

Non-performing loans – A danger for the Banking Union?

By [Céline Antonin](#), [Sandrine Levasseur](#) and [Vincent Touzé](#)

The establishment of the third pillar of the Banking Union, namely the creation of a European deposit insurance scheme, has been blocked up to now. Some countries – like Germany and the Netherlands – are arguing that the risk of bank default is still too heterogeneous in the euro zone to allow deposit guarantees to be pooled.

Our article, [L'Union bancaire face au défi des prêts non 'performants'](#) ["The Challenge of Non-performing Loans for the Banking Union"], focuses on how to solve the "problem" of non-performing loans (NPLs) in a way that can break this deadlock and finally complete the Banking Union. This is a crucial step in order to restore confidence and allow the emergence of an integrated banking market.

Our review of the current situation shows that:

1. The level of NPLs is still worrying in some countries. The situation is alarming in Cyprus and Greece, where unprovisioned NPLs represent more than 20% of GDP, whereas the situation is "merely" worrying for Slovenia, Ireland, Italy and Portugal, where unprovisioned NPLs are between 5% and 8% of GDP;
2. In total, at end 2017, the amount of unprovisioned NPLs for the euro area came to 395 billion euros, which is equivalent to 3.5% of euro area GDP. On this scale, the "problem" of non-provisioned NPLs thus seems more modest.

Looking beyond private solutions such as debt forgiveness, provisioning, securitization and the creation of bad banks, our conclusion is that it is the public authorities at the

European level who ultimately have the most effective means of action. They have multiple levers at their disposal, including the definition of the relevant regulatory and institutional framework; supervision by the ECB, which could be extended to more banks; and not least monetary and fiscal policies at the euro zone level, which could be mobilized to buy up doubtful debt or enter the capital of banks experiencing financial distress.

Italy's debt: Is the bark worse than the bite?

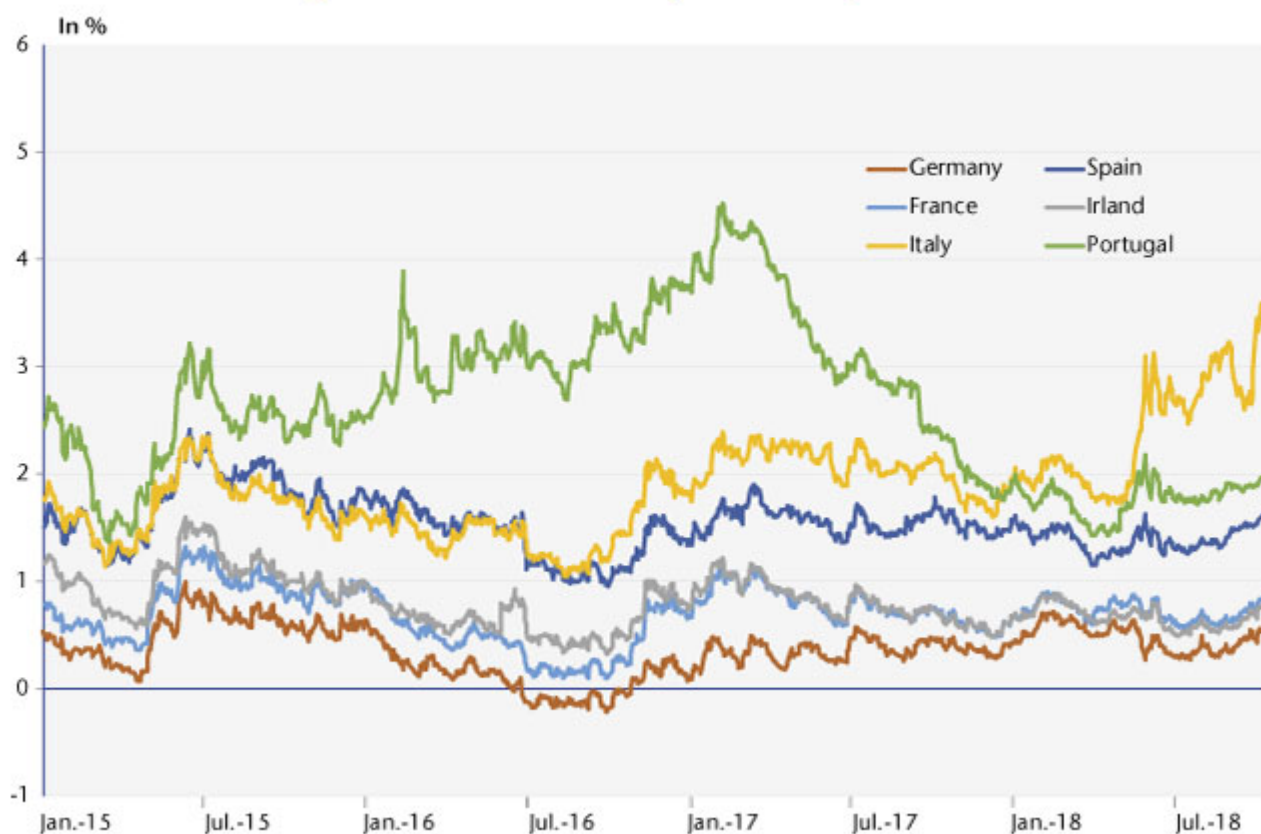
By [Céline Antonin](#)

The spectre of a sovereign debt crisis in Italy is rattling the euro zone. Since Matteo Salvini and Luigi di Maio came to power, their headline-catching declarations on the budget have proliferated, demonstrating their desire to leave the European budgetary framework that advocates a return to an equilibrium based on precise rules^[1]. Hence the announcement of a further deterioration in the budget when the update of the [Economic and Financial Document](#) was published at the end of September 2018 frayed nerves on the financial markets and triggered a further hike in bond rates. (**graphic**).

But should we really give in to panic? The crucial question is just how sustainable the Italian public debt really is. Looking up to 2020, the situation of the euro zone's third-largest economy is less dramatic than it might appear.

Stabilizing interest rates at the level of end September 2018 would leave the public debt largely sustainable. It will decline in 2019, from 131.2% to 130.3% of GDP. Given our assumptions[2], only a very sharp, long-lasting rise in bond interest rates in excess of 5.6 points would lead to an increase in the public debt ratio. In other words, the bond rate would have to exceed the level reached at the peak of the 2011 sovereign debt crisis. Should such a situation occur, it's hard to believe that the ECB would not intervene to reassure the markets and avoid a contagion spreading through the euro area.

