Centre of Planning and
Economic Research (KEPE)

AIECE Spring Meeting 2018

AIECE GENERAL REPORT

Aristotelis Koutroulis (co-ordinator)

Ersi Athanassiou

Yannis Panagopoulos

Sotiris Papaioannou

Ekaterini Tsouma

Warsaw, May 17-18, 2018

Key Global Developments

Broad-based growth acceleration

- With growth accelerating over 4 percent, the broad-based global economic recovery was sustained in the second half of, against the backdrop of the **rebound in investment, manufacturing and trade.**

  - ✓ *Advanced economies*: the cyclical upturn strengthened in 2017, driven mainly by investment spending, exceeding expectations in the euro area, Japan and the United States.

  - ✓ *Emerging Asia*: growth remained strong, led in China and India primarily by net exports and private consumption.

  - ✓ *Commodity-exporting economies, notably Brazil and Russia*: the gradual investment recovery drove the economic upturn in 2017.

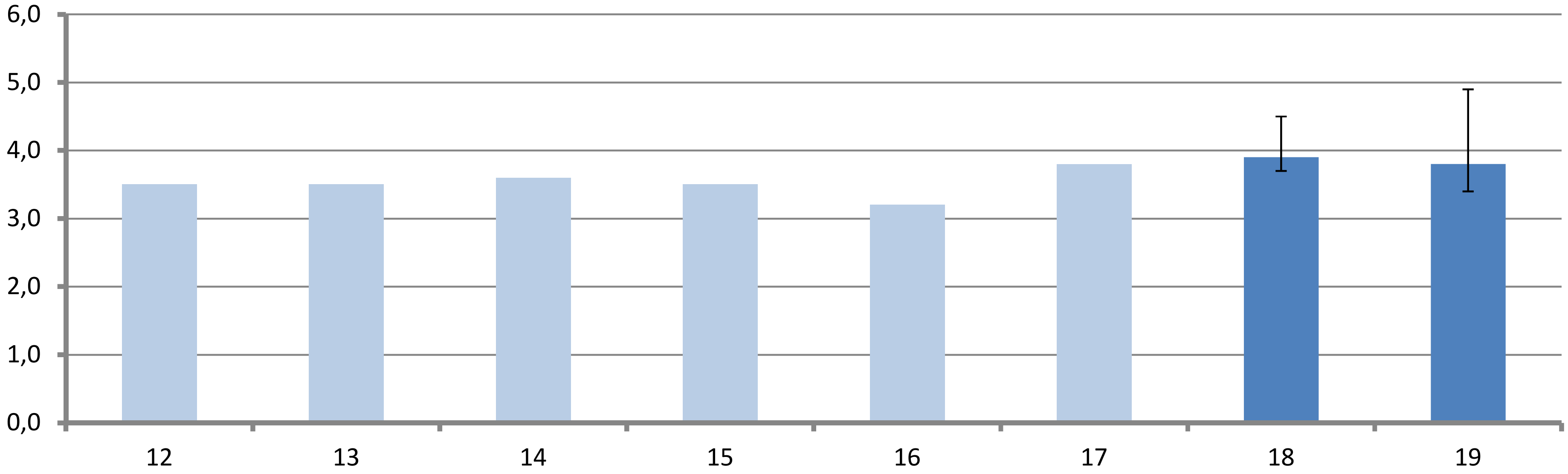
  - ✓ *Other emerging and developing economies*: growth performance was mainly explained by fixed investment and private consumption.

Key Global Developments

Broad-based growth acceleration

- Following the 3.8% growth in 2017, global GDP is projected by international institutes to grow by rates close to 4% in both 2018 and 2019.
- This is more or less in agreement with the average forecasts made by AIECE Institutes over a growth rate of 3.9% for 2018 and 3.8% for 2019.

Global GDP, percentage change, volume



Source: IMF, AIECE Institutes, all institutes with the same weight. Error bands indicate the upper and lower extremes of the member institutes' projections (n=18).

Key Global Developments

Broad-based growth acceleration

- **In the USA**: economic activity in 2017 surprised to the upside, with domestic demand gaining momentum and external demand remaining strong. Growth is expected to be further stimulated in the short- to medium-term, on the basis of the recent tax reform (tax reductions) and the overall US expansionary fiscal policy (public spending increases).

- **In Japan**: the pick-up in growth was mainly driven by the recovery in consumer spending and investment, in combination with the positive effects from the implementation of a fiscal stimulus package. Growth prospects will depend more on export dynamics, as the fiscal stimulus momentum will ease, and the shrinking labour force (related to population aging) will weigh on the growth outlook.

- **China**: growth has remained solid in 2017, with the growth drivers being basically net exports and private consumption, and to a lesser extent state-led investment. However, it is expected to soften in the near term, as fiscal policy will gradually become more neutral, and regulatory policies more restrictive, to mitigate financial risks.

- **Euro area**: the markedly stronger than expected rebound, in particular in the second half of 2017, was more broad-based and relied on significant policy stimulus and strong global demand. It was supported by highly accommodative monetary policy and the steady fading out of the crisis-related drags, which strengthened confidence and domestic demand. The growth momentum is expected to remain robust, mainly driven by domestic demand, even though still expected to moderate gradually. Following the high levels recorded in December 2017 and January 2018, the European Commission’s Economic Sentiment Indicator has already shown some signs of correction, from February to April 2018.

Key Global Developments

Upswing in global trade and rise in commodity prices

- The **2017 upsurge in global trade** reflected the rebound in investment in both advanced and emerging as well as developing economies:
  - ✓ Export and import growth was broad-based among advanced economies.
  - ✓ Commodity exporters led the rebound in import growth.
  - ✓ The recovery in export growth was stronger in emerging Asia.

- With reference to global trade in goods, the AIECE Institutes forecast a gradual deceleration in volume terms, from a growth rate of 5.4% in 2017 down to 4.4% in 2018 and 4.1% in 2019.

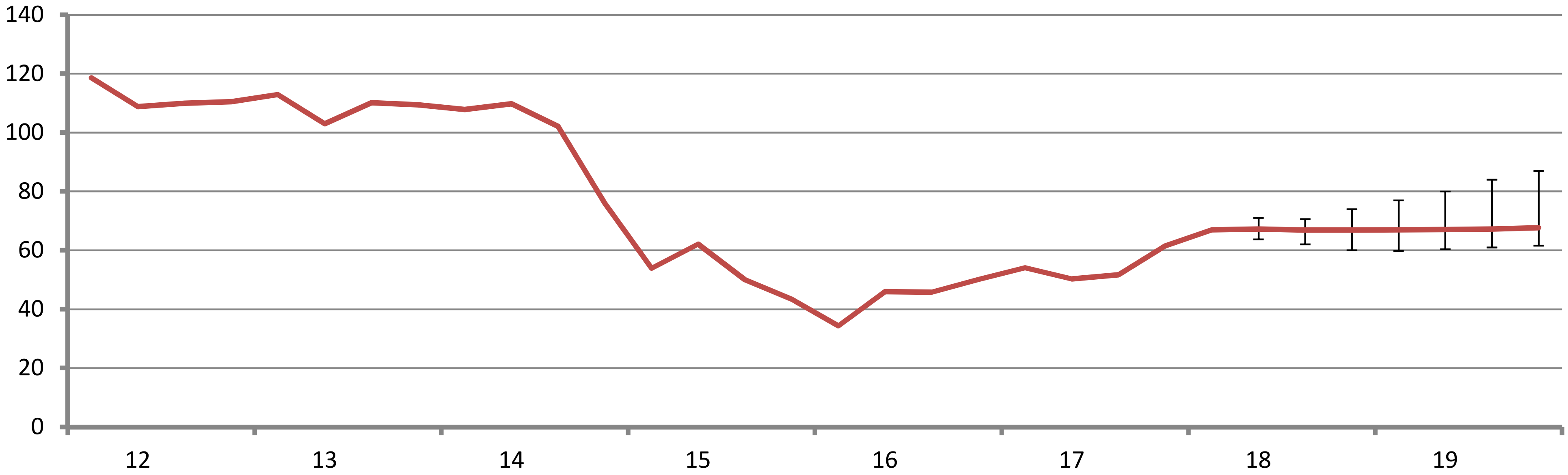
Key Global Developments

Upswing in global trade and rise in commodity prices

- Following the collapse in crude oil prices, leading to a low of around 32$ per barrel in the first quarter of 2016, oil-exporting economies, like Russia, benefitted from the gradual upturn, in particular during the second half of 2017.

- With crude oil prices around 65$ in March 2018, the AIECE Institutes expect for 2018 and 2019, on average, a rather modest upward adjustment with prices at 67$ per barrel.

Crude oil prices, Brent, USD per Barrel



Source: World Bank, AIECE Institutes, all institutes with the same weight. Error bands indicate the upper and lower extremes of the member institutes' projections (n=21).

Key Global Developments

Upswing in global trade and rise in commodity prices

- With **commodity prices** partially recovering, growth in large commodity exporters, like Brazil, rebounded in 2017.

- Apart from energy prices, the recent rise in commodity prices was further driven by **metals**, while **agricultural commodity prices** have been also catching up.

- Although **core inflation** still remains below target in many cases, **headline inflation** is rising modestly in advanced economies, at the back of stronger energy prices. Among emerging and developing economies, inflation developments vary, with core inflation:

  - ✓ reaching historical lows in Brazil and Russia.

  - ✓ picking up in India in the second half of 2017.

  - ✓ moving around 2 percent in China.

  - ✓ remaining high in other regions (such as in sub-Saharan Africa, the Middle East etc.).

Key Global Developments

Policy interest rates

- Across central banks in major advanced economies, it seems that **since the last part of 2017 the direction of monetary policy is drifting more apart**:

  ✓ the ECB and the Bank of Japan are willing to preserve the accommodative policy stance.

  ✓ the signals from the US Federal Reserve (Fed) are more to the direction of a faster normalization.

- According to the forecasts by the AIECE Institutes:

  ✓ the ECB and the Bank of Japan policy rates are expected to remain around zero in 2018 and approach 0.3 and 0.1, respectively, by the end of 2019.

  ✓ A far different path is forecasted for the Fed's main policy rate, with gradual increases leading to a rate of 2.1 by the end of 2018 and 2.6 by the end of 2019.

  ✓ Similarly, the Bank of England is expected by AIECE Institutes to follow a course of a gradual increase in the main policy rate, reaching 0.8 and 1.2 by the end of 2018 and 2019, respectively.

Euro Area Outlook

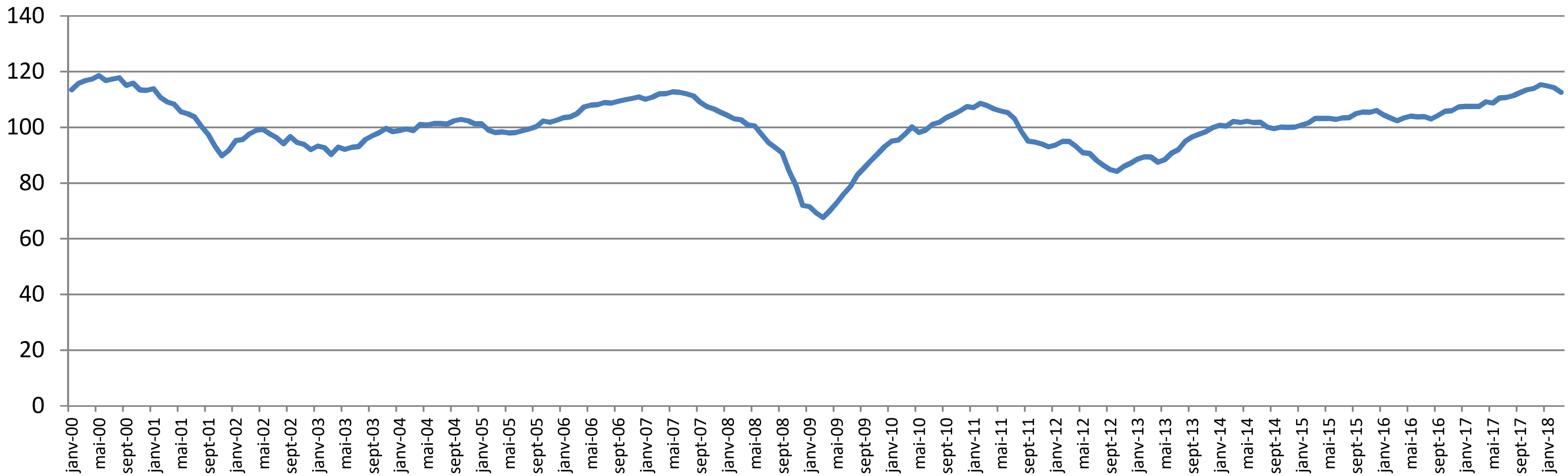
GDP growth and main aggregates

- **In 2017 euro area featured a markedly stronger economic recovery than expected**
- Last year's estimated growth rate for the euro area economy has been upgraded to 2.4%, or 0.3 percentage points higher than the rate envisaged in November in *AIECE General Report*.
- The upgrade reflects a stronger-than-expected rebound of domestic demand, supported by
  - ✓ improving labour market conditions
  - ✓ high consumer and business confidence
  - ✓ favourable financing conditions
- The acceleration of global economic activity and trade and the corresponding increase in external demand played a positive role as well.

GDP growth and main aggregates

- **Growth momentum is expected to be sustained in 2018**
- The European Commission's monthly Economic Sentiment Indicator (ESI) remains at historically high levels thereby revealing optimistic expectations regarding the growth prospects of the euro area economy.

Economic Sentiment Indicator for the euro area



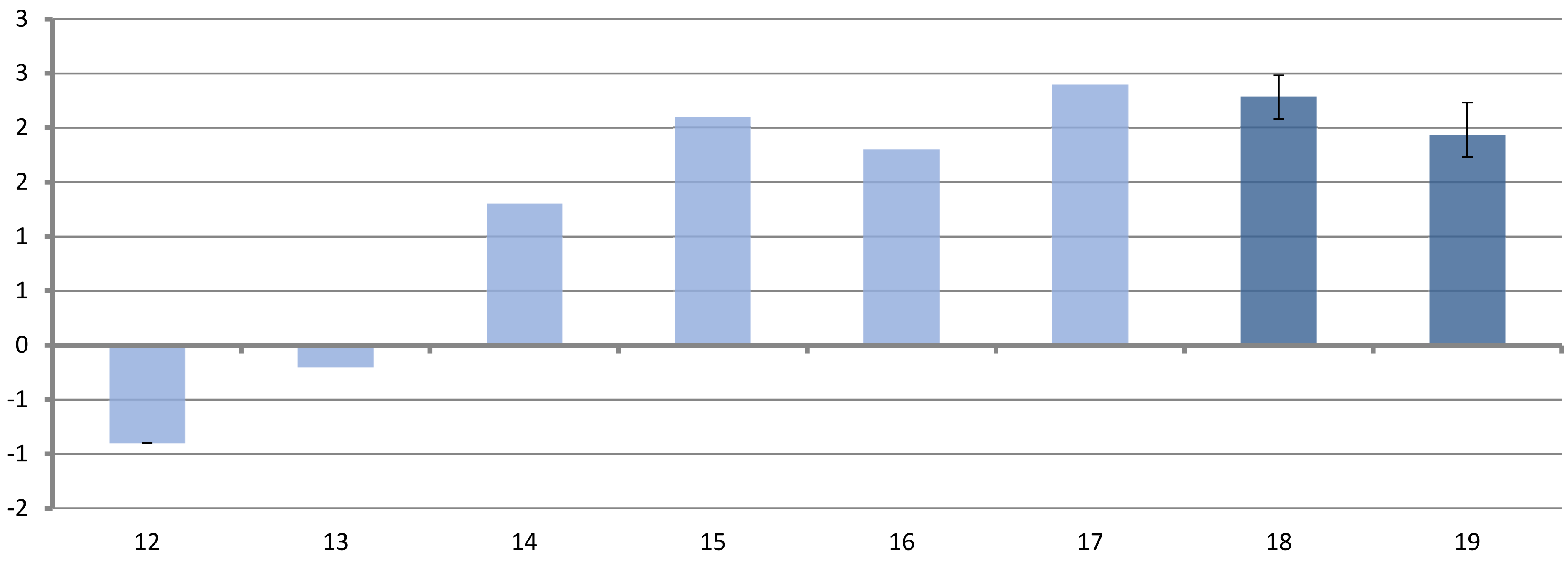
Source: European Commission

Euro Area Outlook

GDP growth and main aggregates

- AIECE institutes seem to share households’ and businesses’ optimism.
- Compared to the November *AIECE General Report*, the average euro area’s growth projection has been revised upwards from 1.9% to 2.3% for 2018.

Euro area GDP (Annual percentage change, volume)



Source: Eurostat and all AIECE institutes, the same weight for each institute - Error bands indicate the upper and lower extremes of the AIECE insittutes' projections (n=23).

