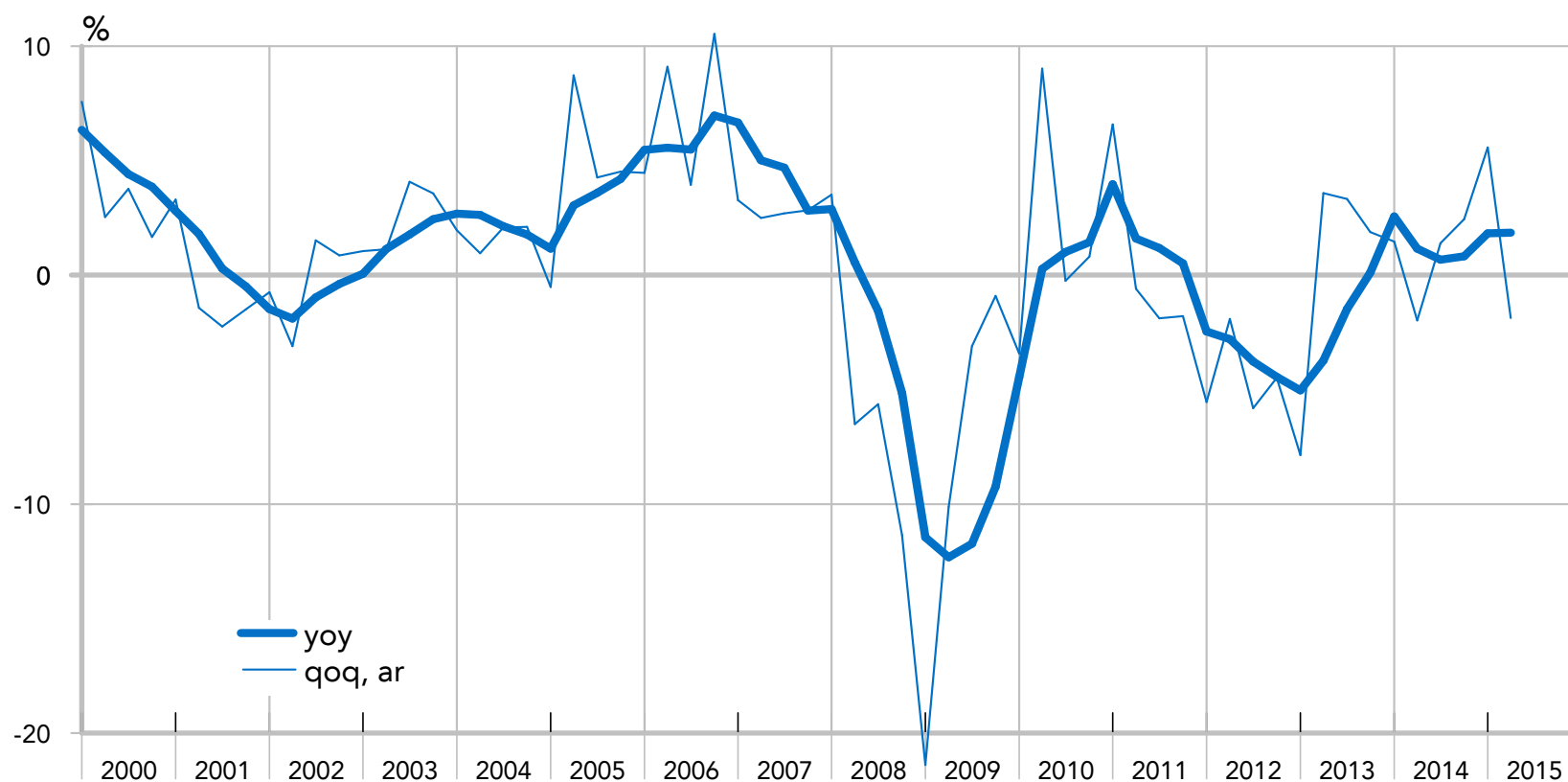
## ➤ Drop in interest burden

16 institutes are forecasting an increase in long term interest rates, 5 are expecting a stagnation. 0 institute sees a new drop.

Many of the forthcoming economic story of the Euro area will be associated with the recovery in the investment cycle

# Investment is still the missing growth engine

## Euro zone : Investment in real terms

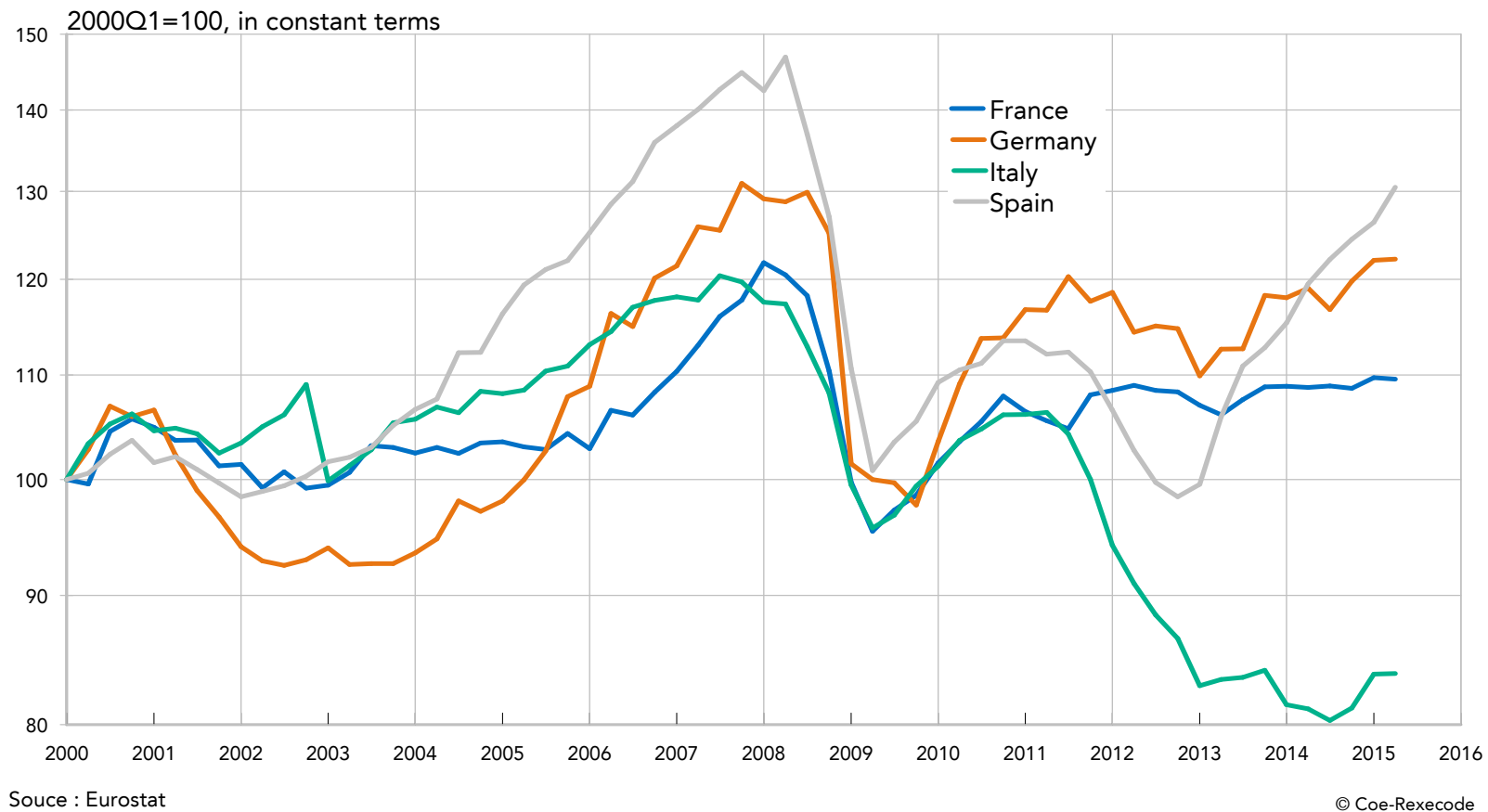


Source : Eurostat

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# A new kind of divergence in the Euro area : huge discrepancy in the investment cycle

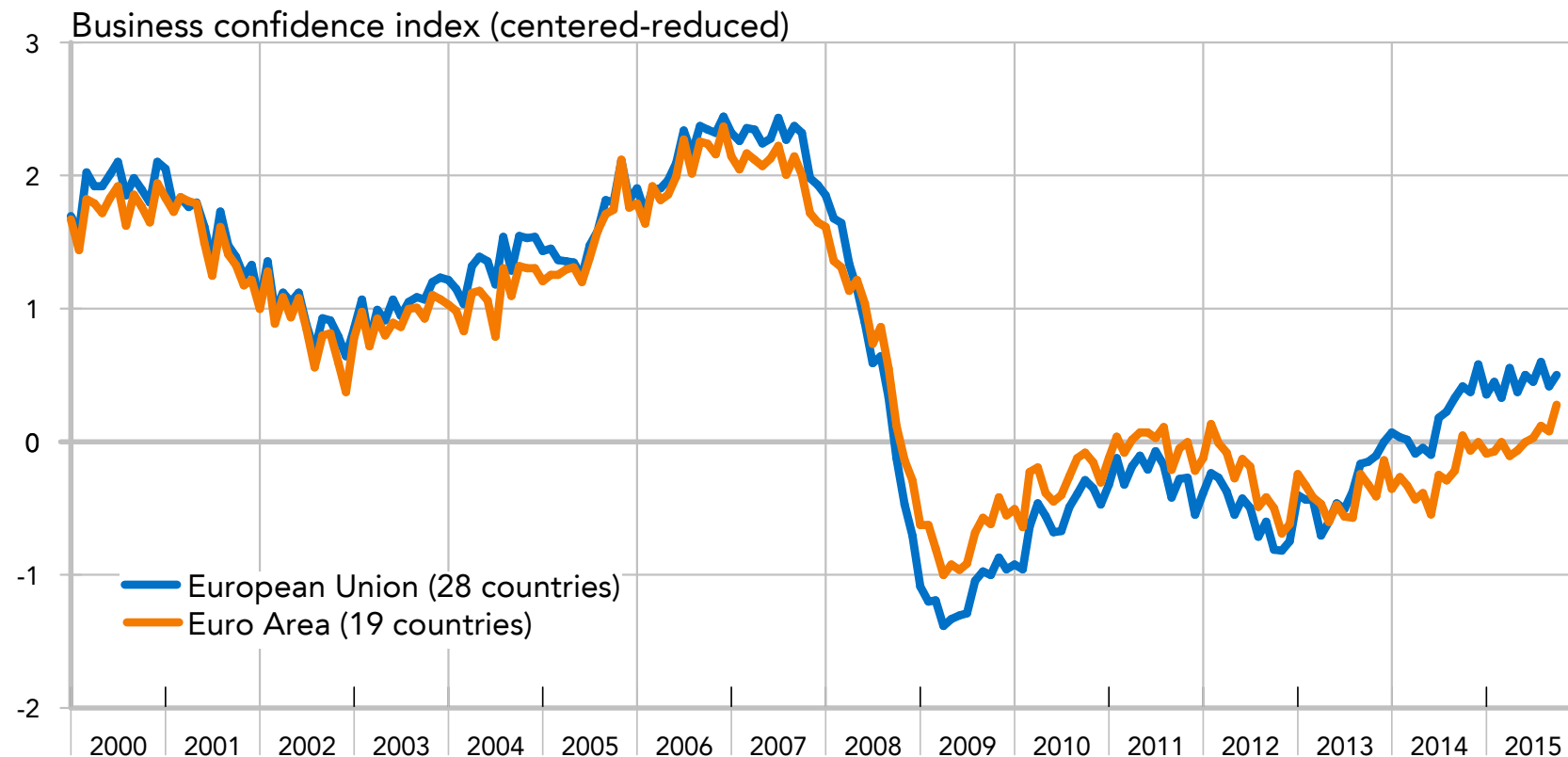
## Investment in machinery and transportation equipment





