



GKI Economic Research Co.

We analyse, you take the decision.

AIECE Autumn Meeting

Brussels, 3-4.11.2016



General Report

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Topics

- 1. Key global developments**
- 2. Outlook for Europe**
- 3. Policy environment**
- 4. Challenges for Europe and the risks to the forecast**



1. Key Global Developments

Main points

- GDP forecast
- Crude oil prices
- Fed's Federal Funds Rate
- Euro/dollar exchange rate

Global developments: key findings

- IMF/OECD revised down its GDP projections by 0.1% for both 2016 and 2017
- Grim medium/long term outlook due to Brexit, yet so far moderate impact
- Marked increase in the price of crude oil since January 2016
- Long term interest rates have decreased and reached record lows recently in certain countries
- AIECE institutes project the dollar to appreciate against the euro in 2017

Global GDP forecast

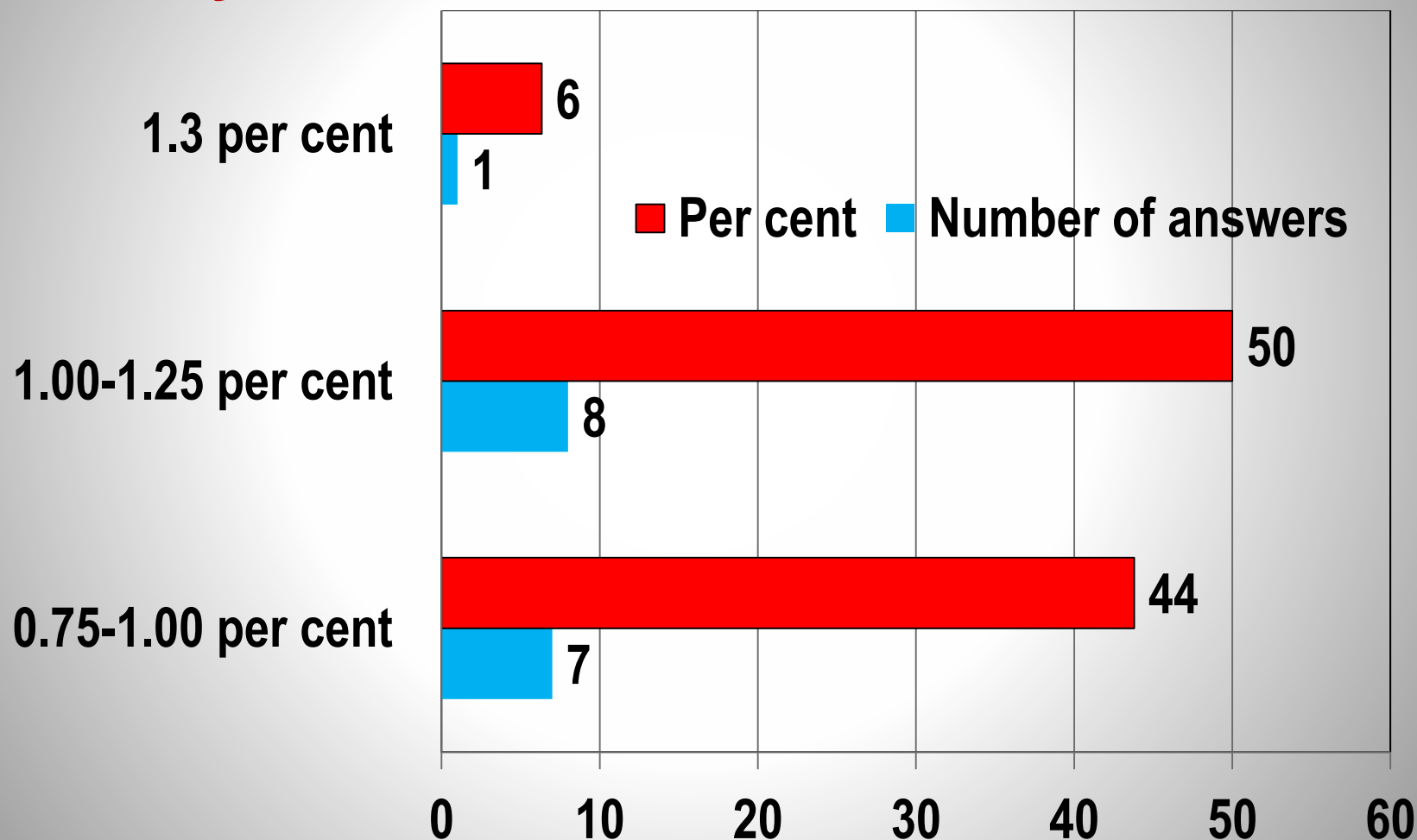
| | 2016 | 2017 |
|---------------------------------------|-------------|-------------|
| Forecasts in per cent | | |
| OECD | 3.1 | 3.2 |
| IMF | 3.1 | 3.4 |
| Revisions in percentage points | | |
| OECD (compared to June 2016) | -0.1 | -0.1 |
| IMF (compared to April 2016) | -0.1 | -0.1 |

Crude oil price projections by the AIECE institutes (quarterly averages)

| Year | Brent USD/barrel |
|----------------|------------------|
| 2015 Q1 | 53,9 |
| Q2 | 62,1 |
| Q3 | 50 |
| Q4 | 43,1 |
| 2016 Q1 | 34,4 |
| Q2 | 46 |
| Q3 | 47,1 |
| Q4 | 49,3 |
| 2017 Q1 | 50,3 |
| Q2 | 51,8 |
| Q3 | 53 |
| Q4 | 54 |

Source: WB & AIECE Institutions, 2015Q1 – 2016Q2: Actual Figures, 2016Q3 – 2017Q4: Projections of AIECE institutions

The projection of the US Federal Funds Rate by the AIECE institutes for Q4 2017



The forecast of the EUR/USD exchange rate by the AIECE institutes (quarterly averages)

| Year | EUR/USD |
|---------|---------|
| 2015 Q1 | 1,10 |
| Q2 | 1,13 |
| Q3 | 1,12 |
| Q4 | |
| 2016 Q1 | 1,10 |
| Q2 | 1,13 |
| Q3 | 1,12 |
| Q4 | 1,11 |
| 2017 Q1 | 1,11 |
| Q2 | 1,10 |
| Q3 | 1,10 |
| Q4 | 1,10 |

Source: AIECE Institutes

2. Outlook for Europe

GDP forecasts by AIECE institutes in their own countries

| | 2015 | 2016 | 2017 |
|----------------|------|------|------|
| Austria | 0,9 | 1,7 | 1,5 |
| Belgium | 1,4 | 1,4 | 1,4 |
| Denmark | 1,0 | 1,0 | 2,0 |
| Finland | 0,2 | 1,1 | 1,2 |
| France | 1,3 | 1,4 | 1,3 |
| Germany | 1,5 | 1,8 | 1,3 |
| Greece | -0,2 | -0,1 | 1,9 |
| Hungary | 2,9 | 2,1 | 2,8 |
| Ireland | 26,3 | 4,3 | 3,8 |
| Italy | 0,8 | 0,7 | 0,8 |
| Netherlands | 2,0 | 1,7 | 1,7 |
| Norway | 1,6 | 0,9 | 2,1 |
| Poland | 3,6 | 3,2 | 3,4 |
| Spain | 3,2 | 2,9 | 2,1 |
| Sweden | 4,2 | 2,9 | 2,1 |
| Switzerland | 0,8 | 3,4 | 2,3 |
| United Kingdom | 2,2 | 1,7 | 1,0 |

What is behind Ireland's GDP?

- 12.5% corporate tax rate
- U.S. companies relocated their headquarters to Ireland
- Asset depreciation of foreign MNCs was responsible for 50% of Ireland's nominal GDP growth in 2015
- In 2014, Perrigo Co. and Jazz Pharmaceuticals Plc. Corporations alone brought €523 billion after moving their headquarters to Ireland, an increase compared to their €391 billion figure in 2013
- No sudden increase in value added production

Sources: Bloomberg, Seamus Coffey

2.1. Euro area outlook

Main points

- GDP forecast
- Summary of AIECE member institutes' polls on:
 - Factors that will contribute to GDP growth in 2016
 - Main driving forces of GDP growth in 2017
 - Evaluation of investment climate in the own country
 - Evaluation of factors limiting investments in the own country
 - Evaluation of government measures to raise employment
 - Evaluation of government measure to reduce unemployment

Outlook for the euro area

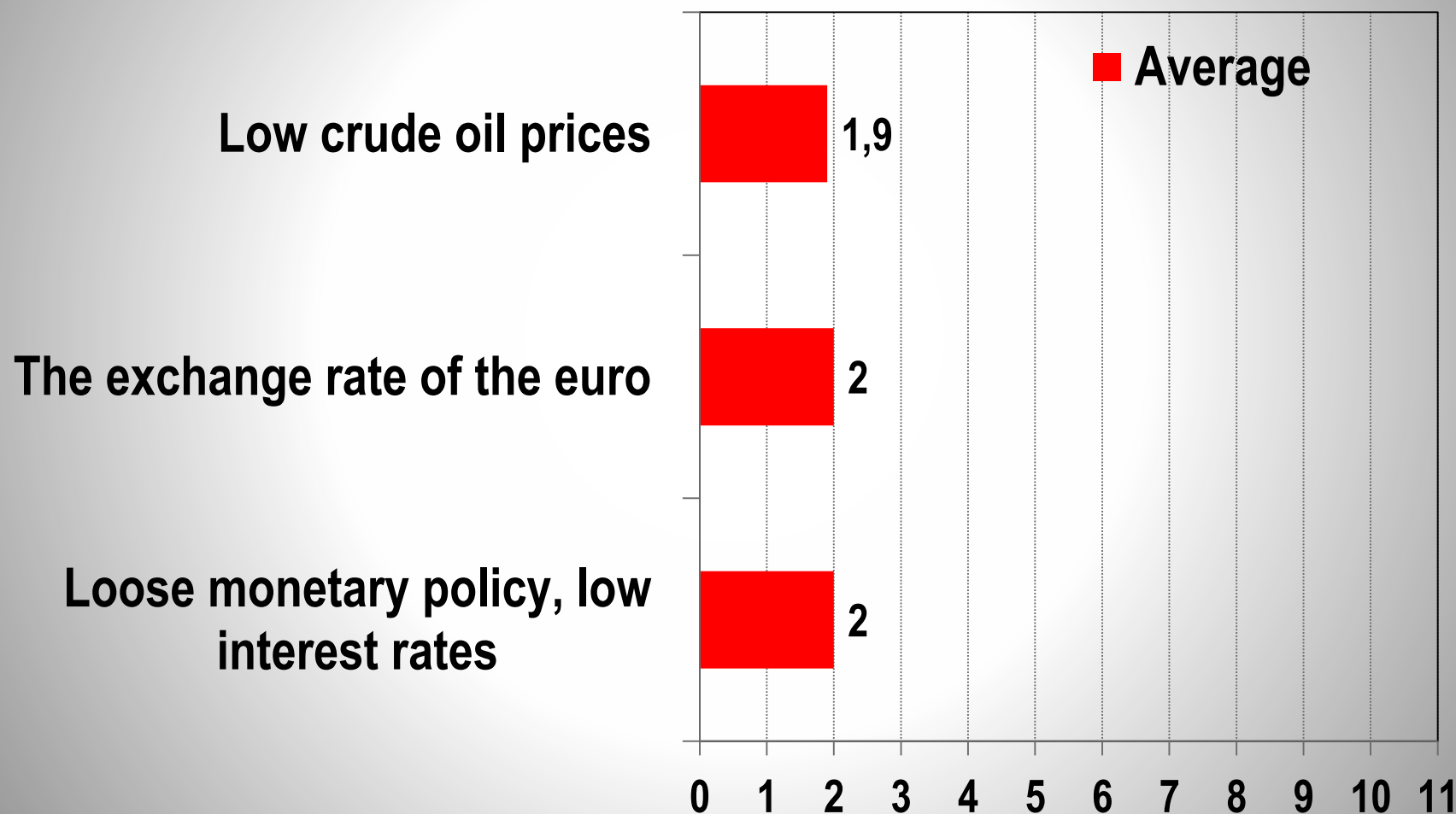
- AIECE institutes project a 1.6% & 1.5% GDP growth for 2016 and 2017 respectively
- There is a moderate shift toward a more pessimistic economic outlook compared to the spring meeting
- Depending on the cyclical position of each country, AIECE institutes expect investment rates to either rise or remain flat
- Fixed capital formation is forecast to grow by 3.8% & 4.1% in 2016 and 2017, respectively in the euro area
- Low but rising inflation

GDP forecasts for the euro area

| | 2016 | 2017 |
|--|-------------|-------------|
| Forecasts in per cent | | |
| AIECE institutes | 1.6 | 1.5 |
| IMF | 1.7 | 1.5 |
| Revisions in percentage points | | |
| AIECE institutes (compared to May 2016) | -0.1 | -0.2 |
| IMF (compared to April 2016) | -0.2 | -0.1 |