Euro Area Outlook

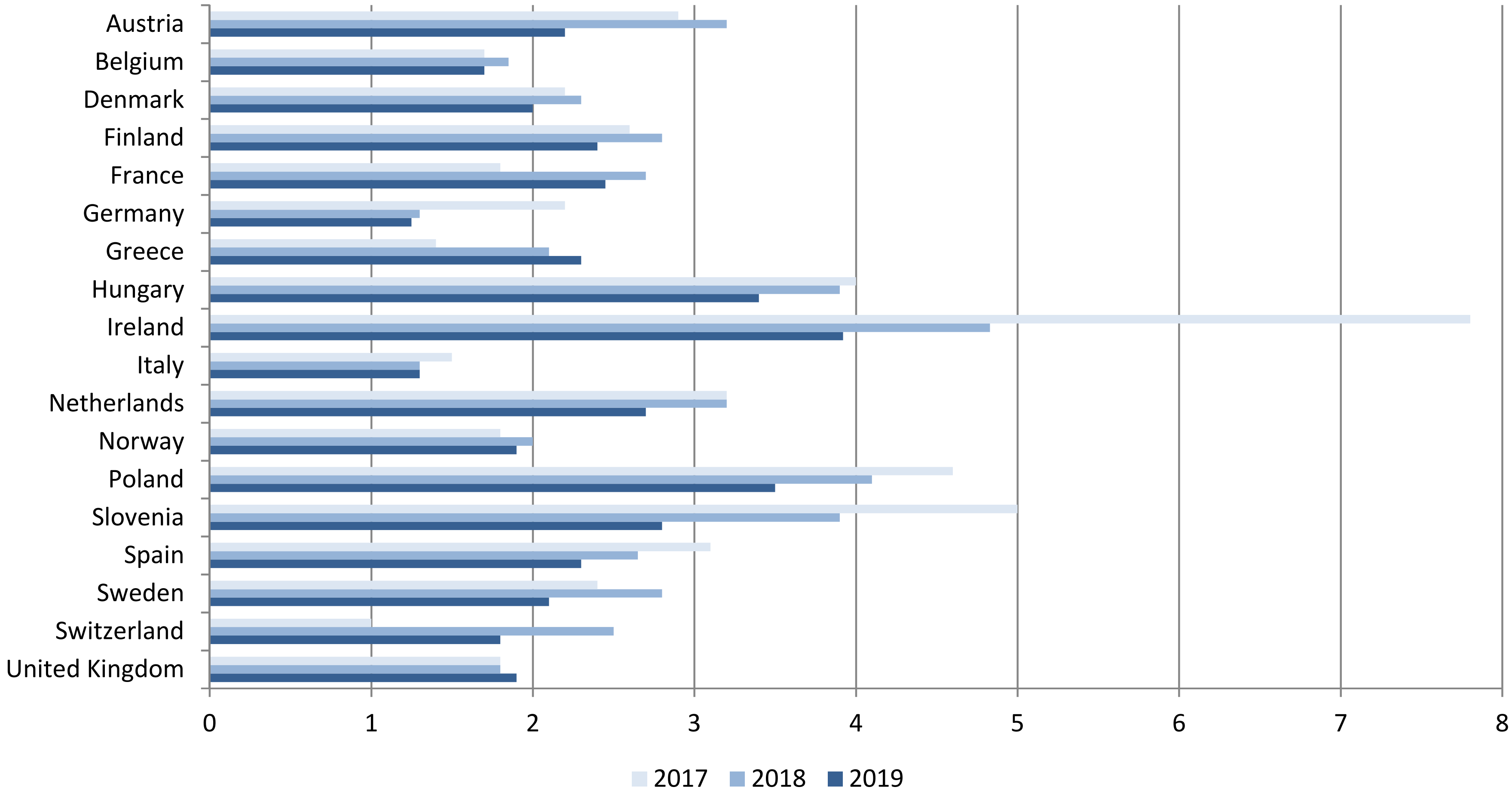
GDP growth and main aggregates

- **Growth is expected to remain broad-based across individual member-states of the euro area**

  - ✓ AIECE institutes growth projections for their home countries range from 1.2% for Italy to 4.8 % for Ireland.
  - ✓ For a second year in a row, all member-states will register positive growth rates.
  - ✓ Fourteen out of seventeen euro area institutes have adjusted upwards their November forecasts for their home countries.

GDP growth and main aggregates

GDP growth in AIECE economies (Annual percentage change, volume)



Source: Eurostat and all AIECE institutes, average for each country (n=26)

Euro Area Outlook

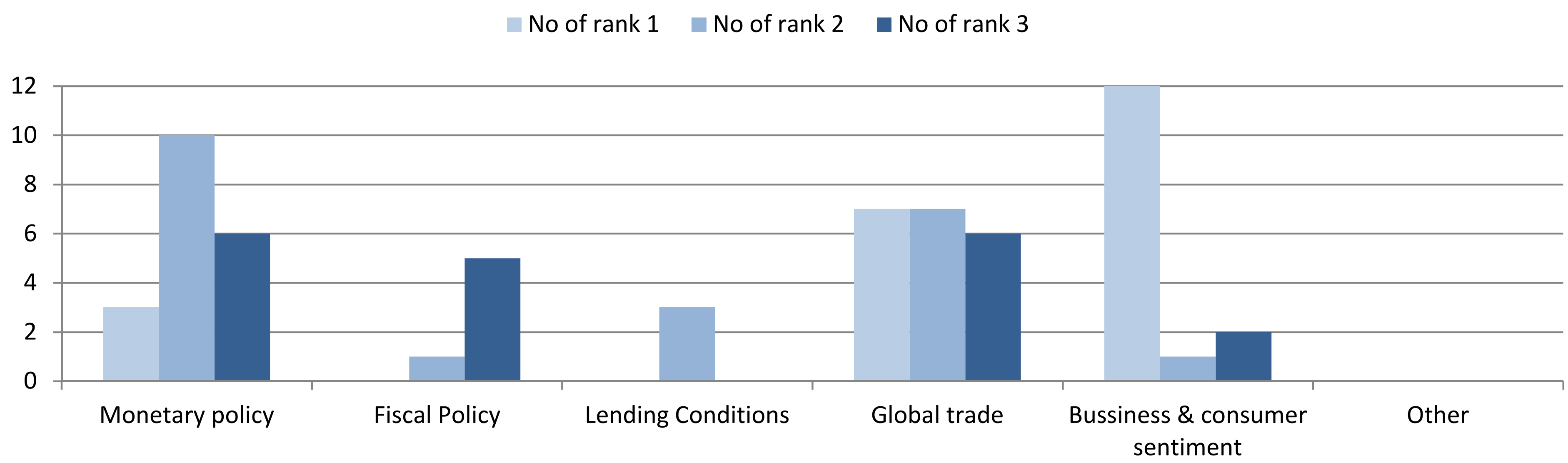
GDP growth and main aggregates

- **Economic expansion will be driven by domestic and external factors alike**

- AIECE institutes project that euro area growth will benefit mostly from

  ✓ buoyant confidence on the part of businesses and consumers
  ✓ global trade and
  ✓ monetary policy stimulus

Important growth factors in the euro area (2018)



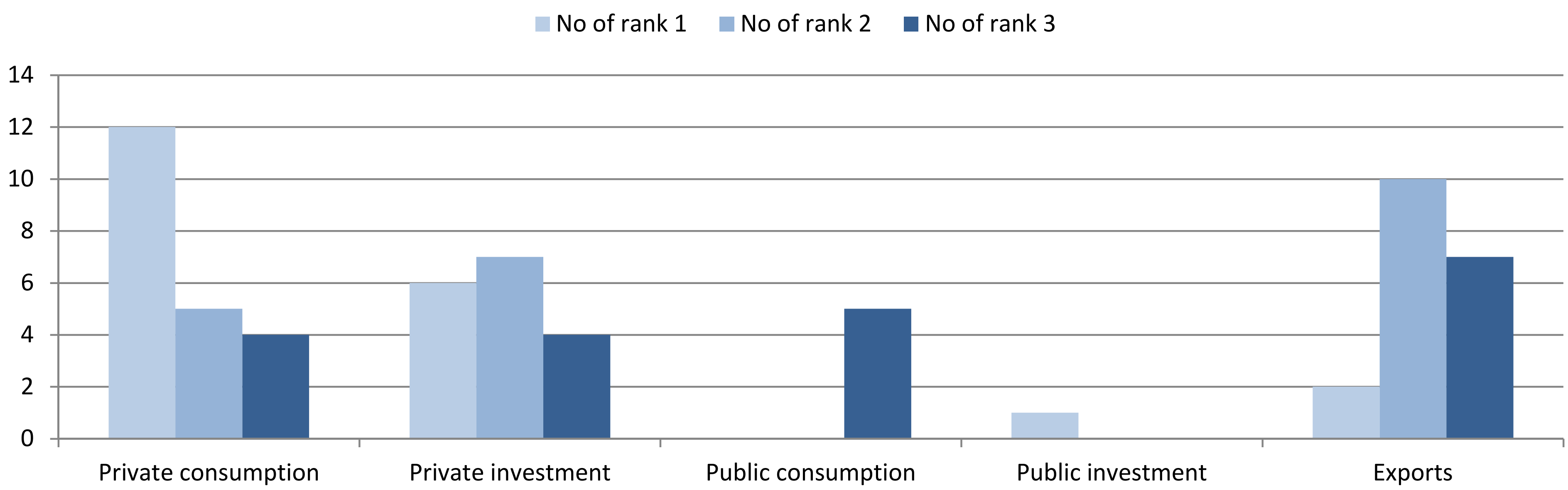
Source: All AIECE institutes(n=23)

Euro Area Outlook

GDP growth and main aggregates

- The top contributors to euro area GDP growth
  - ✓ Private consumption
  - ✓ Private investment
  - ✓ Exports

Contributors to euro area GDP growth in 2018



Source: All AIECE institutes (n=22)

Euro Area Outlook

GDP growth and main aggregates

- **Euro area investment expenditure is rising despite impediments to investment growth in Member-States**

  ✓ Gross fixed capital formation is expected to gain momentum this year.

  ✓ In relation to the cyclical position of each individual economy, all euro area AIECE institutes reported for their home countries either normal or strong investment expenditure, with the exception of the Greek institute.

GDP growth and main aggregates

- **AIECE institutes reported country-specific impediments to investment activity**

  - ✓ policy and outlook uncertainty (FPB and IRES for Belgium, IFW for Germany and KEPE for Greece)
  - ✓ uncertainty related to the potential access to the UK market (ESRI for Ireland)
  - ✓ lack of competitiveness (Roe-Rexecode for France)
  - ✓ excess of accumulated stocks prior to the crisis (CERPEDE for Spain)
  - ✓ non-performing loans and weak bank lending (REF for Italy and KEPE for Greece)
  - ✓ expected demand (AP for Italy)
  - ✓ city planning policies (ETLA for Finland)
  - ✓ lack of new projects or bottlenecks appearing at the level of preparation of projects co-funded by the EU (Analytics CCIS for Slovenia).

Euro Area Outlook

GDP growth and main aggregates

- **Euro area growth is projected to continue at a more moderate pace in 2019**

- According to the average projection of AIECE institutes, economic growth in the euro area is set to decelerate and stand at 1.9% in 2019

  ✓ To a certain degree, this loss of growth momentum is related to the expectations regarding the course of monetary policy over the forecast horizon (AIECE institutes' answers reveal that monetary policy will continue supporting growth but less so than in 2018, as it is expected that the ECB will proceed to a gradual normalization of its policy)

  ✓ Along with monetary policy, robust global activity and high economic sentiment will be the most important growth factors.

Euro Area Outlook

Labour market conditions

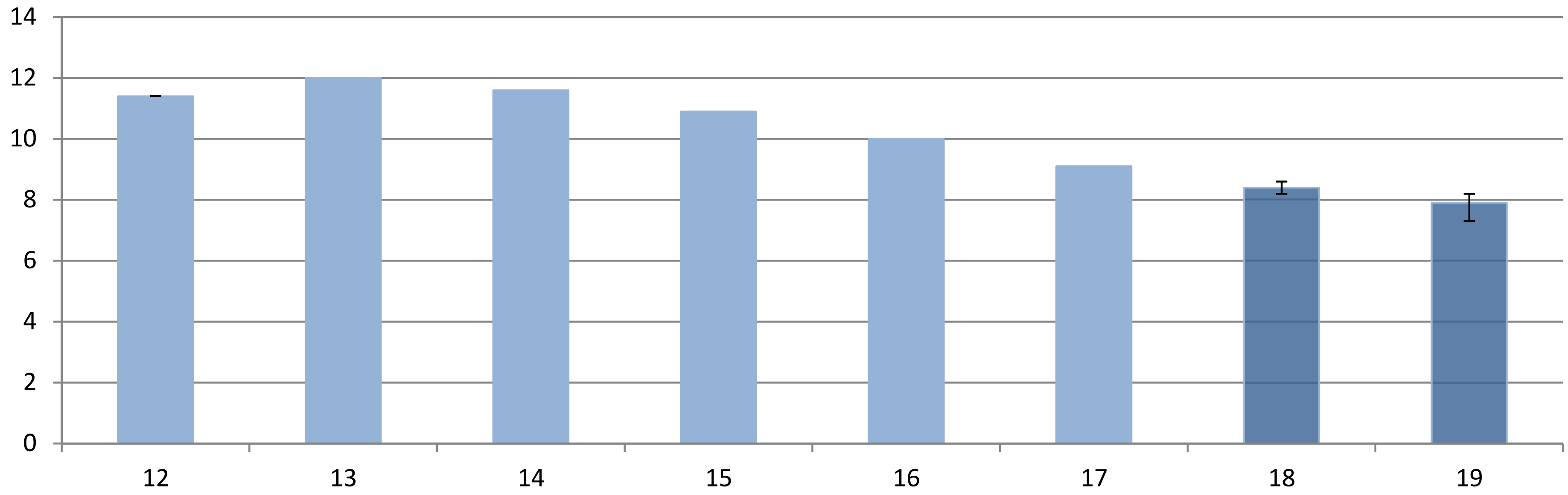
- **Labour market conditions are gradually improving**

  ✓ Total employment in the euro area increased by 1.6% in 2017.

  ✓ Unemployment rate over the same year fell to 9.1%.

  ✓ AIECE institutes project that unemployment will keep on its downward trend falling to 8.4% and 7.9% over the current and the next year, respectively

Euro area annual unemployment rate (Percent of total labour force - Eurostat definition)



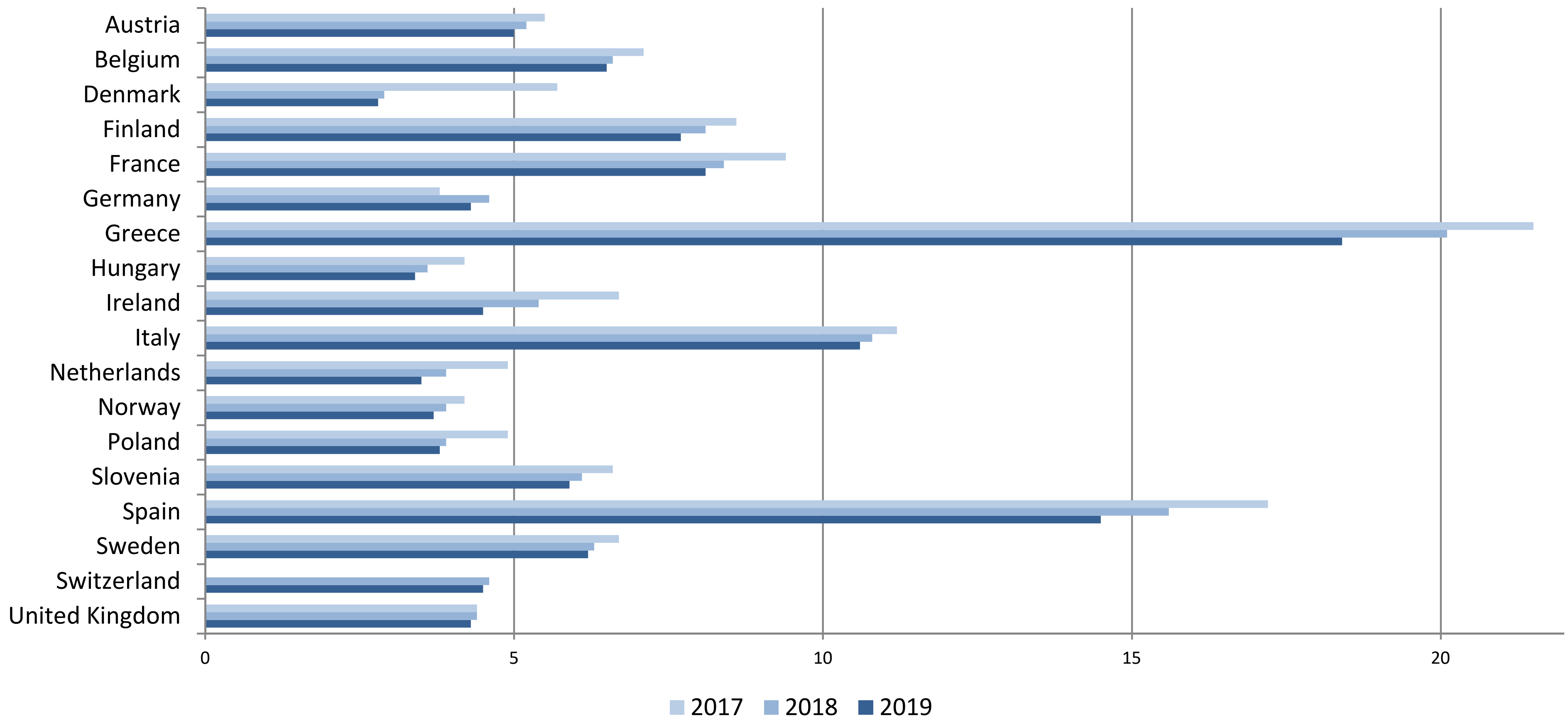
Source: Eurostat and all AIECE institutes, the same weight for each institute - Error bands indicate the upper and lower extremes of the AIECE insittutes' projections (n=16).