# The construction sector slowly recovers but is still lagging behind

## Business survey in construction sector



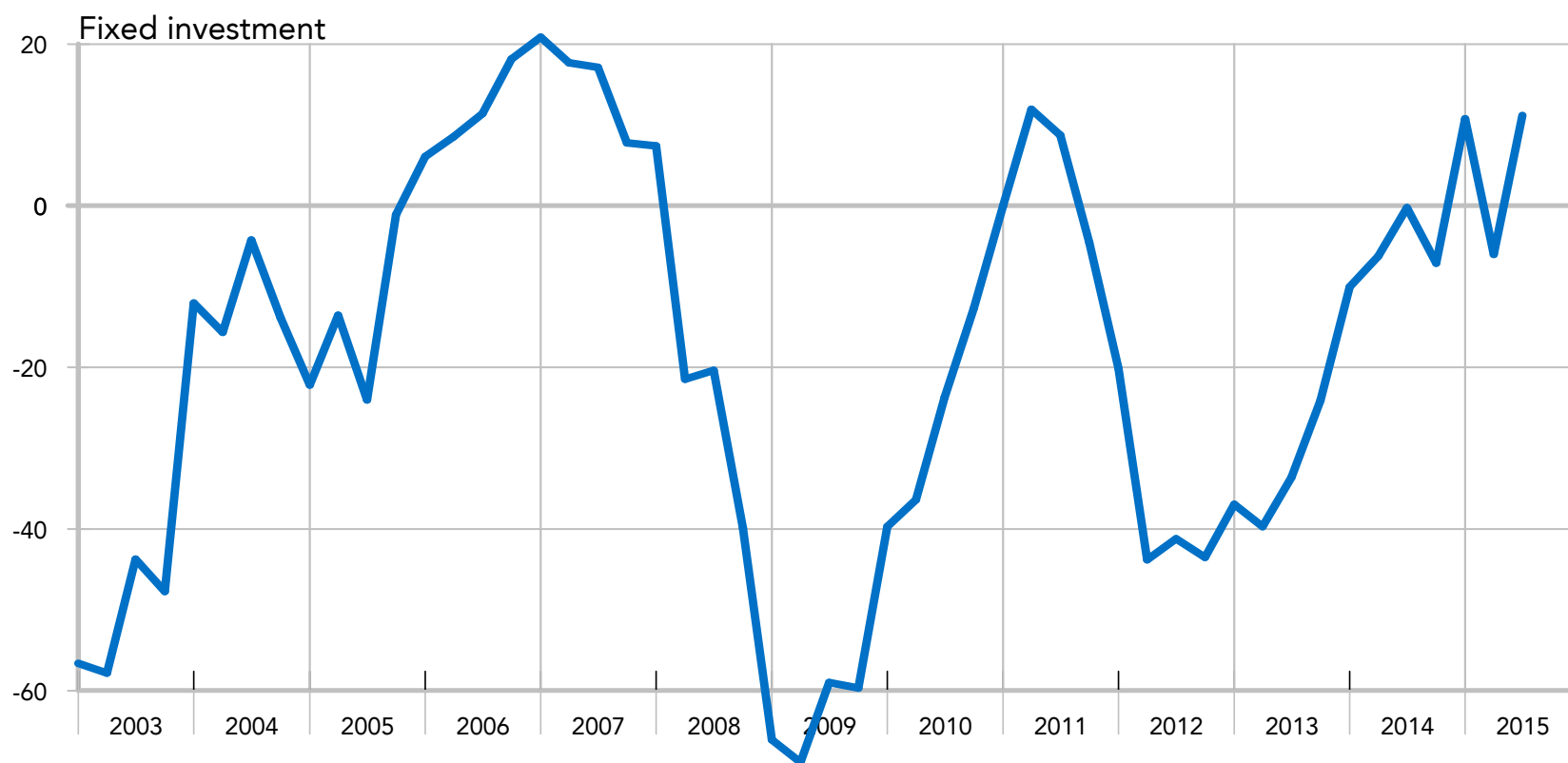
Source : EC Surveys

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# Credit demand from enterprises is positively influenced by demand for investment

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## Euro area : Elements influencing credit demand from enterprises



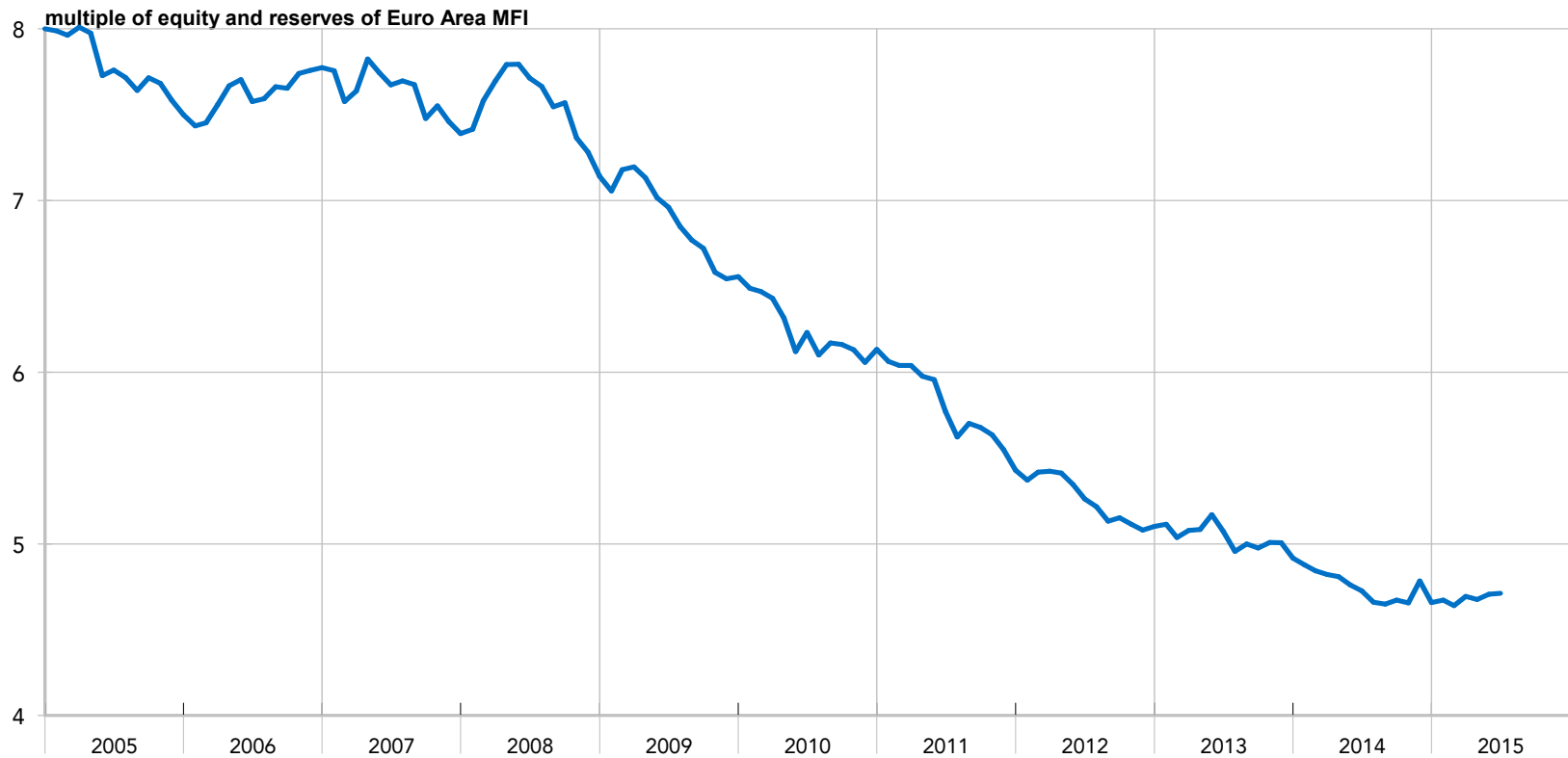
Source : ECB, loan officer survey

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# Is the banking sector deleveraging process over ?

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## Euro Area : Lending to residents as a multiple of equity of monetary and financial institutions



Source : ECB

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# AIECE forecasts for GDP and fixed investment growth



Source : AIECE institutes



Source : AIECE institutes

# Downside and upside risks for euro area

(ordered by decreasing magnitude of perceived risk)

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## Downside risks

- ❑ Turmoil in emerging countries due to the expected Fed rate hike and external balances
- ❑ China hard landing
- ❑ Drop of activity in oil-exporting countries
- ❑ Full-blown deflation in Europe
- ❑ US growth accident
  
- ❑ Also mentioned :
  - Further escalation of tensions in the Middle East and/or Ukraine,
  - The threats of "Brexit" and "Grexit",
  - Quick acceleration of price level dynamics which would force the ECB to suddenly tighten its monetary policy

## Upside risks

- ❑ Corporate investment surge in Europe
- ❑ Real estate cycle driven by the end of banks' deleveraging
- ❑ Reacceleration of China growth
- ❑ Easing of geopolitical tensions in EMEA
- ❑ Further drop in oil prices
  
- ❑ Also mentioned :
  - Further easing by the ECB

# The inflow of migrants : an asymmetric shock for the European Union

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## Key figures

- ❑ 710k illegal entries at borders - 9 first months of 2015, vs 282k in 2014
- ❑ Huge acceleration during summer : 360k entries in August and September (equivalent to 1,25M illegal entries in 2015 annualised)
- ❑ Refugees are coming mainly from Syria (~50%) Afghanistan (~17%), Irak, Erythrea and Kosovo (~5% each)
- ❑ Asylum demands are concentrated on Germany (30% in July), Hungary (27%), Austria (8%), Italy (8%) and Sweden (7%)
- ❑ Number of refugees in Germany in 2015 estimated between 800k and 1,5M vs 200k in 2014 (a demographic shock : from +0,7% to +1,6% of population)

## Macroeconomic impacts for the main destination countries

- ❑ Increase in public and private consumption
  - Budget expenses : 6 billions € (0,2 % of GDP) for Germany in 2015
  - Impact estimated between 0,3-0,4 points of GDP for Germany via internal consumption (est. DB)
- ❑ Increase in labor supply
  - Absorption by labor market under pressure like in Germany
  - Decreasing wage pressures for different qualifications and younger working age categories
- ❑ Modification in demographic trajectories

Estimated GDP impact of +0.1% in 2015  
and +0.2% in 2016 at euro area level

## To be debated... on the euro area

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- What is the underlying strength of the structural recovery in Europe beyond the cyclical factors at play?
- What drives the acceleration in fixed investment embedded in 2016 forecasts?
- Can Europe withstand the negative externalities induced by a strong slowdown of emerging economies?
- Can the Volkswagen turmoil disrupt German industry?
- Are any structural reforms having a material impact on the growth path in Europe?
- Will the refugee inflow affect Europe's growth potential beyond the induced fiscal stimulus?