Figure. Interest rate on 10-year sovereign bonds



Source: Datastream.

A

very strong fiscal stimulus in 2019

Changes in the public debt ratio depend heavily on the assumptions adopted. The ratio varies with the general government balance, the GDP growth rate, the deflator, and the apparent interest rate on the public debt (see calculation formula below).

In budgetary matters, despite their differing views, the two parties making up the Italian government (La Lige and the 5 Star Movement) seem to agree on at least one point: the need to loosen budget constraints and boost demand. In any case the government contract, published in May 2018, was unequivocal. It announced a fiscal shock amounting to approximately 97 billion euros over 5 years, or 5.6% of GDP over the five-year period. But although the measures have been gradually reduced, the draft presented to the Italian Parliament plans for a public deficit of 2.4% of GDP for 2019, far from the original target of 0.8% set in the Stability and Growth Pact forwarded to the European Commission on 26 April 2018. We assume that the 2019 budget will be adopted by the Parliament, and that the deficit will indeed be 2.4% of GDP. We therefore anticipate a positive fiscal impulse of 0.7 GDP point in 2019. This stimulus breaks down as follows:

- A decrease in compulsory taxation of 5 billion, or 0.3 GDP point, linked to the gradual introduction of the “flat tax” of 15% for SMEs, a measure supported by the League. The extension of the flat tax to all businesses and households was postponed until later in the mandate, without further clarification;
- An increase in public spending, calculated roughly at 7 billion euros, or 0.4 GDP point. Let’s first mention the flagship measure of the 5 Stars Movement, the introduction of a citizens’ pension (in January 2019) and a citizens’ income (in April 2019), for an estimated total amount of 10 billion euros. The citizens’ pension will supplement the pension of all pensioners, bringing it to 780 euros per month. For the working population, the principle is similar – supplementing the salary up to 780 euros – but subject to conditions: recipients will have to take part in training and accept at least one of the first three job offers that are presented to them by the Job Centre. The revision of the pension reform, which provides for the “rule of 100”, will also allow retirement when the sum between a person’s age and the years

worked reaches 100, in certain conditions. This should cost 7 billion euros in 2019. Finally, an investment fund of 50 billion euros is planned over 5 years; we are expecting an increase in public investment of 4 billion euros in 2019. To finance the spending increase without pushing the public deficit above 2.4%, the government will have to save 14 billion euros, equivalent to 0.8 GDP point. For the moment, these measures are very imprecise (further rationalization of spending and tax amnesty measures).

For 2020, the Italian government has declared that the public deficit will fall to 2.1% of GDP. However, to arrive at this figure, given our growth assumptions, would require tightening up fiscal policy somewhat, which is not very credible. We therefore assume a quasi-neutral fiscal policy in 2020, which means that the deficit would remain at 2.4% of GDP.

With a very positive fiscal stimulus in 2019, annual growth (1.1%) should be higher than in 2018. This acceleration is more visible year-on-year: growth in Q4 of 2019 will be 1.6%, compared with 0.6% in Q4 of 2018. Although low, this level is nevertheless higher than the potential growth rate (0.3%) in 2019 and 2020. The output gap is in fact still large and leads to 0.4 GDP point of catch-up per year. Spontaneous growth^[3] thus amounts to 0.7 GDP point in 2019 and 2020. In addition, we anticipate a much stronger fiscal impulse in 2019 (0.7 GDP point) than in 2020 (0.1 GDP point). Other shocks, such as oil prices or price competitiveness, will be more positive or less negative in 2020 than in 2019.

Changes in the public debt ratio also depend on developments in the GDP deflator. However, prices should remain stable in 2019 and 2020, due in particular to wage moderation. Thus, nominal growth should be around 2% in 2019 and 2020.

Finally, we assume that the interest rate on the debt will stay at the level of the beginning of October 2018. Given the maturity of the public debt (seven years), the rise in rates

forecast for 2019 and 2020 will be very gradual.

Reducing the public debt up to 2020

Under these assumptions, the public debt should decline continuously until 2020, falling from 131.2% of GDP in 2018 to 130.3% in 2019 and then to 129.5% in 2020 (table). In light of our assumptions, the public debt will fall in 2019 if the apparent interest rate remains below 3.5% of GDP, i.e. if the debt-service charge relative to GDP is less than 4.5%.

Table. Changes in the public debt to GDP ratio based on our hypotheses

	2017	2018	2019	2020
Public debt /GDP (d_t)	131.8%	131.2%	130.3%	129.5%
Apparent interest rate on the debt (i)	2.9%	2.7%	2.9%	3.0%
GDP growth in value (g)	2.2%	2.1%	2.3%	2.1%
<i>GDP growth in volume</i>	1.6%	1.0%	1.1%	1.0%
<i>GDP deflator</i>	0.6%	1.1%	1.2%	1.1%
Primary deficit in % of GDP (s_t)	1.5%	1.8%	1.5%	1.6%
<i>Public deficit in % of GDP</i>	-2.3%	-1.8%	-2.4%	-2.4%
<i>Debt-service charge in % of GDP</i>	3.8%	3.6%	3.8%	4.0%
Projected public debt/GDP (d_{t+1})	131.2%	130.3%	129.5%	129.1%
<i>Apparent interest rate stabilizing the debt</i>	3.4%	3.4%	3.5%	3.3%
<i>Primary deficit stabilizing the debt</i>	0.9%	0.8%	0.8%	1.1%
<i>Public deficit stabilizing the debt</i>	-2.9%	-2.7%	-3.1%	-2.8%

Sources: AMECO, author's calculations..

Note : Changes in the public debt depend not only on the primary deficit, but also on the apparent interest rate and the growth rate, according to the formula: $d_{t+1} = d_t \frac{(1+i)}{(1+g)} - s_t$ which g = growth rate of nominal GDP, i = apparent interest rate on the debt, s = primary public deficit / GDP, d = public debt / GDP.

Reading note: the public debt/GDP ratio in 2017 was 131.8% and should fall to 131.2% in 2018.

However, for the apparent interest rate to rise from 2.7% in 2018 to 3.5% in 2019, given the 7-year maturity on the debt, the interest rate charged by markets would have to rise by about 5.6 points on average over the year, for one year. While this scenario cannot be excluded, it seems certain that the

ECB would intervene to allow Italy to refinance at lower cost and avoid contagion.