Euro Area Outlook

Labour market conditions

- **Unemployment remains elevated in a certain number of member-states .**

Annual unemployment rates in AIECE economies (Percent of total labour force - Eurostat definition)



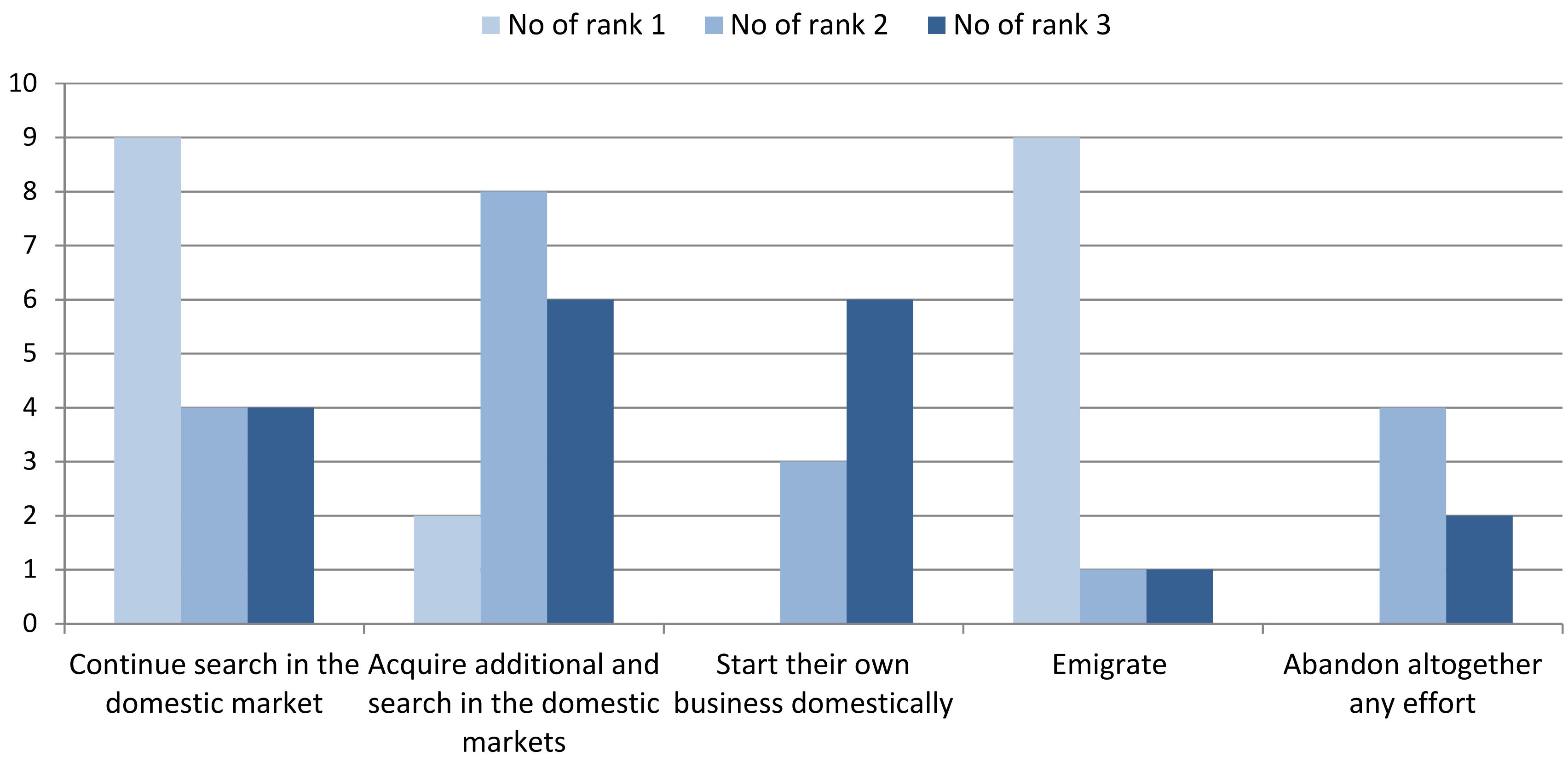
Source: Eurostat and all AIECE institutes, average for each country (n=25)

Euro Area Outlook

Labour market conditions

- **Highly skilled workers’ responses to low wages or unemployment across countries are mixed**

Responses of highly-skilled workers to low wages and unemployment in AIECE countries



Source: All AIECE institutes(n=23)

Labour market conditions

- Taking into account the answer of each institute and connecting it with current economic performance of the institutes' home country reveals some interesting regularities:

  - ✓ On average, in countries characterized by healthier economic fundamentals and a richer production base, highly qualified workers respond to low wages or unemployment by searching for better-paid jobs domestically.

  - ✓ In countries with relatively weaker economic fundamentals skilled but low-paid or unemployed workers tend to seek better job opportunities abroad.

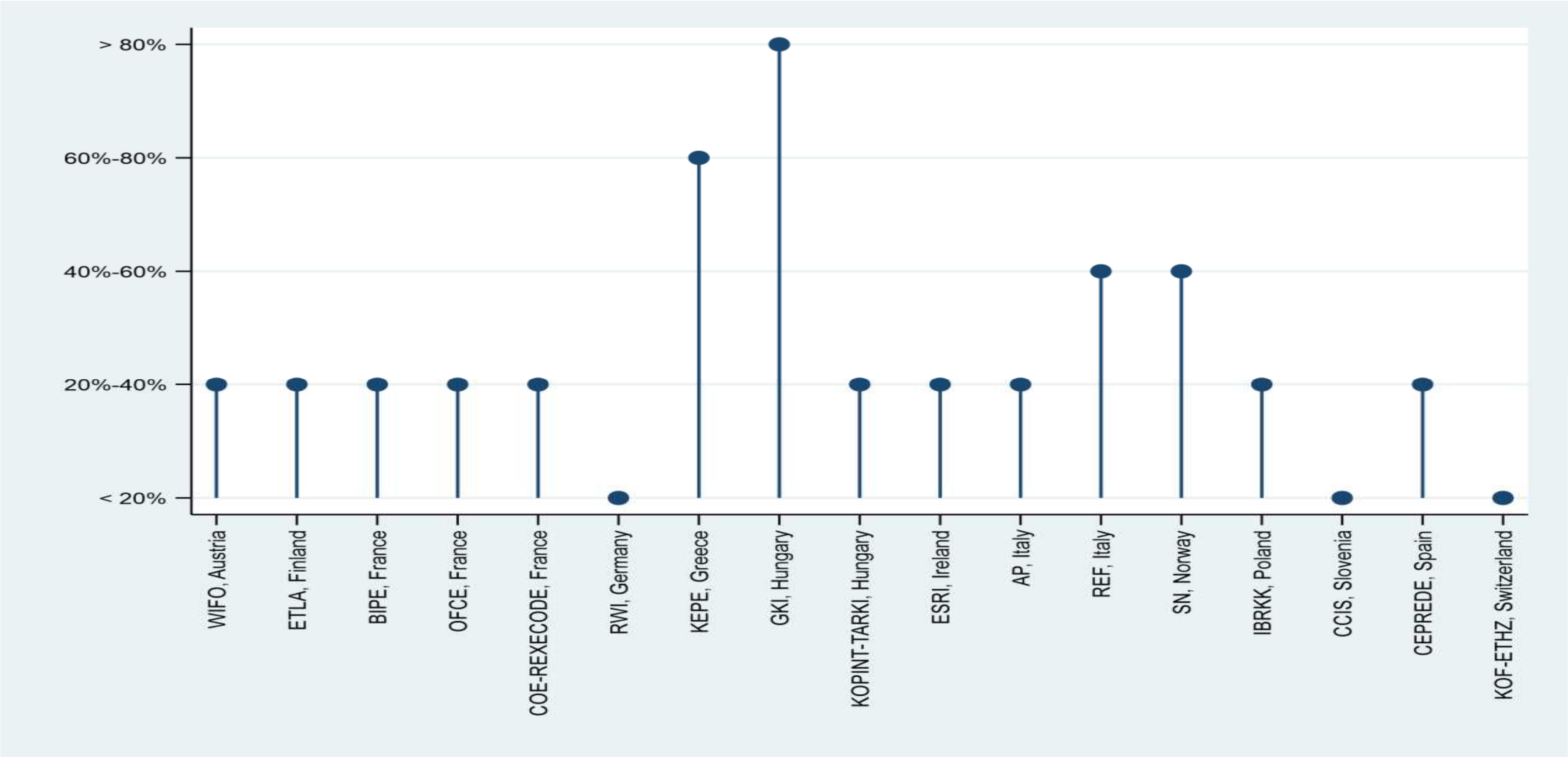
  - ✓ If skilled but low-paid or unemployed workers are to abandon any effort to improve their conditions, this is more likely to happen in strong rather in weak economies

Euro Area Outlook

Labour market conditions

- **Non-negligible shares of involuntary part time work uncover true labour underutilization in Europe**

Shares of involuntary part-time work out of total part-time work



Source: All AIECE institutes(n=17)

Euro Area Outlook

Prices and costs

- **Euro area HCPI inflation is set to remain mild over the next two years**

.

- In 2017, the euro area HCPI inflation accelerated to 1.5% from 0.2% in 2016.

  - ✓ The increase of **headline inflation** was driven by rising energy prices and the soft recovery of primary commodity prices.

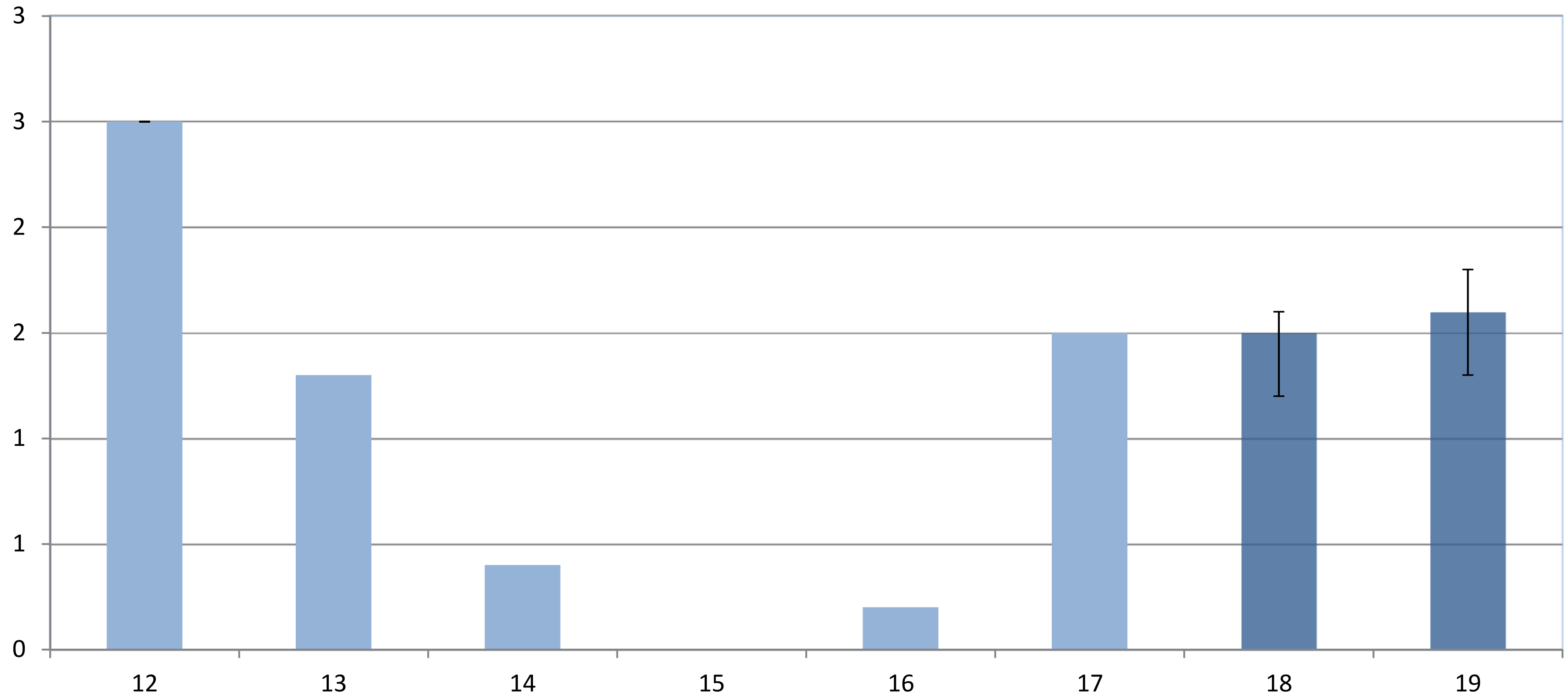
  - ✓ **Core inflation** (all items except energy and unprocessed food) remained at low levels as domestic factors (e.g. wage growth dynamics) exerted no pressures.

- Euro area HCPI inflation is projected to remain at 1.5% in 2018 before picking up slightly to 1.6% in 2019

Euro Area Outlook

Prices and costs

Euro area HICP inflation (Annual average rate of change)



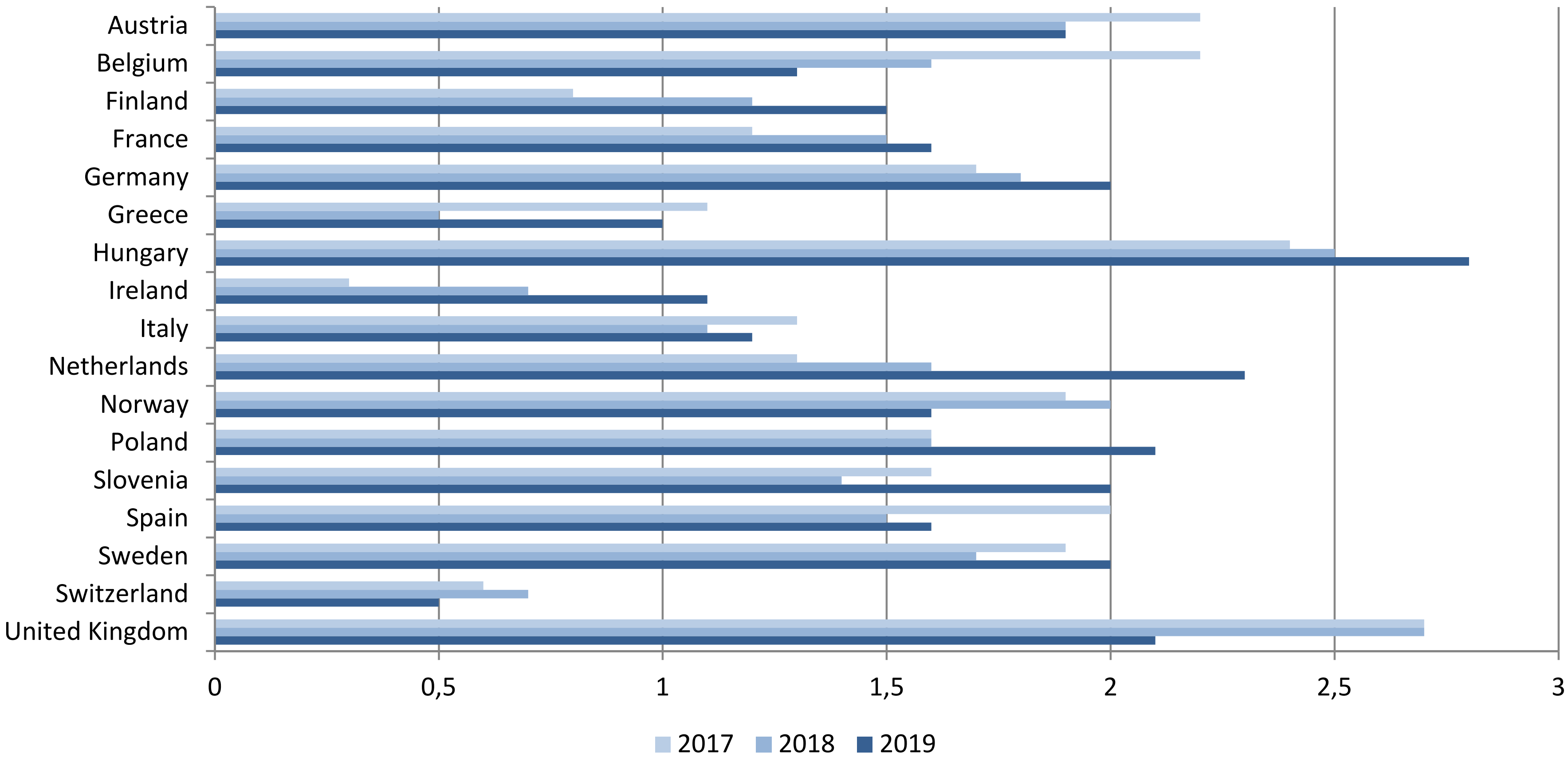
Source: Eurostat and all AIECE institutes, the same weight for each institute - Error bands indicate the upper and lower extremes of the AIECE insittutes' projections (n=19).

Euro Area Outlook

Prices and costs

- ✓ Inflation in member states will keep moving in the same direction
- ✓ At the same time, inflation rate differentials among member states are set to persist.