## To be debated... on the UK and Switzerland

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- When is the first move in BoE interest rates expected?
- Impact of a Brexit on macroeconomic trends?
- Are wealth effects at play in the evolution of households' expenses in the UK?
- What has been the macroeconomic impact of Swiss Franc appreciation vs the Euro?



## To be debated... on Northern Europe

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- Have deposit rates in **Sweden** and **Denmark** reached the bottom line and what kind of lessons can be drawn for the ECB?
- Is any significant negative effect of decreasing oil prices to occur in **Norway**?
- What are the main explanations for the low growth figures in **Finland** (Russia, electronics...)?

## To be debated... on Central Europe

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- Can Central Europe maintain its current expansion pace?
- What can be expected of the general elections result in Poland?
- Will the Volkswagen scandal have any spillover effects on its Central European supplier countries?
- What will be the impact if Central European countries are forced to welcome quotas of refugees against their will?

# Agenda

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1 European economic outlook

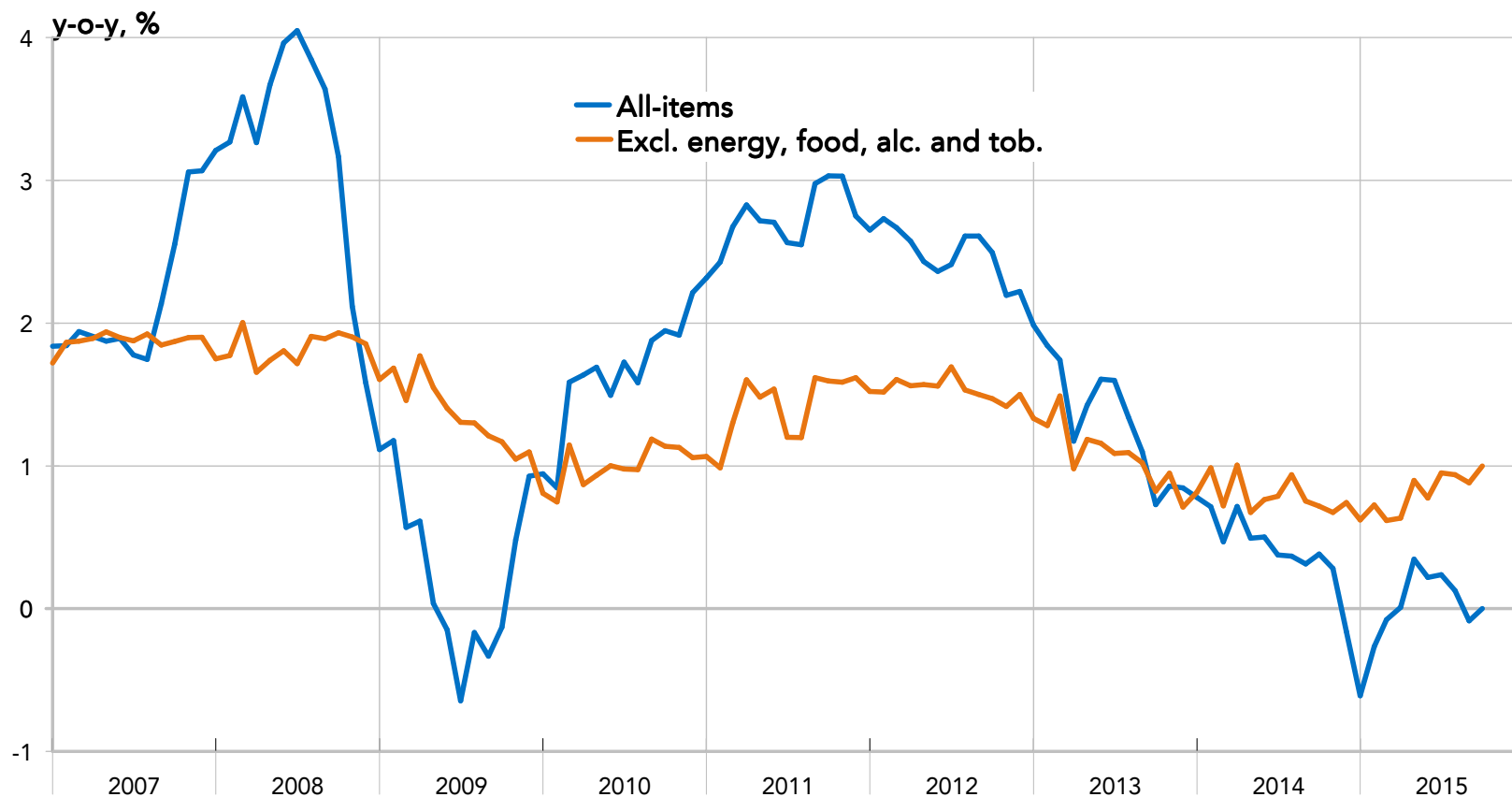
2 Monetary policy

3 Fiscal policy

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# Inflation is still very far from the 2% objective, though core inflation is resilient and improving

## Eurozone Harmonized consumer price index



Source: Eurostat

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# The ECB's balance sheet

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## Eurozone Balance sheet of the ECB

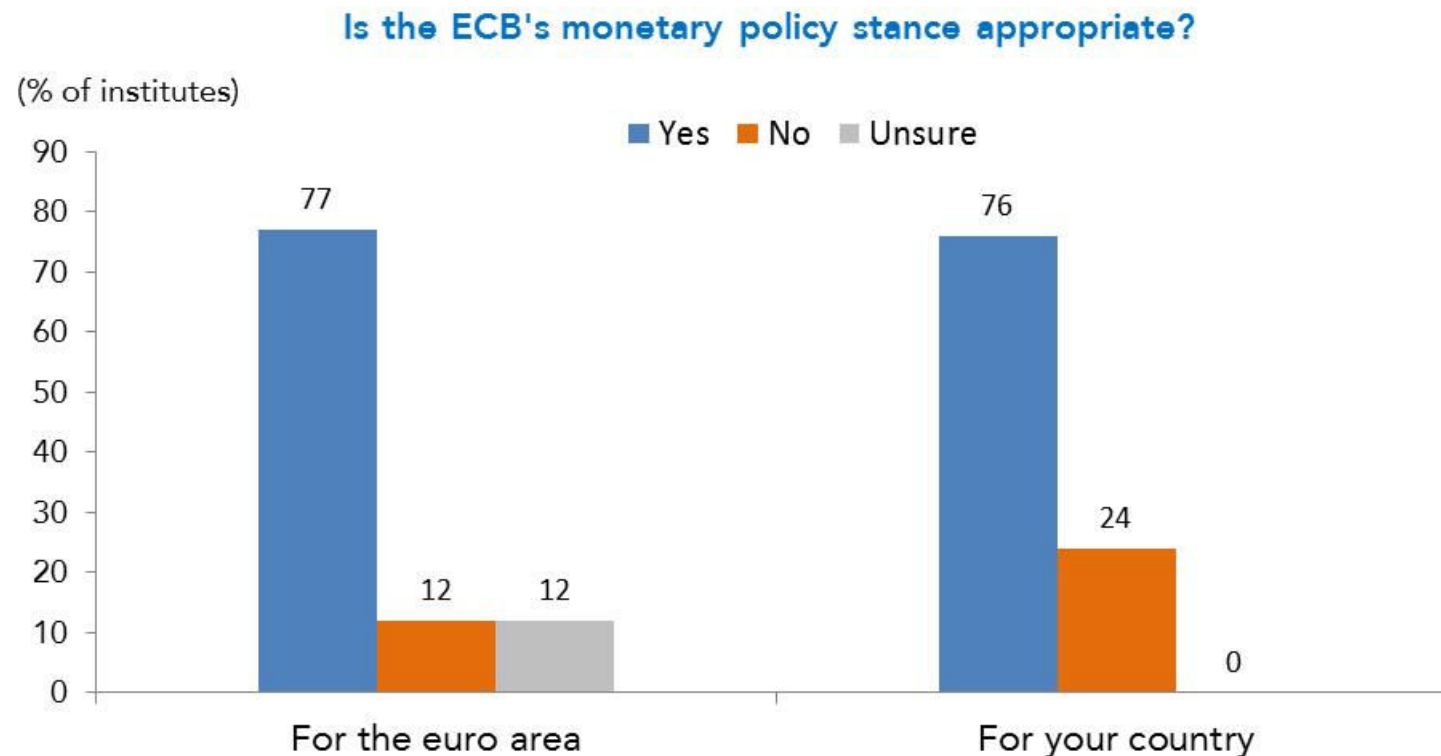


Source: ECB

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# The ECB's monetary policy stance is judged appropriate for the euro area (not so much for Germany)

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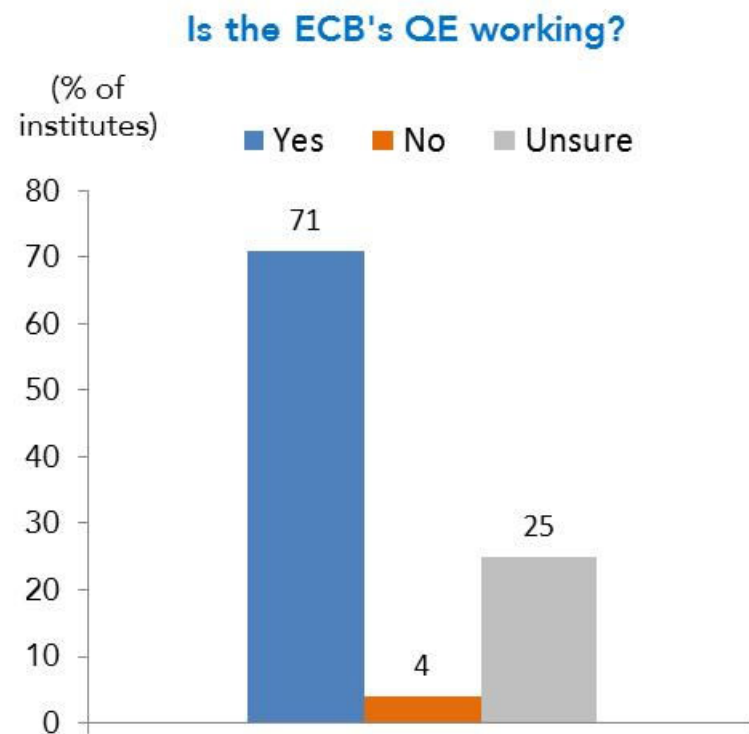


Source : AIECE institutes

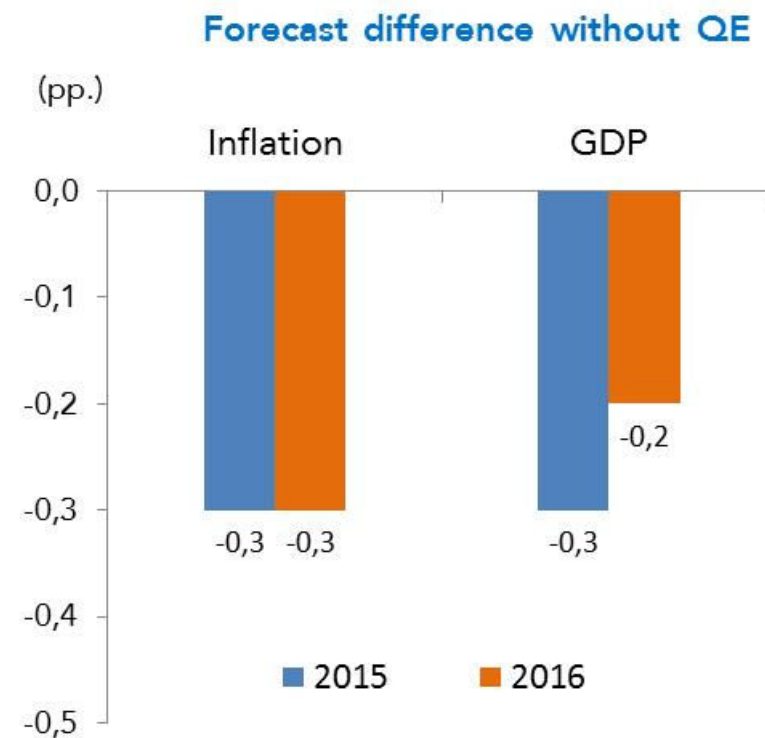
**But the 3 responding German AIECE institutes consider the ECB's monetary policy stance inappropriate for Germany**