Still, even if interest rates do not reach this level, any additional rise in interest rates will further limit the Italian government's fiscal manoeuvring room, or it will lead to a larger-than-expected deficit. Also, the deficit forecast by the government is based on an optimistic assumption for GDP growth of 1.5% in 2019; if growth is weaker, the deficit could widen further, unsettling nerves on the market and among investors and jeopardizing the sustainability of the debt.

[1] L. Clément-Wilz (2014), "Les mesures 'anti-crise' et la transformation des compétences de l'Union en matière économique" ["'Anti-crisis' measures and the transformation of the competences of the EU in economic matters"], *Revue de l'OFCE*, 103.

[2] For more information, see the forthcoming 2018-2020 forecast for the global economy, *Revue de l'OFCE*, (October 2018).

[3] Spontaneous growth for a given year is defined as the sum of potential growth and the closing of the output gap.

Measuring precautionary savings related to the risk of unemployment

By [Céline Antonin](#)

The question of how disposable income is shared between savings and consumption involves trade-offs that take place at the household level and has direct implications at the aggregate level. For example, if the propensity to save is higher among wealthy households, a consumer stimulus will be more effective if it targets low incomes. Another example concerns how progressive the income tax system is: if the savings rate rises with income, then making income tax more progressive will have a more than proportional effect on the decline in national savings, with consequences for investment. Other issues such as tax incentive schemes to encourage savings (life insurance, Livret A accounts) or the question of the relevant tax base (work versus consumption, income versus wealth) depend on this trade-off. The measurement of precautionary savings is essential, especially to understand the implications of rising unemployment during a shock such as the 2008 crisis. So if the increase in unemployment affects all households equally, and if rich households have a stronger precautionary motive than others, then the recession will be more violent.

Historically, the models of the life cycle and permanent income, which originated with Modigliani and Brumberg (1954) and Friedman (1957), provided one of the first theoretical frameworks for thinking about savings behaviours. Friedman (1957) introduced the notion of permanent income, defined as the constant income over time that gives the household the same discounted income as its future income, and showed that the permanent consumption (and thus the savings) is proportional to the permanent income over the lifetime. Thus, households should save during their working lives and start dis-saving upon retirement. These models have been enriched by the precautionary savings theory, which shows that savings also serves as insurance against contingencies that might affect the household, particularly with respect to income (unemployment, loss of wages, etc.). As a result, households are saving not only to offset lower future income, but also to

insure against all kinds of risks, including risk to income. The main difficulty when trying to evaluate this precautionary behaviour is to find an accurate measure of the risk to income. The most convincing approach involves the use of subjective household survey data about trends in income and in the likelihood of unemployment (Guiso *et al.*, 1992; Lusardi, 1997; Lusardi, 1998; Arrondel, 2002; Carroll *et al.*, 2003; Arrondel and Calvo-Pardo, 2008). This approach quantifies the share of wealth accumulation that is related to the precautionary motive.

What is the amplitude of the precautionary motive? Do all households exhibit precautionary behaviour, or does it depend on their income? The working paper on [The Linkages between Savings Rates, Income and Uncertainty. An illustration based on French data](#) ["Les liens entre taux d'épargne, revenu et incertitude. Une illustration sur données françaises"] first seeks to test the homogeneity of savings rates empirically according to the level of income. It is also interested in the existence of precautionary savings behaviour related to income and tries to quantify this, based on the French INSEE 2010-2011 Family Budget survey. The precautionary motive is assessed by means of the subjective measure of the likelihood of unemployment that is expected by household members over the next five years.

The precautionary motive exists for all French households: the extra savings linked to the risk of unemployment is around 6-7%, and the proportion of precautionary holdings attributable to the risk of unemployment comes to around 7% of total wealth. The precautionary motive can be differentiated according to the level of income: middle-income households accumulate the most precautionary savings. Their savings represents 11-12% of the total household wealth of the second, third and fourth income quintiles, compared with about 5% for households in the income quintiles at the extremes.

Italy: The horizon seems to be clearing

By [Céline Antonin](#)

With growth in Italy of 0.4% in the third quarter of 2017 (see **table** below), the country's economy seems to have recovered and is benefiting from the more general recovery in the euro zone as a whole. The improvement in growth is linked to several factors: first, the continued closing of the output gap, which had worsened sharply after a double recession (2008-2009 and 2012-2013). In addition, the expansionary fiscal policy in 2017 (+0.3 fiscal impulse), mainly targeted at businesses, and thriving consumption driven by expanding employment and rising wages explain this good performance. The increase in employment is the result of the reduction in social contributions that began in 2015 as well as the pick-up in growth in 2016 and 2017.

Despite all this, Italy remains the “sick man” of the euro zone: GDP in volume is still more than 6% below its pre-crisis level, and the recovery is less solid than for its euro zone partners. Furthermore, the public debt, now over 130%, has not yet begun to fall, potential growth remains sluggish (0.4% in 2017), and the banking sector is still fragile, as is evidenced by recent bank recapitalizations, in particular the rescue of the Monte dei Paschi di Siena bank (see below).

In 2018-2019, Italy's growth, while remaining above potential, should slow down. Indeed, fiscal policy will be neutral and growth will be driven mainly by domestic demand. Unemployment will fall only slowly, as the employment support measures implemented in 2017 wind down and productivity returns to its

trend level [\[1\]](#) over the forecasting horizon (see [OFCE, La nouvelle grande modération \[in French\], p. 71](#)). Furthermore, the banking sector will continue its long and difficult restructuring, which will hold back the granting of bank loans.

In the third quarter of 2017, the contribution of domestic demand to growth (consumption and investment) reached 0.8 point, but massive destocking attenuated the impact on growth (-0.6 point). Gross Fixed Capital Formation (GFCF) leapt 3% in the third quarter of 2017, returning to its 2012 level, thanks to a strong increase in the productive sector (machinery, equipment and transport). Private consumption, the other pillar of domestic demand, grew on average by 0.4% per quarter between the first quarter of 2015 and the third quarter of 2017, thanks to falling unemployment and a reduction in precautionary savings. Credit conditions have improved slightly due to the quantitative easing policy pursued by the ECB, even though the channel for the transmission of monetary policy is suffering from the difficulties currently hitting the banking sector.