HICP inflation in AIECE economies (Annual average rate of change)



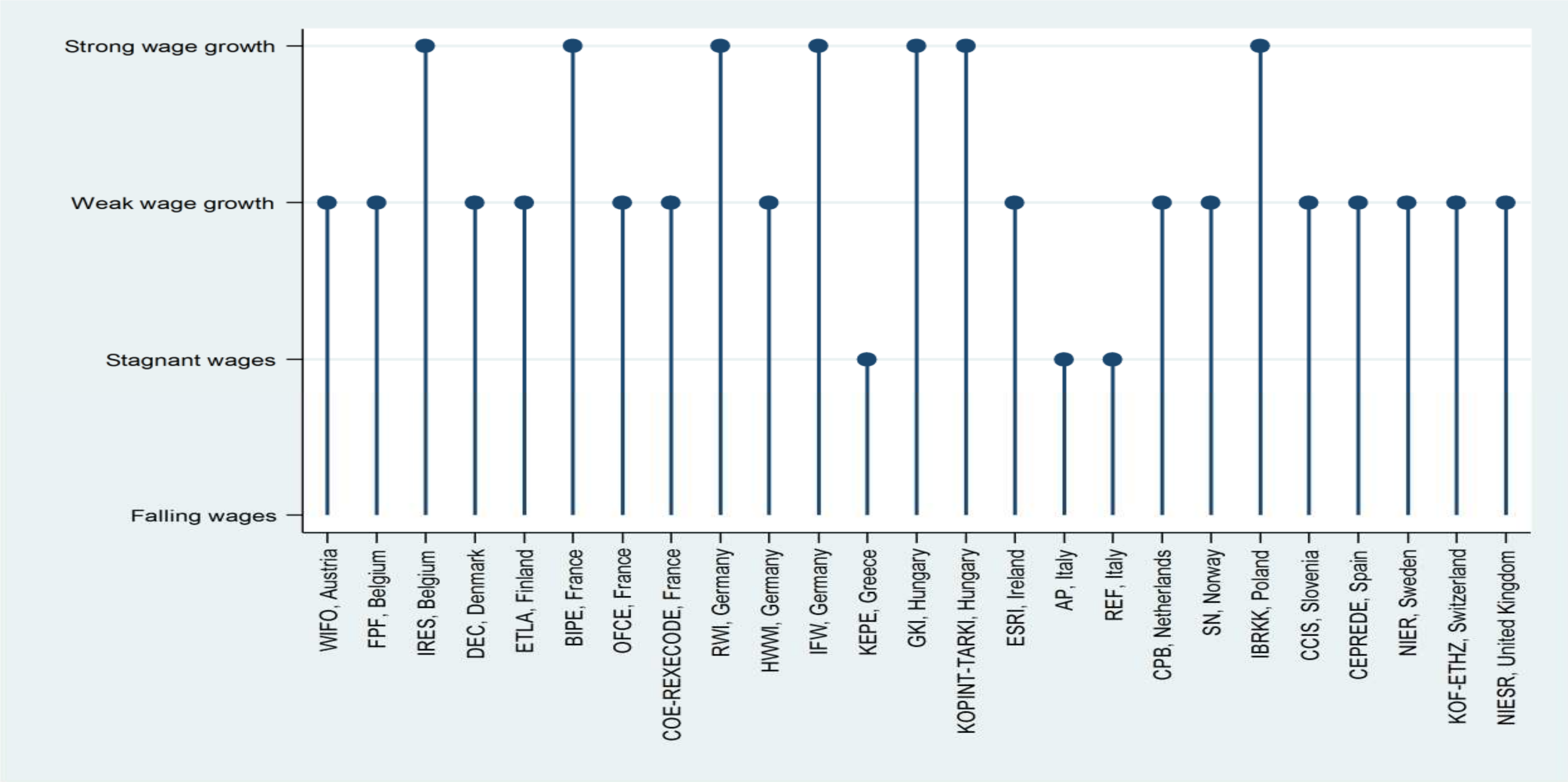
Source: Eurostat and all AIECE institutes, average for each country (n=24)

Euro Area Outlook

Prices and costs

- **Nominal wage dynamics remain weak in most euro area economies**

Nominal wage dynamics

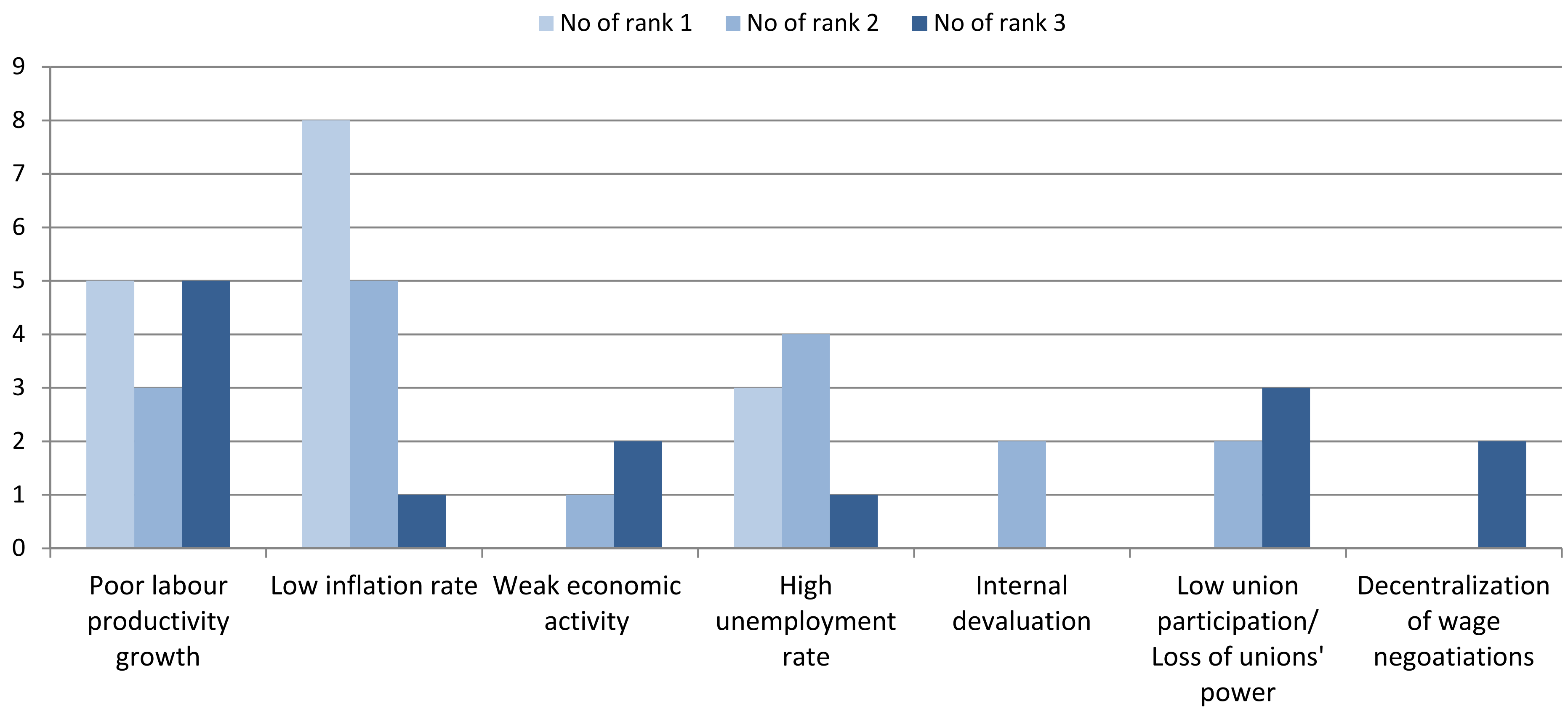


Source: All AIECE institutes(n=25)

Prices and costs

- Poor labour productivity and low inflation rates stand out as the most important factors weighing on nominal wage growth.

Factors weighing on nominal wage growth



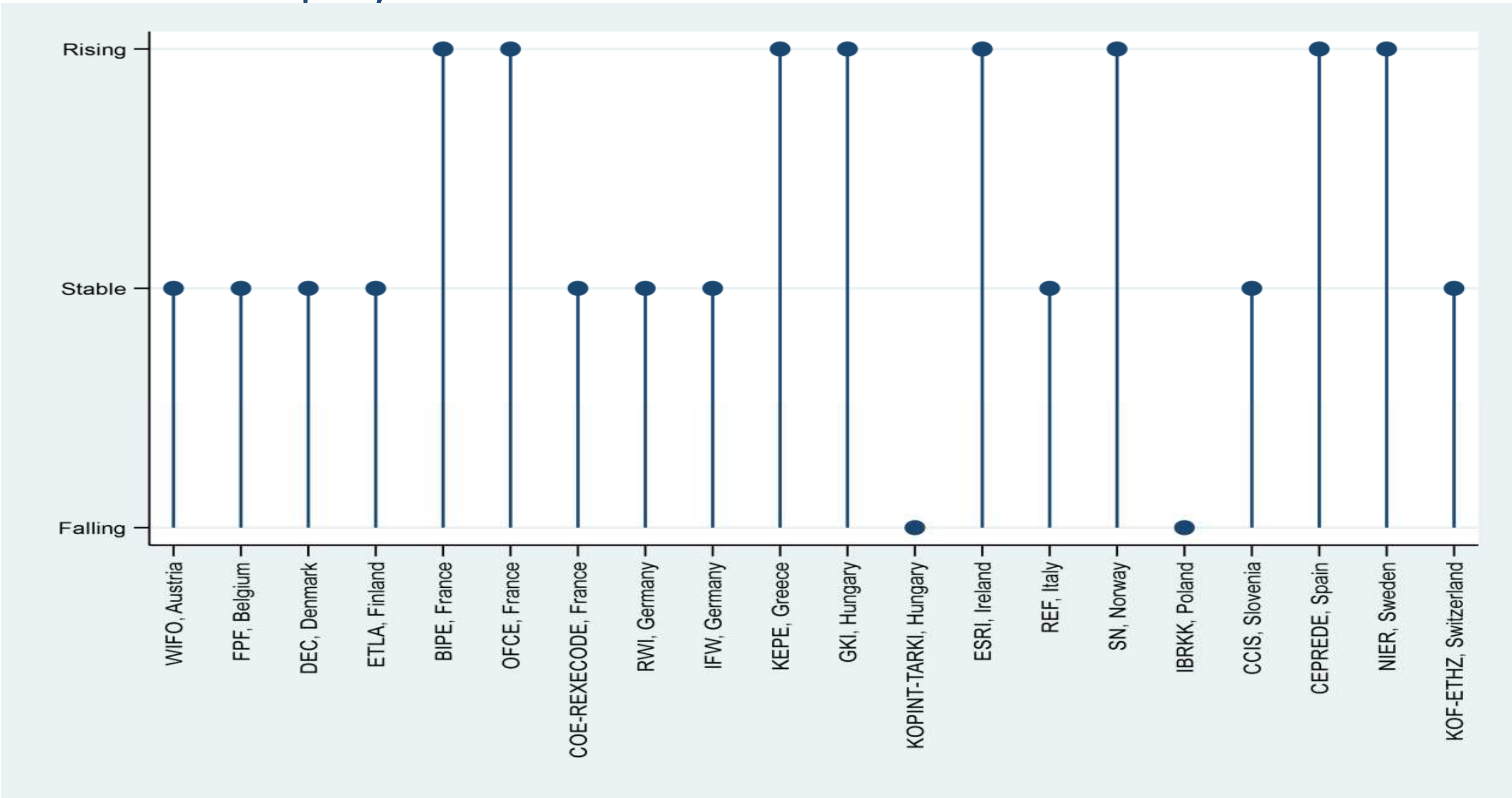
Source: All AIECE institutes(n=25)

Economic inequality

- According to a recent report prepared under the umbrella of the OECD Centre for Opportunity and Equality, income inequality in OECD-EU countries has increased considerably over the last four decades.
- This longer-term trend has been linked to several factors, ranging from changes in technologies to changes in labour market structures and weaker redistribution policies.
- Meanwhile, private wealth inequality is trending upwards as well, surpassing income inequality.

Economic inequality

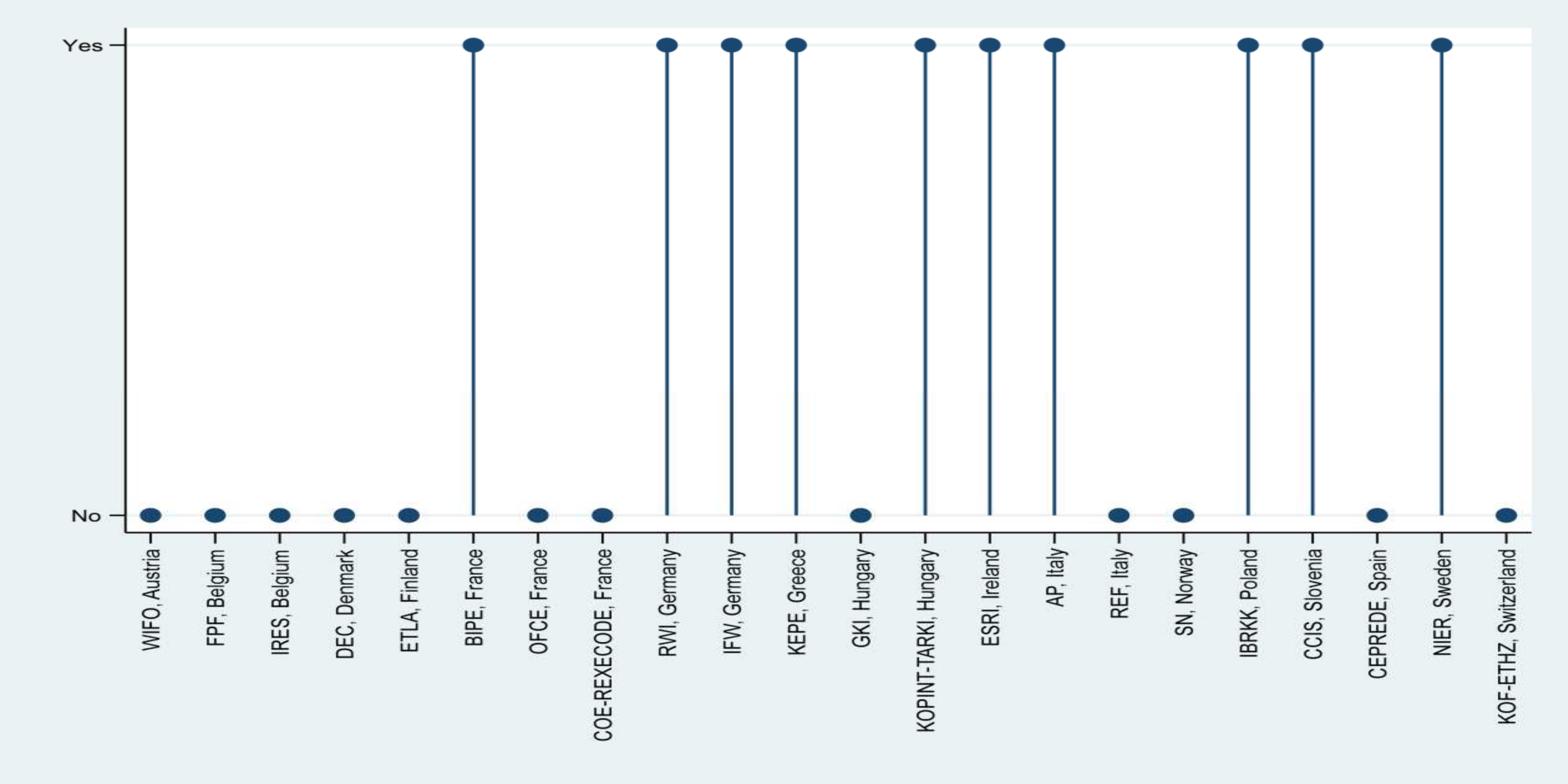
Current trends of inequality in AIECE countries



Source: All AIECE institutes(n=20)

Economic inequality

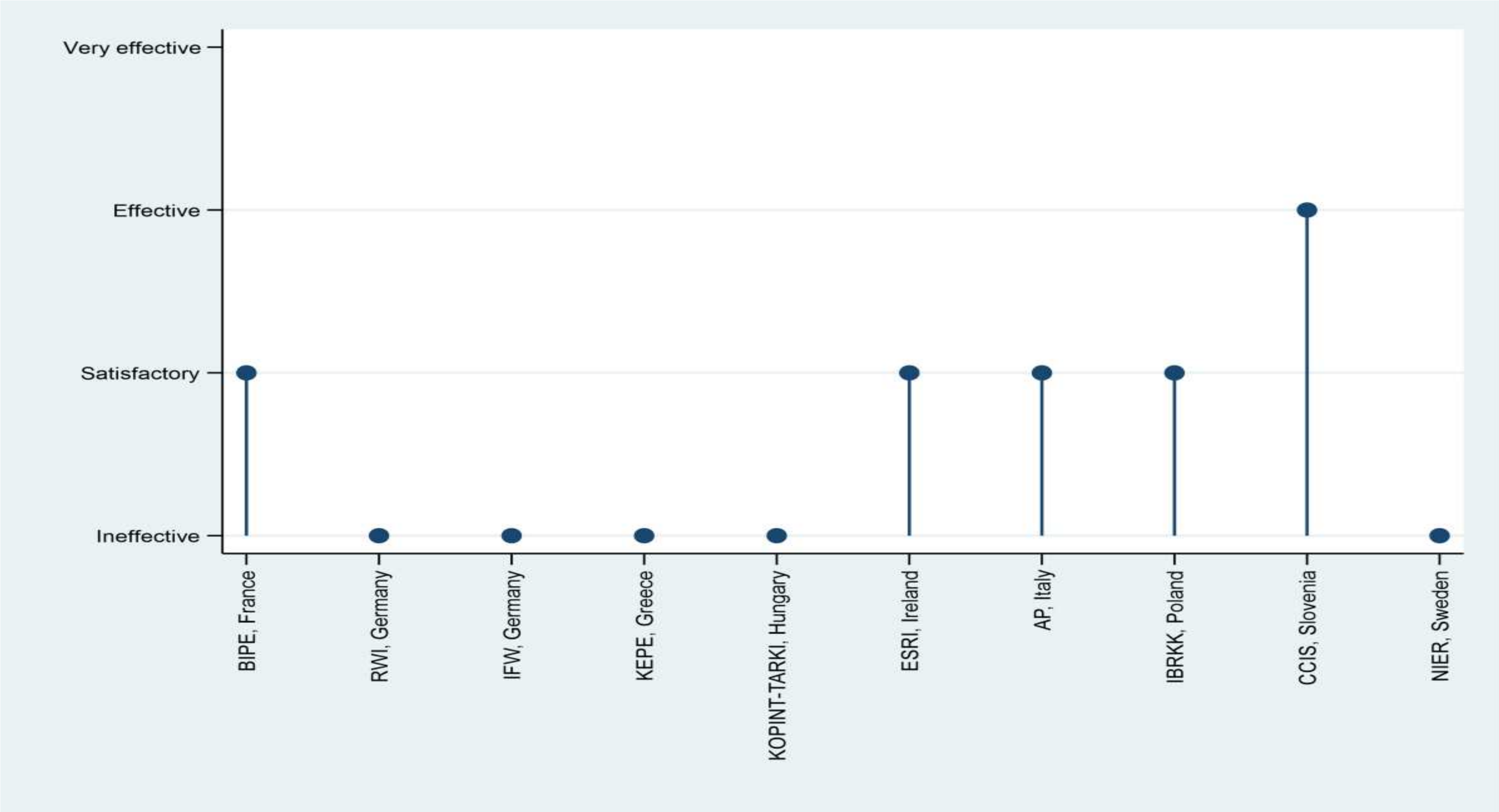
Governments' responses to economic inequality in AIECE economies