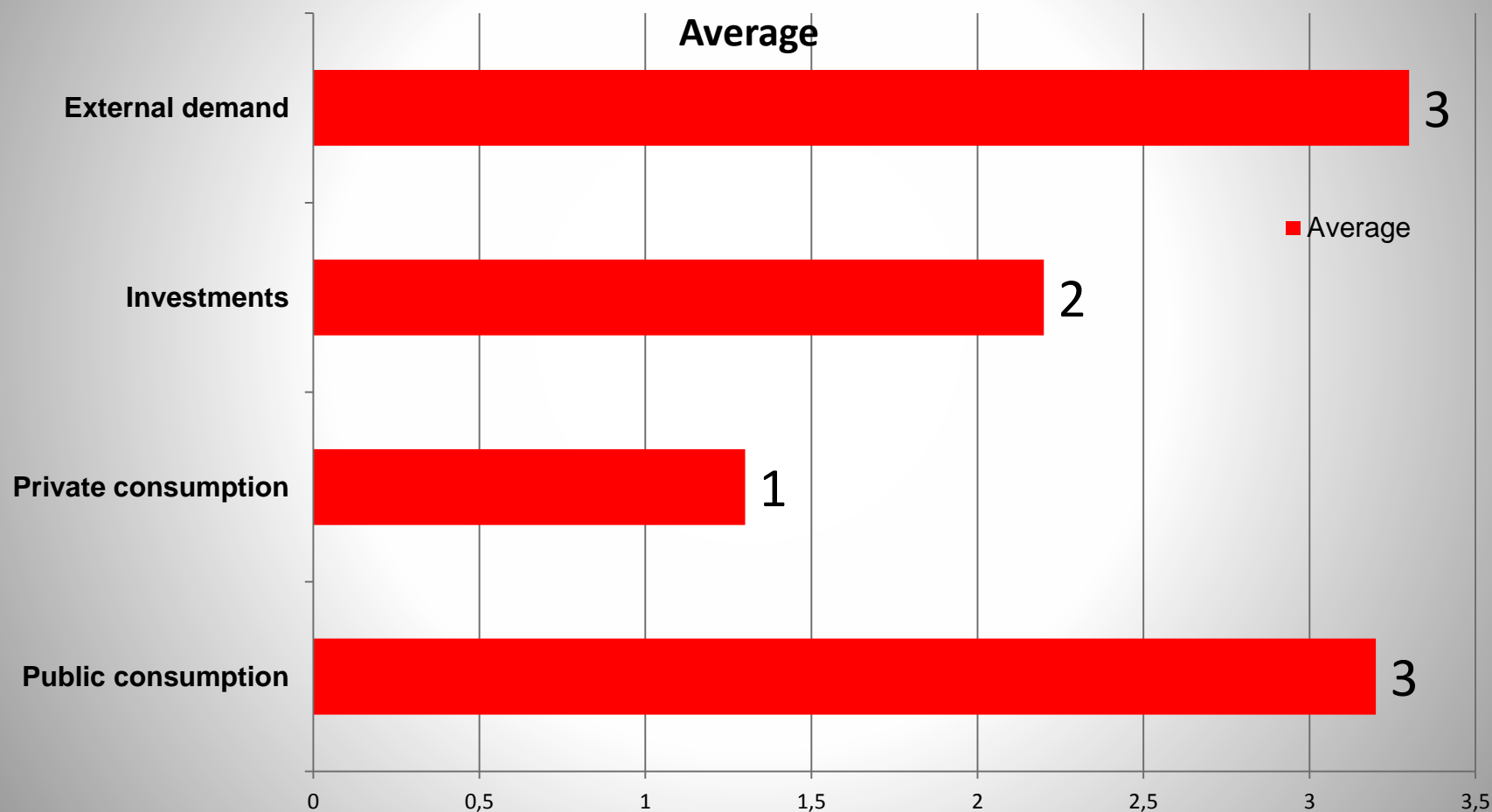
Source: IMF forecast, AIECE institutes

Ranking of three factors' contribution to GDP growth in 2016



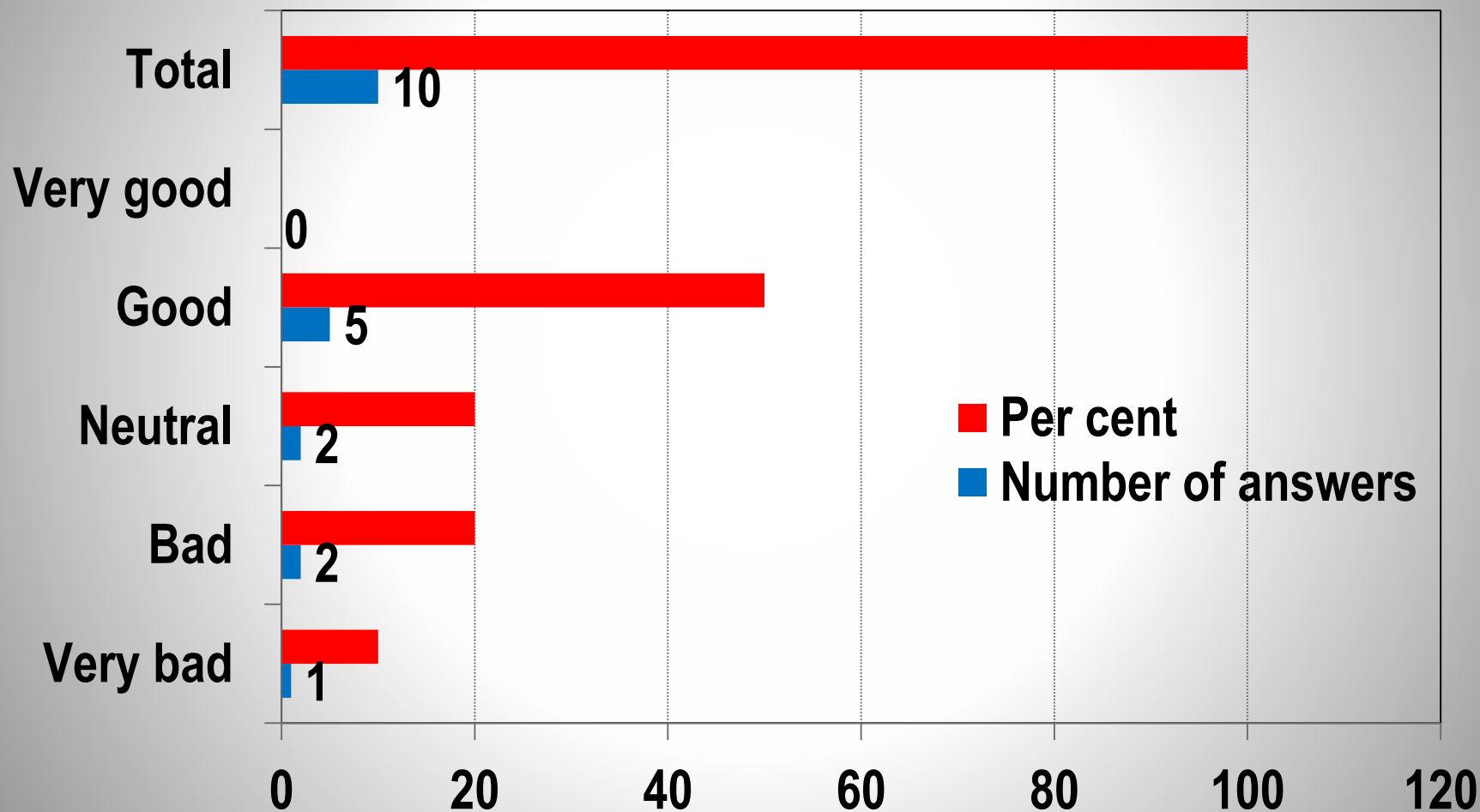
Source: AIECE Institutes

Ranking of the main driving forces of GDP growth in 2017



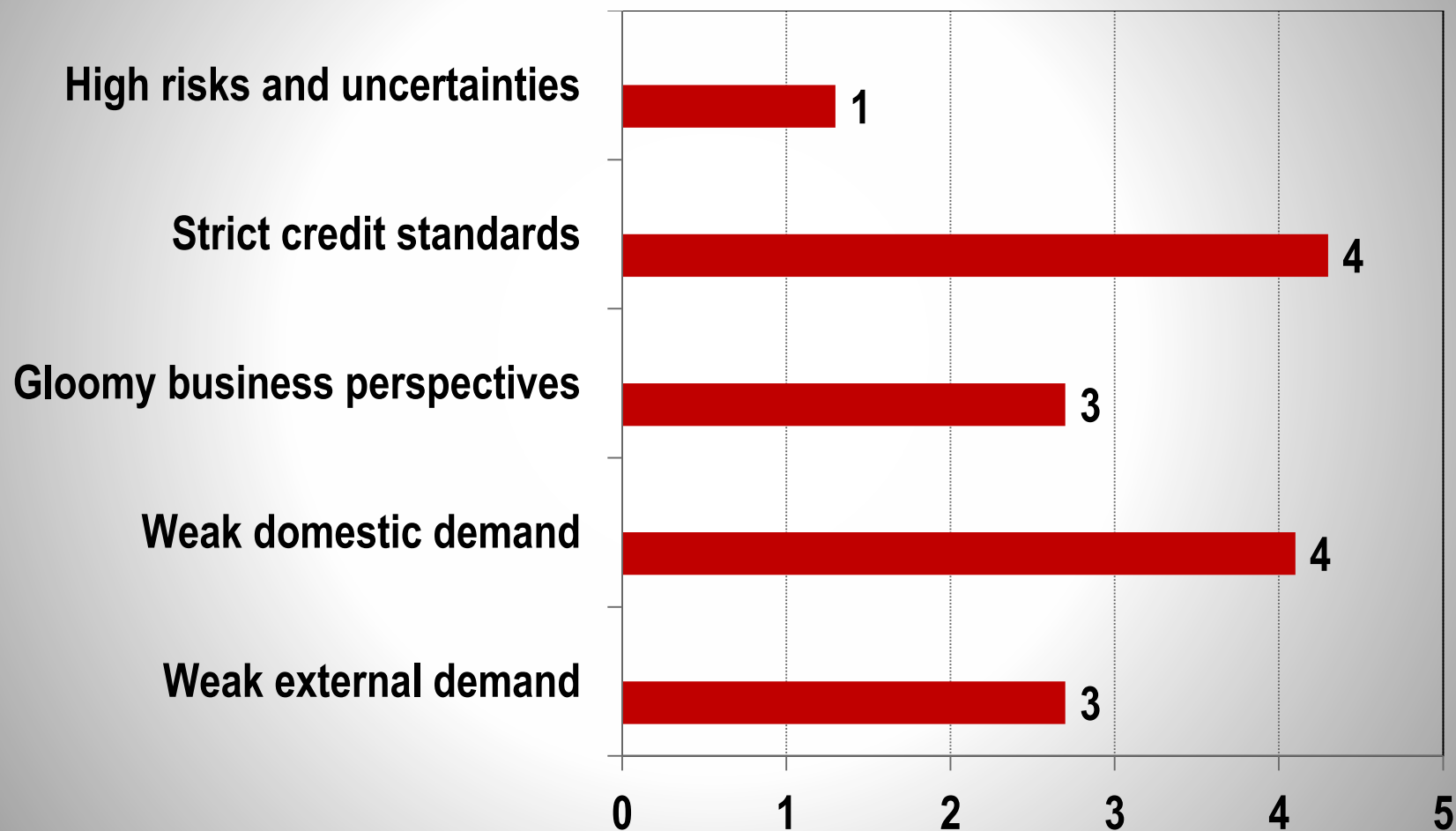
Source: AIECE Institutes

The evaluation of the investment climate in the own country



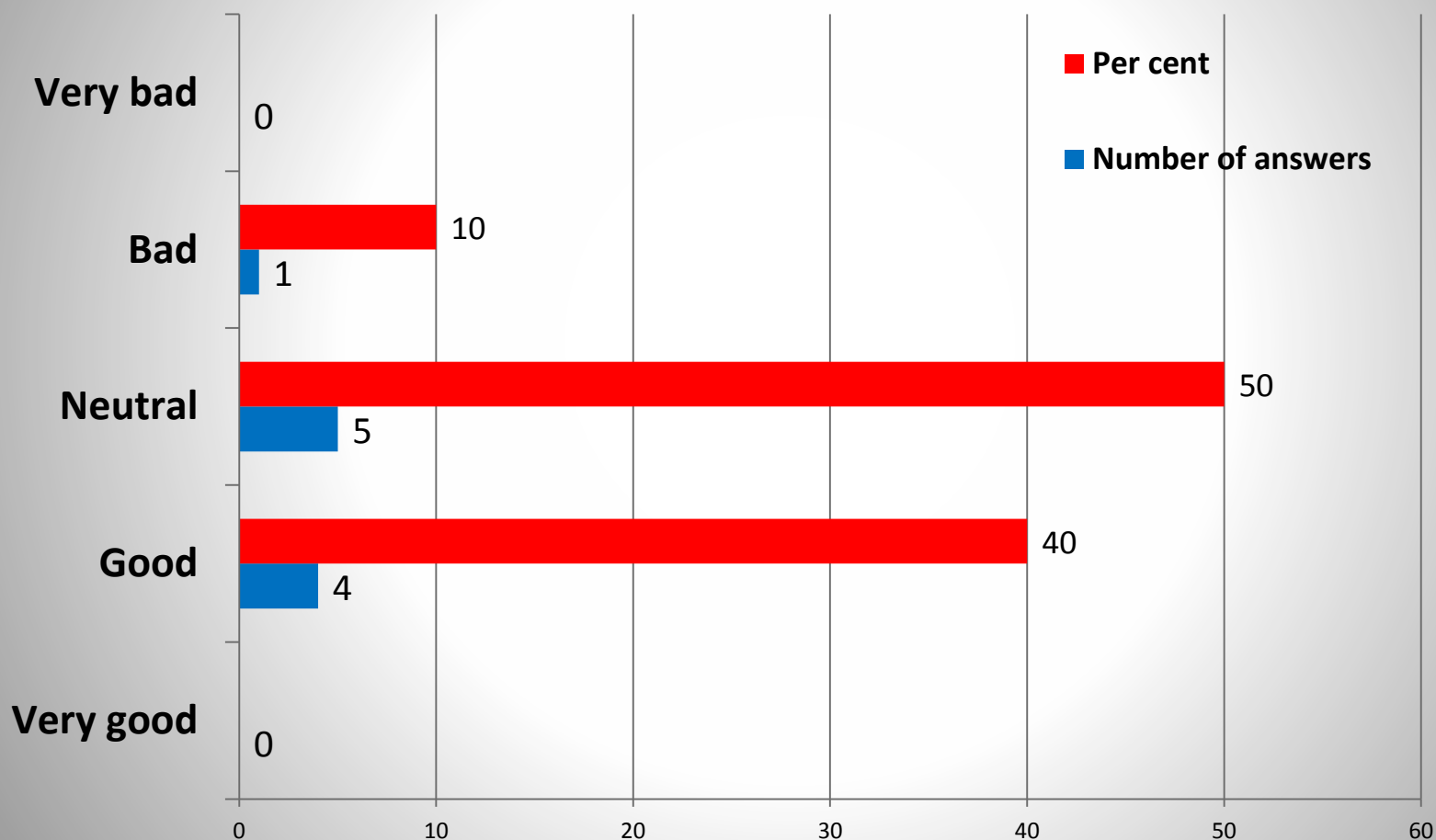
Source: AIECE Institutes

Ranking of the evaluation of factors limiting investments in the own country



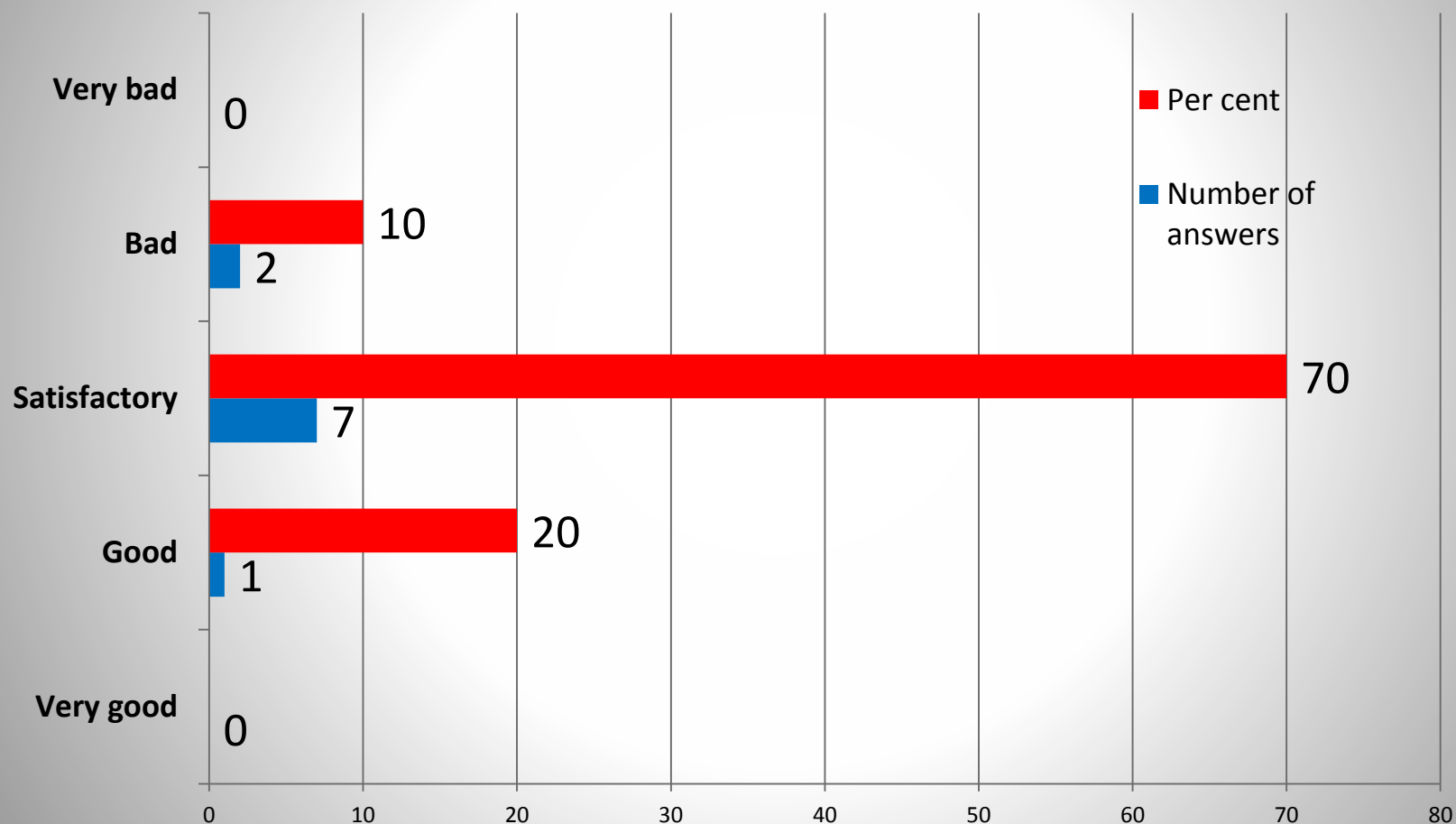
Source: AIECE Institutes

The evaluation of government measures to raise employment



Source: AIECE Institutes

The evaluation of government measures to reduce unemployment



Source: AIECE Institutes

Questions

- Will the projected increase of crude oil prices drag on GDP growth in the euro area?
- Do current account imbalances (high surpluses and high deficits in individual countries) in the euro area restrain GDP growth?
- Is the competitive position of the euro area and its member states going to improve over the forecasting horizon?
- Is there a place in the euro area for growth enhancing strategy? What should governments do to promote GDP growth (and to improve productivity as one of the main elements of competitiveness)?
- What impact do you expect from the CETA deal?

2.2. Developments in EU countries not belonging to the euro area

Countries

- United Kingdom
- Denmark
- Sweden
- Poland
- Hungary



2.2.1. United Kingdom

Key points

- After a relatively strong GDP growth in Q2 Brexit has taken its toll on the British economy
- GDP growth: for 2016 1.7%; for 2017 1.0%
- Driving factors: loose monetary policy, low crude oil prices for 2016; external demand, public consumption for 2017
- Purchasing power has markedly weakened due to depreciation of the sterling, while exposing the economy vulnerable to external shocks
- Unemployment rate is likely to increase by 0.6 percentage points in 2017
- Medium term uncertainties related to Brexit drag on GDP growth

Figures on the UK

| Variables | % volume change from previous year | |
|--|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 1,7 | 1,0 |
| Private consumption | 2,3 | -0,1 |
| Public consumption | 0,8 | 0,6 |
| Gross fixed capital formation | -1,9 | -3,3 |
| Total domestic demand | 1,1 | -0,8 |
| Exports of goods and services | 1,9 | 3,7 |
| Imports of goods and services | 0,9 | -2,1 |
| Net exports | 0,3 | 1,8 |
| Consumer prices | 0,5 | 2,5 |
| Employment | 1,3 | 0,2 |
| Unemployment rate (%) | 5,0 | 5,6 |
| General government balance in % of GDP | -3,7 | -3,5 |
| Gross public debt in % of GDP | 89,4 | 90,4 |
| Current account balance in % of GDP | -6,0 | -3,2 |

Source: NIESR

United Kingdom: Questions

- How will Brexit look like? Will there be a soft Brexit (with a priority to the access to the single market at the expense of limitations over borders and laws as well as contributing to the EU budget) or a hard one (with an emphasis on regulatory sovereignty at the expense of the access to the single market)?
- Do limitations on immigration not risk the normal functioning of the British economy? Can the British economy thrive without foreign workers?
- What may be the net effect of the depreciation of the pound sterling? Can it be a remedy to the huge current account deficit?
- Do capital inflows fund the huge current account deficit?
- Does the depreciation of the pound sterling endanger the Bank of England's 2% inflation target?
- Is the UK becoming more inward looking and illiberal country after Brexit?