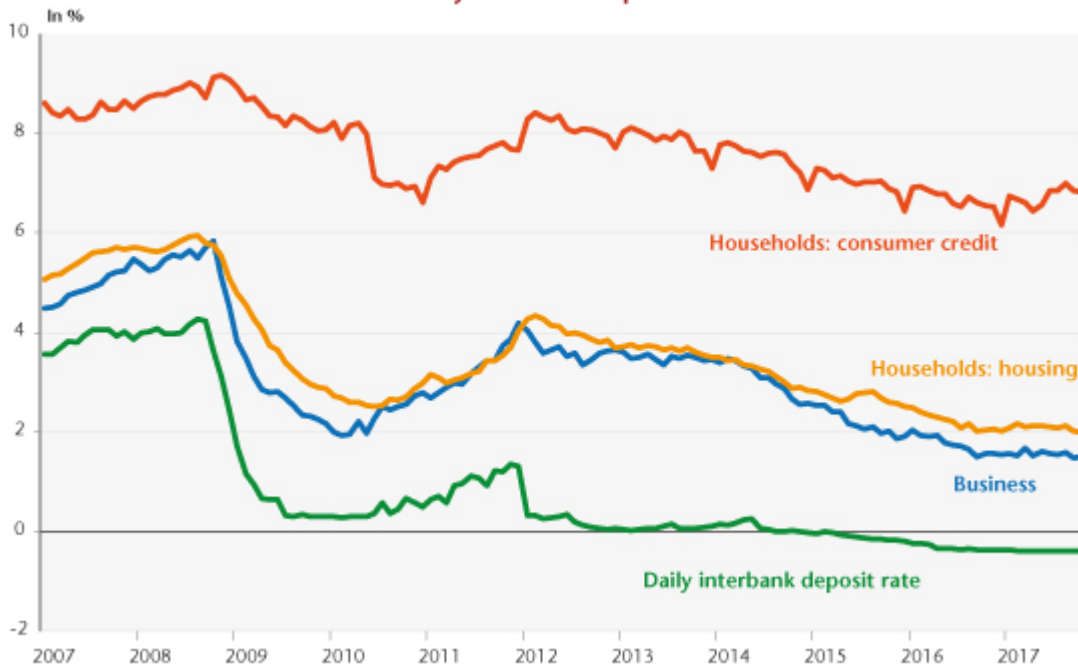
The number of people in employment rose to 23 million in the second quarter of 2017, back to its pre-crisis level, while the unemployment rate is declining only slowly due to the steady increase in the labour force [\[2\]](#). Job creation did indeed take place between 2014 and 2017 (around 700,000 jobs created, 450,000 of them permanent), mainly due to the lowering of charges on new hires in 2015 and 2016 and the resumption of growth. Moreover, according to INPS figures, the number of new hires on permanent contracts decreased (between January-September 2016 and January-September 2017) by -3.1%, as did conversions from temporary contracts to fixed-term contracts (-10.2%), while the numbers of new hires on temporary contracts exploded (+ 27.3%): in other words, it is mainly precarious contracts that are currently contributing to job growth. From 2018, the pace of job creation is expected to

decline due to the winding down of the measures cutting employer social contributions (which represented a total of 3 billion euros) and the slowdown in economic growth. This underpins a forecast of a very slow decline in unemployment: employment is expected to rise more slowly in 2018 and 2019, but the labour force is also growing more slowly, due to a bending effect, a distortion linked to the slowdown in job creations and the retirement of the baby boom generation.

The productivity cycle in Italy is still in poor shape, despite the downward revision of the productivity trend (-1.0% for the period 2015-2019). The measures taken to cut social security contributions over the 2015-2016 period will have enriched employment growth by 27,000 jobs per quarter (extrapolating the estimates by [Sestito and Viviano, Bank of Italy](#)). Our hypothesis was for a closure of the productivity cycle over the forecast horizon, with productivity picking up pace in 2018 and 2019 [\[3\]](#).

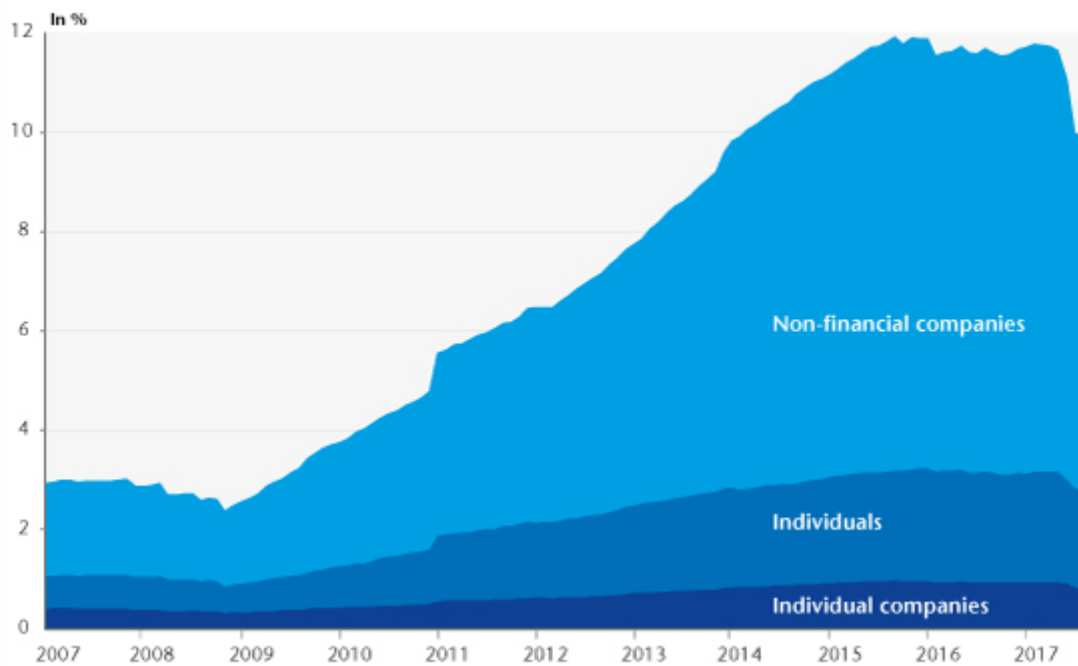
Moreover, the productive investment rate recovered strongly in the third quarter of 2017: it should continue to rise in 2018 and 2019, thanks in particular to a higher pace of extra-depreciation, to the ECB's quantitative easing programme and to clearing up the situation of the banks, which should allow a better transmission of monetary policy (**Figure 1**). In addition, the amount of bad debt (*sofferenze*) began to fall sharply (down 30 billion euros between January and October, 2 GDP points – **Figure 2**). This is linked to the gradual restructuring of bank balance sheets and the economic recovery in certain sectors, particularly construction, which accounts for 43% of business bad debt.