Source: All AIECE institutes(n=22)

Economic inequality

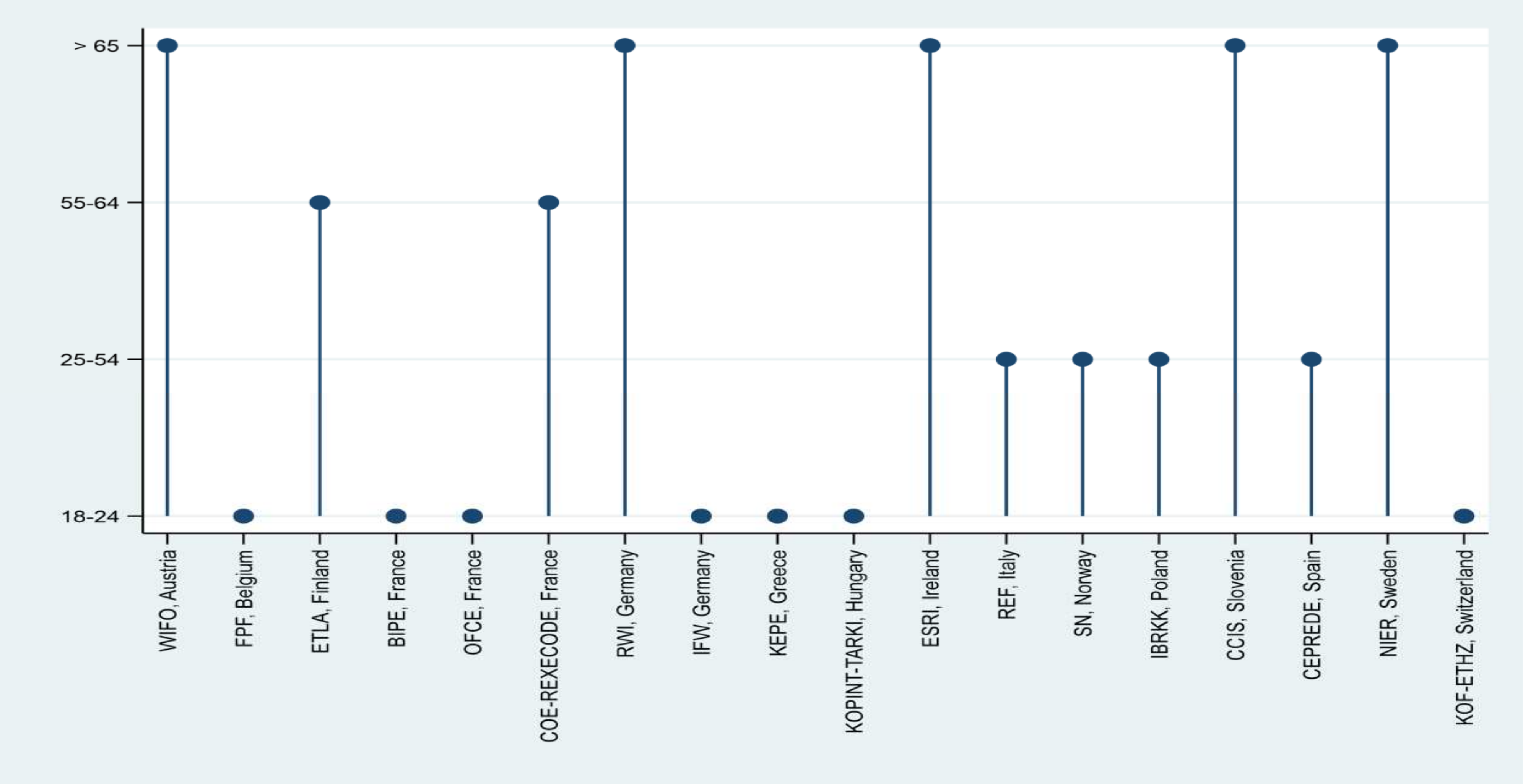
Effectiveness of Government's measures to tackle inequality in AIECE economies



Source: All AIECE institutes(n=10)

Economic inequality

Age profile of individuals facing the highest risk of poverty in AIECE countries



Source: All AIECE institutes(n=18)

Questions

- While the widespread adoption of flexible labour contracts (e.g., temporary, part-time, sub-contracting, etc) is often a sign of a superior method of allocating labour, more and more low-skilled European workers face an increasingly difficult workplace. What should be done to reverse the structural trend toward insecure and less stable jobs?
- Poor labour productivity was identified by AIECE institutes as one of the most important factors weighing on nominal wage growth. What explains poor labour productivity growth in certain euro area economies?
- Do labour market reforms involve a trade-off between the efficiency and the equity objective?
- How one might explain the differences among AIECE countries regarding the age profile of individuals that are more vulnerable to poverty?

Non Euro Area Outlook

Denmark

- The Danish economy remains on a solid, broad-based upswing. According to the Danish Economic Council GDP growth is expected at 2.3% in 2018 and 2.0% in 2019.
- Private consumption is expected to pick up, fueled by high consumer confidence and rising household disposable income.
- Private investment is expected to increase, supported by optimistic business sentiment, capacity ulilization pressures, and a possible frontloading of residential construction before the property tax reform takes full effect.
- The outlook for exports remains positive, as Danish firms are well-positioned competitively to benefit from growth in the country's main export markets.

Outlook for Denmark, GDP and main components

Annual percentage change

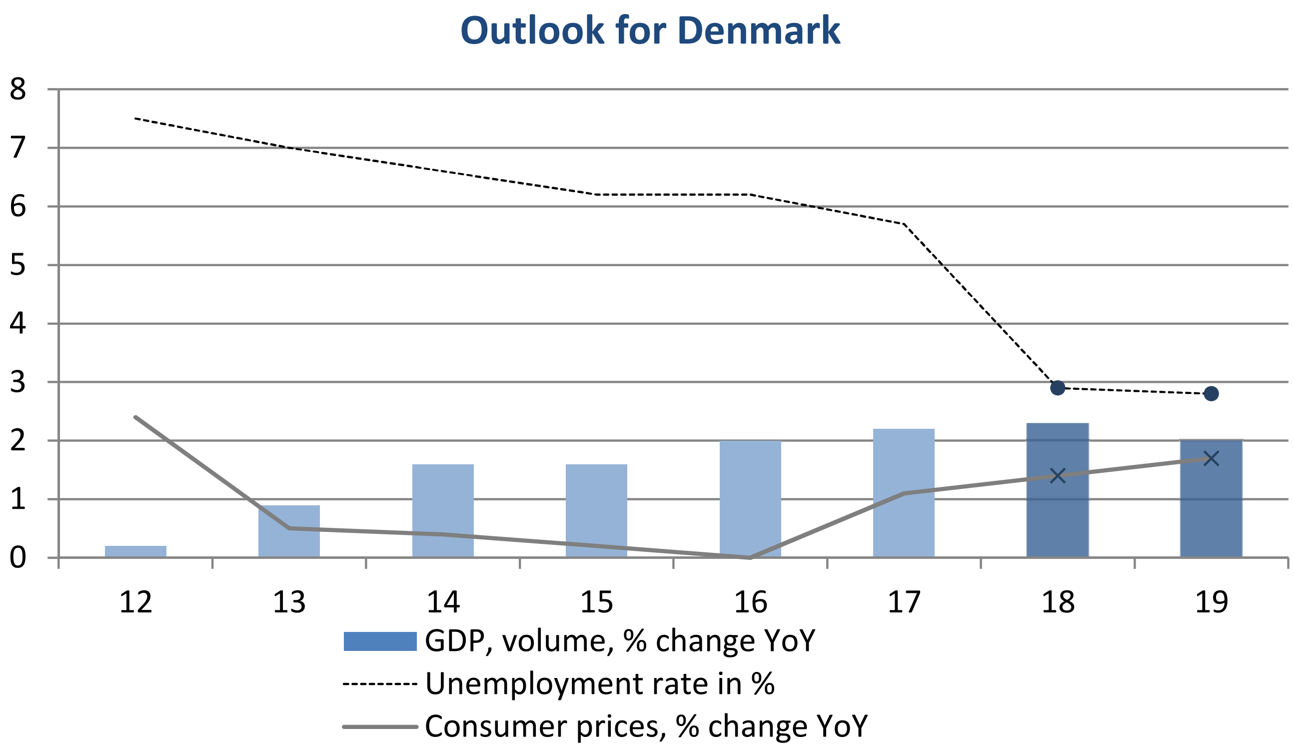
	2017	2018*	2019*
GDP	2.2%	2.3%	2.0%
Private consumption	1.5%	2.9%	2.7%
Public consumption	1.2%	0.9%	1.1%
Gross fixed capital formation	3.7%	4.8%	4.4%
Exports of goods and services	4.4%	2.9%	4.0%
Imports of goods and services	4.1%	4.1%	5.6%

Source: Eurostat, IMF and Danish Economic Council
*forecast

Non Euro Area Outlook

Denmark

- The unemployment rate lies close to its structural level. Labour market pressures remain contained, but they are set to build up as employment is anticipated to increase further.
- Wage growth is expected to pick-up slightly from its current moderate pace, contributing, together with increasing energy prices, to a slow rise in inflation.



Source: Eurostat, IMF and Danish Economic Council

Non Euro Area Outlook

Sweden

- The Swedish economy strengthen further, with the NIER forecasting GDP growth at 2.8% for 2018 and 2.1% for 2019.
- The global economic upswing and the competitive value of the krona will fuel strong export growth.
- Business investment is also expected to grow rapidly, due to strong demand growth and high capacity utilization.
- Lower housing prices have recently dampened consumer confidence, and may have negative consequences for household consumption and housing investment. However, households still operate from a strong position and thus private consumption is expected to grow at a steady 2.1% in 2018 and 2019.

Outlook for Sweden, GDP and main components

Annual percentage change

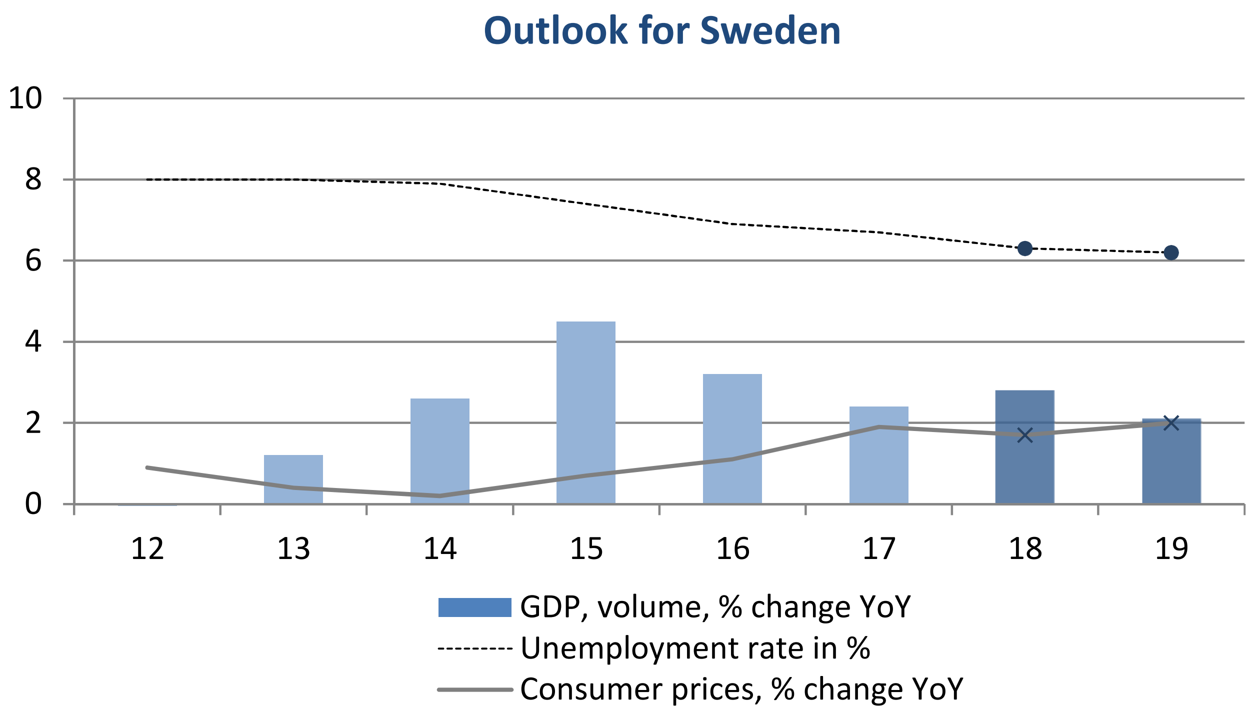
	2017	2018*	2019*
GDP	2.4%	2.8%	2.1%
Private consumption	2.4%	2.1%	2.1%
Public consumption	0.4%	0.9%	0.8%
Gross fixed capital formation	6.0%	5.8%	3.3%
Exports of goods and services	3.7%	5.7%	4.3%
Imports of goods and services	5.0%	5.7%	4.0%

Source: Eurostat and NIER National Institute of Economic Research.
*forecast

Non Euro Area Outlook

Sweden

- Employment growth is anticipated to be more subdued, and the unemployment rate will continue to fall gently. Wage growth will accelerate due to labour shortages, but inflation is not expected to reach 2% until 2020.
- A repo rate hike is not expected until the 1st quarter of 2019.
- Unchanged personnel density in the provision of public services will require taxes to be raised or benefits to be cut by just over SEK 20 billion (EUR 1.9 billion).



Source: Eurostat and NIER National Institute of Economic Research.

Non Euro Area Outlook

Poland

- Strong GDP growth in the Polish economy is expected to continue, with the IBRKK forecasts standing at 4.1% for 2018 and 3.5% for 2019.
- Private consumption growth is set to slow gradually, but it will nevertheless remain strong due to fast wage growth and high consumer confidence.
- Investment growth is expected to be solid, fueled by the utilization of European funds via public companies, high capacity utilization, low interest rates and a solid demand outlook. However, labour shortages and an unfavorable political sentiment impede private investment.
- Exports are expected to grow strongly, stimulated by growth in key export markets and more particularly in the EU.

Outlook for Poland, GDP and main components

Annual percentage change

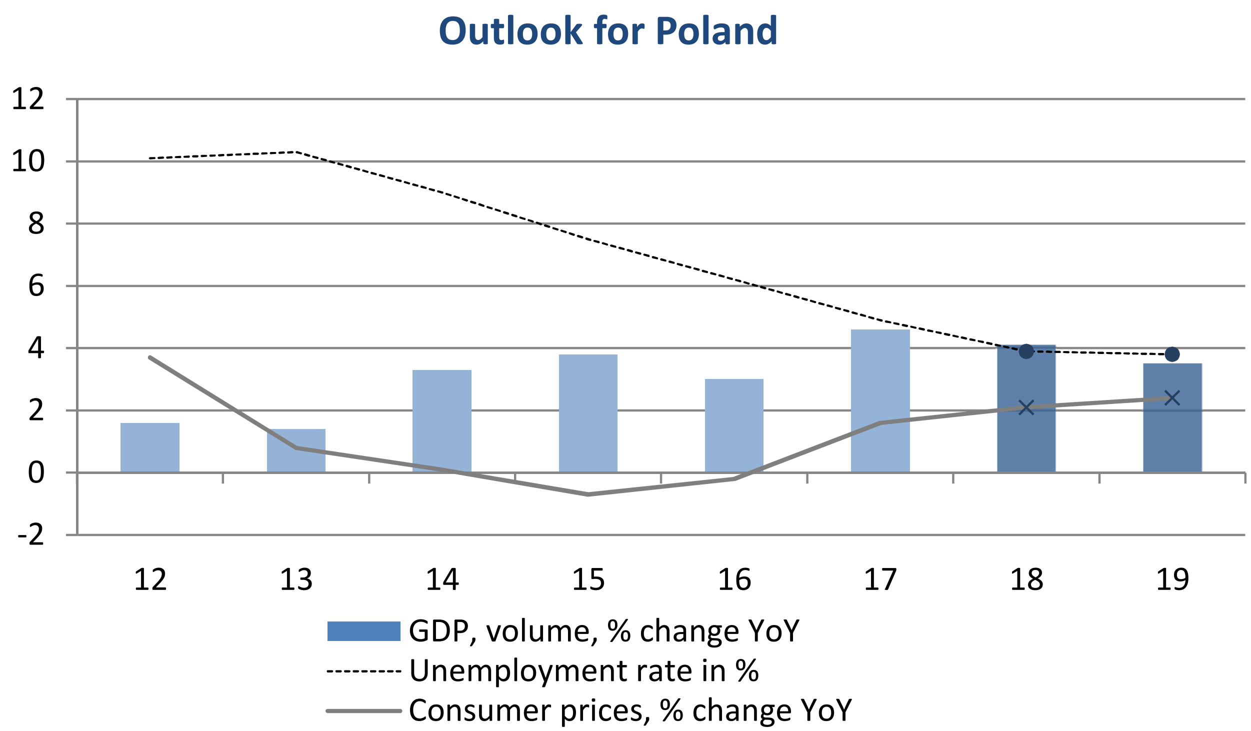
	2017	2018*	2019*
GDP	4.6%	4.1%	3.5%
Private consumption	4.7%	3.8%	3.3%
Public consumption	3.4%	3.1%	3.9%
Gross fixed capital formation	3.4%	5.1%	4.7%
Exports of goods and services	8.2%	6.7%	5.5%
Imports of goods and services	8.7%	7.8%	7.1%

Source: Eurostat and IBRKK Institute for Market, Consumption and Business Cycles Analysis.
*forecast

Non Euro Area Outlook

Poland

- Employment will continue rising, and unemployment will decrease further. Wage growth is anticipated to strengthen due to an increasing scarcity of qualified workers, and this will induce a gradual increase in inflation.
- Monetary policy is anticipated to remain expansionary, with interest rates being kept low over the next two years.