# The ECB's QE is thought to be working and to have a significant impact on inflation and growth

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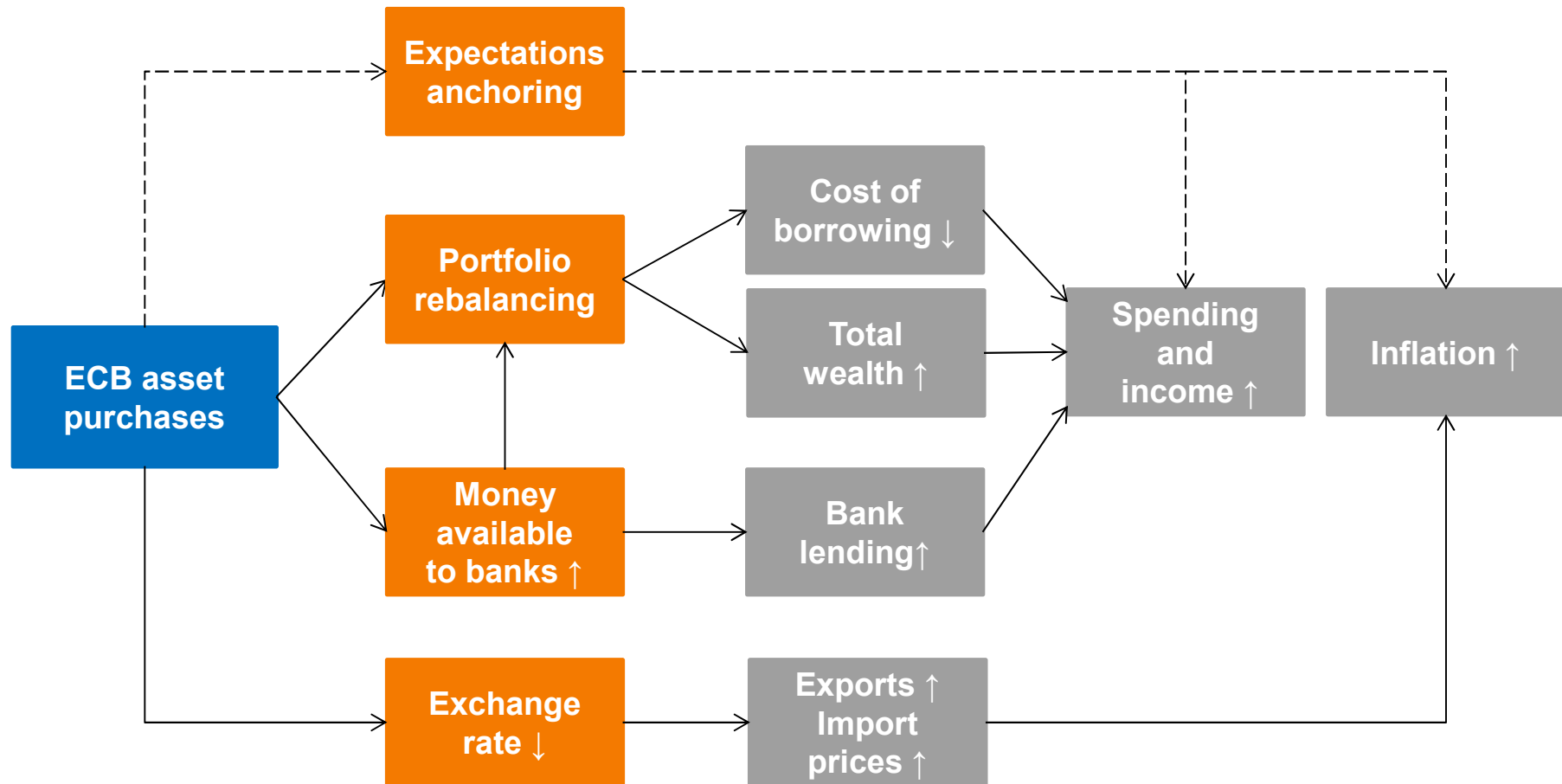


Source : AIECE institutes



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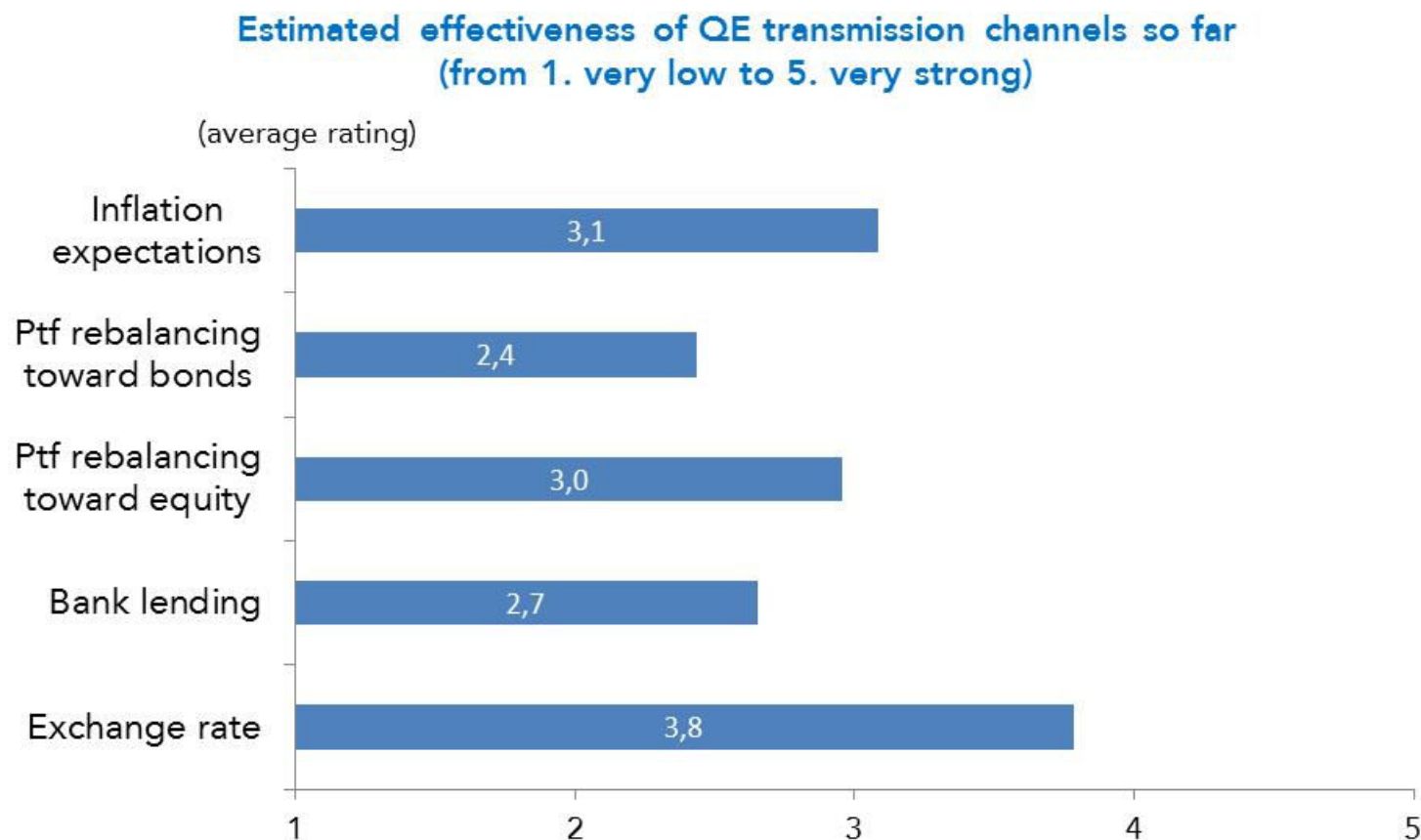
# Theoretical QE transmission channels





# AIECE views on the effectiveness of QE transmission channels

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Source : AIECE institutes

# Inflation expectations channel

## Eurozone Euro Forward Inflation Swap 5YF5Y

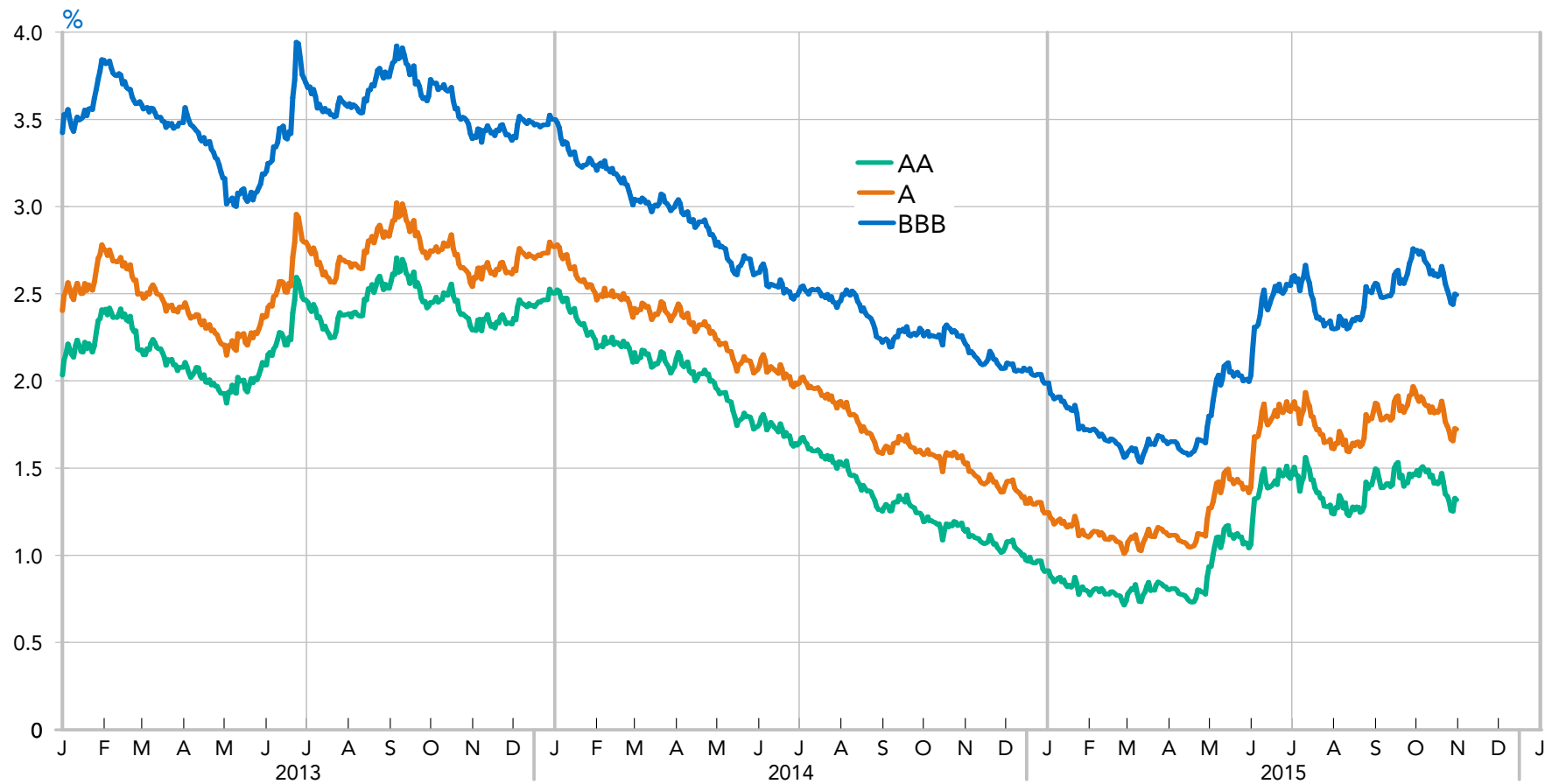


Source : Thomson Reuters

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# Portfolio rebalancing towards bonds channel