Figure 1. Interest rates on new loans to households and business and daily interbank deposit rate



Source: Bank of Italy.

Figure 2. Bad debt (*sofferenze*) as a share of GDP



Sources: Istat, Bank of Italy.

In 2017, it was domestic demand that was driving growth; the contribution of foreign trade was zero because of the dynamism of imports and the absence of any improvement in price competitiveness. We anticipate that the contribution of foreign trade will be null in 2018 and slightly positive in 2019 thanks to an improvement in competitiveness (Table).

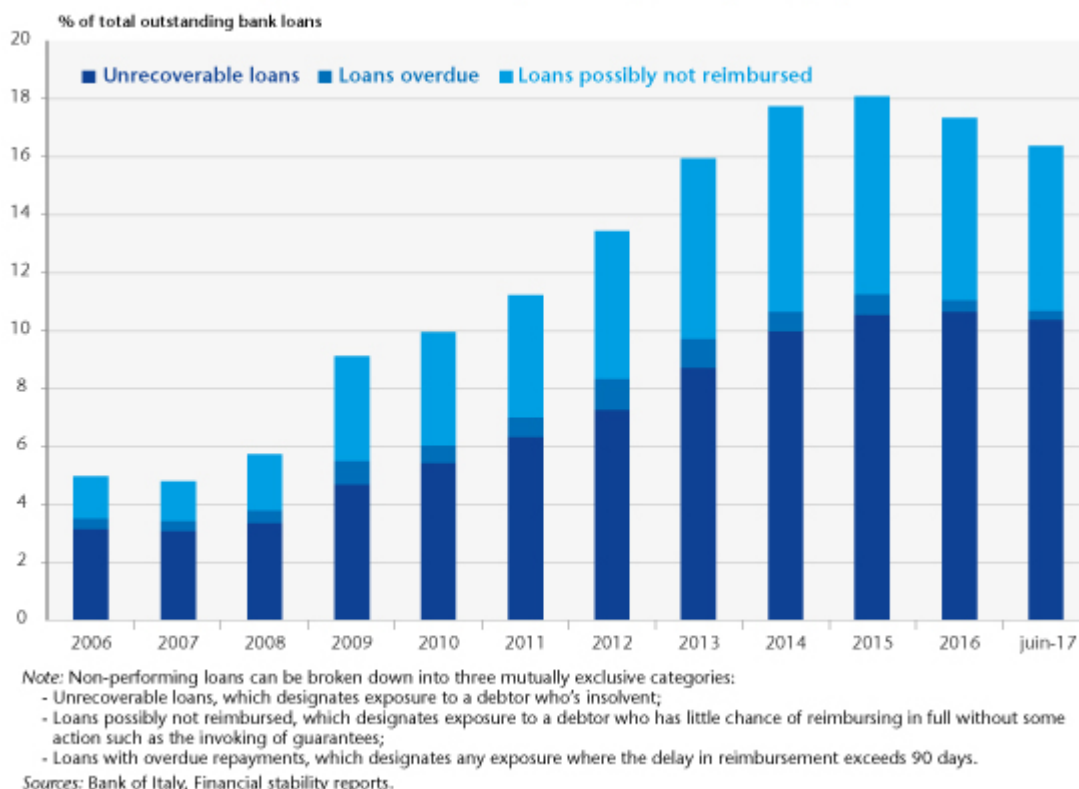
Fiscal policy was expansionary in 2017 (+0.3 point impulse) and supported growth. This has mainly benefited business: support for the world of agriculture, extra-depreciation, the reduction of the corporate tax rate (IRES) from 27.5% to 24% in 2017, a boost in the research tax credit, etc. 2018 should not see a noticeable increase in taxation, and spending is expected to increase slightly (0.3%). The additional public expenditure should reach 3.8 billion euros, for: youth bonuses (youth employment measures), prolongation of extra-depreciation in industry, the renewal of civil service contracts and the fight against poverty. As for public revenue, the government has ruled out a VAT hike that would have brought in 15.7 billion euros; the adjustment will therefore come from a smaller reduction in the deficit and an increase in revenue (5 billion euros forecast). To boost revenue, the government is counting on the fight against tax evasion (repatriation, recovery of VAT with electronic invoicing), and the establishment of a web tax on large companies on the Net.

A banking sector in full convalescence

The deterioration in the situation of Italy's businesses, in particular small and medium-sized enterprises, has led since 2009 to a sharp increase in non-performing loans. Since 2016, the situation of the Italian banking sector has improved somewhat, with a return on equity of 9.3% in June 2017 against 1.5% in September 2016. The ROE is higher than the European average (7% in June 2017) and puts the country ahead of Germany (3.0%) and France (7.2%). In addition, at the end of June 2017, the ratio of bad debt to total loans came to 16.4% (8.4% net of provisions), of which 10.4% was for unrecoverable loans (**Figure 3**). Banks are shedding these loans at an increasing pace with various partners (Anglo-American hedge funds, doBank, Atlante and Atlante 2 funds, etc.). Hence, between 2013 and 2016, the share of bad loans that were repaid in the year rose from 6 to 9%. Overall, the amount of bad

loans was cut by 25 billion euros between 2016 and June 2017, down to 324 billion euros, of which 9 billion euros came from the liquidation of the Venetian banks (Banca Popolare di Vicenza and Veneto banca). This improvement reflects the fact that the banks are increasingly adopting active management policies for bad debts. In addition, the 2015 Asset Seizure Reform reduced the length of property seizure proceedings.

Figure 3. Share of non-performing debt by category



The Italian government has implemented various reforms to cope with the difficulties facing the country's banking sector. First, it has been working to accelerate the clearance of bad debts and to reform the law on bankruptcy. Legislative Decree 119/2016 introduced the "martial pact" (*patto marciano*), which makes it possible to transfer real estate used as collateral to creditors (other than the debtor's principal residence); the real estate can then be sold by the creditor if the default lasts more than 6 months. Other rules aim at speeding up procedures: the use of digital technologies for hearings of the parties, the establishment of a digital register of ongoing bankruptcy proceedings, the reduction of opposition

periods during procedures, an obligation for judges to order provisional payments for amounts not in dispute, the simplification of the transfer of ownership, etc.