2.2.2. Denmark

Key points

- Steady but low growth in Q1 and Q2 of 2016
- GDP growth projection: 1% in 2016; 2% for 2017
- Main driving force: domestic demand
- Uncertainties surround the minority government
- Increasing purchasing power due to rising wages and low inflation
- Moderate productivity growth remains a challenge

Figures on Denmark

| Variables | % volume change from previous year | |
|---|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 1,0 | 2,0 |
| Private consumption | 2,0 | 2,3 |
| Public consumption | 1,2 | 0,5 |
| Gross fixed capital formation | 1,4 | 3,2 |
| private excl. dwellings | 2,1 | 3,8 |
| dwellings | 4,3 | 4,3 |
| government | -3,6 | -0,1 |
| Total domestic demand | 1,2 | 2,2 |
| Exports of goods and services | 0,4 | 2,5 |
| Imports of goods and services | 0,6 | 2,8 |
| Consumer prices | 0,4 | 1,5 |
| Unemployment rate in % | 3,2 | 3,1 |
| Public sector fiscal balance in % of GDP | -0,6 | -1,6 |
| Gross public debt | 40,4 | 40,8 |

Source: Secretariat of The Danish Economic Councils

2.2.3. Sweden

Key points

- Slowing growth compared to 2015
- GDP growth projection: 3.4% in 2016; 2.3% for 2017
- Driving force: external demand, private consumption (especially housing demand)
- Large inflow of refugees may positively impact GDP growth, especially due to labour shortage in low skill sectors
- Monetary policy to remain expansionary
- Fiscal policy has room to be expansionary

Figures on Sweden

| Variables | % volume change from previous year | |
|-------------------------------|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 3,4 | 2,3 |
| Private consumption | 2,8 | 2,3 |
| Public consumption | 3,4 | 2,2 |
| Gross fixed capital formation | 6,7 | 3,1 |
| Exports of goods and services | 2,6 | 3,2 |
| Imports of goods and services | 4,5 | 3,3 |
| Consumer prices | 1,0 | 1,4 |
| core consumer prices | 1,4 | 1,2 |
| Unemployment rate | 6,8 | 6,5 |
| Gross public debt /GDP | 40,9 | 39,1 |
| Current account balance/GDP | 4,7 | 5,2 |

Source: Confederation of Swedish Enterprise, NIER, Stockholm

2.2.4. Poland

Key points

- Poland is likely to continue on a trajectory of above average growth rate following 3.6% in 2015
- GDP growth projection: 3.2% in 2016; 3.4% for 2017
- Driving force: consumption, rising wages and employment, higher social transfers, EU funded projects
- Slight rise in the inflation rate to 1.5% projected for 2017
- Yet strong political uncertainties loom over any positive forecasts regarding the Polish economy

Figures on Poland

| Variables | % volume change from previous year | |
|----------------------------------|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 3,2 | 3,4 |
| Private consumption | 3,6 | 3,3 |
| Public consumption | 3,0 | 2,8 |
| Gross fixed capital formation | 3,1 | 6,1 |
| Total domestic demand | 2,7 | 3,5 |
| Exports of goods and services | 6,3 | 5,8 |
| Imports of goods and services | 7,3 | 7,1 |
| Consumer prices | -0,4 | 1,2 |
| core consumer prices | 0,3 | 1,4 |
| Unemployment rate in % | 9,2 | 9,2 |
| Public sector fiscal balance/GDP | -2,9 | -3,7 |
| Gross public debt/GDP | 53,1 | 53,9 |
| Current account balance/GDP | 2,2 | 0,8 |

Source: IBRKK Warsaw

2.2.5. Hungary

Key points

- GDP growth projection: 2.1% in 2016; 2.8% in 2017, one of the lowest in the region
- Driving factors: EU funding, private consumption, low energy prices, loose monetary policy
- Low government deficit offers room for the government to wiggle
- The recently submitted tax changes may contribute positively to the economy's growth potential
- There is an increasing shortage of skilled workforce, while the investment and regulatory environment remains highly unpredictable

Figures on Hungary

| Variables | % volume change from previous year | |
|----------------------------------|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 2,1 | 2,8 |
| Private consumption | 4,6 | 3,6 |
| Public consumption | 2,8 | 1,8 |
| Gross fixed capital formation | -10,0 | 4,3 |
| Total domestic demand | 1,8 | 3,0 |
| Exports of goods and services | 6,0 | 6,5 |
| Imports of goods and services | 6,1 | 7,2 |
| Consumer prices | 0,5 | 1,6 |
| Unemployment rate in % | 5,3 | 5,0 |
| Public sector fiscal balance/GDP | -1,9 | -2,5 |
| Gross public debt/GDP | 74,2 | 73,3 |
| Current account balance/GDP | 5,2 | 4,7 |

Source: KOPINT and GKI Budapest

2.3 Other European countries



Switzerland, key points

- Swiss GDP growth is expected to rise by 1.6% and 1.8% in 2016 & 2017, respectively
- Driving forces: low oil prices, loose monetary policy, external & domestic demand
- The current deflation is likely to be replaced with a very modest 0.2% rate of inflation in 2017
- Both the deficit and gross public debt remains low
- In addition, current account surplus will persist while productivity slowly rises
- Due to loose, expansionary monetary policy the housing market may be a source of economic imbalances

Figures on Switzerland

| Variables | % volume change from previous year | |
|----------------------------------|------------------------------------|------|
| | 2016 | 2017 |
| GDP | 1,6 | 1,8 |
| Private consumption | 1,0 | 1,2 |
| Public consumption | 1,5 | 1,0 |
| Gross fixed capital formation | 2,0 | 0,2 |
| Exports of goods and services | 3,5 | 2,3 |
| Imports of goods and services | 3,3 | 2,7 |
| Consumer prices | -0,4 | 0,2 |
| Unemployment rate in % | 4,6 | 4,6 |
| Real household disposable income | 1,3 | 2,0 |
| Public sector fiscal balance/GDP | 0,4 | -0,1 |
| Gross public debt/GDP | 33,8 | 34,0 |
| Current account balance/GDP | 10,7 | 9,9 |

Source: KOF Swiss Economic Institute

Norway: key points

- After an initial slow down this year (0.9%) compared to 2015 (1.6%), GDP is projected to grow by 2.1% for 2017
- Driving forces: expansionary fiscal and monetary policy, more competitive exchange rate, gradual increase of oil prices, domestic consumption (housing)
- Constraints: weak external demand for oil, low private investments
- Unemployment rate shall decrease from 4.7% to 4.5% in 2017
- Inflation will also decrease from 3.4% to 2% in 2017
- Risks related to the housing market and household indebtedness are offset by macro-prudential policy tools

Figures on Norway

| Variables | % volume change from previous year | |
|---|------------------------------------|------|
| | 2016 | 2017 |
| GDP Mainland Norway | 0,9 | 2,1 |
| Private consumption | 1,9 | 2,0 |
| Public consumption | 2,6 | 1,9 |
| Gross fixed capital formation Mainland Norway | 4,3 | 5,1 |
| Total domestic demand Mainland Norway | 2,6 | 2,6 |
| Exports of goods and services Traditional goods | -1,4 | 3,3 |
| Imports of goods and services | 0,8 | 2,3 |
| Consumer prices | 3,4 | 2,0 |
| core consumer prices | 3,0 | 1,9 |
| Employment | -0,2 | 0,7 |

Source: Statistics Norway

Questions

- What are the advantages of independent monetary policy for the countries not belonging to the euro area?
- Is the independent exchange rate policy a positive contribution to economic growth and structural adjustment in the countries outside of the euro area?
- How do Danish, Swiss and Swedish economic policy decision makers manage the effects of the appreciation of their currencies originating from heavy capital inflows?
- Are there any lessons to draw for the United Kingdom from Switzerland's relations with the EU?
- To what extent is GDP growth dependent on the inflow of EU funds in Poland and Hungary? What will be the driving forces of GDP growth when the inflow of EU funds starts to phase out?

3. Policy environment

Monetary policy

Fiscal policy

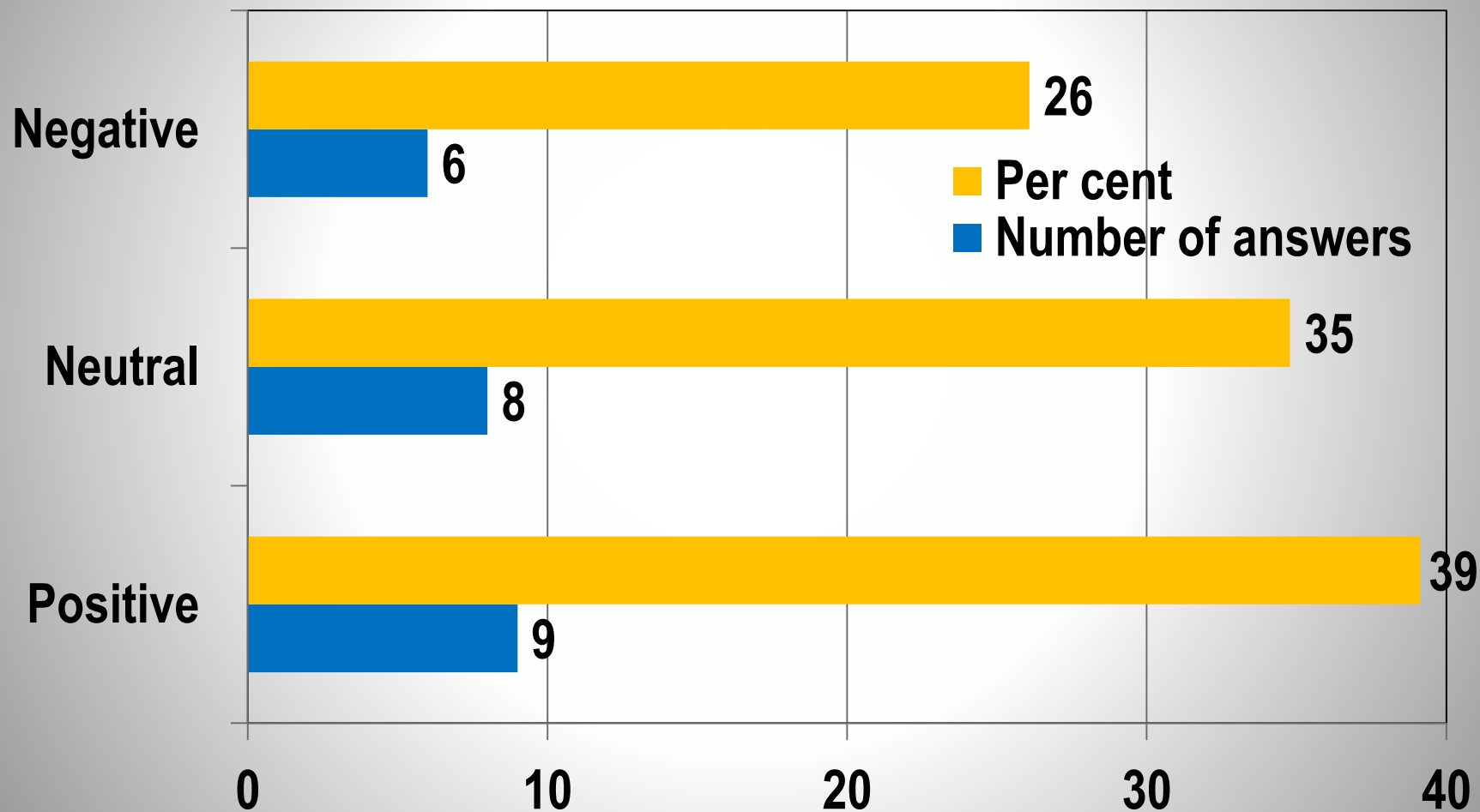


3.1. Monetary policy

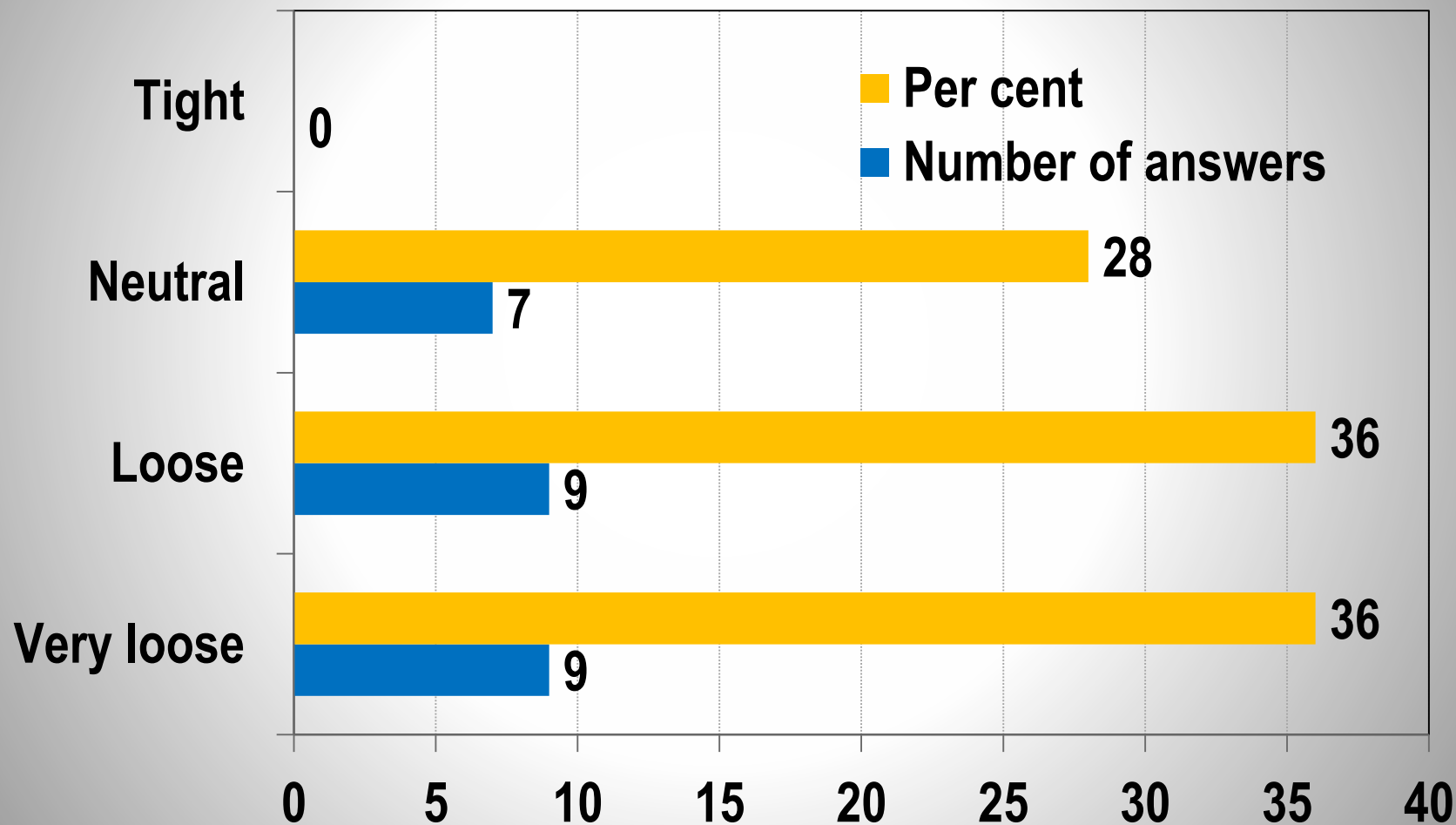
Key points

- Falling base rates
- Quantitative easing
- Liquidity trap
- Distorting financial markets
- Government debt with negative yields
- Complicated global situation

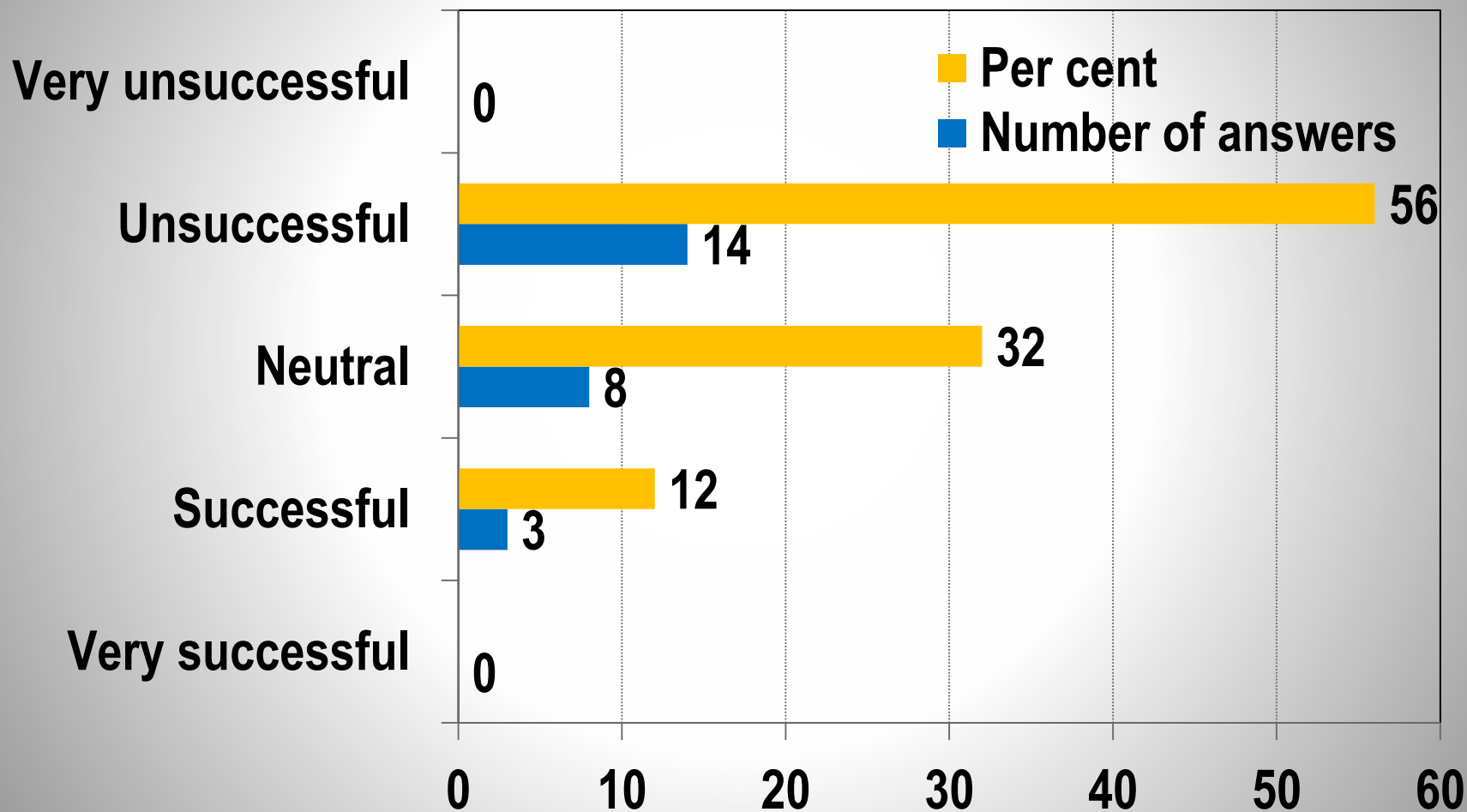
The assessment of the monetary stance of the ECB by the AIECE institutes