## Eurozone Corporate bonds iboxx



Source: iBoxx

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# Portfolio rebalancing towards equity channel

## Eurozone: Euro Stoxx 50



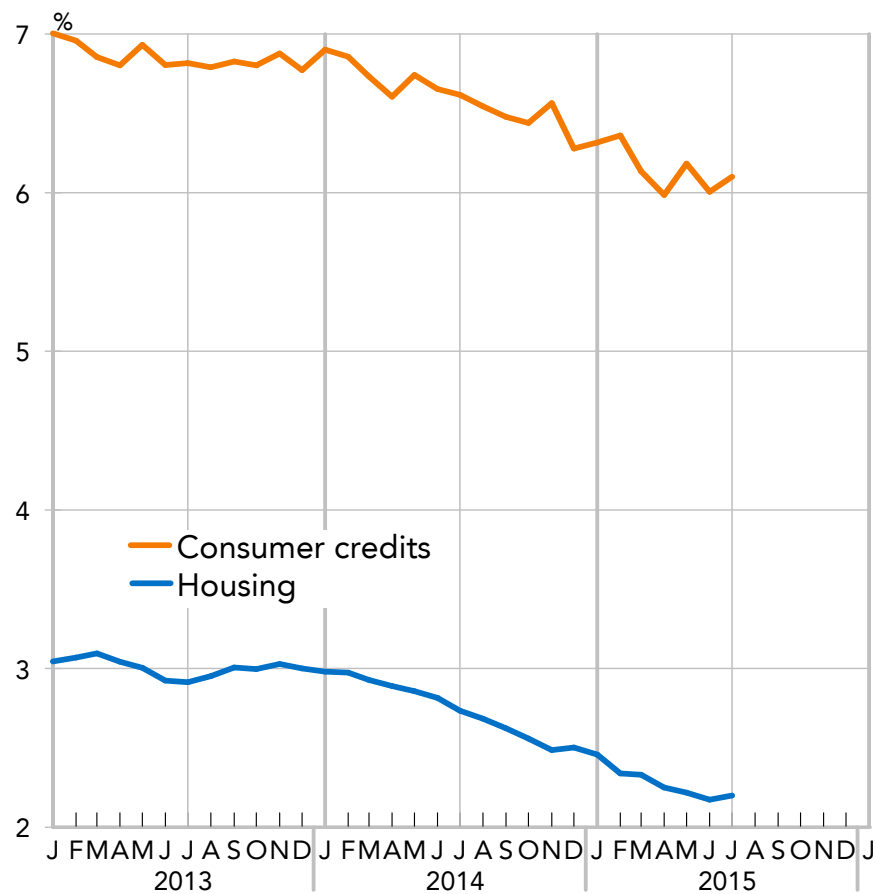
Source : STOXX

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# Bank lending channel (1/2)

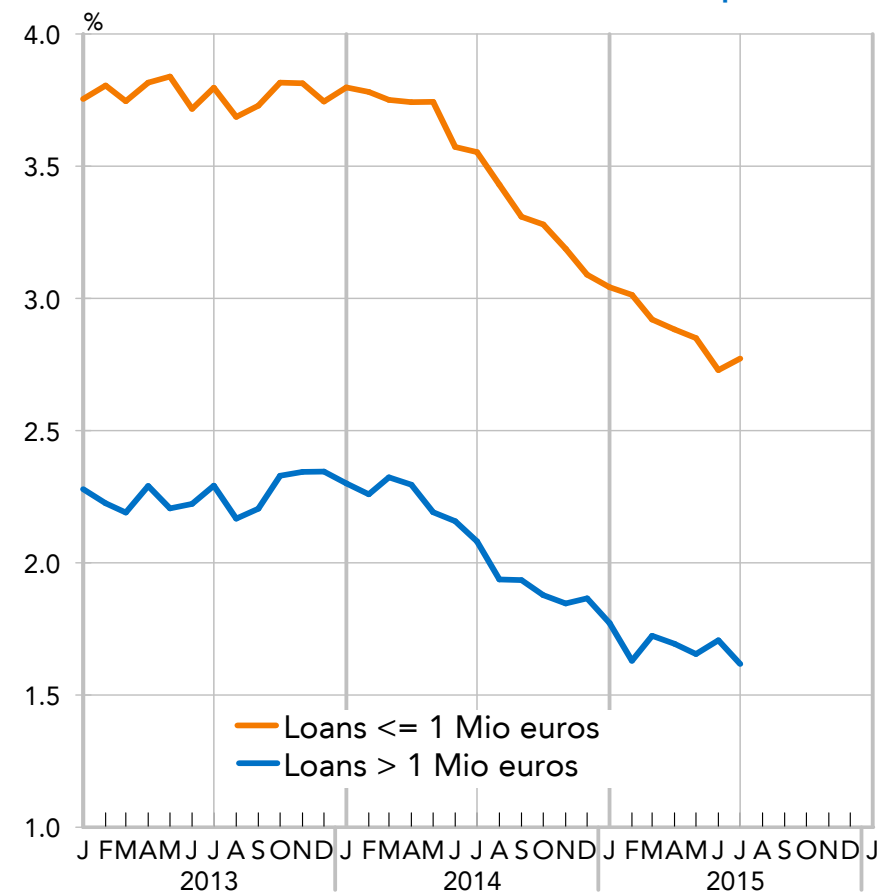
## Eurozone

Interest rates on new loans (households)



Source: ECB

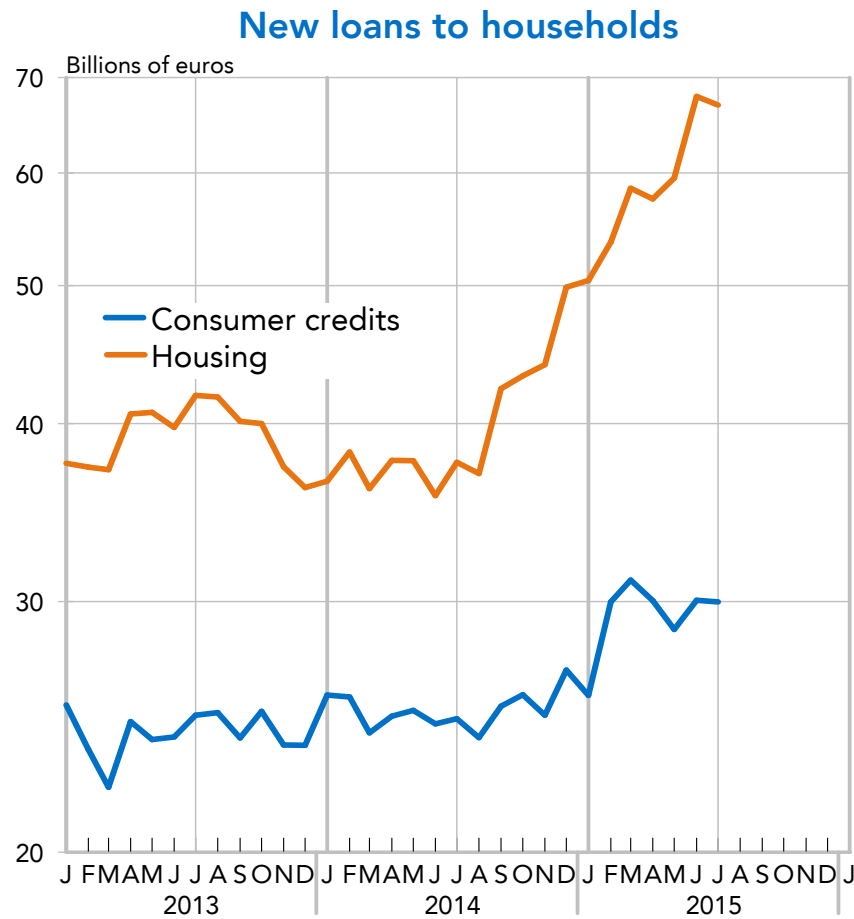
Interest rates on new loans (non financial corporations)



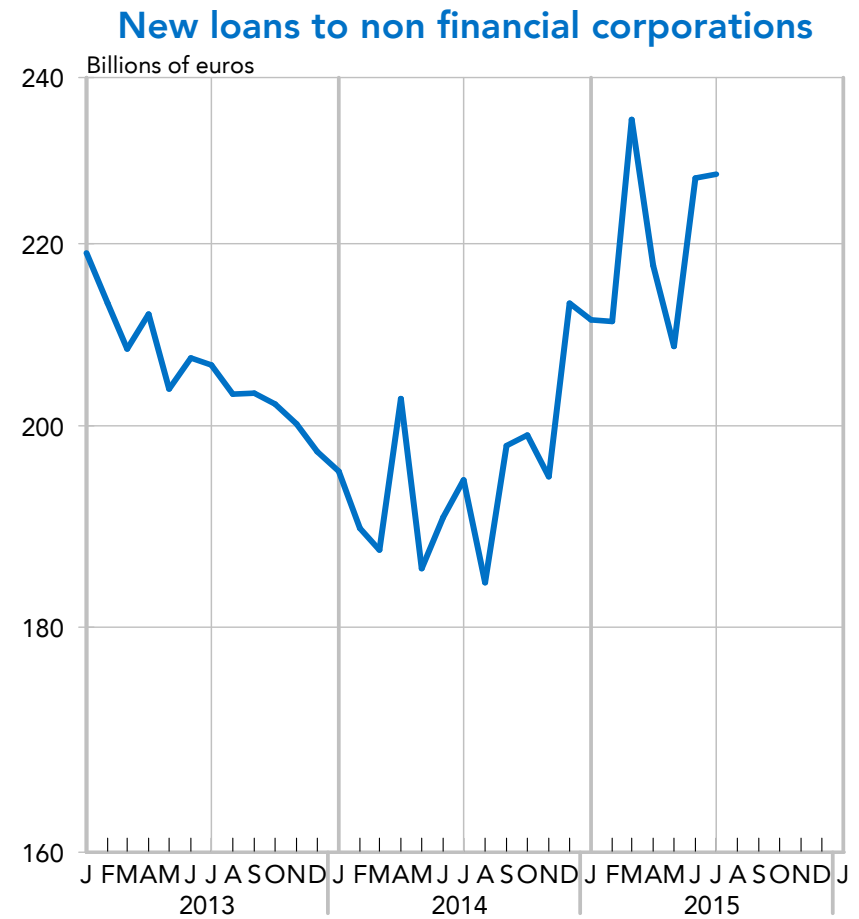
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# Bank lending channel (2/2)