Source: Eurostat and IBRKK Institute for Market, Consumption and Business Cycles Analysis.

Non Euro Area Outlook

Hungary

- Hungarian institutes GKI and Kopint-Tárki forecast GDP growth in their country between 3.8% to 4% in 2018, and 3.2% to 3.6% in 2019.
- The dynamic expansion of private consumption will remain a key growth driver, although a moderate slow down in consumption growth is expected in 2019, as the positive impact of minimum wage increases fades.
- Investment is anticipated to grow at a strong rate, supported by the renewed inflow of EU funds, FDI and high capacity utilization.
- The global upturn, along with the operation of new automotive capacities, will contribute to healthy export growth. Imports will grow strongly, due to the dynamic expansion of consumption and investment.

Outlook for Hungary, GDP and main components

Annual percentage change

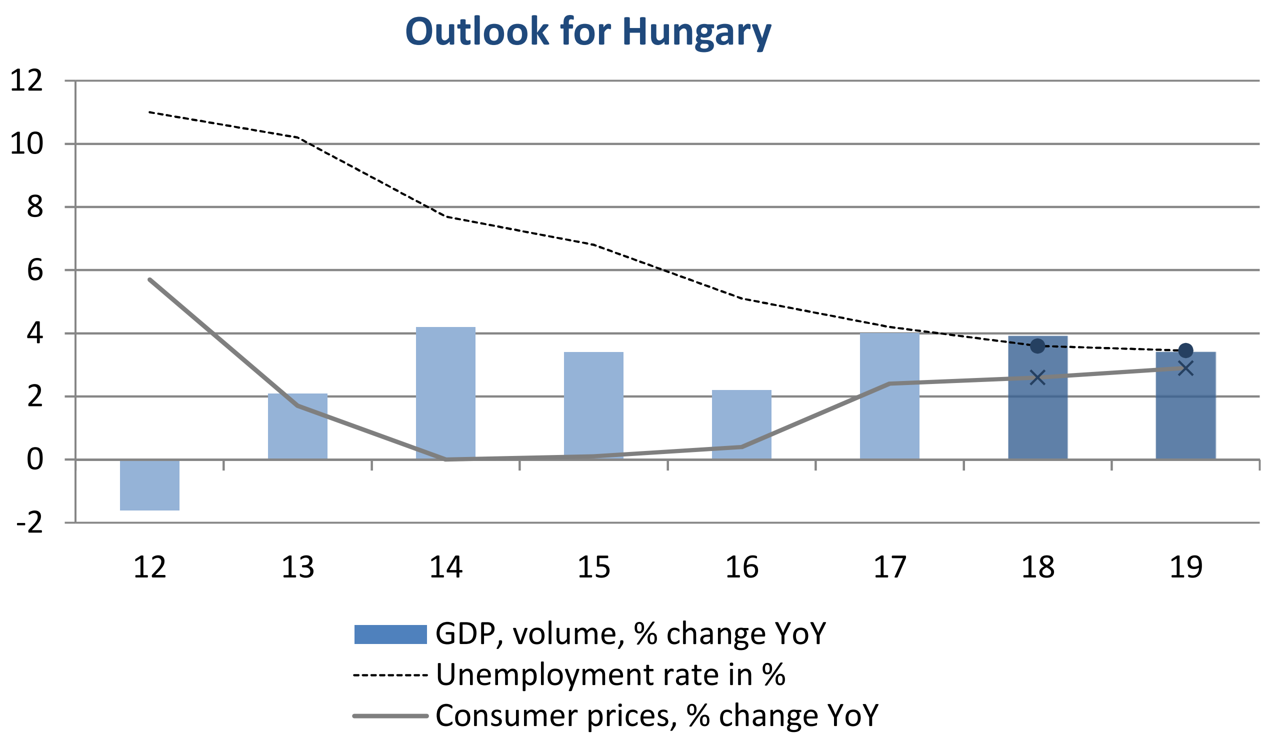
	2017	2018*	2019*
GDP	4.0%	3.9%	3.4%
Private consumption	4.7%	4.3%	3.8%
Public consumption	0.3%	0.8%	0.5%
Gross fixed capital formation	16.8%	9.5%	7.3%
Exports of goods and services	7.1%	7.0%	6.5%
Imports of goods and services	9.7%	8.3%	7.7%

Source: Eurostat, *average forecast of GKI Economic Research Co. and Kopint-Tárki Institute of Economic Research.

Non Euro Area Outlook

Hungary

- Employment is expected to increase and unemployment will decrease further, with shortages of skilled labour persisting and contributing to wage growth.
- Consumer price inflation will remain close to target.
- Fiscal expansion will continue, and the general government deficit is projected to reach 2.8% by 2019.



Source: Eurostat, average forecast of GKI Economic Research Co. and Kopint-Tárki Institute of Economic Research.

Non Euro Area Outlook

United Kingdom

- GDP growth in the UK is slowing down, with NIESR forecasts for GDP growth standing at 1.8% for 2018 and 1.9% for 2019, under the assumption of a soft Brexit scenario.
- Brexit uncertainty will continue to weigh on business investment.
- Uncertainty, together with elevated inflation and real disposable income losses resulting from the sterling's earlier depreciation, will continue dampen private consumption. NIESR expects subdued consumption growth, together with a slowdown in investment growth in 2018 and pick up in 2019.
- Exports continue to benefit from the upswing in global activity and the sterling's competitive value, but export growth is expected to slow down gradually, as the impact of the sterling's depreciation unwinds.

Outlook for the UK, GDP and main components

Annual percentage change

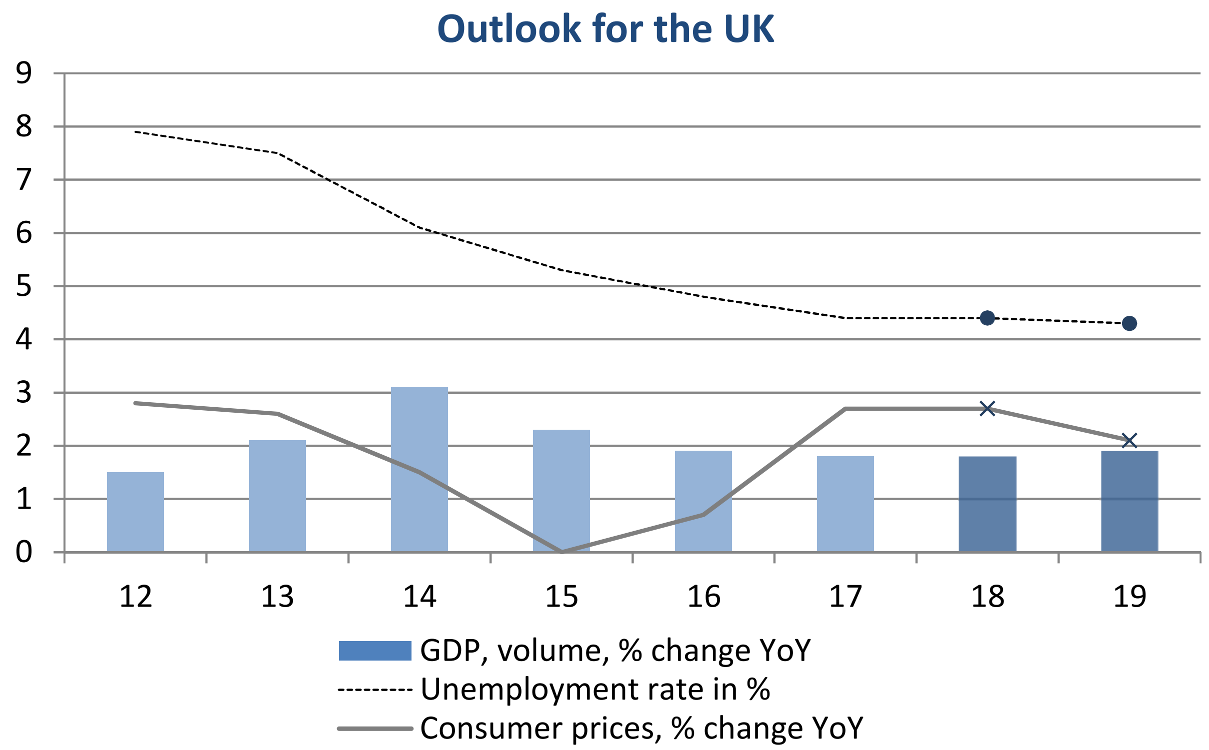
	2017	2018*	2019*
GDP	1.8%	1.8%	1.9%
Private consumption	1.7%	1.2%	1.1%
Public consumption	0.1%	1.1%	0.7%
Gross fixed capital formation	4.0%	2.7%	3.3%
Exports of goods and services	5.7%	4.0%	3.7%
Imports of goods and services	3.2%	2.3%	2.2%

Source: Eurostat and NIESR The National Institute of Economic and Social Research.

Non Euro Area Outlook

United Kingdom

- The unemployment rate is forecasted to remain close to equilibrium and wage growth appears to be accelerating.
- Consumer price inflation is slowing down in recent months and is expected to ease further to 2.1% in 2019.



Source: Eurostat and NIESR The National Institute of Economic and Social Research.

Non Euro Area Outlook

Norway

- The downturn of the Norwegian economy bottomed out just over a year ago, and Statistics Norway expects GDP growth to reach 2.0% in 2018 and 1.9% 2019.
- Private investment, excluding housing, is expected to strengthen, led by an increase in petroleum investment, but also driven by higher capacity utilization, growing optimism and favourable credit conditions.
- Growing employment and declining unemployment are anticipated to boost private consumption, through increased confidence and higher incomes.
- Export prospects are positive, as a weaker krone helps Norwegian businesses to take advantage of the global upturn.

Outlook for Norway, GDP and main components

Annual percentage change

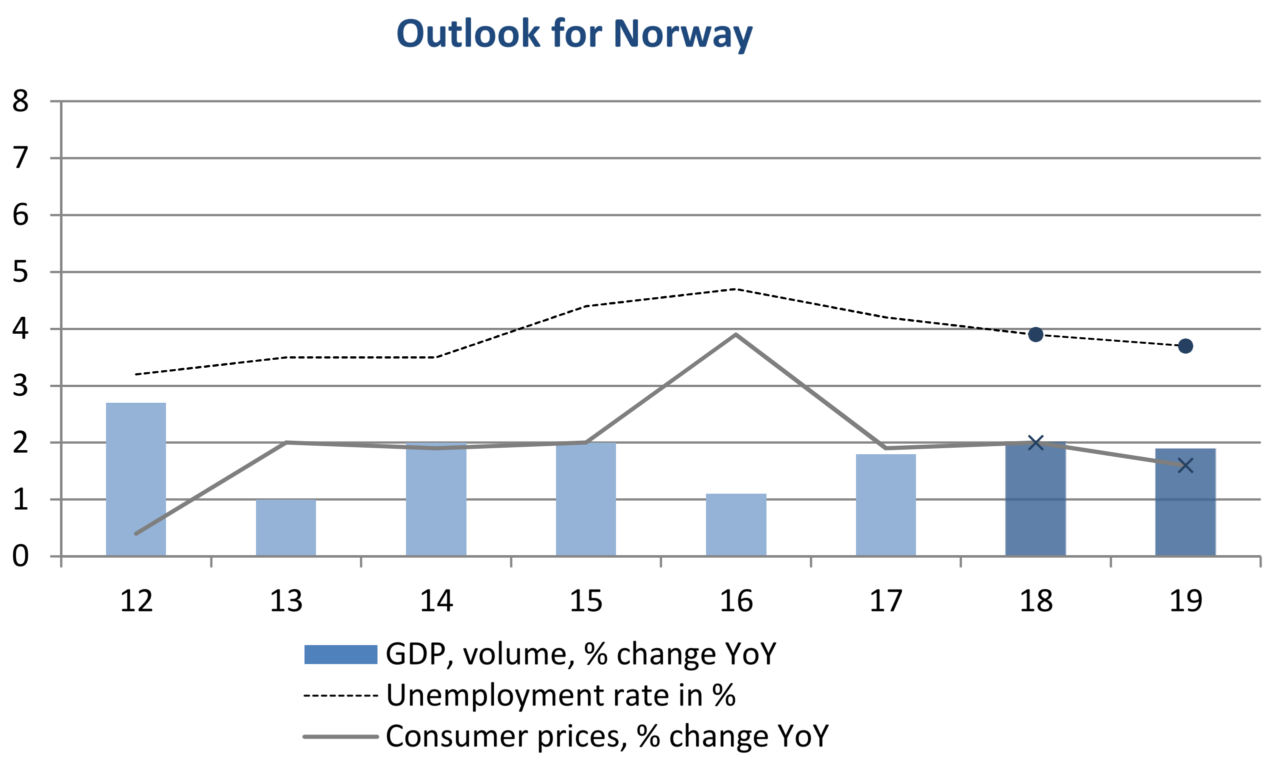
	2017	2018*	2019*
GDP	1.8%	2.0%	1.9%
Private consumption	2.3%	2.5%	2.7%
Public consumption	2.0%	1.5%	1.7%
Gross fixed capital formation	3.5%	2.5%	2.1%
Exports of goods and services	0.8%	2.0%	2.0%
Imports of goods and services	2.2%	2.2%	2.8%

Source: Eurostat and SN Statistics Norway

Non Euro Area Outlook

Norway

- The housing market downturn and the projected appreciation of the krone are likely to exert countering effects on growth, with risks of a serious negative impact being nevertheless low.
- Wage growth will pick up gradually, as the oil sector recovers and labour market conditions improve. Inflation is forecasted at 2% this year and 1.6% in 2019, the latter estimate being related to the expected appreciation of the krone.



Source: Eurostat and SN Statistics Norway

Non Euro Area Outlook

Switzerland

- The Swiss economy is showing good momentum, with KOF expecting GDP growth at 2.5% in 2018 and 1.8% in 2019.
- The global upturn and the depreciation of the Swiss franc against the euro are expected to support strong export growth and foster business investment.
- Private consumption Is anticipated to grow moderately, supported by a return to nominal wage increases, a decline in unemployment and a continuation of negative interest rates.

Outlook for Switzerland, GDP and main components

Annual percentage change

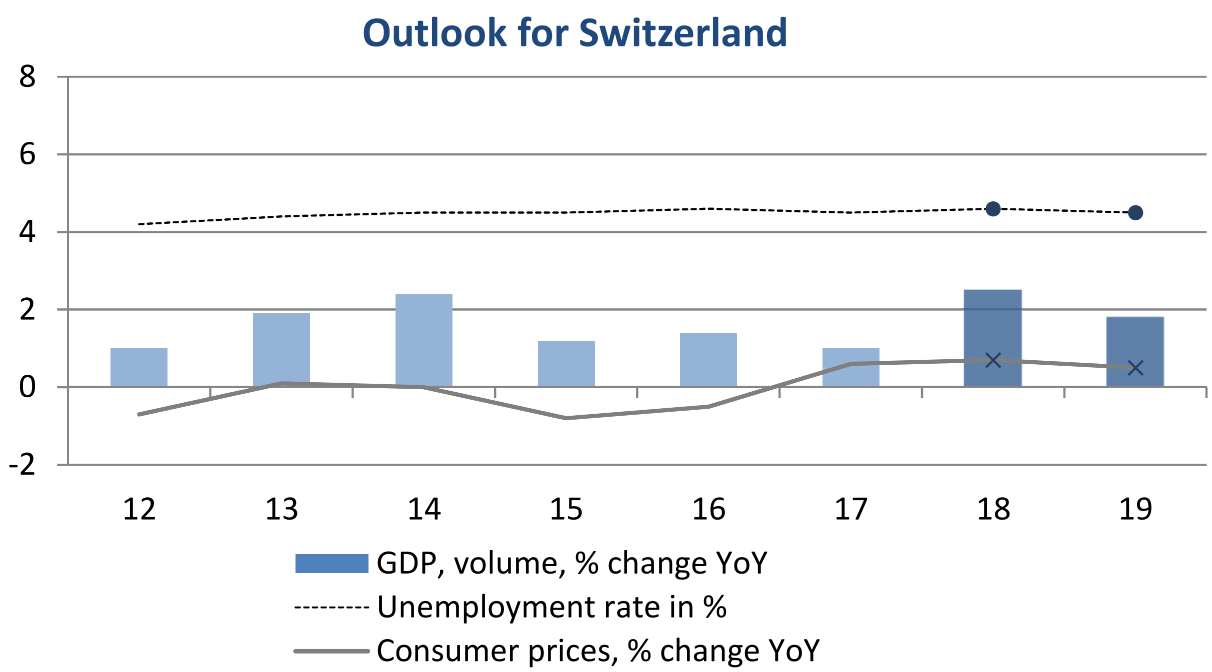
	2017	2018*	2019*
GDP	1.0%	2.5%	1.8%
Private consumption	1.2%	1.6%	1.4%
Public consumption	0.9%	1.2%	0.6%
Gross fixed capital formation	3.0%	3.0%	1.8%
Exports of goods and services	-1.0%	5.6%	5.1%
Imports of goods and services	-2.6%	5.9%	5.0%

Source: Eurostat and KOF Swiss Economic Institute.