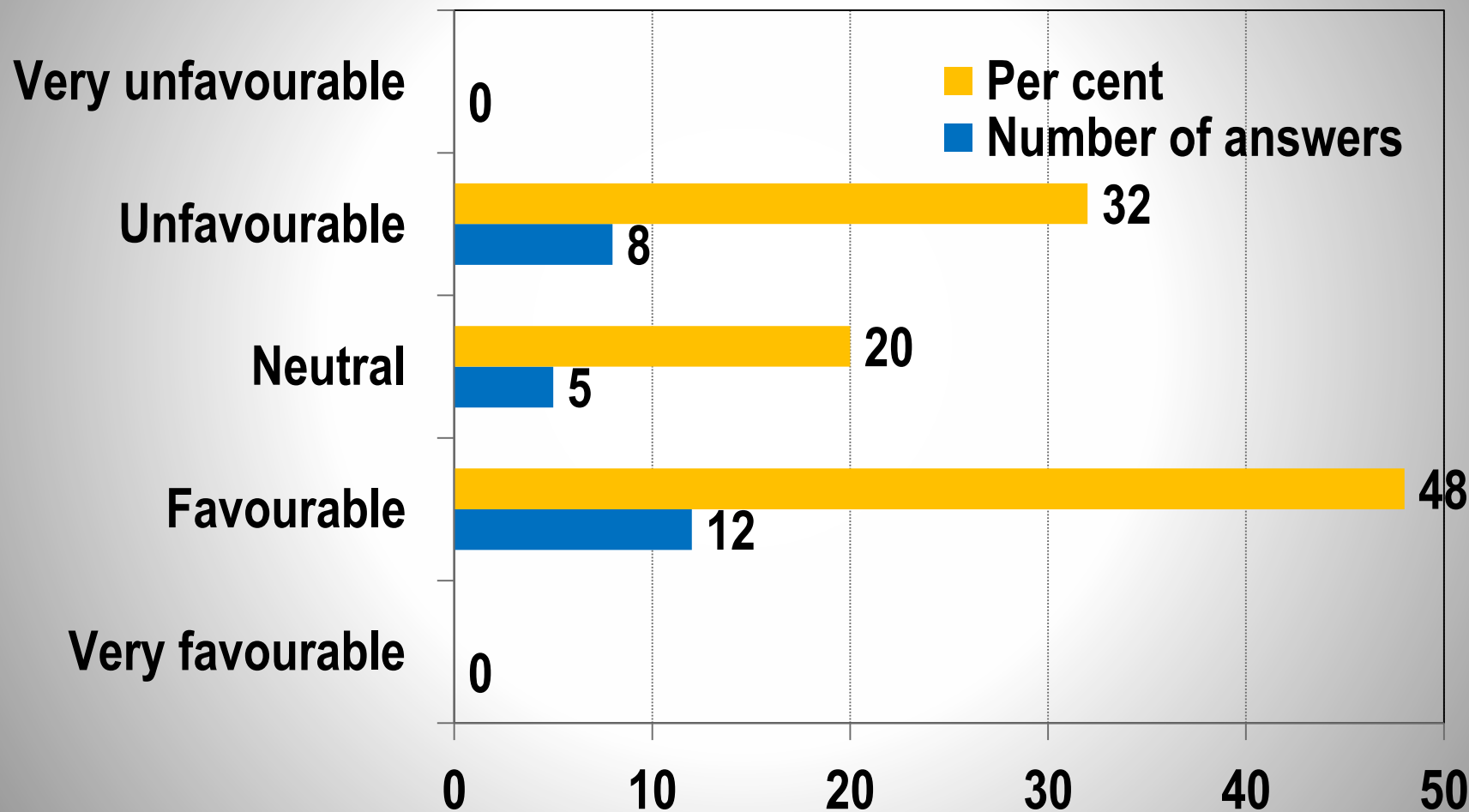
The desirable monetary stance of the ECB according to the AIECE institutes



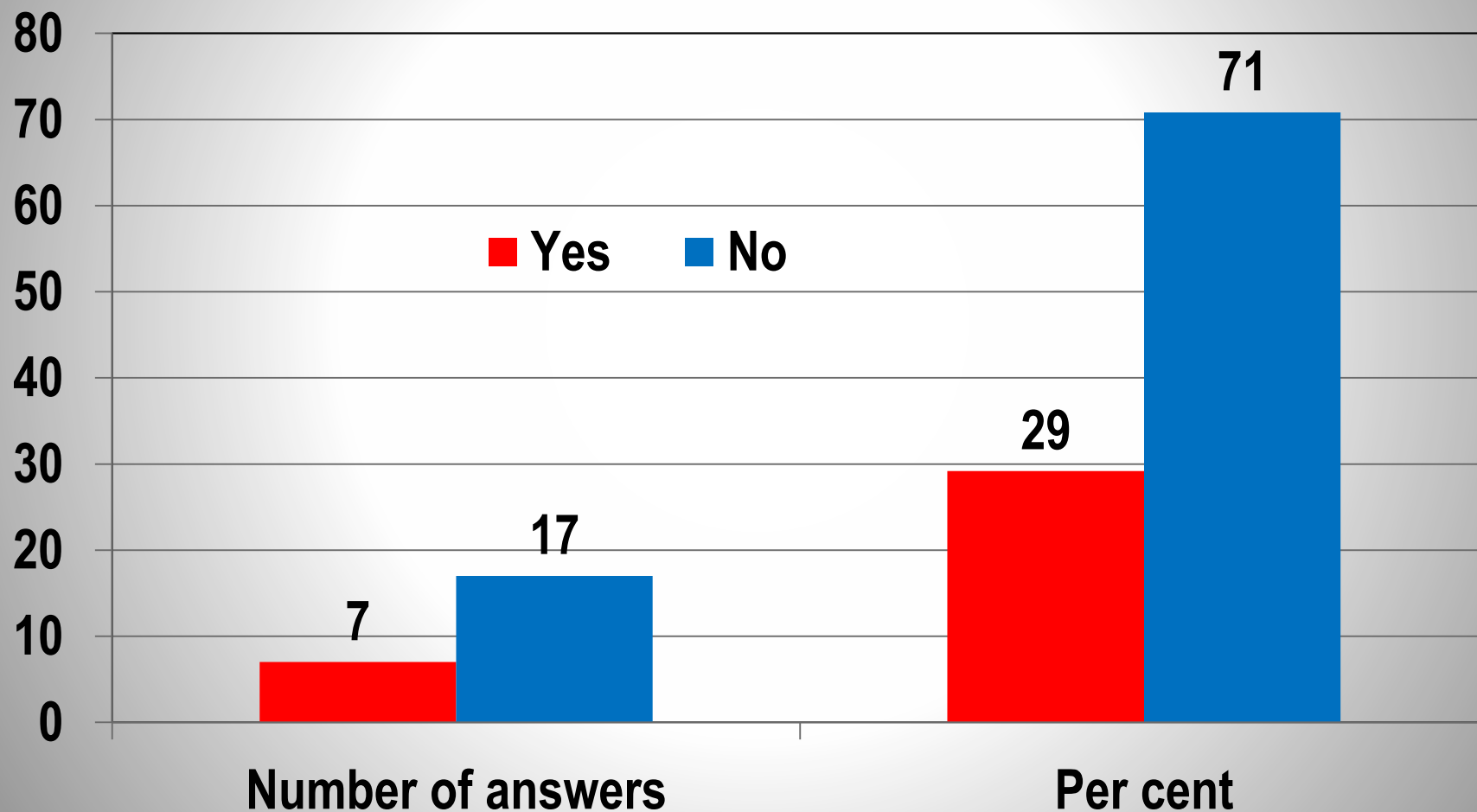
The assessment of the performance of the ECB in achieving its policy targets



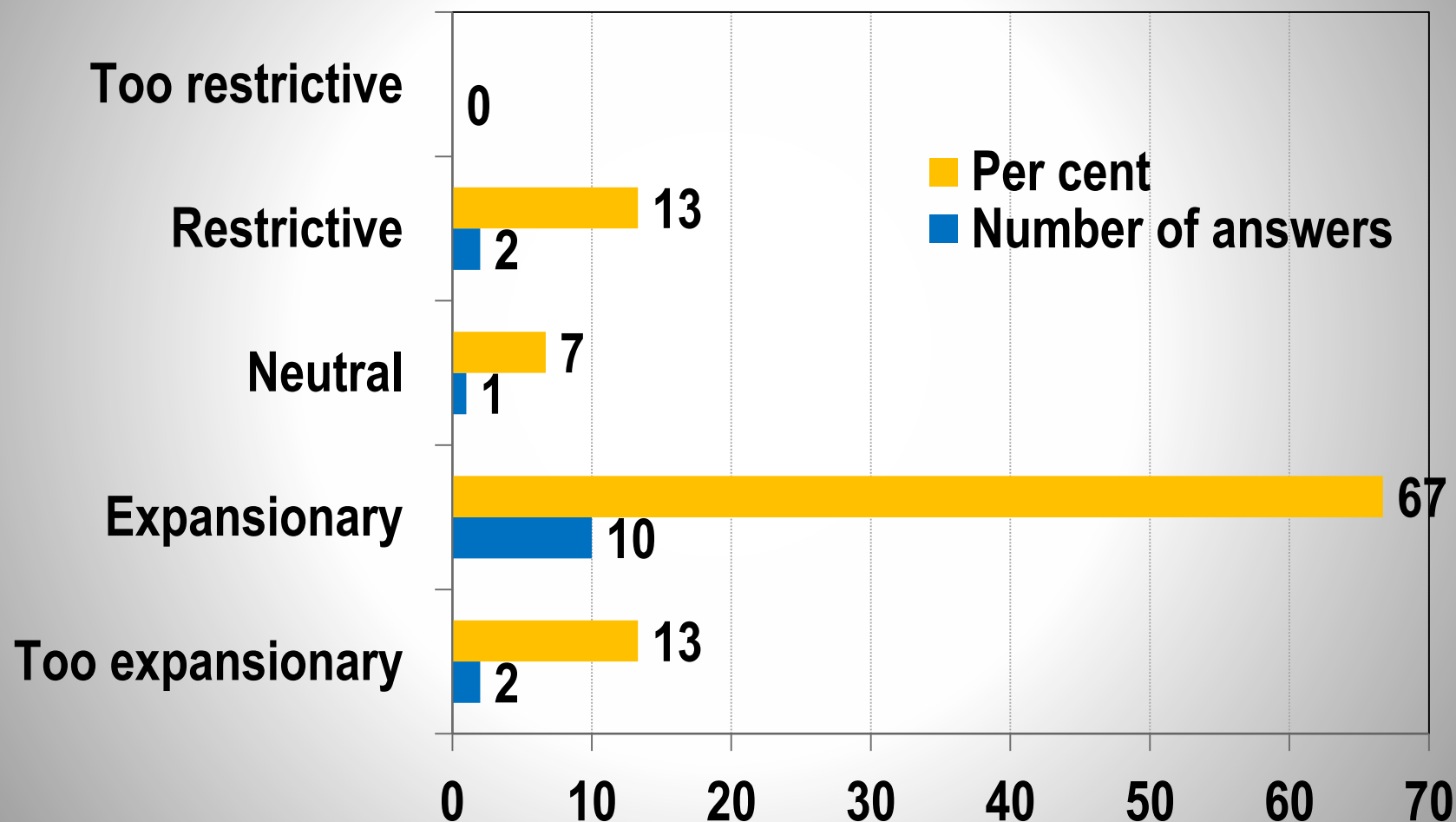
The assessment of the negative deposit rates



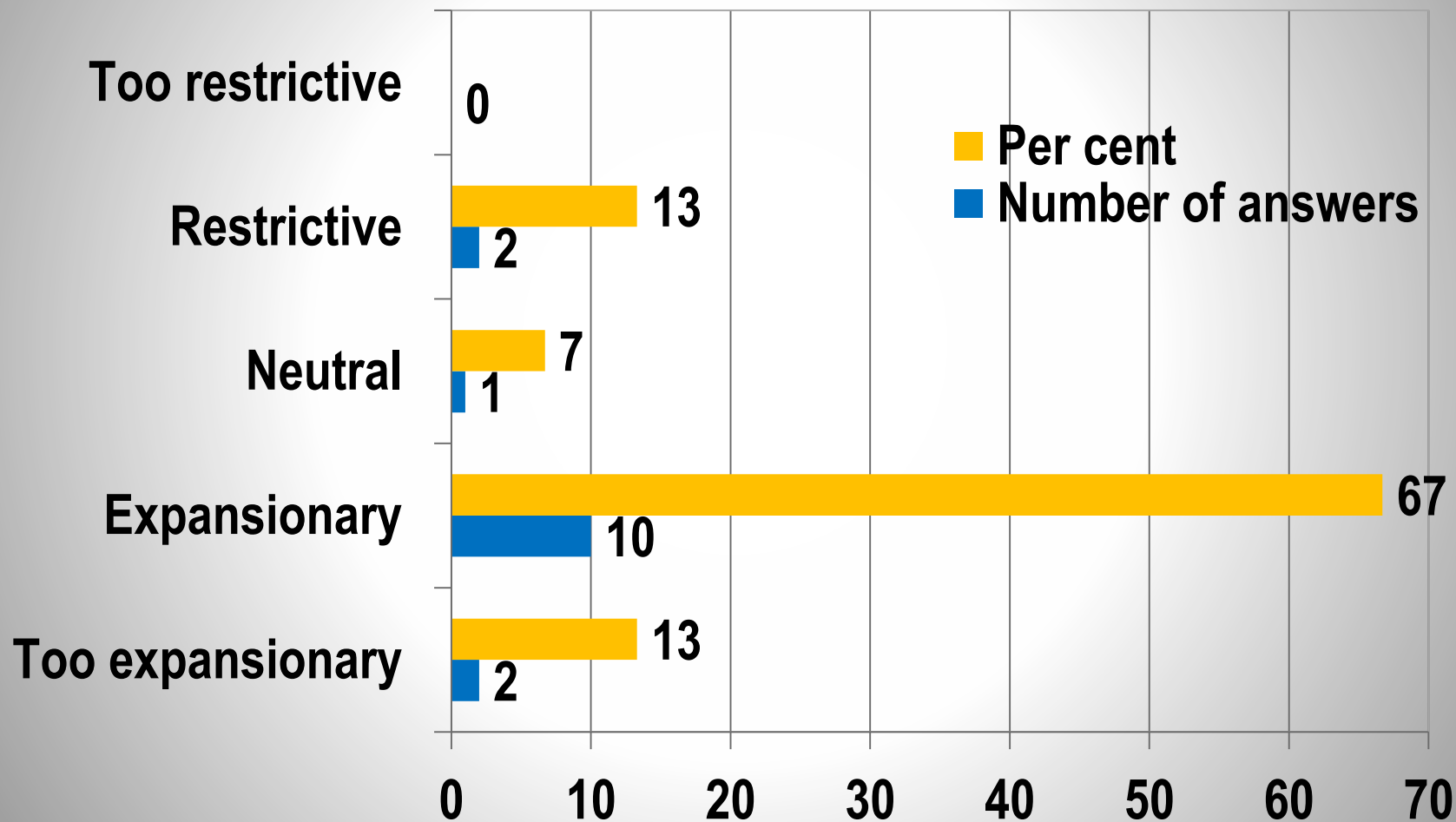
Should the ECB take further measures to raise inflation and bolster GDP growth?



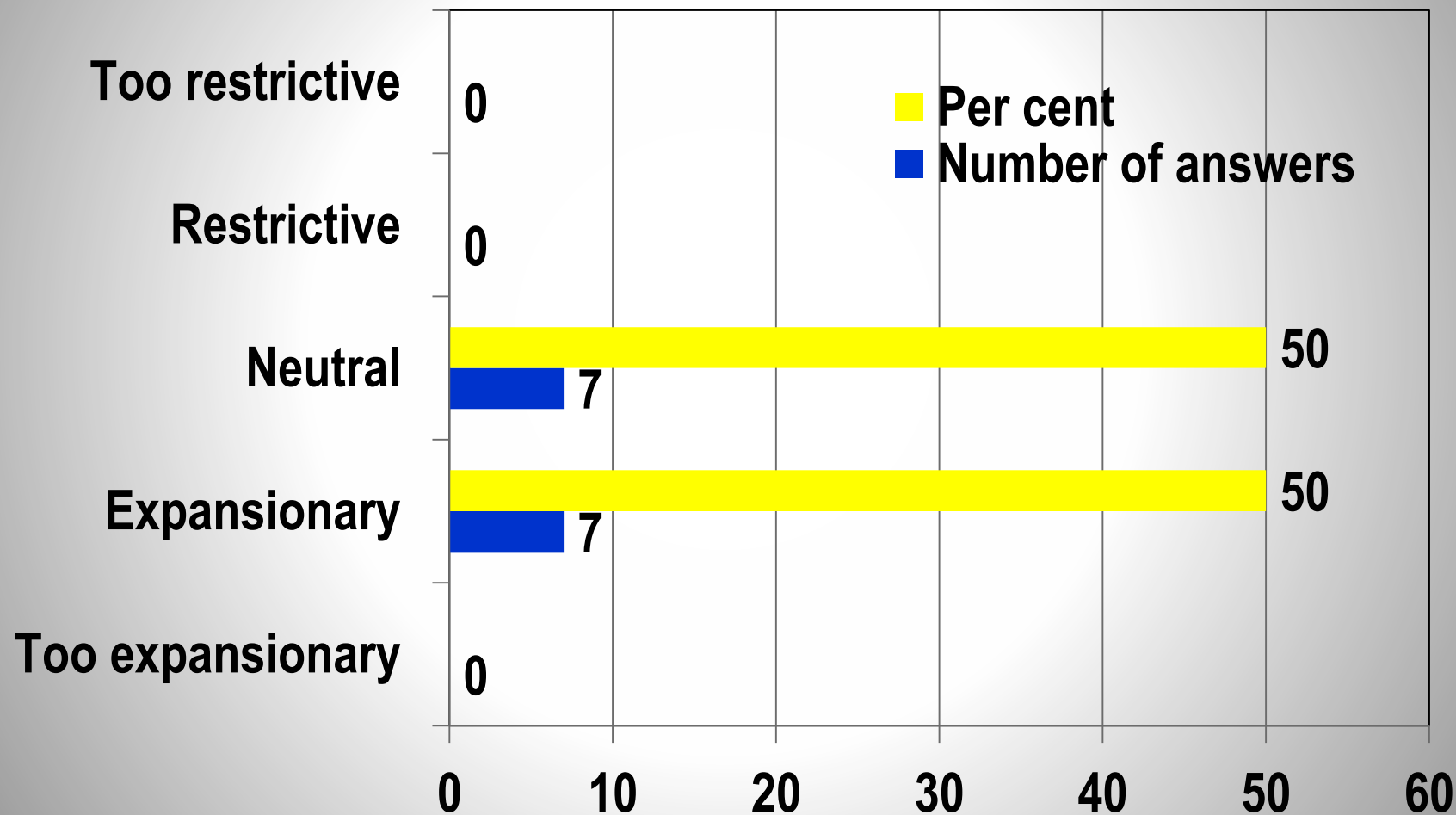
The assessment of the monetary policy environment in the own country in 2016



The expected monetary policy environment in the own country in 2017



The desirable monetary stance in the own country in 2017



Questions 1.