## Eurozone



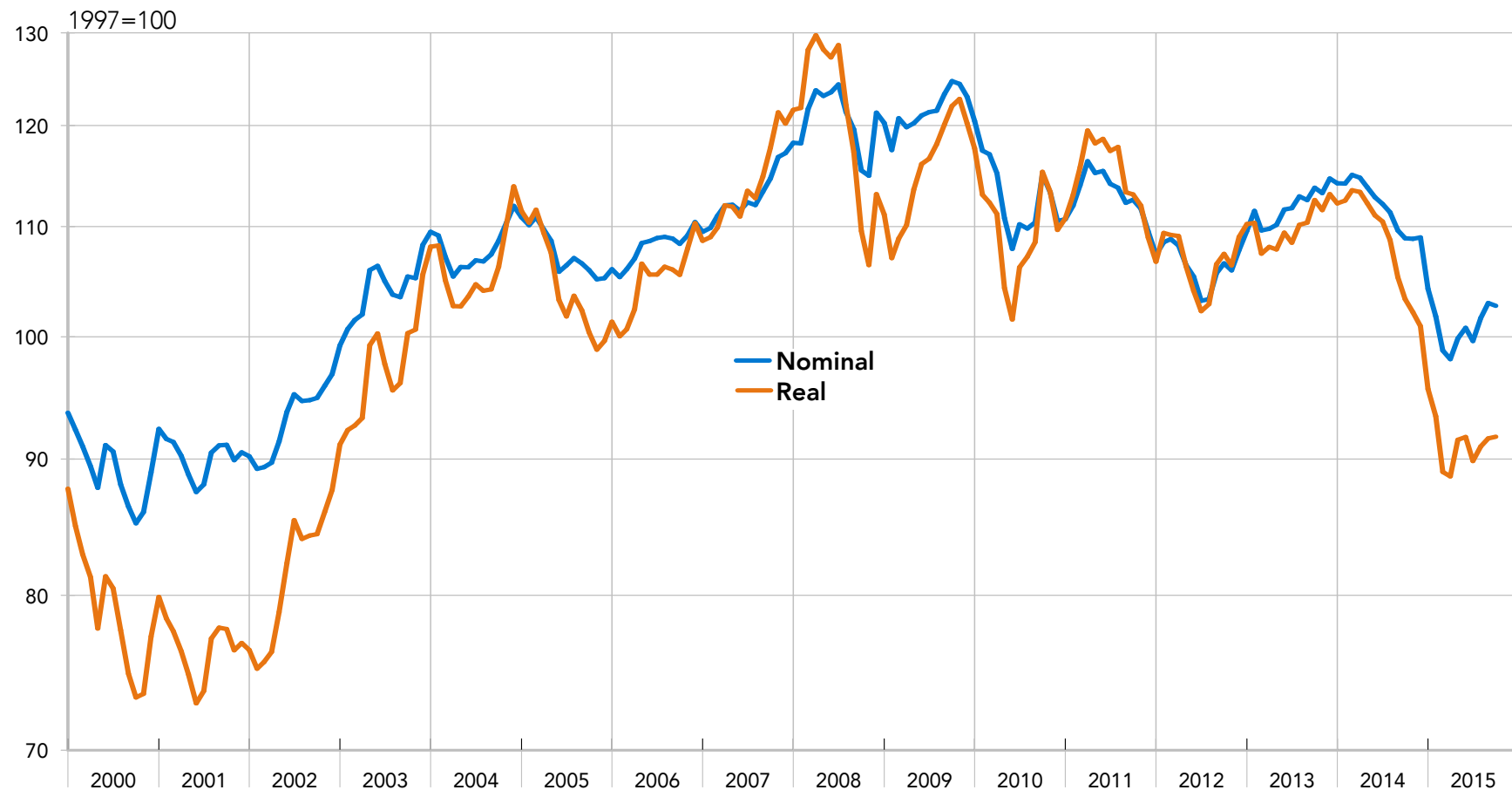
Source: ECB



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# Exchange rate channel

## Effective exchange rate of the euro



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# AIECE perspective on potential QE risks

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Source : AIECE institutes



# Towards a QE2?

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- ❑ Expectations of further monetary loosening at the December 3<sup>rd</sup> ECB governing council in Frankfurt have risen
- ❑ 54% of AIECE institutes believe the QE will be extended timewise (vs. 12% which believe it will not and 35% which are unsure)
- ❑ The average estimated prolongation period is 8 more months until May 2017
- ❑ Only 27% of AIECE institutes believe it will be extended in terms of the size of monthly purchase amounts and 21% in terms of the composition of assets purchased
- ❑ 48% of AIECE institutes believe that a full-fledge QE2 is not desirable vs. 20% which think it is

# Questions for discussion

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- Should the ECB resist the mounting pressure of financial markets in favour of a QE expansion?
- What more/else can be done to improve the ECB QE's effectiveness?
- Is the ECB's QE programme responsible for the increased volatility on financial markets?
- What will be the impact of the upcoming Fed and BoE monetary tightenings on the ECB's monetary policy?

# Agenda

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1 European economic outlook

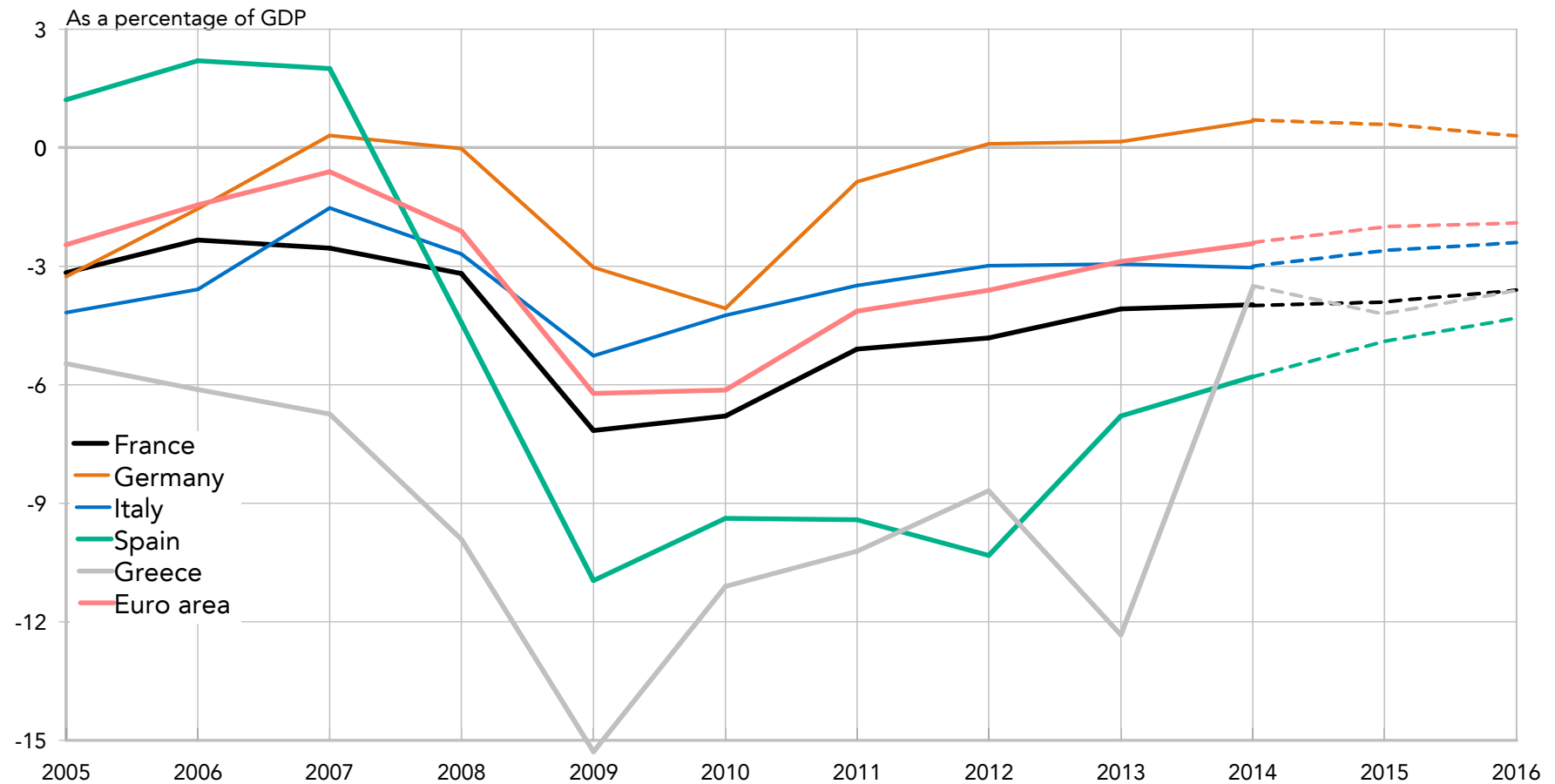
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# Fiscal positions have greatly improved

## Public deficit



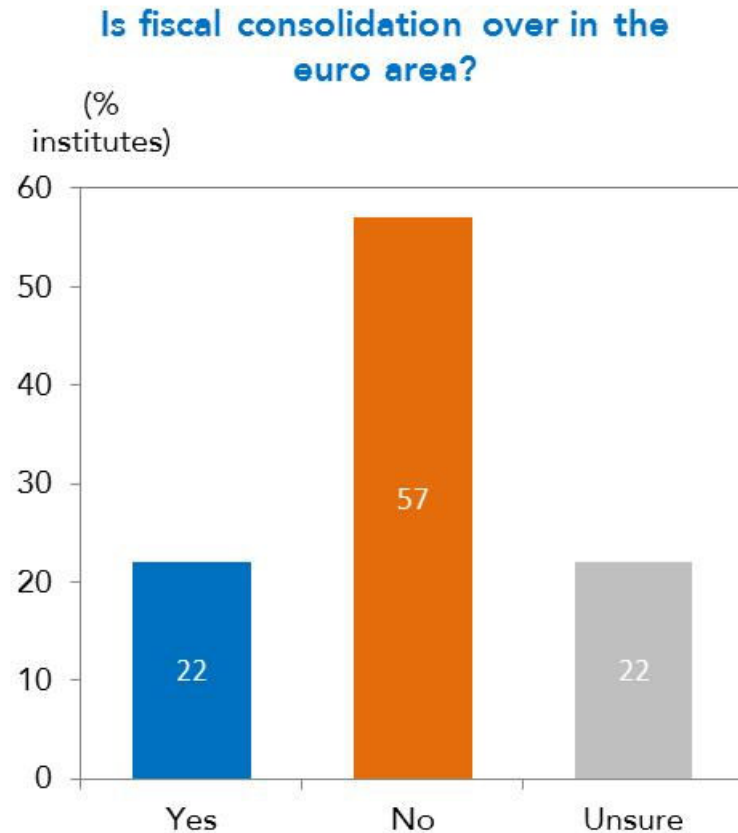
Source: European Commission  
Forecasts Coe-Rexecode

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## ...yet fiscal consolidation is not fully over...