In April 2016, the government introduced a public guarantee system (*Garanzia Cartolarizzazione Sofferenze, GCS*) covering bad debts, for a period of 18 months (extendable for another 18 months). To benefit from this guarantee, the bad debt must be securitized and repurchased by a securitization vehicle; the latter then issues an asset-backed security, the senior tranche of which is guaranteed by the Italian Treasury.

The Atlante investment fund was also set up in April 2016, based on public and private capital, in order to recapitalize troubled Italian banks and redeem bad debt.

There are many lessons to be drawn from the case of the Monte dei Paschi di Siena bank (MPS, the country's fifth-largest bank), which has been a cause of major concern. The Italian State, working in coordination with the European Commission and the ECB, had to intervene as a matter of urgency, following the failure of the private recapitalization plan at the end of 2016. A system of public financial support for banks in difficulty was introduced after a government proposal – "*Salva Risparmio*" [\[4\]](#) of 23 December 2016 – was enacted on 16 February 2017. The precautionary recapitalization of MPS was approved by the Commission on 4 July 2017 [\[5\]](#), in the amount of 8.1 billion euros. The Italian State increased its stake in the bank's capital by 3.9 billion euros on the one hand, and on the other 4.5 billion euros of the bank's subordinated bonds were converted into shares. The State is also to buy 1.5 billion euros of shares resulting from the forced conversion of bonds held by individuals (i.e. a total of 5.4 billion euros injected by the State, giving it a 70% holding in the capital of MPS). MPS will also sell 26.1 billion euros of bad debt to a special securitization vehicle, and the bank will be restructured.

Two other banks, the Venetian banks Banca Popolare di Vicenza and Veneto banca (the 15th and 16th largest banks in the country in terms of capital), were put into liquidation on 25 June 2017, in accordance with a “national” insolvency procedure, which lies outside the framework set by the European BRRD Directive [\[6\]](#). The Intesa Sanpaolo bank was selected to take over, for one symbolic euro, the assets and liabilities of the two banks, with the exception of their bad debts and their subordinated liabilities. The Italian State will invest 4.8 billion euros in the capital of Intesa Sanpaolo in order to keep its prudential ratios unchanged, and it can grant up to 12 billion euros of public guarantees.

The Italian banking sector is thus in the midst of restructuring, and the process of clearing up bad debt is underway. However, this process will take time; the ECB nevertheless seems to want to tighten the rules. In early October 2017, the ECB unveiled proposals demanding that the banks fully cover the unsecured portion of their bad debt within two years at the latest, with the secured portion of the debt to be covered within at most seven years. These proposals will apply only to new bad debt. The Italian parliament and the Italian government reacted to these announcements by warning of the risk of a credit crisis. Even though these are only proposals, for now, this indicates that it is a priority to clear Italy’s bad debt rapidly, and that the government must stay the course.

Table. Italy: Summary of forecasts

Change from the preceding period (%)												
	2017				2018				2016	2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0.5	0.3	0.4	0.3	0.3	0.3	0.2	0.3	1.1	1.5	1.2	0.9
GDP per capita	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	1.0	1.2	0.9	0.7
Household consumption	0.7	0.2	0.3	0.3	0.3	0.3	0.3	0.3	1.5	1.5	1.2	1.0
Public consumption	0.4	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.5	0.8	0.1	-0.2
Total GFCF, of which:	-2.2	1.1	3.0	0.5	0.4	0.3	0.3	0.4	3.0	3.2	3.0	1.3
Productive	-7.2	3.6	8.2	0.6	0.5	0.4	0.4	0.3	7.1	6.6	6.4	1.3
Housing	0.7	-0.3	0.4	0.2	0.2	0.2	0.2	0.2	2.8	1.8	0.7	0.6
Exports of goods and services	1.8	0.1	1.6	0.6	0.7	0.7	0.7	0.7	2.6	5.1	2.9	2.3
Imports of goods and services	0.7	1.6	1.2	0.6	0.6	0.6	0.6	0.6	3.3	5.4	2.8	2.0
<i>Contributions:</i>												
Domestic demand excl. stock	0.1	0.4	0.7	0.3	0.3	0.2	0.2	0.2	1.5	1.6	1.3	0.8
Change in stock	0.1	0.4	-0.5	0.0	0.0	0.0	0.0	0.0	-0.3	-0.1	-0.2	0.0
Foreign trade	0.3	-0.4	0.1	0.0	0.0	0.0	0.0	0.0	-0.2	0.0	0.1	0.1
Consumer prices (HICP) ¹	1.4	1.6	1.2	1.2	0.8	0.8	0.8	0.9	-0.1	1.0	0.5	1.0
Unemployment rate	11.6	11.2	11.2	11.1	11.0	10.9	10.9	10.8	11.7	11.3	10.9	10.8
Current balance as % of GDP									2.7	2.6	2.6	2.5
Current deficit as % of GDP									-2.5	-2.0	-1.5	-1.2
Public debt as % of GDP									132.8	132.3	131.1	129.9
Fiscal impulse in GDP points									0.3	0.3	0.1	0.1
GDP – euro zone	0.6	0.7	0.6	0.4	0.4	0.4	0.4	0.4	1.8	2.4	1.9	1.6

1. For the quarters, year-on-year. For the years, annual average.

Sources: ISTAT, Author's calculations, OFCE October 2017 forecast.

[1] Estimated according to a model using trend breaks, we estimate the productivity trend at -1.0% for the period 2015-2019, due to growth that is more job-rich.

[2] This increase in the labour force is due to a higher participation rate among older workers (aged 55-64), which is linked to the lowering of the minimum retirement age. It is also due to women's increased participation in the labour market, as a result of the Jobs Act (extension of maternity leave, telecommuting, financial measures to reconcile work and family life, a budget of 100 million euros for the creation of childcare services, etc.).

[3] The increase in productivity per capita in market waged employment rose from -0.7 % in 2017 to 0.3 % in 2018 and 0.6 % in 2019.

[4] The Salva Risparmio Decree Law provides for the creation of a fund with 20 billion euros to support the banking sector. This allows the State to carry out precautionary recapitalizations of banks; it provides guarantees on new issues of bank debt; and it provides liquidity from the central bank under Emergency Liquidity Assistance (ELA). It also protects savers by providing the possibility of the State buying back subordinated bonds converted into shares prior to the public intervention.