- Would you comment on the monetary policy of the ECB please? Is there deflationary pressure in the euro area?
- Monetary conditions in the euro area depend to a large extent on the monetary policy of the US Fed. How can the monetary stance of the Fed and the short-term prospects of its monetary policy be evaluated?
- What would the implications of rate hikes by the Fed on the monetary policy of the ECB be?
- What are the advantages and disadvantages as well as the risks of the zero or negative interest rate policy of the major central banks?
- Is the risk of a liquidity trap present in the euro area?

Questions 2.

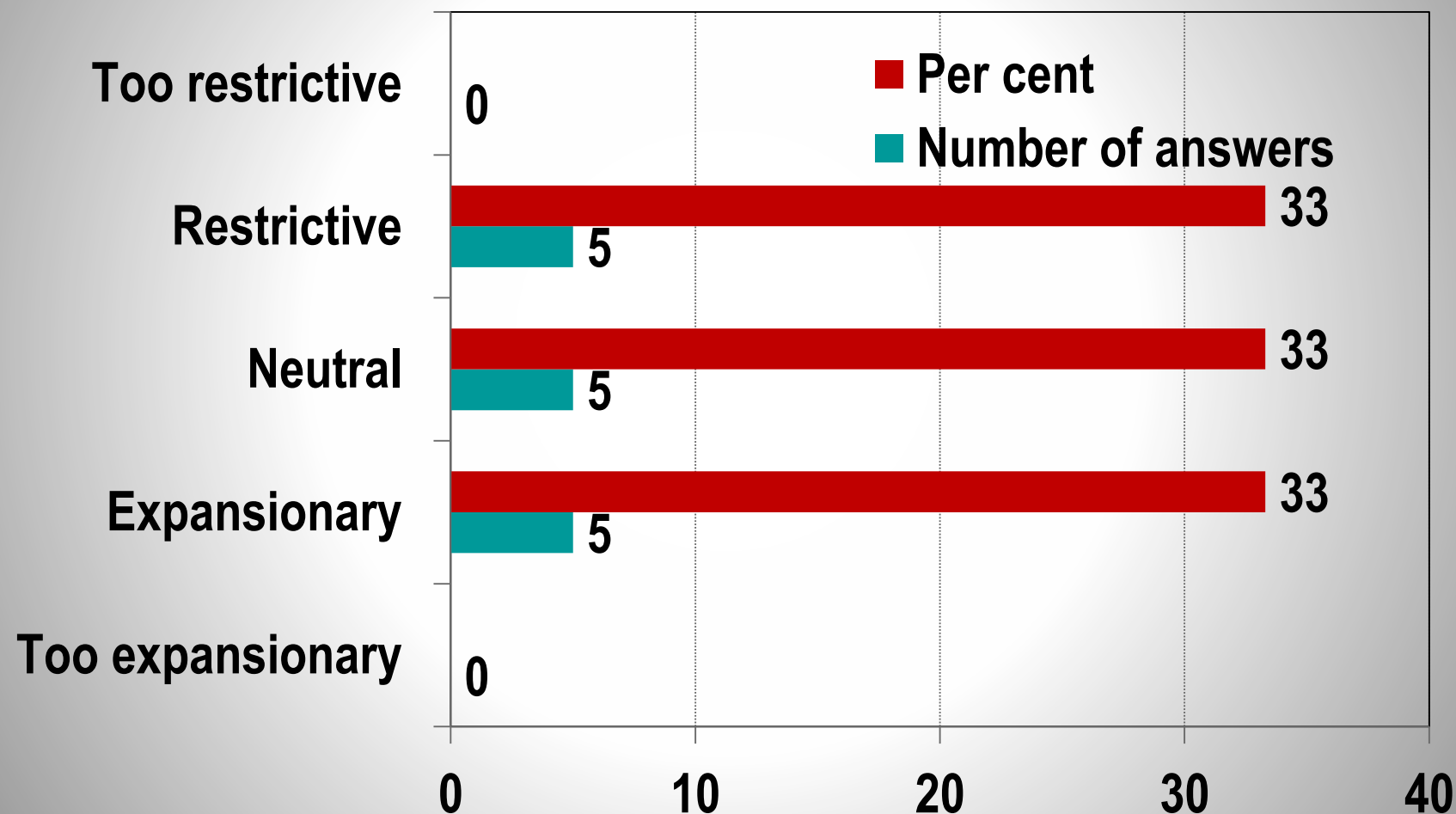
- Stock indices and real estate prices reached all time high levels in the US and in some EU member states not least as a result of loose monetary policies. Are stock markets and real estate markets overvalued and posing threats to financial stability?
- How do the ECB's standard and non-standard monetary policy measures spill over to countries outside the euro area?

3.2. Fiscal policy

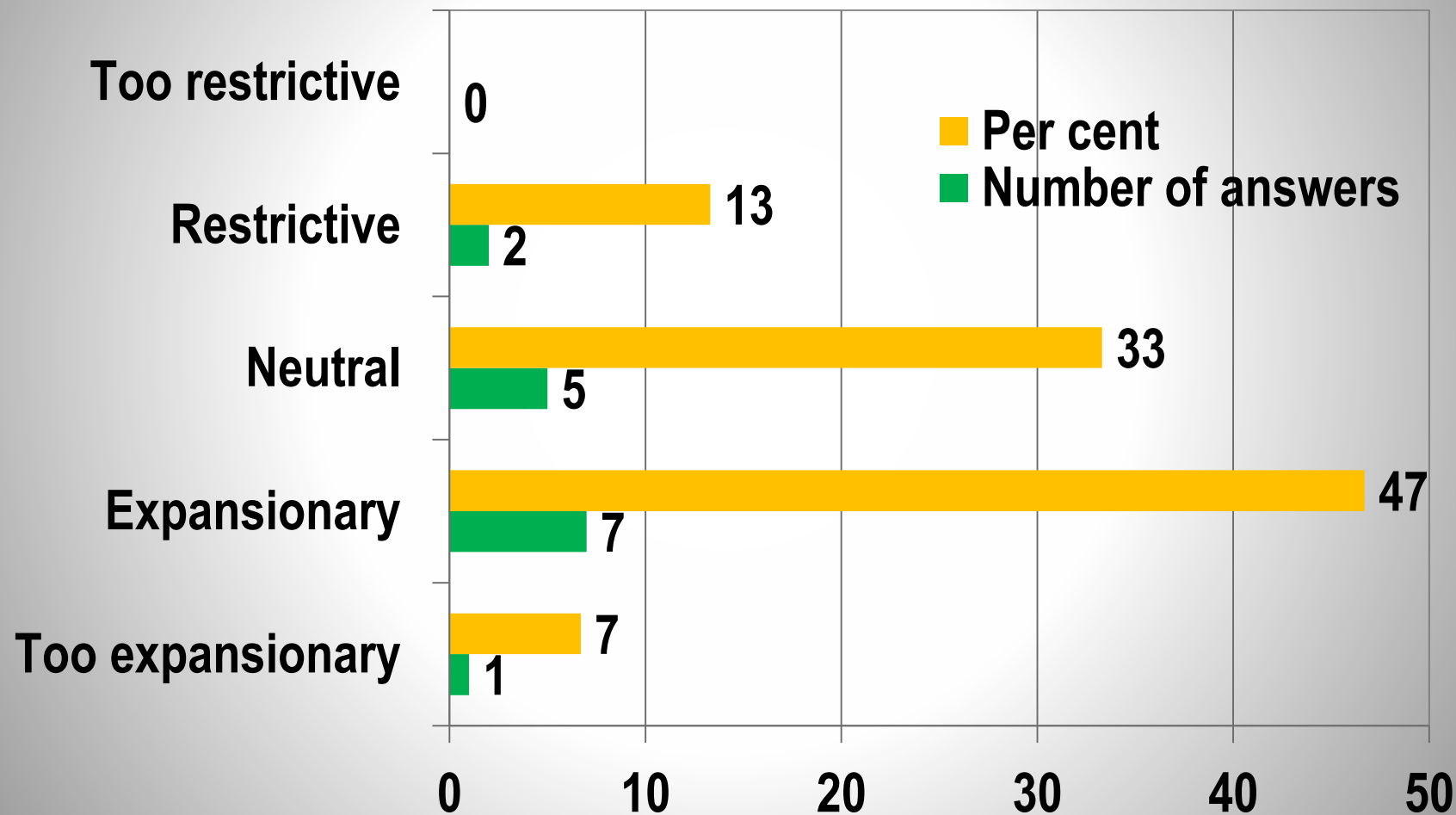
Key points

- According to the forecasts of the AIECE institutes, the general government deficit remains below 3 per cent of GDP in 2016 and 2017 in all countries except France, Spain, the United Kingdom and Poland, the latter in 2017
- In 2017, the general government deficit ratio is expected to decrease in the majority of the countries

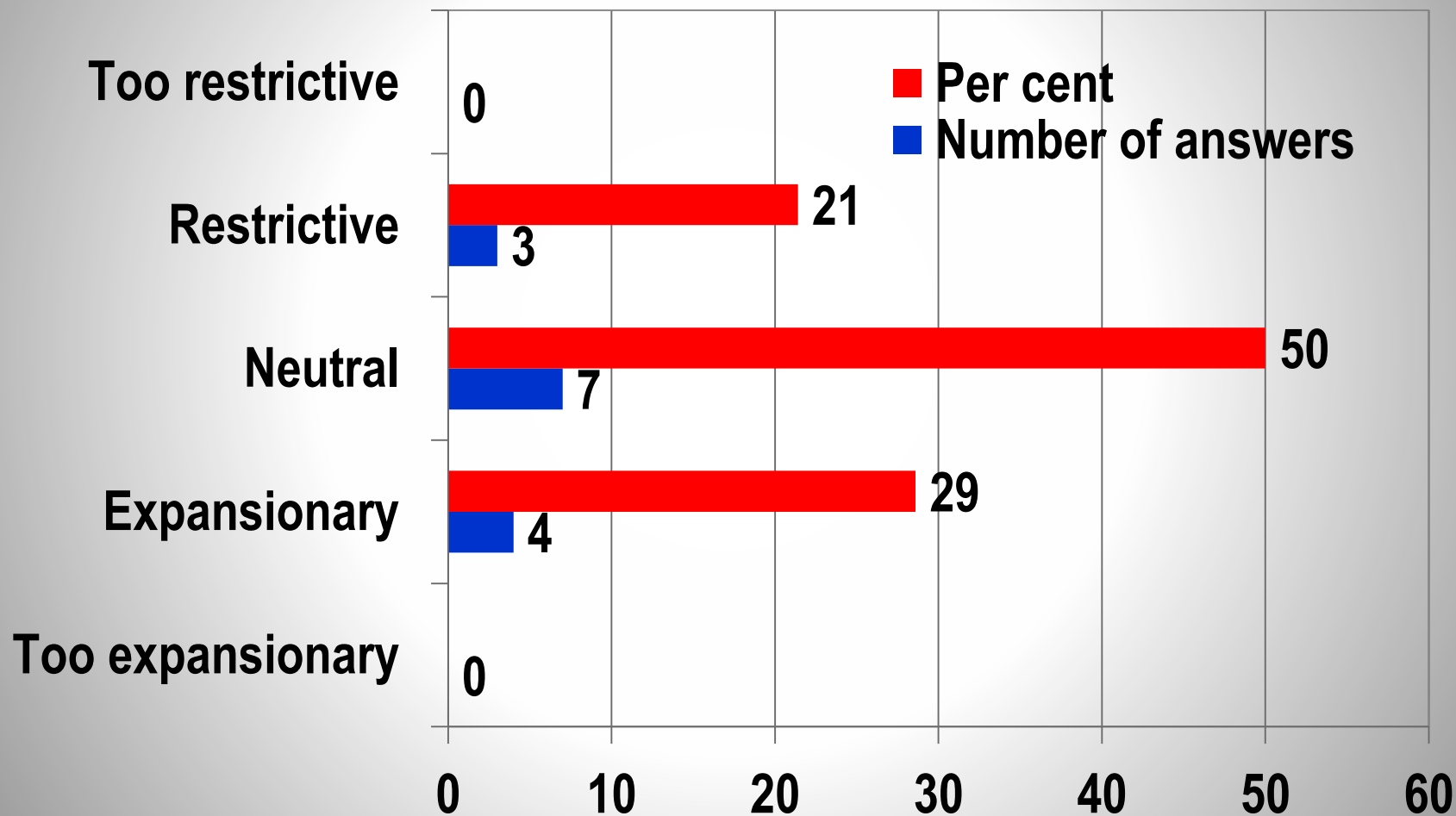
The evaluation of the fiscal policy stance in 2016



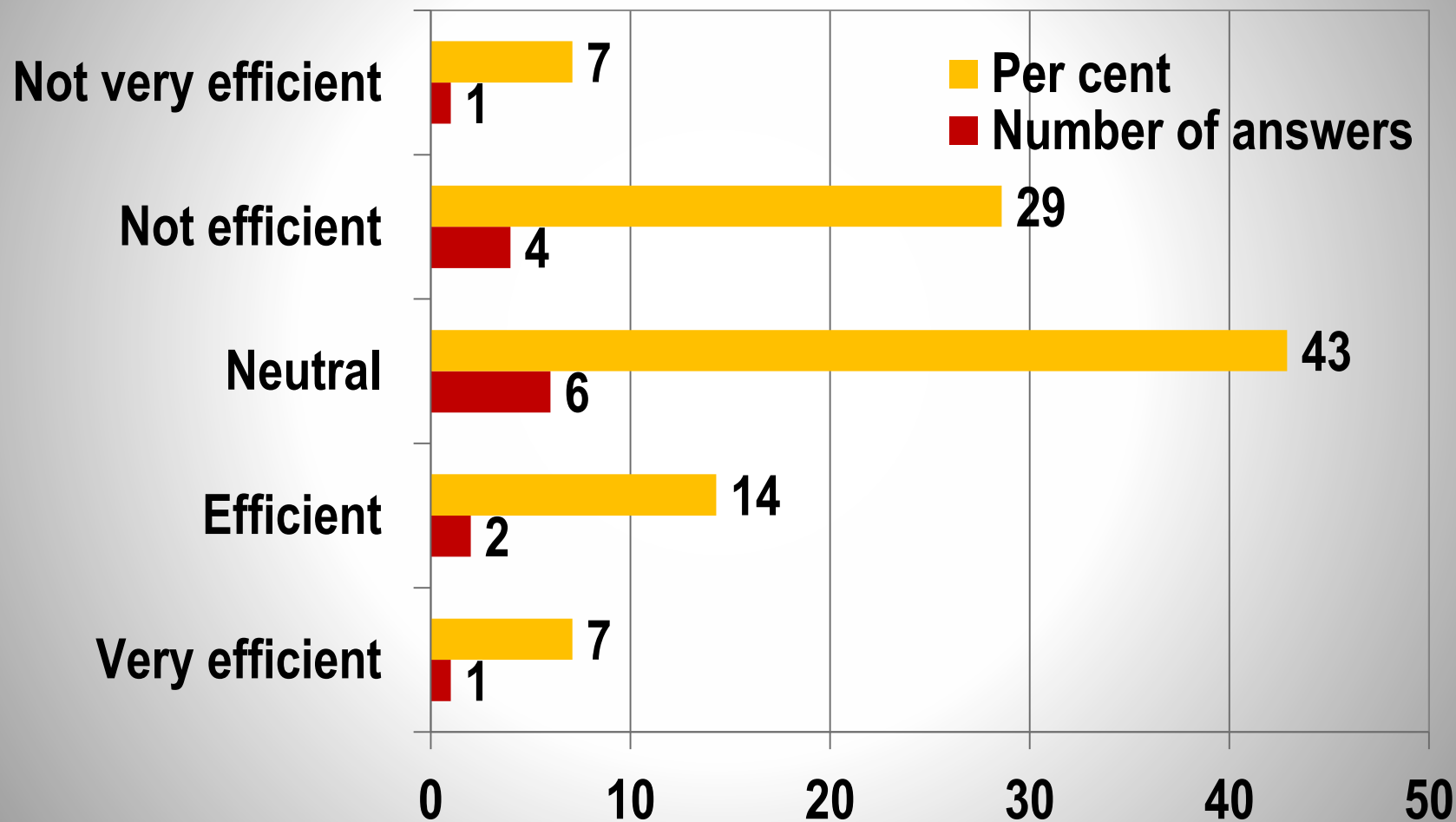
The evaluation of the fiscal policy stance in 2017



The desirable fiscal policy stance in 2017



The evaluation of the current measures to reduce the general government debt



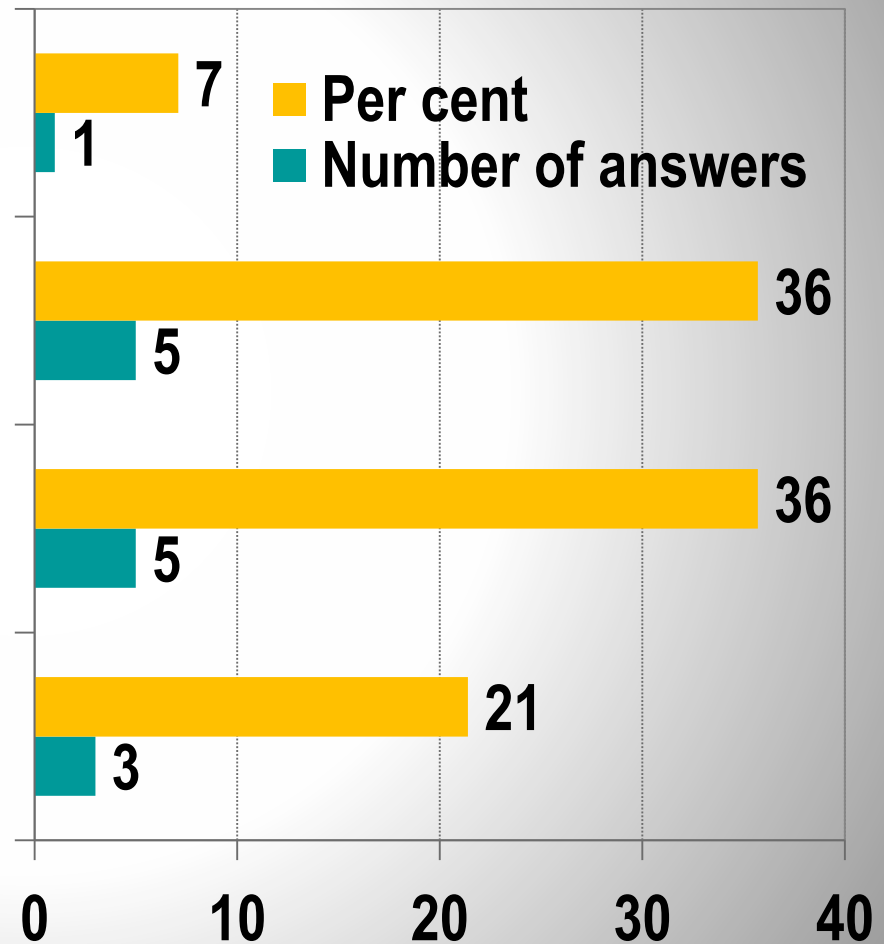
The evaluation of the relationship between monetary policy and fiscal policy

Fiscal policy is overburdened

Neutral

Monetary policy is
overburdened

They support each other



Questions 1.