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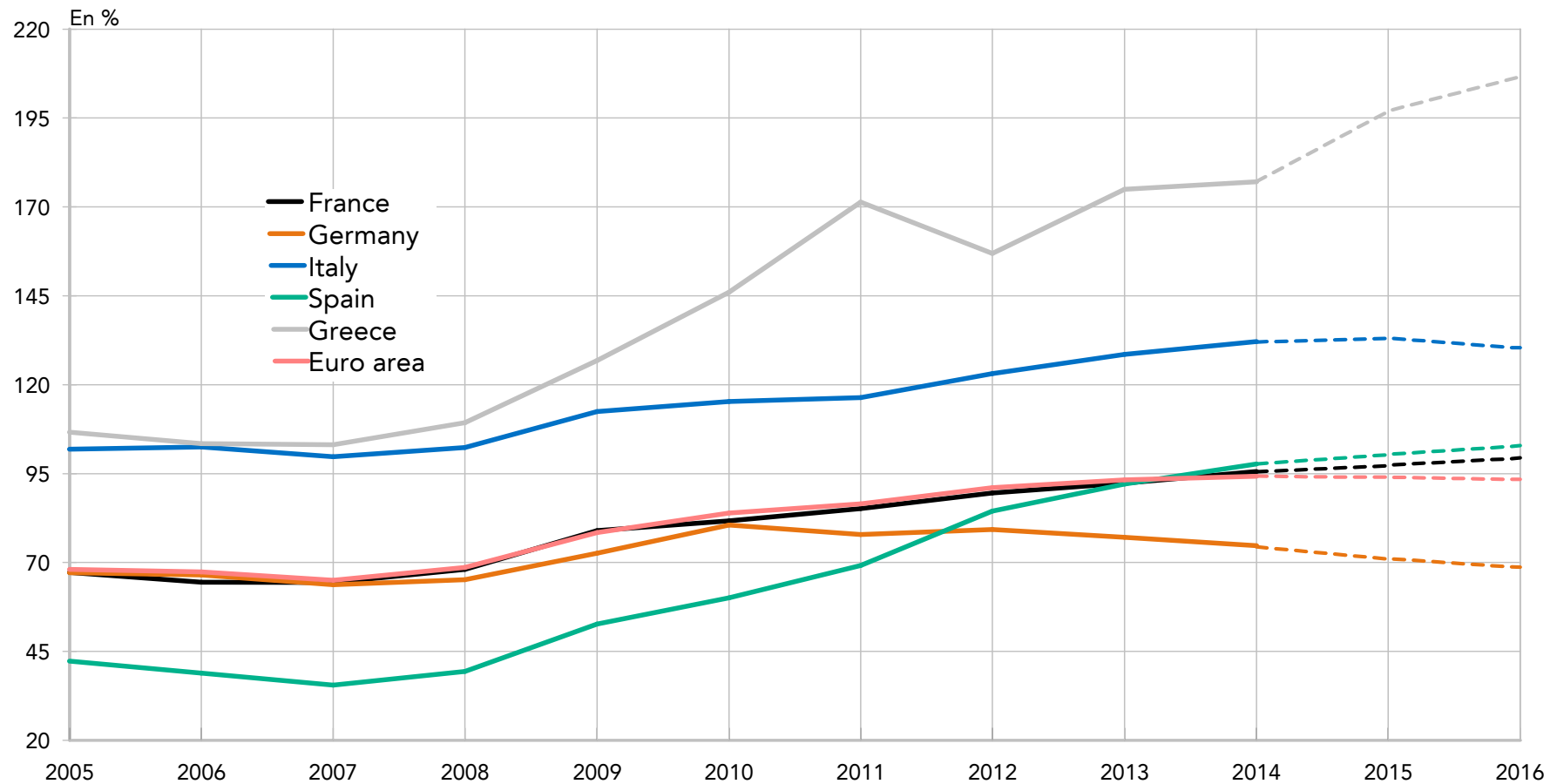
Source : AIECE institutes

### Latest European Commission forecast:

- ❑ **Euro area** fiscal impulse as measured by change in cyclically adjusted budget balance: -1.1% in 2013, -0.2% in 2014, -0.2% in 2015, +0.2% in 2016
- ❑ **Germany**: -0.3% in 2014, -0.6% in 2015, +0.4% in 2016
- ❑ **France**: -0.6% in 2014, -0.1% in 2015, -0.2% in 2016
- ❑ **Italy**: +0.3% in 2014, +0.1% in 2015, +0.5% in 2016

## ...and the evolution of public debt levels presents a less rosy picture

### Public debt



Source: European Commission  
Forecasts Coe-Rexecode

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## Though not fully solved, the Greek situation is not deemed to threaten EU growth any more

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- ❑ Only 28% of AIECE institutes are convinced that Greece will duly implement the reforms upon which the 3<sup>rd</sup> international bailout is conditional
- ❑ 88% of AIECE institutes believe Greece will not be able to repay its public debt without a nominal haircut
- ❑ Yet 71% of AIECE institutes do not think the Greek situation can threaten European growth prospects for 2015/2016. The risk seems contained
- ❑ The probability that Greece leaves the euro area before 2020 is evaluated at 25%

# Questions for discussion

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- Should the fiscal impulse of certain euro area countries be increased, as hinted by the ECB?
- Could the sustainability of euro area countries' public finances be considerably overestimated due to the low interest rate environment?
- Is Italy loosening its fiscal policy too fast?
- Will the public debt-to-GDP ratios re-converge?
- When should Greece's public debt be renegotiated?



# Agenda

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1 European economic outlook

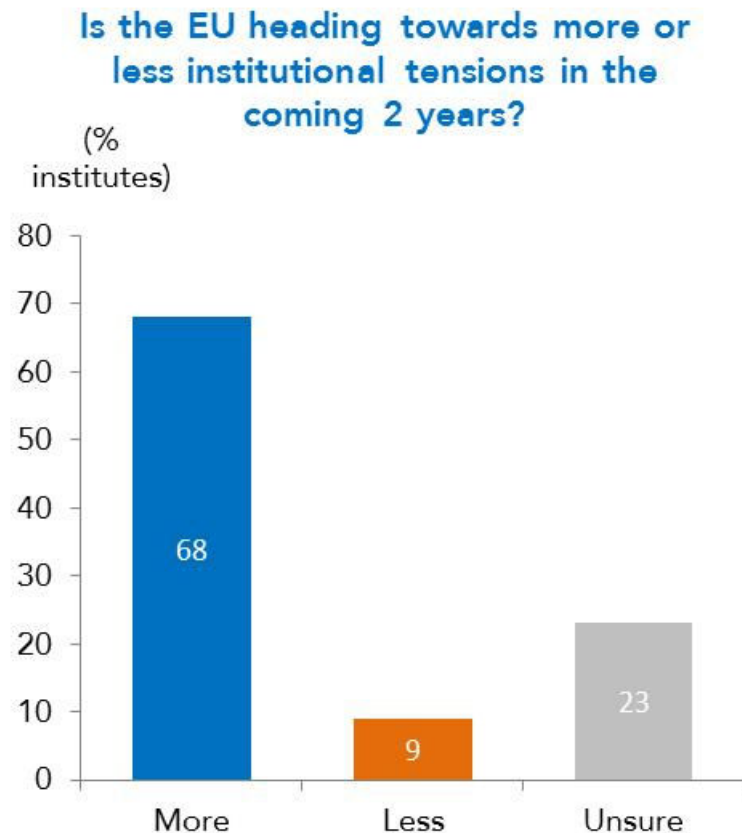
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# Towards more institutional tensions

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Source : AIECE institutes

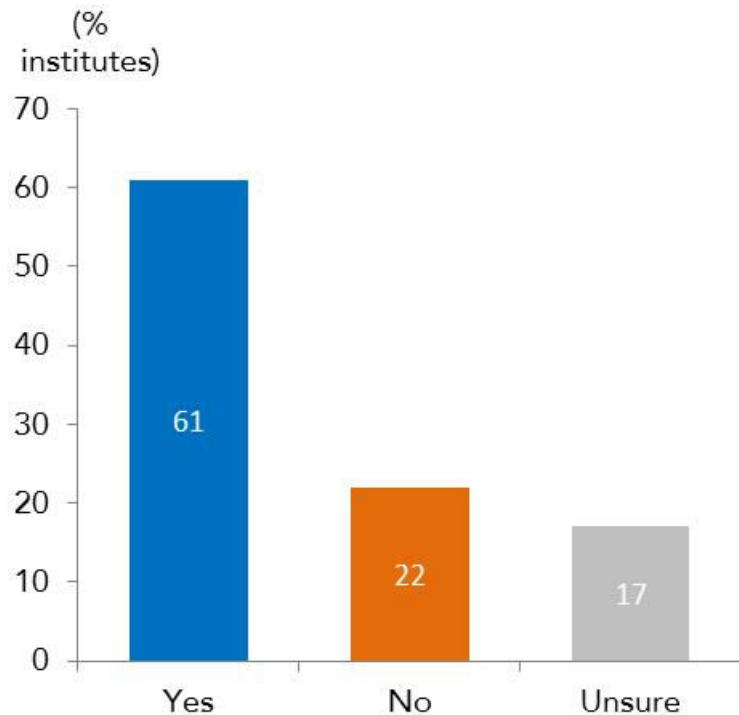
## A longlist of institutional risk factors:

- ❑ "Brexit" risk
- ❑ Treatment of refugee crisis
- ❑ Differing economic doctrines on fiscal policy and structural reforms
- ❑ Persistence of disparities and lack of convergence
- ❑ Remaining Greek risk
- ❑ Burgeoning of anti-EU sentiment
- ❑ Potential divisions regarding Ukraine/Russia

# The « Brexit » risk

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Does the "Brexit" referendum pose a major threat for the EU project?



Source : AIECE institutes

## ❑ On the one hand

- ❑ UK not a member of the EA
- ❑ Could hold status similar to Norway or Switzerland

## ❑ On the other hand

- ❑ Dangerous precedent
- ❑ Negative signal for European construction
- ❑ Encouragement for Euroskeptic forces
- ❑ Would alter balance of powers within EU

# Solving the institutional challenge

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- ❑ The EU project has always rested upon the **idea of continuing consolidation**
- ❑ Only one AIECE institute believes that the **5 Presidents' report** on "Completing Europe's Economic and Monetary Union" provides the basis to solve the EU's institutional challenges
- ❑ **Completing the banking and financial union** would appear as the first and priority step to solidify the EU
- ❑ Divergences appear on the sheer idea and underlying mechanism of a **fiscal union**, especially regarding the question of transfers