[5] European Parliament, [The precautionary precaution of Monte dei Paschi di Siena](#)

[6] For greater detail, see the note [in French] by Thomas Humblot, [Italie : liquidation de Veneto Banca et de Banca Popolare di Vicenza](#), July 2017.

OPEC meeting: Much ado about nothing?

par [Céline Antonin](#)

On 30 November 2017, OPEC members decided on a nine-month extension of their 2016 agreement on production caps with country quotas, i.e. until December 2018. Other producing countries associated with the agreement, led by Russia, decided to continue their cooperation by also extending their agreement on production cuts.

This decision was highly anticipated by the markets, and thus came as no surprise, especially since the display of unity barely concealed underlying divergences between some countries: there is on one side the relatively moderate

position of Russia, which dragged its feet in signing the agreement, and on the other, the proactive stance of Saudi Arabia, which has resumed more active price management after several years of a more relaxed approach. The oil-producing countries are still divided between on the one hand a desire to support prices and balance their public finances, and on the other the constant fear of market share being stolen by the inexorable rise of US shale oil. Given this dual constraint, and the prospect of a progressive rebalancing between supply and demand over the next two years, we conclude that oil prices should hover around 59-60 dollars per barrel in 2018 and 2019.

Worldwide demand is of course continuing to grow, driven by the emerging markets and the United States, but the overall supply is still plentiful (Table 2). In our October 2017 forecast, we anticipated a continuation of quotas until March 2018; we have now extended this until December 2018, which translates into a slightly lower level of supply in 2018 (-0.2 million barrels per day below the October 2017 forecast).

The return to active management since end 2016

Since 2014, the OPEC countries have, at the instigation of Saudi Arabia, allowed, if not tacitly encouraged, the continuation of a situation of abundant supplies in order to maintain low prices and to squeeze out some of the unconventional production in the US in an effort to protect its market share. However, the position of the Saudi kingdom changed at the end of 2016: first, its offensive strategy vis-à-vis shale oil in the US did not really bear fruit, as production there continued at a steady pace. In addition, the sharp drop in prices seriously depressed Saudi public finances. The public deficit rose from 3.4% of GDP in 2014 to 15.8% in 2015, then 17.2% in 2016. At the same time, the Saudis are seeking to modernize their economy and privatize the state oil company, Saudi Aramco, and to do that they need

oil to be more expensive and more profitable.

In an attempt to boost oil prices, the OPEC countries have gone outside the cartel to involve a number of non-member countries, notably Russia. Two agreements to reduce production were concluded at the end of 2016^[1]: these called for a coordinated decline of nearly one million barrels per day (mbd) for OPEC members and 0.4 mbd for the other producers (Table 1). Have these agreements been respected? And have they raised prices? Not really. One year after the agreement, the countries concerned have complied about 80% with the production ceilings, but in a very unequal way. And the withdrawal of 1.3 mbd from the market did not have a strong impact on prices, for four reasons:

1. First is the fact that the benchmark adopted for establishing production cuts was the level in October 2016, which is high for several countries;
2. In addition, three OPEC countries were “spared” by the production cuts. Iran was for instance granted a production ceiling of 4 mbd (0.3 mbd more than in October 2016), to enable it to regain its level prior to Western sanctions. Similarly, Libya and Nigeria were not subject to a production ceiling, yet they experienced a sharp rise in production between October 2016 and July 2017 (460,000 barrels per day for Libya and 190,000 barrels per day for Nigeria);
3. Furthermore, output from non-OPEC countries continued to rise strongly, with US production increasing by 1.1 mbd between October 2016 and July 2017 and Brazilian output by 0.3 mbd, which largely offset the reductions in Russia (-0.3 mbd) and Mexico (-0.1 mbd);
4. Finally, inventories are still at high levels: they represent 102 days of demand in the United States and 99 days of demand in the OECD countries.

Table 1. Respect for the agreements to cut production, October 2017

In millions of barrels per day (mbd)

	Production october 2017	Reference: october 2016	Commitment to cut production	Actual reduction	Respect for commitment
OPEC country					
Algeria	1.02	1.05	-0.05	-0.03	60 %
Angola	1.68	1.60	-0.08	0.08	-103 %
Ecuador	0.54	0.55	-0.03	-0.01	38 %
Equatorial Guinea	0.14	0.16	-0.01	-0.02	167 %
Gabon	0.20	0.20	-0.01	0.00	0 %
Iran	3.85	3.70	0.09	0.15	167 %
Iraq	4.36	4.54	-0.21	-0.18	86 %
Kuwait	2.74	2.91	-0.13	-0.17	130 %
Qatar	0.61	0.65	-0.03	-0.04	133 %
Saudi Arabia	10.16	10.55	-0.49	-0.39	80 %
United Arab Emirates	2.91	3.07	-0.14	-0.16	115 %
Venezuela	1.91	2.09	-0.10	-0.18	189 %
Total OPEC 12	30.12	31.07	-1.18	-0.95	81 %
Libya	0.96	0.55			
Nigeria	1.69	1.47			
Total OPEC 14	32.77	33.09			
Non-OPEC countries*					
Azerbaijan	0.80	0.83	-0.04	-0.03	86 %
Kazakhstan	1.91	1.79	-0.02	0.12	-600 %
Mexico	2.27	2.42	-0.10	-0.15	150 %
Oman	1.01	1.02	-0.05	-0.01	22 %
Russia	11.13	11.45	-0.30	-0.32	107 %
Total non-OPEC	17.12	17.51	-0.50	-0.39	78 %

* Only the main non-OPEC countries that have made commitments to cut output are presented here.
Sources: EIA for production figures, International Energy Agency (Oil Market Report) for production ceilings.