- How can fiscal and monetary policy be reconciled?
- What are the risks for the forecast of the general government deficit and gross government debt ratio?
- Which could the most important growth promoting tools of fiscal policy be?
- Which may be the main features of structural reforms in your country?

Questions 2.

- Should the fiscal rules enshrined in the effective EU law be changed in order to ensure growth promoting fiscal policies?
- Structural reforms usually tend to increase general government expenditures. Is the implementation of structural reforms compatible with meeting certain criteria on the general government deficit and government gross debt?
- What is the relationship between growth promoting budgetary measures and structural reforms?

4. Challenges for Europe and the risks to the forecasts

Main topics

- Financial stability
- Brexit
- The response of the EMU and the EU to the challenges
- Risks



4.1. Financial stability

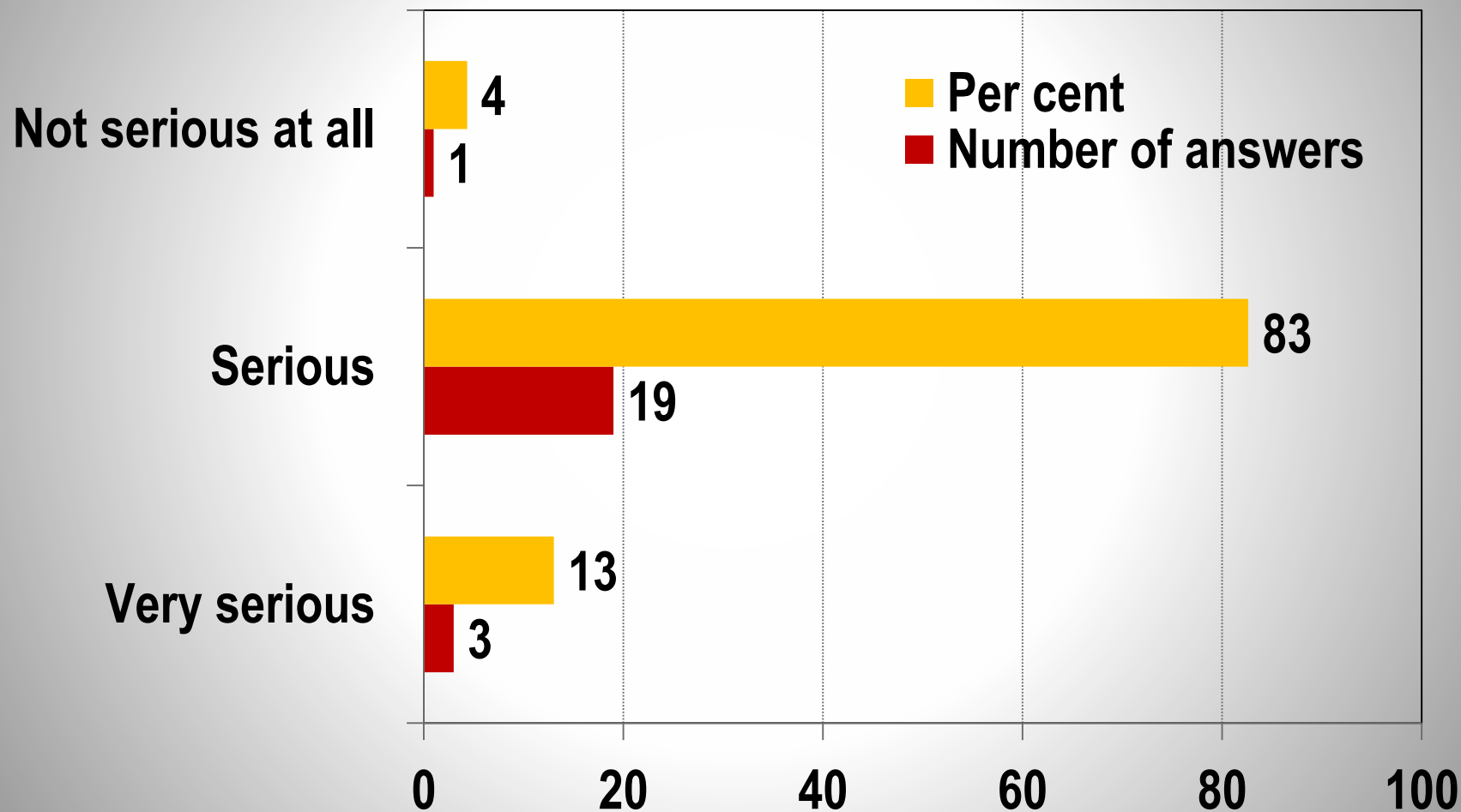
Internal challenges

- The revival of the sovereign debt crisis in Greece
- The poor state of the Portuguese and the Italian banking system
- The precarious state of some large banks
- The adverse consequences of negative interest rates
- Deteriorating international competitiveness
- The departure of the United Kingdom from the EU
- Spread of Euroscepticism, lack of credibility
- Deep political division, inflexibility of EU institutions

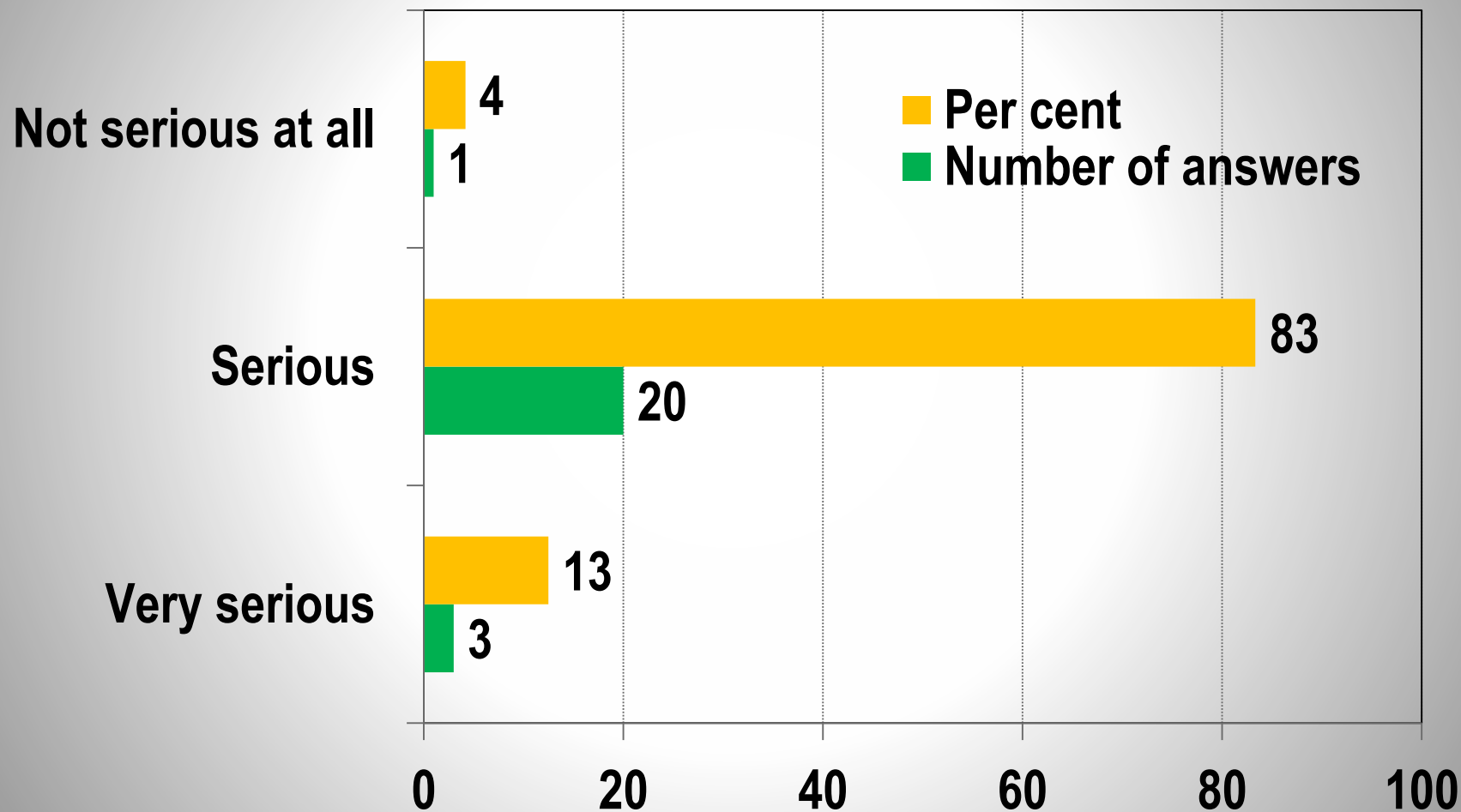
External challenges

- US presidential elections
- Geopolitical tensions in the Middle East, refugee crisis
- Conflict between Russia and Ukraine
- The slow down in China and the sharp depreciation of the Chinese currency
- The possible tightening of US monetary policy
- Terrorism

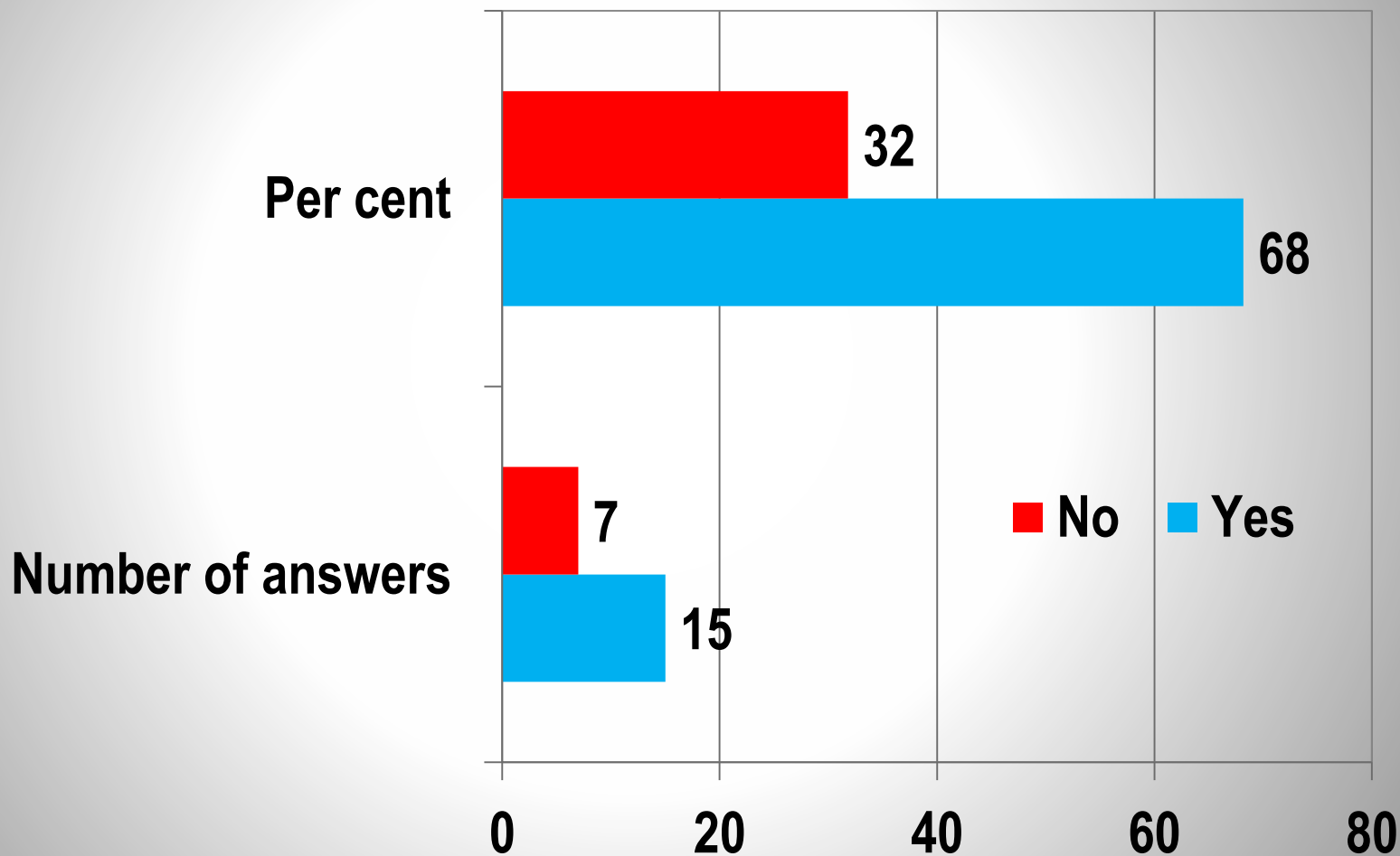
Italian developments as a risk to the financial stability of the euro area



The impact of large banks on financial stability in the euro area



In case of emergency, should governments bail out large banks in the euro area



Questions

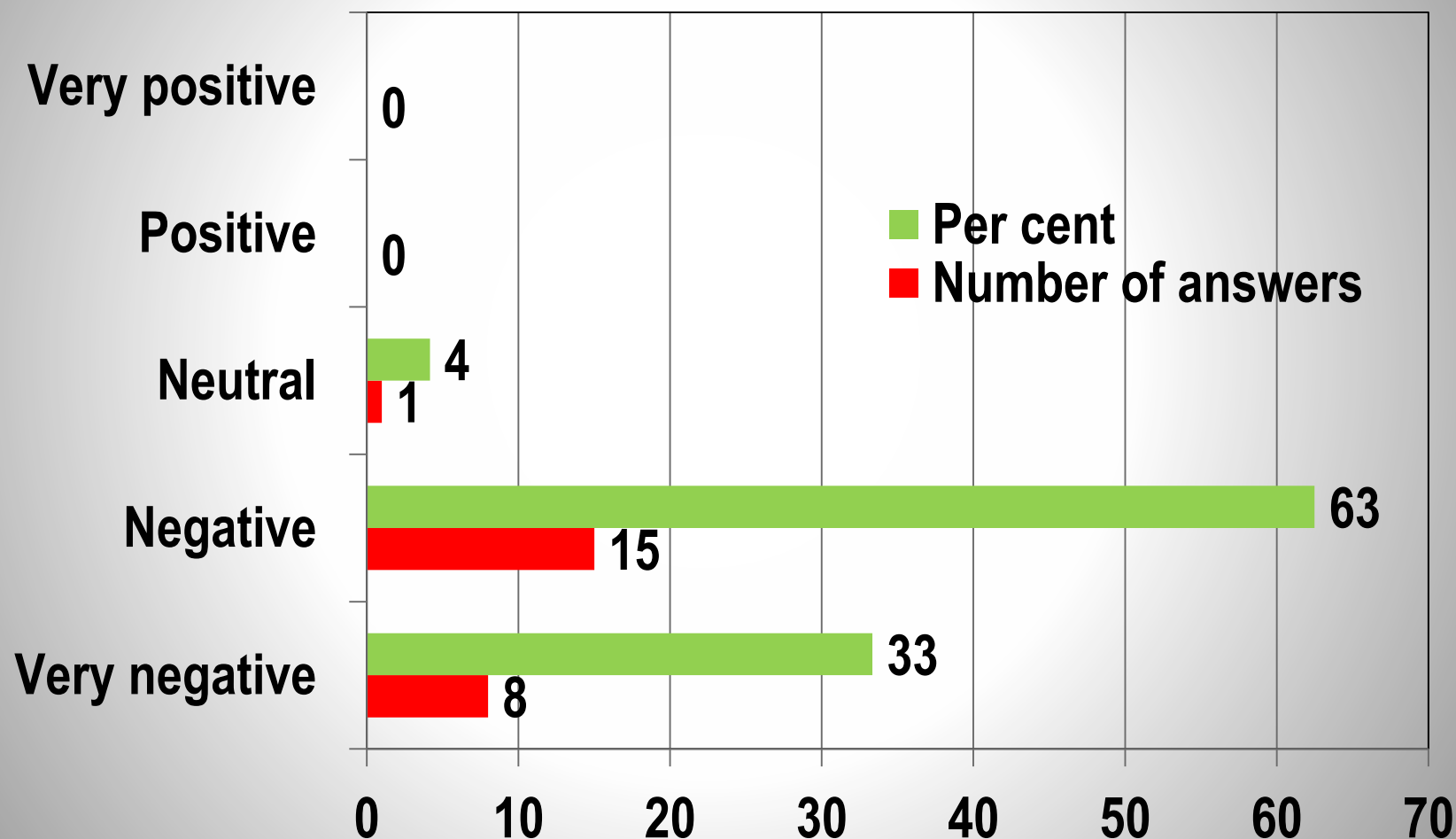
- How efficient are the rules introduced after the financial crisis on bank resolution?
- How credible are the rules introduced after the financial crisis on bank resolution?
- Where will the money come from for bank resolution?