Non Euro Area Outlook

Switzerland

- Consumer price inflation is forecasted at 0.7% in 2018 and 0.5% in 2019. Monetary policy will remain focused at keeping the attractiveness of Swiss franc investments low, the current negative policy rate is expected to be preserved in 2018.
- KOF points out that part of the expected improvement in GDP in 2018 can be attributed to license fees from international sporting events. In 2019, the absence of such major events, together with the gradual slowdown in the global economy, are reasons behind the expected lower GDP growth.



Source: Eurostat and KOF Swiss Economic Institute.

Non Euro Area Outlook

Questions

- How do you expect the positive growth outlook for the euro area to affect economic developments in your country?
- Do you see a risk of a sharper downturn in Swedish and Norwegian housing markets?
- How do you assess the risk of higher labour shortages in non euro area countries, and what could this imply for future wage growth? What are the policy options to address this issue?

Monetary Policy

- The basic goals of the ECB's monetary policy are:

  a) to maintain *price stability* (e.g. a headline inflation below but close to 2% over the medium term) and

  b) to promote *economic recovery* in the euro area.

The main *monetary tools/vehicles* used for achieving these goals are :

a) the policy rates and b) the Asset Purchase Programme (APP).

Monetary Policy

- The Policy Rates (currently low/negative rates)

Advantages

The low/negative policy rates (NIR), applied by the ECB since June 2014, have been consistent with the target of raising inflation in the Euro area, while also providing vital support to the recovery of Euro area by (a) encouraging investors to switch from low yield government securities to riskier assets such as equities, corporate bonds, or any property that provide a better return, and (b) by reducing the cost of funds even for those borrowers/investors of large companies who can directly finance their investments through commercial paper and corporate bond markets

Monetary Policy

- Policy Rates (currently low/negative rates)

Disadvantages

Most of the criticism, is mainly linked to the possibility of excessive risk-taking by commercial banks, which might cause financial fragility. More specifically, as banks' margins are squeezed due to low/NIR, they may start lending to riskier borrowers to maintain their profit levels. As a result, apart from boosting investment and strengthening aggregate demand, low/NIR policies may, undermine financial stability and contribute to the build-up of *asset price bubbles*. Such potential risks require close monitoring and supervisory scrutiny by the corresponding monetary authorities.

Question

AIECE institutes were asked about the possible timing of a future rise in ECB policy rates. The majority of respondents (15 out of 22 institutes) believe that policy rates will start increasing later that the 1st quarter of 2019, six (6) institutes believe that the increase will be initiated in 1st quarter of 2019 and one (1) institute suggests that interest rates will increase before September 2018.

Monetary Policy

- Quantitative easing (QE)

The Asset Purchase Programme (APP), implemented since 2015 though an covering purchases of private and public sector securities from banks, has also contributed towards raising the inflation rate and supporting the ongoing recovery of the euro area through the credit channel. From January 2018 and up until September 2018, APP net purchases will run at a reduced monthly pace of €30 billion (from a previous pace of €60 billion per month). The ECB' intention is to continue carrying out asset purchases until the path of inflation is consistent with the target.

Question (1)

AIECE institutes were asked to express their opinion on what the future of the QE programme should be. The majority (13) of the AIECE institutes recommend that the pace of the QE should be further downsized, while three (3) institutes suggest that the programme should maintain its current pace. In addition one (1) institute suggests that QE should be terminated and one institute (1) recommends that it should be reversed.

Monetary Policy

- Quantitative easing (QE)

Question (2)

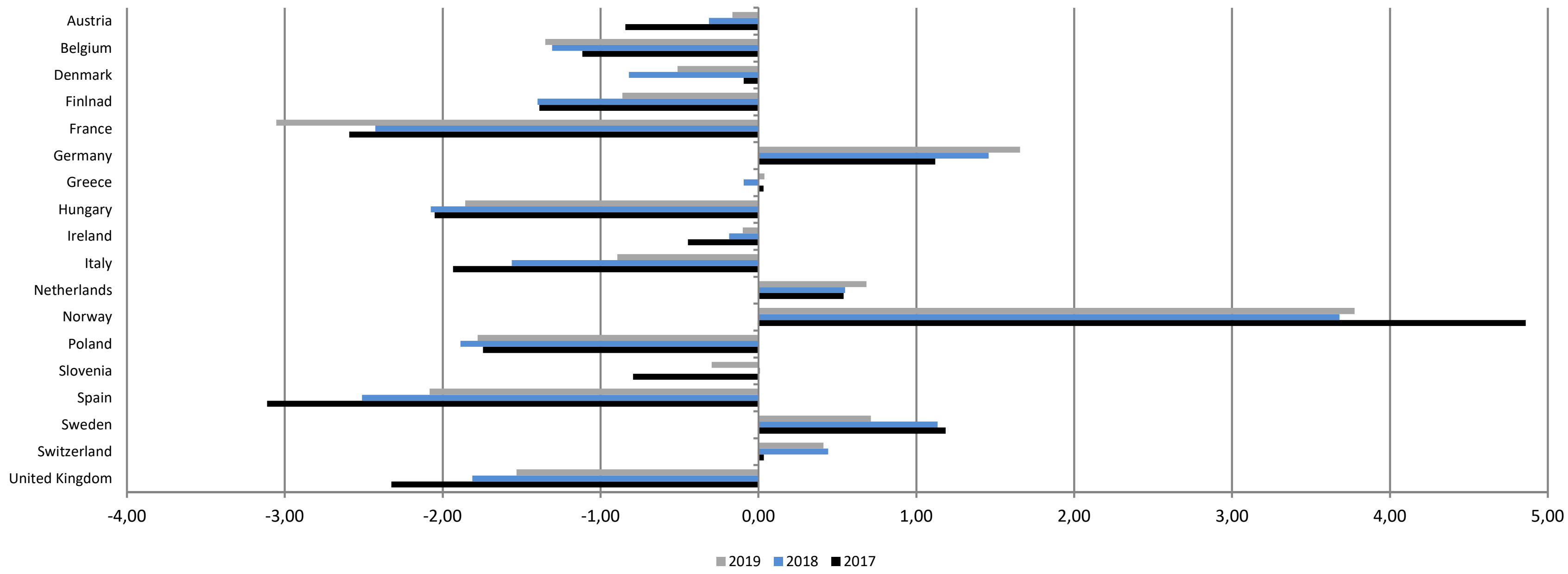
Further to the downsizing of the APP from January 2018, AIECE institutes were asked to assess any remaining important risks for the euro area in relation to the programme. The majority of institutes (16) believe that there is still a risk of asset-price bubbles, 13 institutes recognize the risk of reduced willingness for structural reforms, 12 institutes point to a possible slowdown in productivity growth, while one (1) institute speaks for the possibility of “mispricing of risks and moral hazard”.

Fiscal policy

Fiscal balances

- According IMF – WEO projections most member countries will have an improvement in their fiscal position in 2018.
- Germany, Netherlands, Norway, Slovenia, Sweden and Switzerland are expected to run a fiscal surplus

Net lending/borrowing (% GDP) in euro area countries



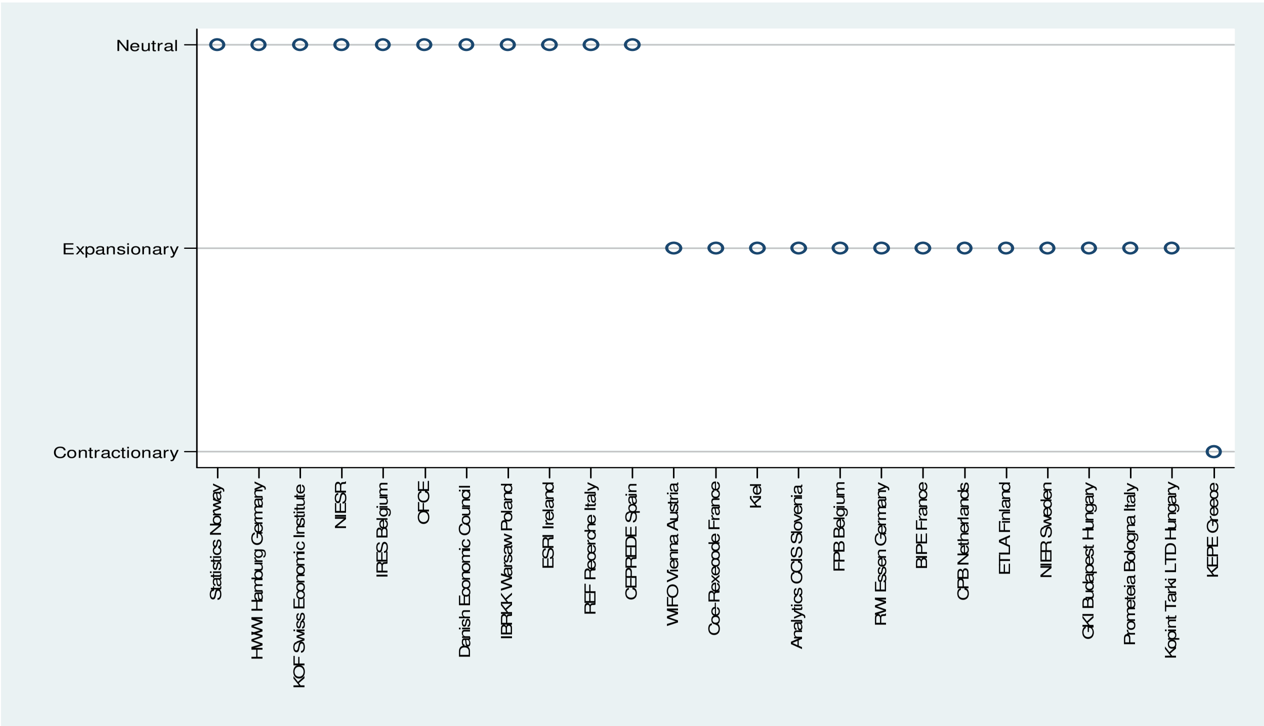
Source: IMF-WEO Database

Fiscal policy

Fiscal policy stance in member countries

- 11 out of 25 institutes consider fiscal policy stance in their country as neutral.
- 13 find it expansionary.
- Fiscal stance in Greece remains contractionary in 2018.

Fiscal policy stance in your country during 2018 (neutral, expansionary, contractionary)



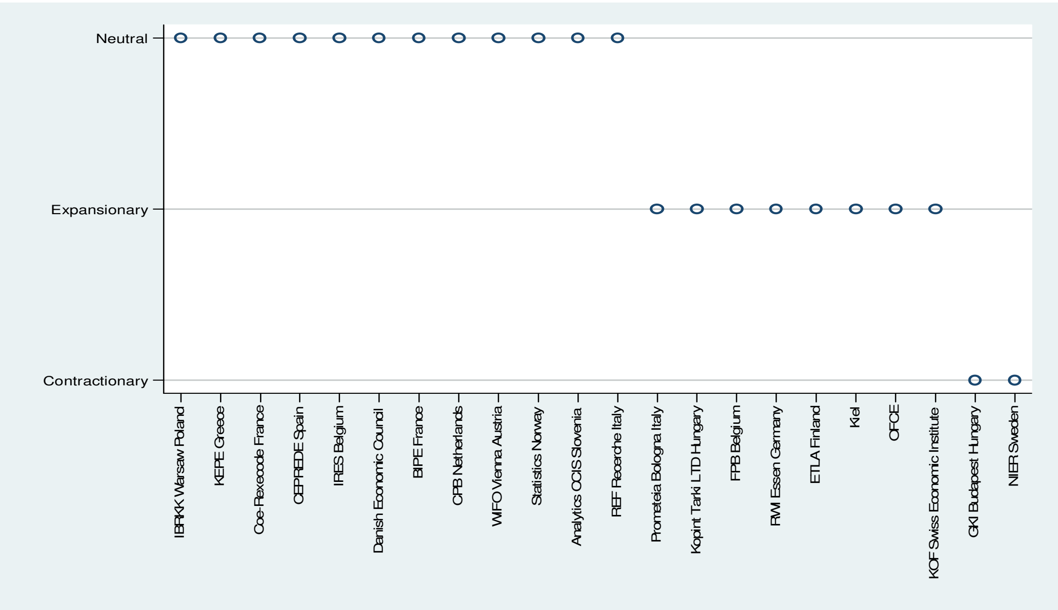
Source: AIECE institutes.

Fiscal policy

Fiscal policy stance in the Euro area

- There is a consensus among most member institutes that the euro area as a whole runs a neutral fiscal policy in 2018.
- A lower number of institutes assess it as expansionary.
- Two member institutes find it contractionary.

Fiscal policy stance in the Euro area during 2018 (neutral, expansionary, contractionary)



Source: AIECE institutes.

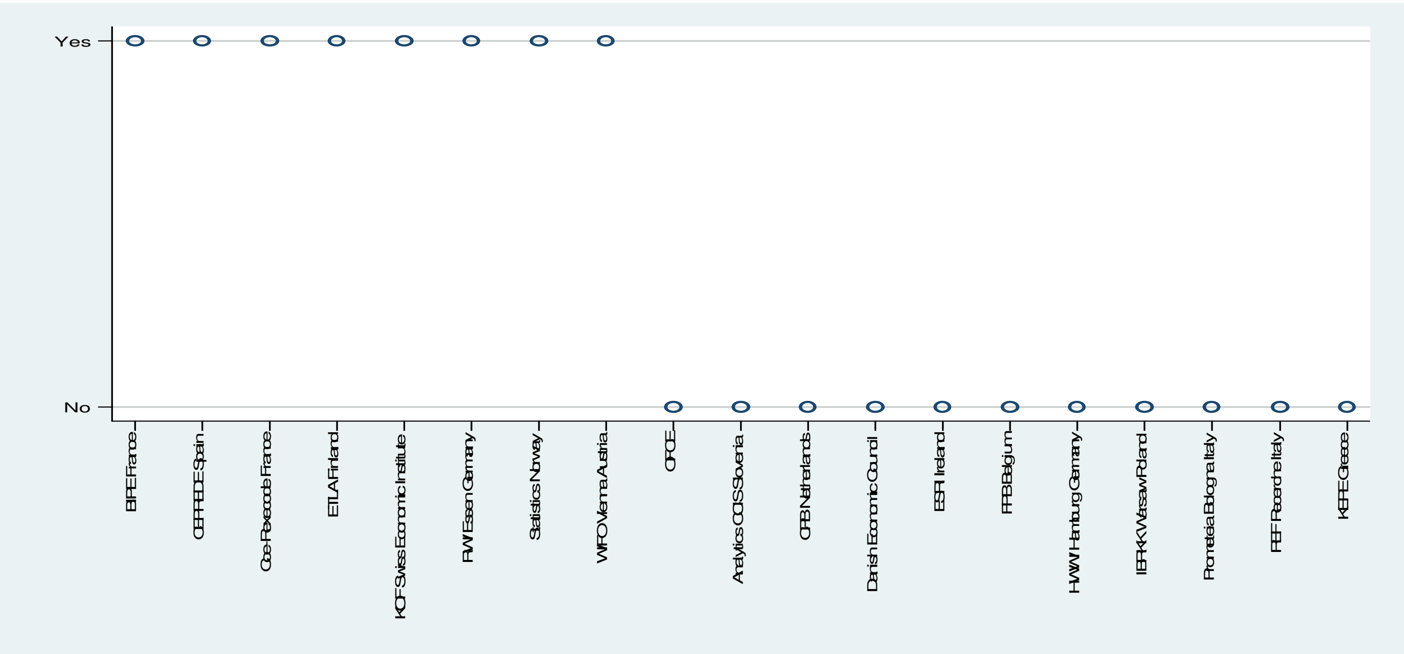
Fiscal policy

Social security system

- We asked member institutes if the current state of the social security system in their country justifies further policy action within the next two years.

- Responses of institutes lean slightly in favor of NO as eleven (11) of them answered negatively while the remaining eight (8) answered positively.

Does the current state of the social security system justify policy action in the next 2 years? (yes, no)



Source: AIECE institutes.