# Questions for discussion

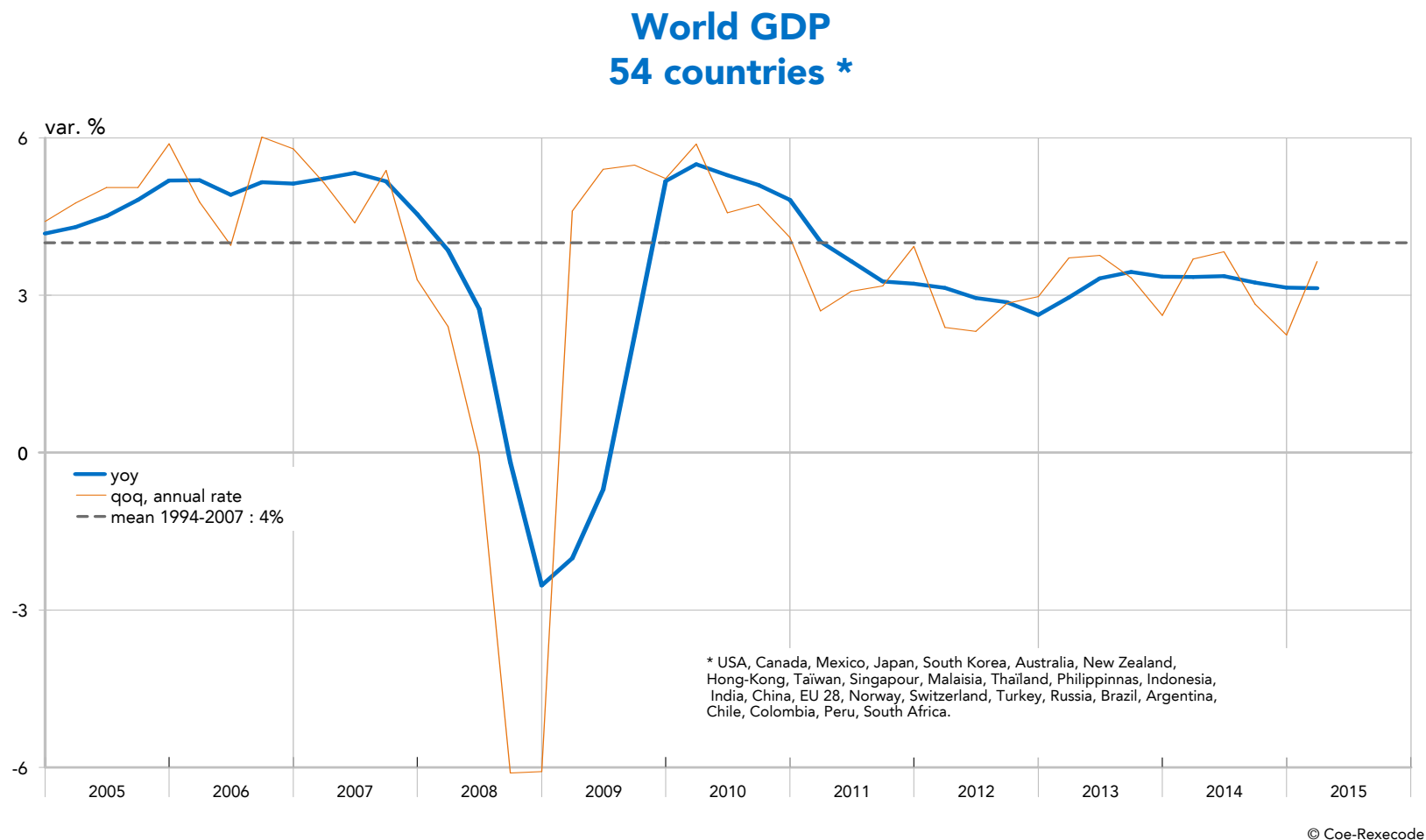
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- Which upon the risks listed before represent the greatest threats for the EU project?
- Which countries may follow suit, were the UK to leave the EU?
- What concrete steps can the Commission undertake to solidify the EU?
- Are fiscal transfers across member states an option? To what extent ?  
What can be their main purpose ?

# Appendix

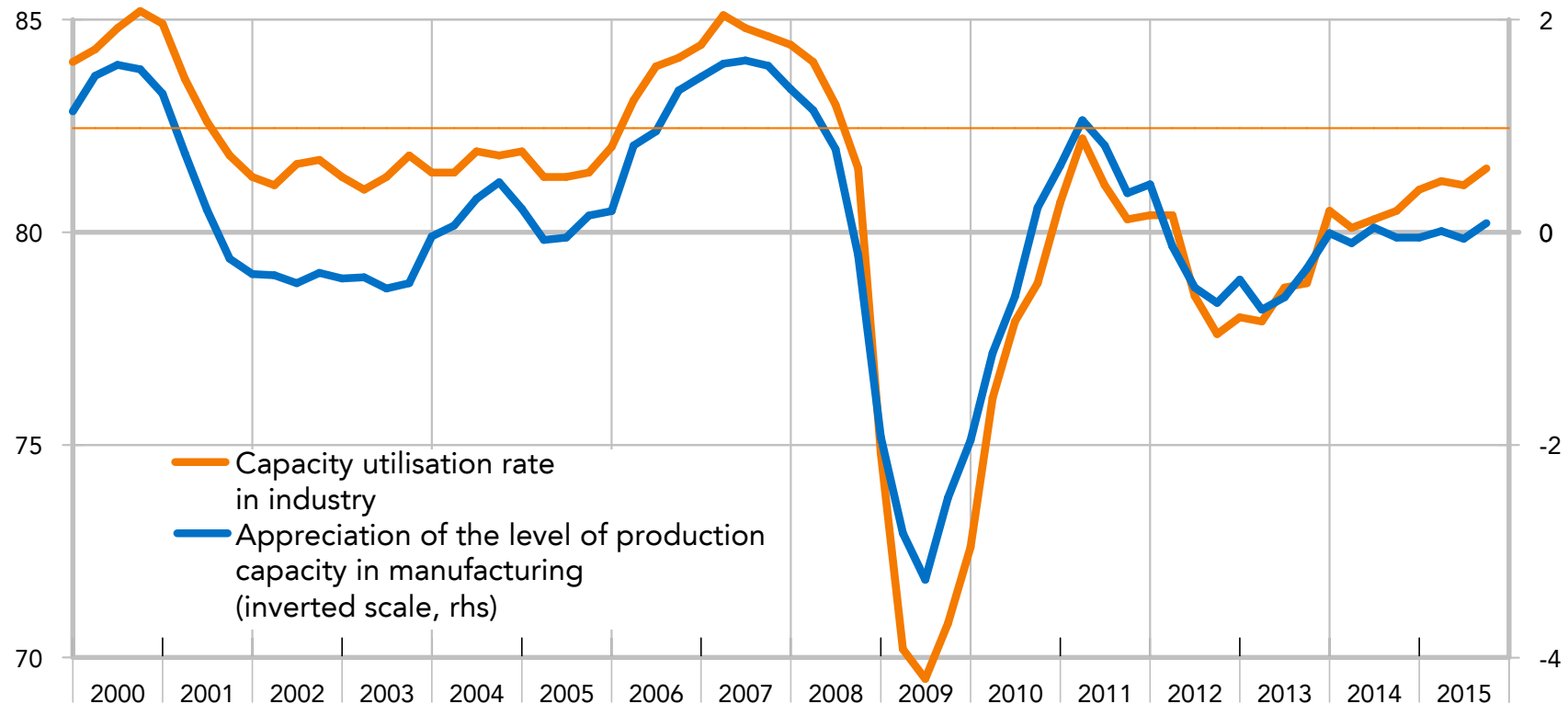
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# Impercetible slowdown of world GDP



# Slow convergence of the capacity utilisation rate in manufacturing towards its long term mean

## Industrial survey in Euro zone



Sources : Eurostat and European Commission survey

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# Fiscal consolidation is not fully over

Table 39: Cyclically-adjusted net lending (+) or net borrowing (-), general government<sup>1</sup> (as a percentage of potential GDP, 1996-2017) 22.10.2015

	5-year averages							Autumn 2015 forecast			Spring 2015 forecast	
	1996-00	2001-05	2006-10	2011	2012	2013	2014	2015	2016	2017	2015	2016
Belgium	-1.7	-1.0	-2.5	-4.2	-3.8	-2.1	-2.5	-2.2	-2.1	-2.1	-1.9	-2.0
Germany	-2.0	-3.2	-1.5	-1.5	-0.2	0.2	0.5	1.1	0.7	0.6	1.0	0.6
Estonia	1.2	-0.3	-1.4	1.8	-1.0	-0.6	0.2	0.0	0.1	-0.2	-0.7	-0.8
Ireland	1.0	0.2	-10.0	-11.4	-6.4	-3.9	-3.3	-2.9	-2.2	-1.6	-3.3	-3.3
Greece	:	:	-10.8	-5.8	-2.7	-6.5	0.8	-0.8	-0.3	-1.0	1.0	-1.4
Spain	-2.9	-1.5	-4.1	-6.4	-6.3	-2.3	-2.2	-2.6	-2.7	-2.6	-2.5	-2.6
France	-2.4	-4.1	-4.9	-5.0	-4.2	-3.4	-2.8	-2.7	-2.5	-2.6	-2.4	-2.4
Italy	-3.5	-4.0	-3.3	-2.6	-1.2	-0.6	-0.9	-1.0	-1.5	-1.5	-0.7	-0.9
Cyprus	:	-4.1	-2.9	-5.7	-4.8	-2.0	-5.6	1.2	0.7	-0.4	0.9	0.5
Latvia	:	-1.9	-4.5	-1.3	0.0	-0.9	-2.1	-2.1	-1.9	-1.8	-1.9	-2.2
Lithuania	:	-1.6	-4.1	-7.3	-2.5	-2.7	-1.1	-1.2	-1.6	-0.9	-1.7	-1.0
Luxembourg	3.1	1.1	1.7	1.4	2.5	2.1	2.3	0.7	0.9	0.9	0.6	0.4
Malta	-7.2	-5.7	-3.1	-2.3	-3.3	-2.4	-2.1	-2.0	-1.6	-1.4	-2.0	-1.5
Netherlands	-0.7	-0.8	-1.9	-3.6	-2.3	-0.4	-0.6	-1.1	-1.1	-1.5	-0.3	-0.4
Austria	-3.0	-1.9	-3.0	-2.7	-2.2	-1.0	-2.2	-1.2	-1.2	-1.1	-1.3	-1.5
Portugal	-4.8	-5.0	-6.2	-6.3	-3.2	-2.2	-5.2	-1.8	-2.3	-2.4	-1.5	-2.1
Slovenia	:	-2.8	-4.0	-5.8	-2.2	-12.7	-3.9	-2.7	-2.6	-2.9	-2.3	-2.7
Slovakia	:	-3.7	-5.8	-3.7	-3.5	-1.7	-2.0	-2.3	-2.1	-2.0	-1.8	-1.8
Finland	0.8	3.2	1.3	-0.9	-1.2	-1.1	-1.7	-1.7	-1.5	-1.5	-1.8	-2.2
Euro area	:	:	-3.4	-3.6	-2.5	-1.4	-1.2	-1.0	-1.2	-1.3	-0.9	-1.1
Bulgaria	-2.1	0.4	-0.9	-1.9	-0.5	-0.8	-5.7	-2.6	-2.4	-2.4	-2.7	-2.5
Czech Republic	-3.1	-5.1	-4.0	-2.6	-3.2	0.0	-1.0	-2.0	-1.5	-1.4	-1.6	-1.6
Denmark	-1.5	0.8	1.2	-0.5	-1.5	1.3	3.8	-1.5	-1.3	-1.0	0.2	-1.4
Croatia	:	-3.9	-5.5	-7.2	-4.1	-3.8	-3.9	-3.6	-3.9	-3.9	-4.1	-4.7
Hungary	:	-7.4	-5.6	-4.8	-0.7	-1.4	-2.2	-2.4	-2.3	-2.3	-2.6	-2.4
Poland	-4.5	-3.2	-5.7	-6.1	-3.9	-3.4	-2.9	-2.6	-2.8	-2.9	-2.4	-2.3
Romania	-3.5	-2.4	-6.2	-4.1	-1.5	-1.1	-0.6	-0.8	-2.7	-3.8	-1.3	-3.4
Sweden	0.4	0.4	1.4	0.0	0.1	-0.2	-0.8	-1.0	-1.0	-0.9	-1.0	-0.8
United Kingdom	-1.1	-2.8	-5.8	-5.8	-6.6	-4.5	-5.3	-4.5	-3.3	-2.4	-4.5	-3.5
EU	:	:	-3.6	-3.8	-3.0	-1.9	-1.8	-1.7	-1.6	-1.5	-1.6	-1.6

<sup>1</sup> Cyclically-adjusted variables for Croatia are based on provisional values for fiscal semi-elasticities and subject to further revisions