4.2. Brexit

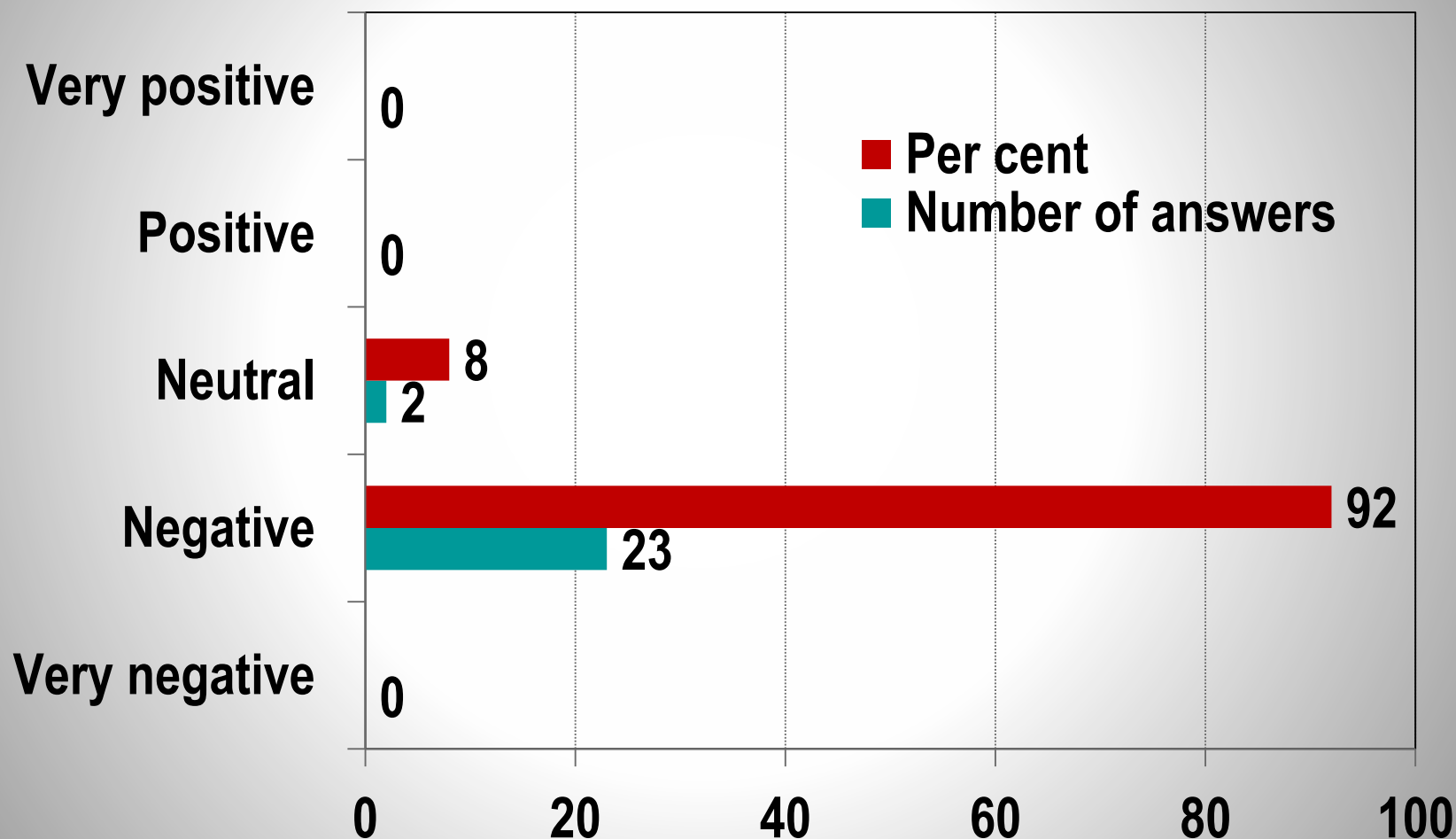
Main points

- Nearly six months ago the majority of the AIECE institutes judged the likelihood of Brexit less than 50 per cent.
- As it is well-known, according to the outcome of the referendum held on 23 June 2016, the UK will leave the European Union.

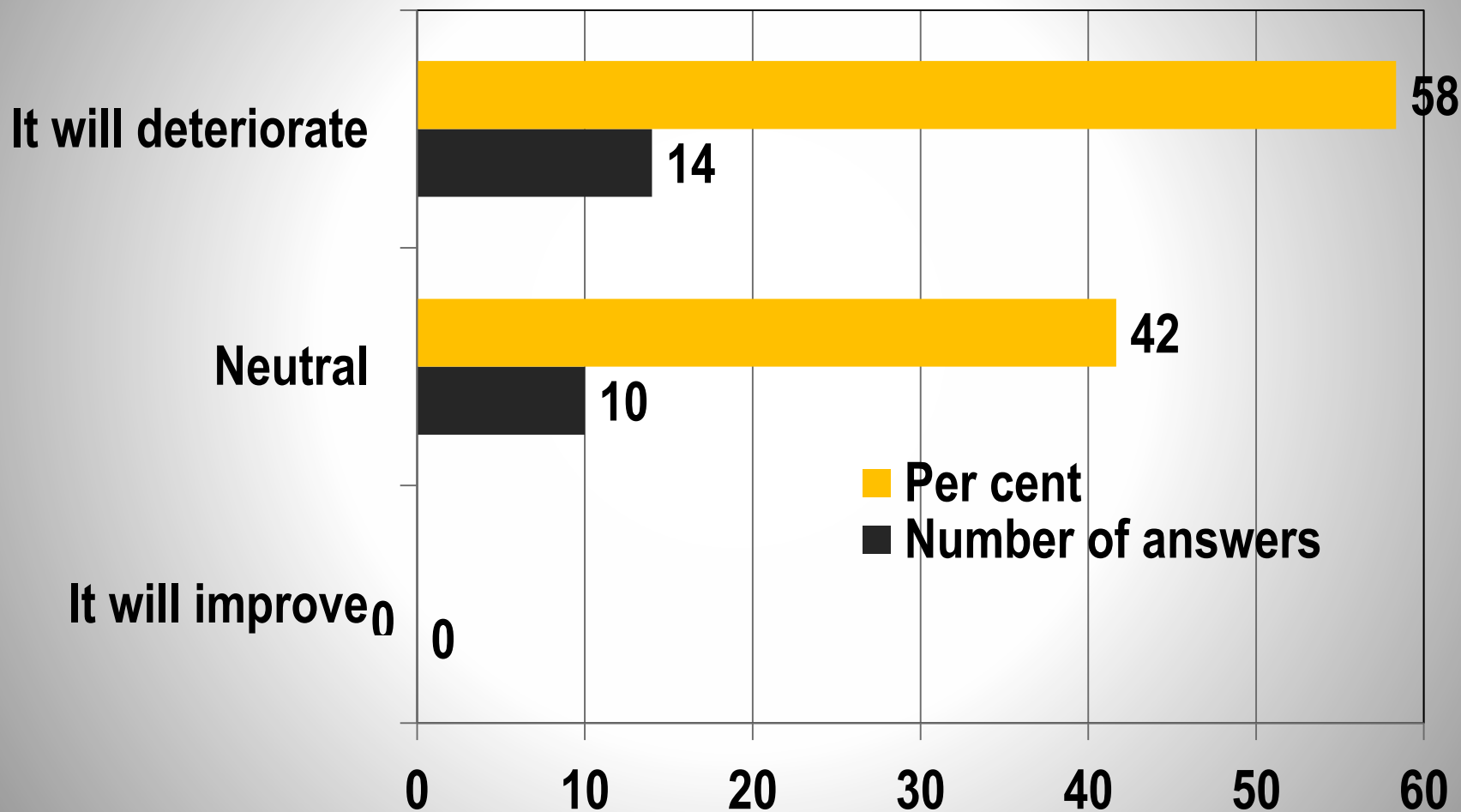
The evaluation of the impact of Brexit on the UK economy



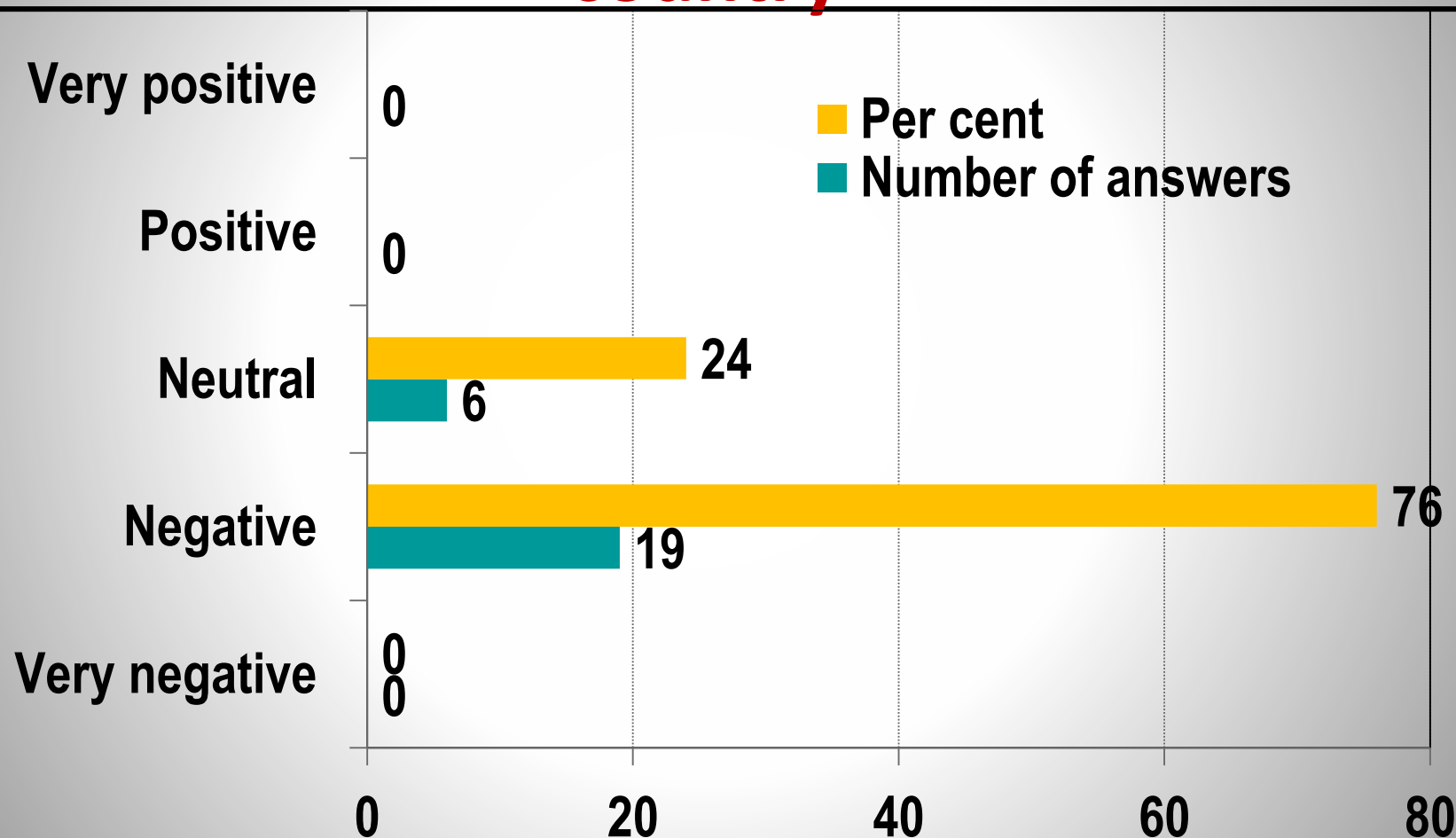
The evaluation of the impact of Brexit on the EU economy



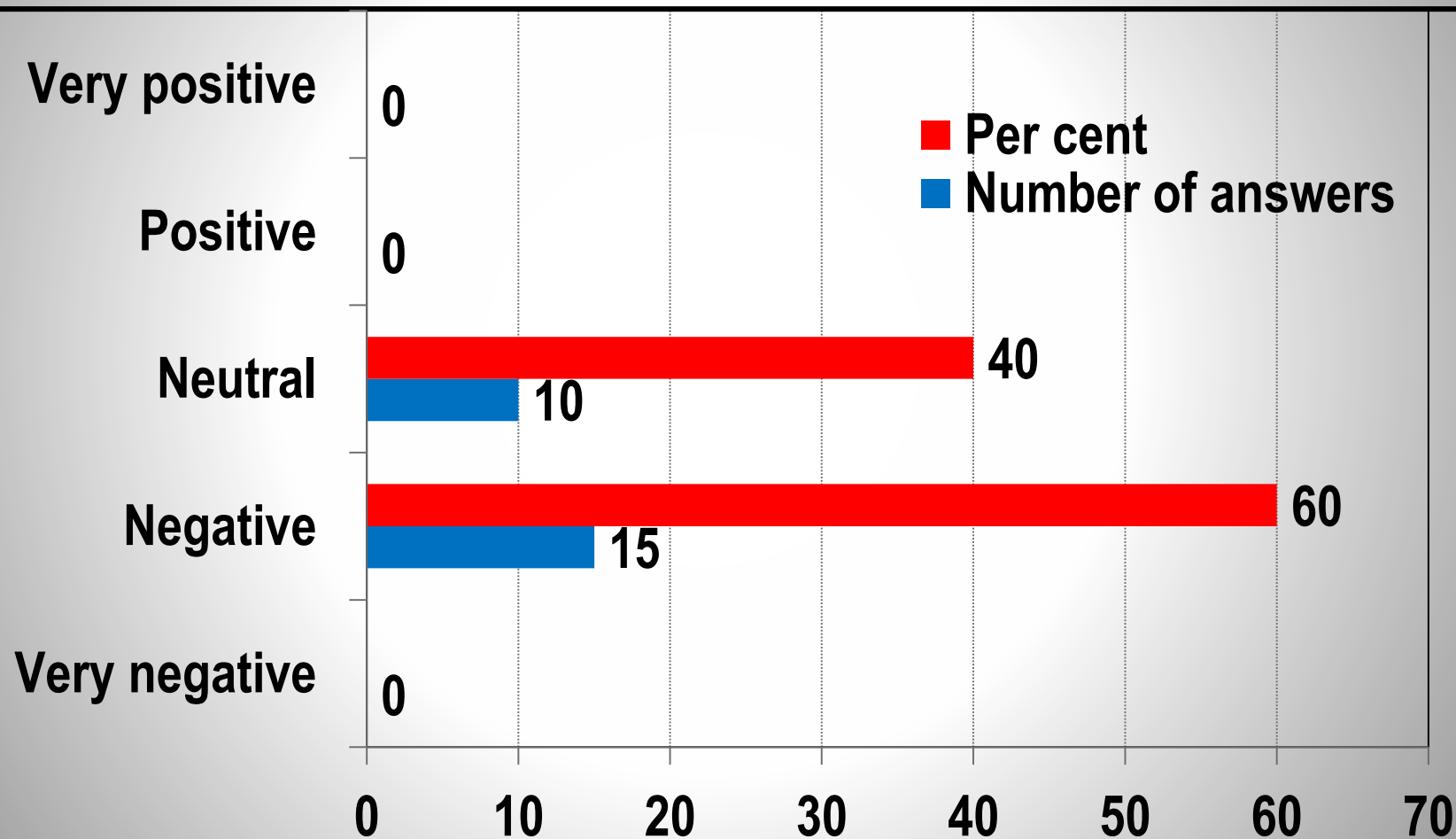
The evaluation of the impact of Brexit on the competitiveness of the EU



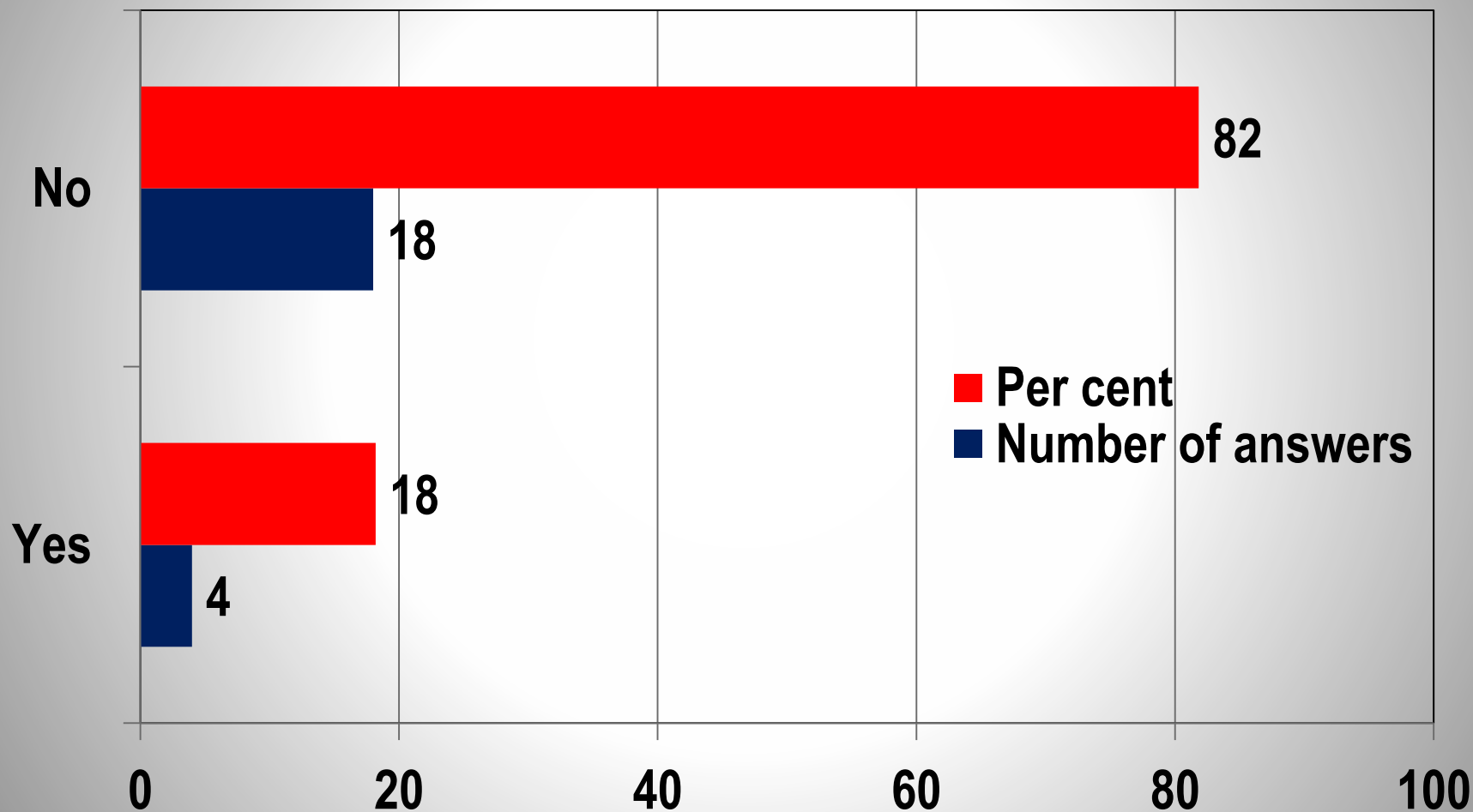
The evaluation of Brexit on the own country



The evaluation of the impact of Brexit on the global economy



Would other member states leave the EU as a result of Brexit?