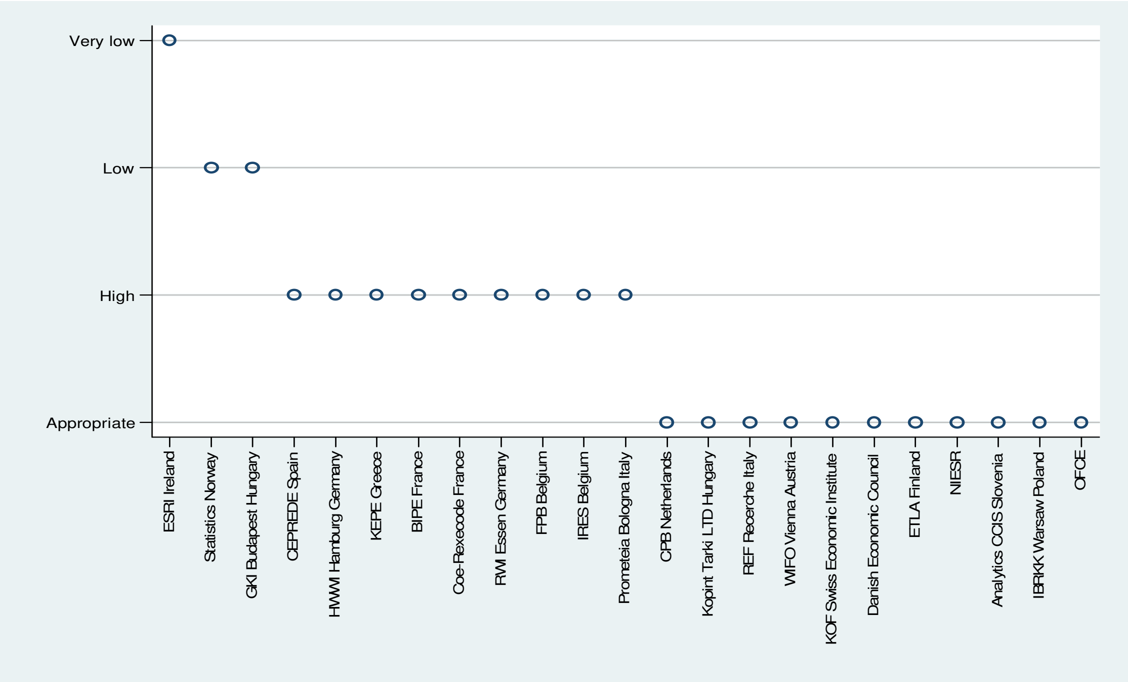
Fiscal policy

Appropriateness of corporate tax rates

- We finally asked member institutes to assess the appropriateness of current corporate tax rates in their country from the point of view of encouraging investment.

- Eleven (11) institutes think it is appropriate, while nine (9) of them assess corporate tax rates as high. However, three (3) of them think they are either low of very low.

Appropriateness of corporate tax rates from the point of view of encouraging investment (Appropriate, high, low, very low)



Source: AIECE institutes.

Risks and challenges for Europe

Downside risks to the outlook for Europe

- AIECE institutes were asked to rank according to their views 10 potential risks to the outlook for Europe:

  - ✓Rising protectionism
  - ✓Rising populism
  - ✓Sharp corrections in financial markets
  - ✓A stronger tightening of US monetary policy
  - ✓A higher than expected rise in energy prices
  - ✓A rapid rise in commodity prices
  - ✓Hard Brexit
  - ✓Geopolitical risks and armed conflicts
  - ✓Political disintegration of the EU
  - ✓Domestic political tensions in certain EU countries

Downside risks to the outlook for Europe

- The downside risks to the outlook for Europe **seem to lie more on the external side.**
- A significant number of AIECE institutes seem to be more wary of risks such as:
  - ✓ rising protectionism (while not that much rising populism).
  - ✓ a stronger tightening of US monetary policy.
  - ✓ sharp corrections in financial markets.
- In contrast, only by a small number of the AIECE institutes rank highly risks directly related to the European environment, such as:
  - ✓ domestic political tensions in certain EU countries.
  - ✓ political disintegration of the EU.
- A rapid rise in commodity prices does not appear to constitute a major downside risk according to many AIECE institutes.
- A higher than expected rise in energy prices is highly ranked by a limited number of institutes.
- Opinions with regard to a hard BREXIT are more divided, with some institutes seeing a high and other institutes seeing a low risk.

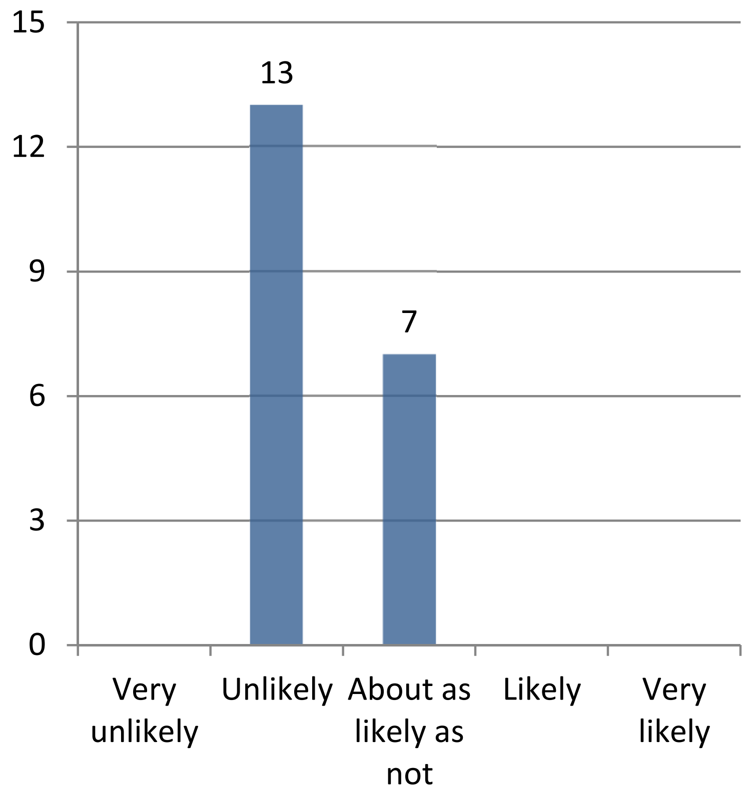
Risks and challenges for Europe

The possibility of a no-deal Brexit

- With less than one year left to reach a withdrawal agreement for Brexit, uncertainty with respect to the outcome of the negotiations remains high.
- Thus far an agreement has been reached with respect to citizens' rights, the financial settlement and a 21-month 'status quo' transition period until 31 December 2020.
- However, fundamental issues concerning the Irish border and the governance of the withdrawal agreement remain unresolved. In addition, many challenges lay ahead with respect to key aspects of the future EU-UK relationship (trade, labour mobility/immigration, security and defence, etc.).
- Given that in the framework of Brexit negotiations 'nothing is agreed until everything is agreed', AIECE institutes were asked to assess the possibility of a no-deal Brexit. The majority of respondents (13) assess a no-deal Brexit scenario as being unlikely, while a fair share of respondents (7) consider this scenario to be about as likely as not.

Possibility of no-deal Brexit

Number of answers



Source: All AIECE Institutes (n=20).

Risks and challenges for Europe

Risks and challenges of Brexit

- A no-deal Brexit scenario is clearly the one posing the greatest economic risks and challenges, including all possible negative implications from a return to tariffs under WTO rules.
- However, less extreme negotiation outcomes, also involve considerable uncertainties and costs.
- For example, with respect to the EU-UK future trade relationship, the plausible scenario of a free trade agreement without a customs union is expected to raise several frictions, due e.g. to:
  - the introduction of non-tariff barriers and border checks,
  - the consequent negative impact on value chains which are currently closely integrated, and
  - the resulting negative impact on productive activities in the UK and the EU, particularly in sectors such as manufacturing, logistics, agriculture and food.
- Individual EU countries are exposed to a different extent to these risks depending on their current productive structure and trading relationship with the UK. Therefore, challenges may also emerge with respect to agreeing on EU's position on the specific matters.

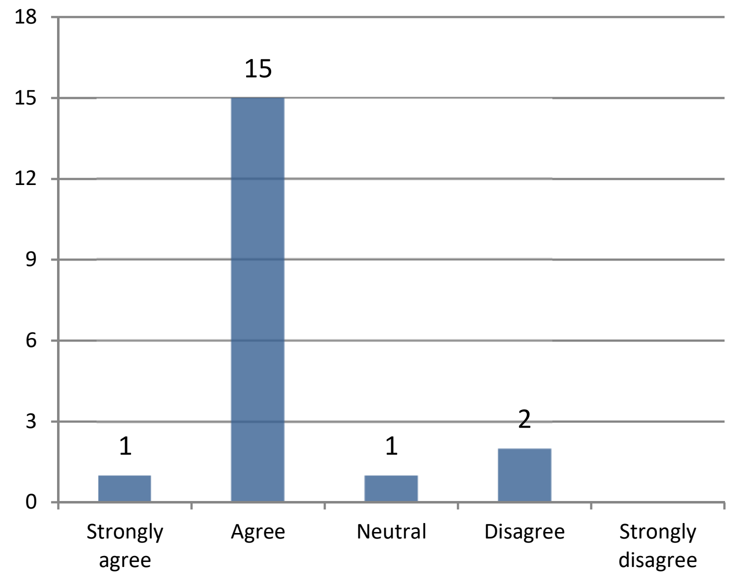
Risks and challenges for Europe

Brexit in the light of global geopolitical tensions and increasing protectionism

- Together with the imminent economic costs of a more distant EU-UK relationship, other crucial issues emerge in view of global issues and the preservation of the historic alliance and close partnership of the UK and the EU.
- In this framework, AIECE institutes were asked whether in the light of global geopolitical tensions and increasing protectionism, the two sides should give ground in order to achieve a closer and deeper economic cooperation post Brexit.
- As it turned out 16 of 19 institutes were in agreement with the idea of giving ground to achieve a closer and deeper cooperation.

Should the UK and the EU give ground in order to achieve a closer and deeper economic co-operation post Brexit?

Number of answers



Source: All AIECE Institutes (n=19).

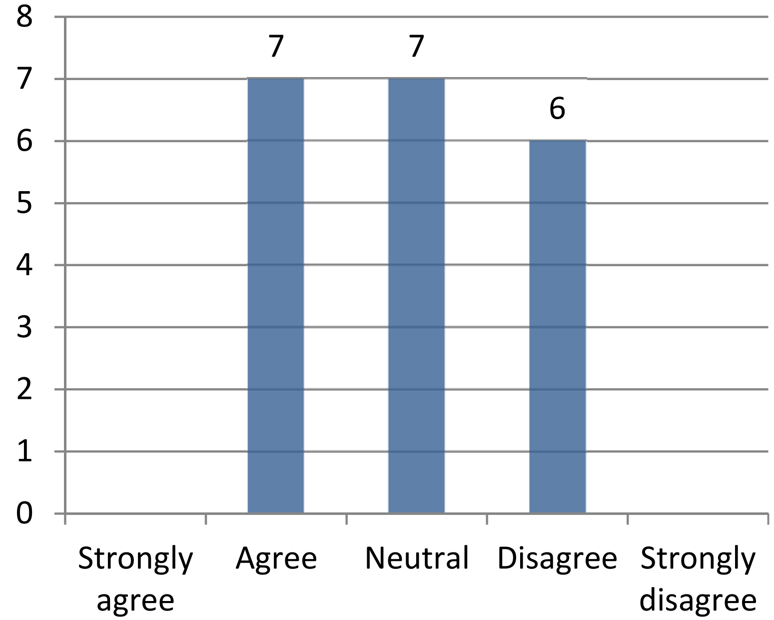
Risks and challenges for Europe

Other potential consequences of Brexit

- AIECE instates were asked whether negotiations between the UK and the EU could lead to an acceleration in trade barriers and regulatory realignments, with potential adverse effects for investment and potential growth.
- Respondents to this question were divided in their perceptions.

Could the EU-UK negotiations lead to an acceleration of trade barriers and regulatory realignments?

Number of answers



Source: All AIECE Institutes (n=20).

Risks and challenges for Europe

Challenges regarding labour mobility

- **Skilled labour mobility across EU Member-States: A factor contributing to economic efficiency or a source of divergence?**

- The flow of highly skilled labour from currently weak European economies to stronger ones has the potential to

  - ✓ balance demand and supply in national labour markets
  - ✓ smoothen compensations of skilled workers across Europe
  - ✓ direct skilled and talented individuals to the most profitable occupations

- At the same time, however, it might deprive the weaker economies of one valuable production factor thereby undermining their prospects to catch up with the stronger economies.

  - ✓ Five out of sixteen institutes seem to acknowledge both the pros and the cons of highly-skilled labour mobility across EU Member-States.
  - ✓ More than half of the institutes' answers were focused on the losses that '*human capital flight*' might bring to the weaker economies (e.g. lower potential growth, delays in catching up with the stronger economies, loss of competitiveness).
  - ✓ Two institutes mentioned that outward migration of talented individuals might be reversed in the future thereby helping the spillover of knowledge and technology from stronger to weaker economies.

Risks and challenges for Europe

Challenges regarding wage restraint policies

- **Internal devaluation and the unbearable burden of being worker in EA Member-states with poor cost competitiveness**

- To improve their cost competitiveness and eliminate external imbalances, some deficit countries of the euro area have resorted to the policy of internal devaluation.

  - ✓ Either explicitly or implicitly all institutes which commented on this issue seem to admit that internal devaluation is the only mechanism that has been left to members of a currency union to re-establish their cost competitiveness.

  - ✓ The majority of institutes seem to acknowledge that through internal devaluation, labour bears a disproportionally higher burden of the adjustment because it is the least mobile factor.

  - ✓ Eight institutes laid emphasis on the need for a fairer burden sharing between factors of production through tax reforms and further policy coordination between creditor and debtor countries.

Risks and challenges for Europe

Challenges regarding wage restraint policies

- Regarding the policy of competitive devaluation as a means to preserve or strengthen the competitive advantage in surplus Member States and the likely consequences of this policy on deficit Member States, this seems to be a rather controversial issue.

  - ✓ Some institutes hold a sceptical stance over wage restraint policies in surplus countries

  - ✓ Other believe that wage levels should be determined solely by domestic labour market conditions and not by external factors.

- Possibly, the wide spectrum of ideas on this issue reflects contrasting economic philosophies, traditions and schools of thought.

Risks and challenges for Europe

Risk of less inclusive growth

- It is generally mentioned that this issue constitutes an ideological question politicians must decide upon.

- Some of the institutes recognize the real and significant risk of a growth process not equally shared and its effects not equally distributed to the benefit of all.

- They claim that the implemented structural reforms, especially in terms of taxation and social and public expenditure, lead to a rise in inequalities, this development being a trend alongside with globalization.

- It is argued that the risk of higher but less inclusive growth is already a descriptive feature in Europe, as real wages have stagnated at the same time as operating cooperate profits operate at a high level and - at least until quite recently -capital owners have taken out high returns investing in asset and equity markets.

- In order for the gains from economic progress to ensure improvements of living standards for all segments of society, the AIECE Institutes suggest some general (and in only a few cases some more specific) directions and measures to be implemented.

- In addition, a number of AIECE Institutes indicate the difficulty in finding a way forward to that matter, or even the impossibility of making the necessary political decisions on the fiscal side, as well as the fact that it does not seem to be high on the policy agenda in advanced economies or at the EU level.

Risks and challenges for Europe

Risk of less inclusive growth

- According to the AIECE Institutes, reforms should have social as well as economic targets.
- To encourage more inclusive growth there should, therefore, be a change in the current policy mix directly encouraging more fiscal and social spending on part of national governments in exchange for a less expansionary monetary policy stance (though, it is mentioned that current research based on UK data shows little evidence of a negative distributional effect of the monetary policy undertaken in the period 2008 to 2014, Bunn & al., 2007).
- Other general suggestions refer to resorting to the European semester to advise countries to provide suggestions on the most urgent reforms to be implemented.
- It is further indicated that policies are necessary that ensure equal opportunities (notably through professional training) and favour redistribution of wealth without deterring work and entrepreneurship.
- Emphasis is also put on adequate labour market policies to increase labour participation and employment as much as possible, reduce long-term unemployment (the latter being especially important if there is a large positive output gap which makes structural unemployment more visible), and policies to provide unemployment protection as well.

Risks and challenges for Europe

Risk of less inclusive growth

- According to some of the more specific suggestions of the AIECE Institutes, actions to ensure the promotion of policies enhancing more inclusive growth could include higher taxes on passive wealth (inheritance tax, real estate tax).

- In more specific terms, the example of the Strategy for Responsible Development is mentioned, which has been launched by the Polish government in 2016. One of its targets is to promote inclusive growth, first of all by social programs supporting low income households with many children, e.g. investments in social sphere, such as nurseries, kindergartens etc.

- Finally, it should be said that not all institutes see a conflict arising between high and inclusive growth, on the basis of the argument that higher growth as a rule creates opportunities for workers that would have problems to get a job in a weak growth environment.

- At the same time it is indicated, that less inclusive growth can be seen as positive in some sense, while it is, still, stressed that it remains questionable whether this type of non-inclusive growth is maintainable in the long run, as it weakens the environment and social coherence, but also the consensus about the credibility of the democratic institutions.

Risks and challenges for Europe

Questions for discussion

- *How do you assess the risk of global trade levels not being sustained over the medium to long term, thus endangering the sustainability of high global growth levels?*
- *On what issues do you believe that the EU and the UK should give ground in order to achieve deeper cooperation*
- *Do you see any special opportunities for specific sectors in your home countries as a result of Brexit? To what extent could these compensate for the costs of Brexit?*
- *Do you believe that European Union’s policy measures regarding labour mobility should be complemented by measures to address the ‘human capital flight’ problem faced by weaker European economies?*
- *Should euro area national governments try to coordinate their policies regarding wage setting?*

Risks and challenges for Europe

Questions for discussion posed by AIECE Institutes

- *What measures should be taken in priority to reinforce the euro area?*
- *How likely is it that the euro area will hold together once the ECB's monetary policy has been normalized and interest rates have risen?*
- *The effect of a global trade war for the growth prospects in Europe and the World: what can history tell us?*
- *What could be the causes and consequences of a major downturn in international equity markets.*