Questions

- Have recent developments in the British economy underpinned the reliability of the impact assessments?
- Are the impact assessments of Brexit not too pessimistic?
- What will be the most favourable model in the relations between the EU and the UK:
 - from the point of view of the UK?
 - from the point of view of the EU?
 - what would be a working compromise?
- Is London's role as an international financial centre challenged because of Brexit?
- What will be the long term implications for the EU?

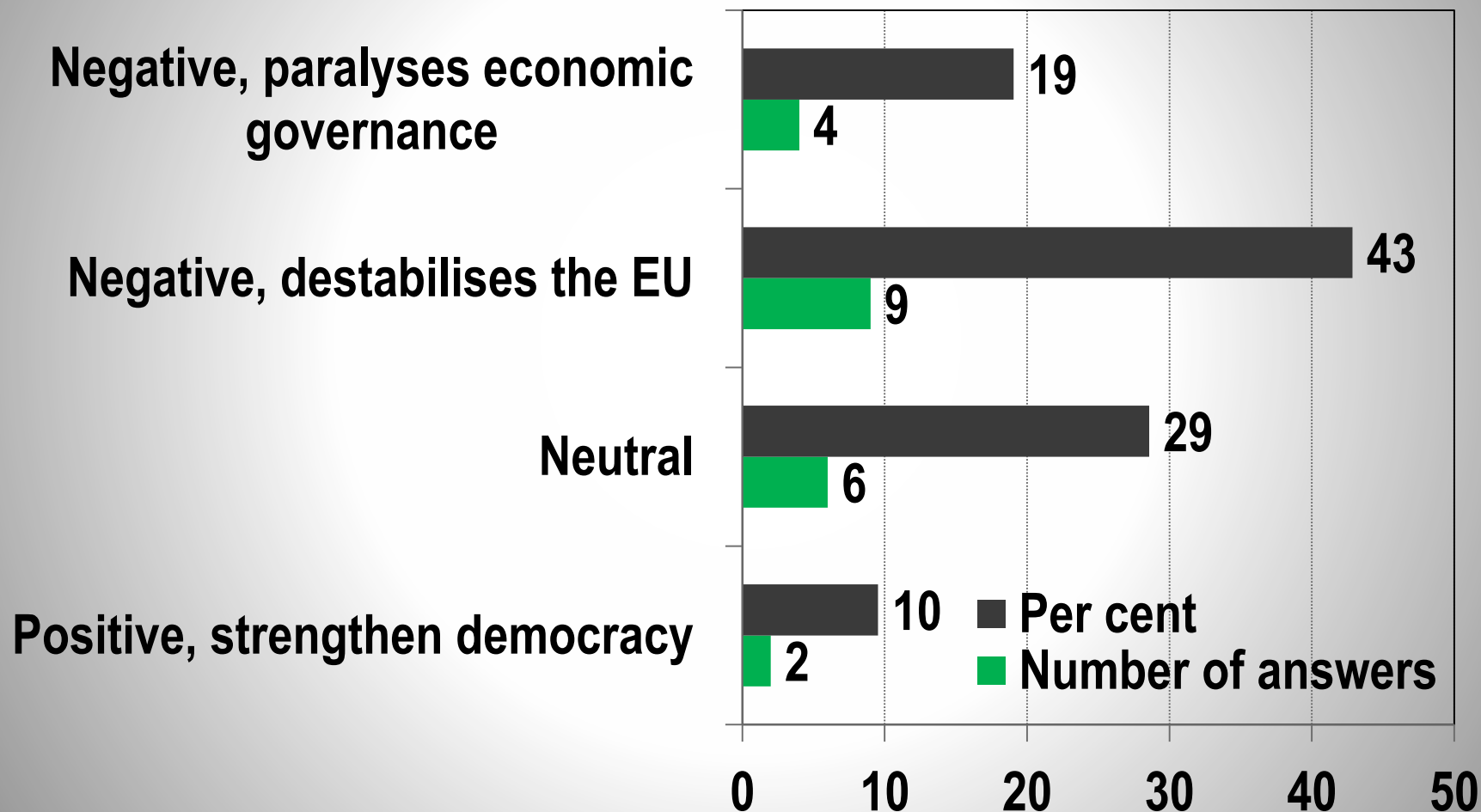
4.3. The response of the EMU and the EU to the challenges

What is at stake?

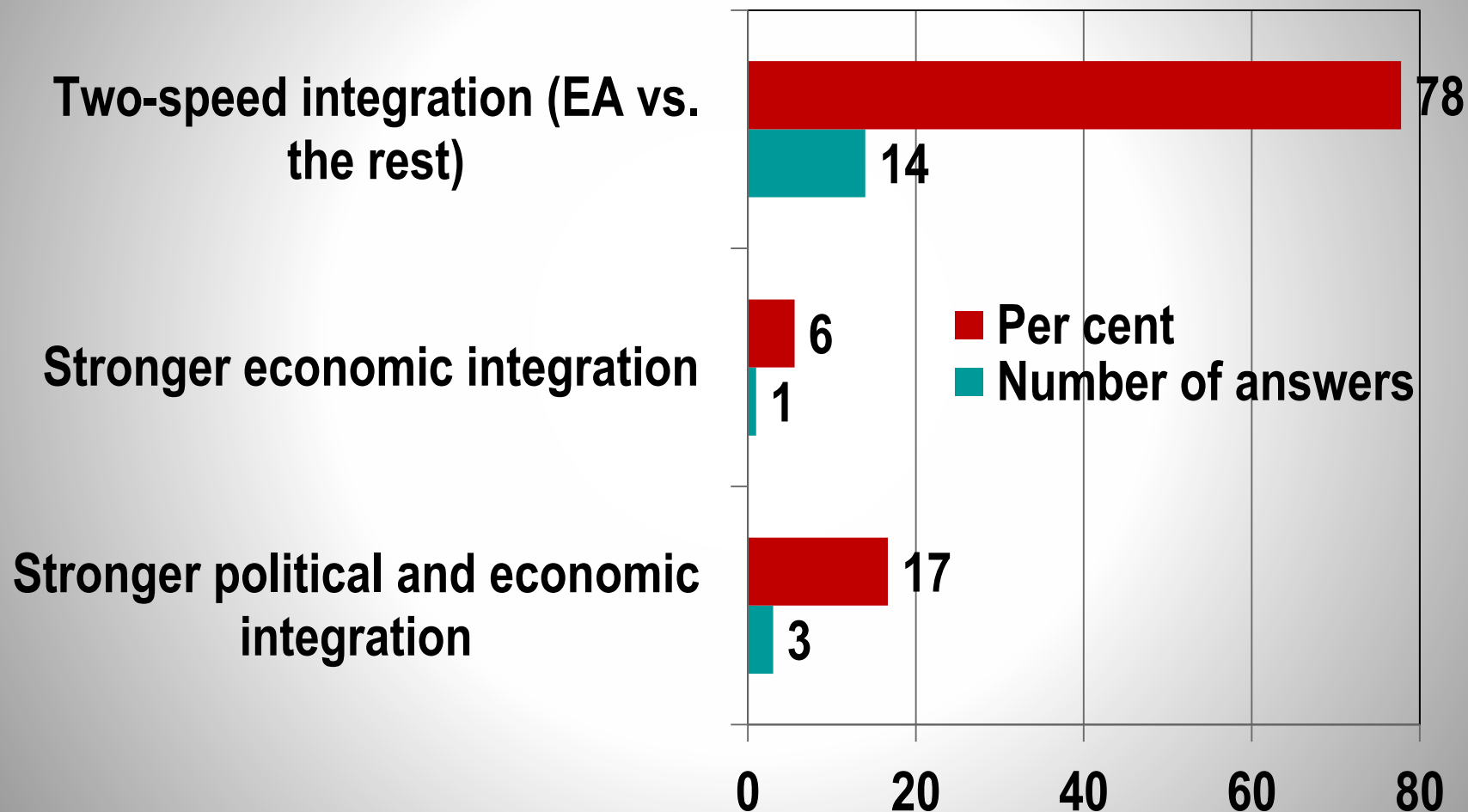
Based on the survey of the European Council on Foreign Relations conducted in 28 member states, radical parties in 18 member countries are urging referendums on the following issues:

- EU membership
- TTIP
- compulsory quotas on the distribution of refugees among member states
- the free flow of workers, etc.

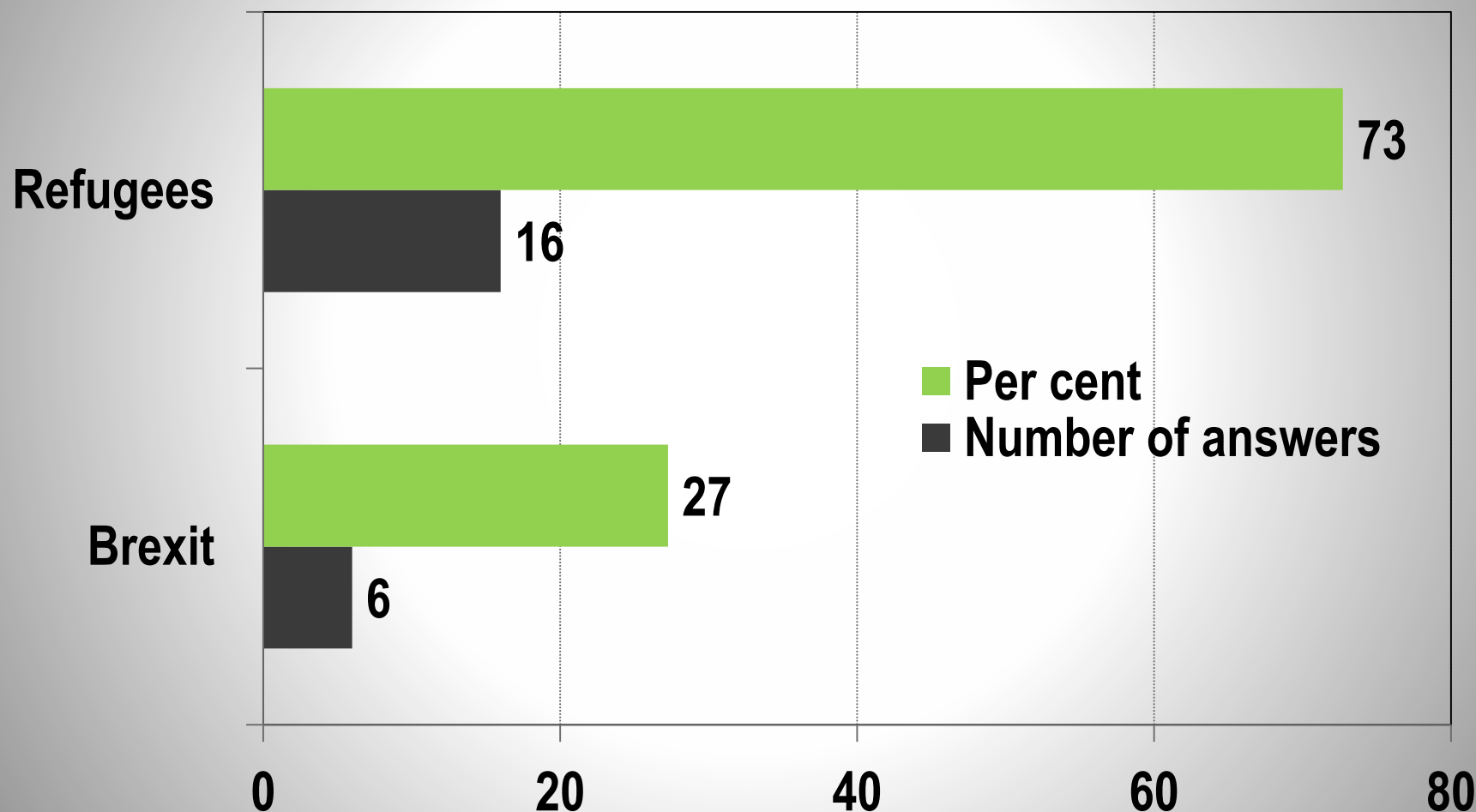
What impact of such referendums related to EU matters will have on the EU integration?



The assessment of the EU's medium-term response to Brexit



Which is the more severe challenge for the EU: Brexit or the refugee issue?



Questions

- In what direction will the EU develop most probably after the Brexit?
- How can referendum initiatives concerning EU matters be contained in order to maintain economic governance in the European Union?
- What may be the direct and indirect economic implications of the refugee crisis?
- Does Brexit have any direct or indirect impact on the EU's refugee crisis?

4.4. Risks to the forecast

Main points

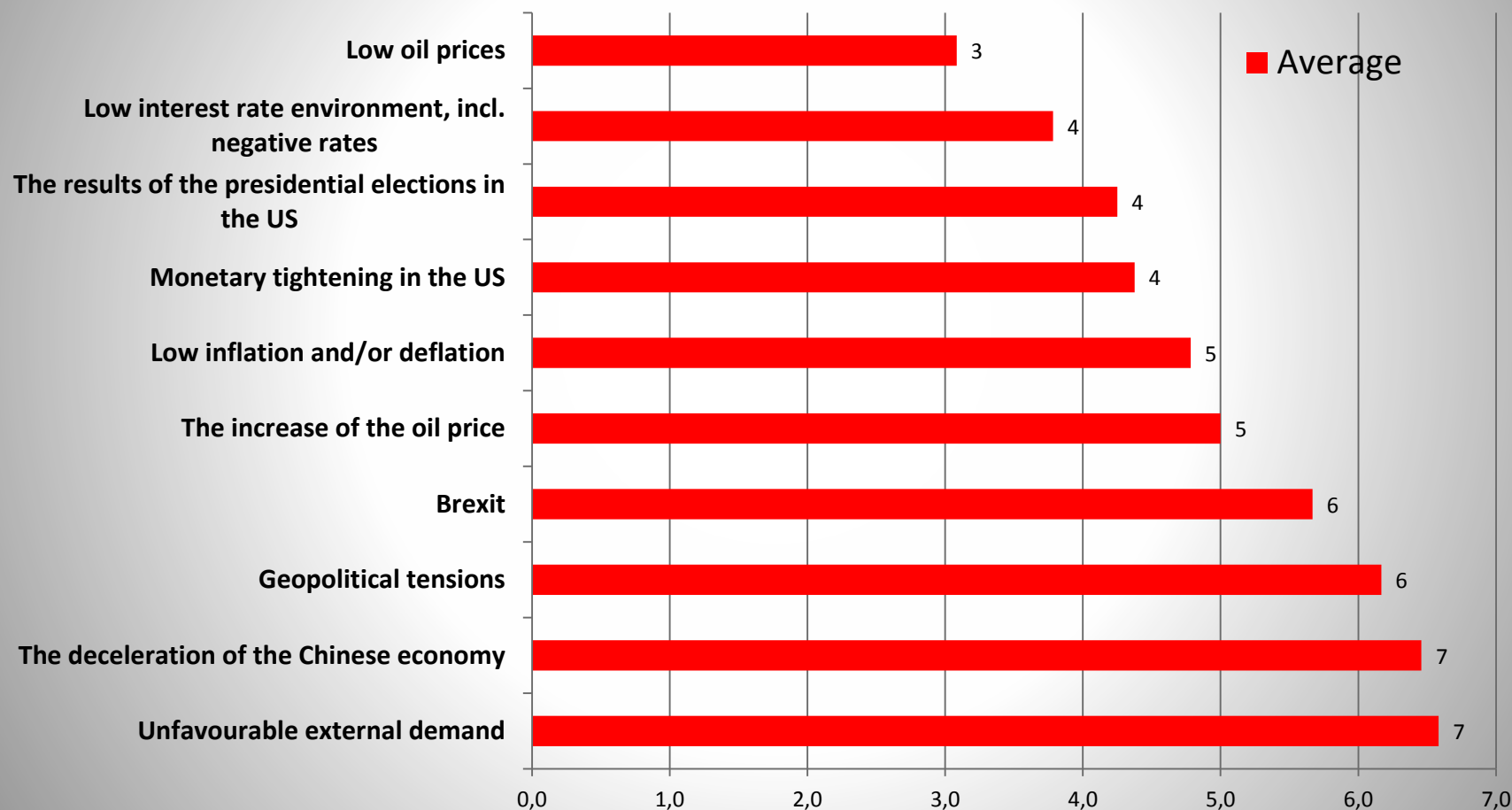
Downside risks

- Unfavourable external demand development
- Slowdown in China

Upside risks

- Loose fiscal policy
- Devaluation of the euro
- Low fuel and commodity prices
- End of Russian – Ukrainian conflict
- Defeat of populist parties

The importance of the downside risks to the projection of the euro area



Questions

- How do you evaluate the impact of the US presidential elections on the EU economy?
- What is the probability of the realization of positive risks to economic growth in the euro area?
- How can the geopolitical risks be evaluated with the increase of oil prices?
- What are the preconditions of the realization of positive risks?