The agreement of 30 November 2017 doesn't change the situation

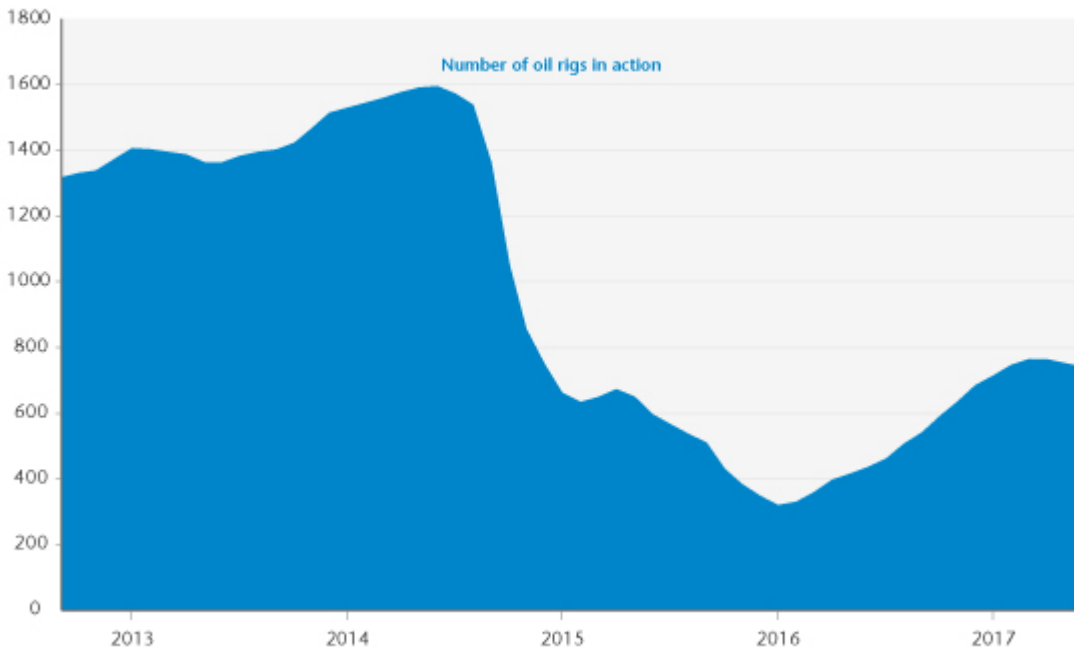
The two 2016 agreements called for limiting production until March 2018, with the possibility of an extension, and OPEC has now decided to extend this by an additional nine months, until December 2018. Moreover, Libya and Nigeria, previously not part of the agreement, have also been incorporated. This information had in fact already been reflected in the market, so the impact was relatively small (USD 5-7 per barrel of Brent). On the other hand, the November 30th meeting highlighted growing differences between the two main protagonists, Saudi Arabia and Russia. Russia had shown more and more reluctance to extend the agreement, due to several factors: first, some new Russian oil fields that were to have been put into service will now have to be postponed, which has angered the producers. Moreover, due to a floating exchange rate regime, a rise in oil prices will lead to a stronger

ruble and undermine the country's competitiveness. Finally, Russia is worried that higher oil prices will encourage American shale oil production and weaken its own market share. As a result, the unity on display in this agreement is actually fragile, and all options will be on the table at the next OPEC meeting in June 2018. Respect for the quotas could even be undermined before this deadline.

American production: Main cornerstone of global production

The way US production develops in 2018 will be of particular importance: especially since 2014, dynamic growth in the US has helped to avoid a surge in oil prices. The number of active oil rigs has been increasing there since the low point of May 2016, but is still well below the 2014 level (graph). However, thanks to more efficient drilling techniques that focus on the most productive areas of the fields (sweet spots), the output of each new well is increasing. In addition, production and investment costs have fallen: production costs are around USD 40 according to the US Bureau of Labor Statistics, which is 35% lower than at the end of 2014; upstream investment costs represent less than USD 15 per barrel produced (compared with USD 27 in 2014). Finally, according to EIA figures, expenditure on oil investment was USD 67 billion in the second quarter of 2017, a 4% year-on-year increase. This underpins our hypothesis that output will rise by 0.6 mbd in 2018 and 2019.

Figure. Number of oil rigs in action in the United States



Source: EIA.

Balancing

supply and demand by 2018-2019

We anticipate sustained growth in global demand (+1.3 mbd in 2018 and +1.4 mbd in 2019), due to the emerging countries (in particular China and India). Chinese demand should represent an additional 0.4 mbd per year, one-third of the overall increase. On the supply side, growth will come from the non-OPEC supply, which should increase by 1 mbd each year from 2017 to 2019. In 2017, the additional supply from North America will represent 0.8 mbd, including 0.6 mbd for the United States and 0.2 mbd for Canada. Kazakhstan and Brazil will contribute upwards of 0.2 mbd each. Production should fall in Mexico (-0.2 Mb) and China (-0.1 Mb). The scenarios for 2018 and 2019 are identical. Iran has the potential to increase its output by at least 0.2 mbd, and some countries could slightly relax their constraints, leading us to forecast an increase in OPEC production of 0.2 mbd in 2018.

However, it's impossible to exclude risks to the supply side. Among the bullish price risks are the likelihood of a more pronounced and coordinated cutback in OPEC production, an escalation in tension between the United States and Iran, and

renewed upheaval in Nigeria and Libya. The bearish risks are linked to the continuation of the OPEC agreement: if OPEC decides not to renew the agreement or compliance with it is limited due to diverging national interests, then prices could fall further.

Table 2. Balance on the oil market and prices of main raw industrial materials

Millions of barrels per day unless stated otherwise

	2016				2017				2018				2016	2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Global demand	96.5	96.8	96.9	97.7	97.7	98.7	98.4	98.7	99.2	99.4	99.5	99.9	97.0	98.4	99.5	100.9
<i>Growth rate¹</i>													1.6	1.5	1.1	1.4
<i>Global GDP¹</i>													3.0	3.3	3.4	3.3
<i>Oil intensity¹</i>													-1.4	-1.8	-1.9	-1.9
Global output	97.4	96.7	96.8	98.0	97.4	97.8	98.2	98.6	99.0	99.3	99.6	99.9	97.2	98.0	99.4	100.7
<i>OPEC share¹</i>	39.0	38.9	39.1	39.9	39.1	39.2	39.4	39.4	39.5	39.5	39.5	39.6	39.2	39.3	39.5	39.9
<i>Non-OPEC share</i>	58.4	57.8	57.7	58.1	58.3	58.6	58.8	59.2	59.5	59.8	60.1	60.3	58.0	58.7	59.9	60.8
Change in inventory	0.9	-0.1	-0.1	0.3	-0.3	-0.9	-0.2	-0.1	-0.2	0.1	0.3	0.3	0.2	-0.4	0.1	0.3
<i>OPEC share¹</i>	0.6	0.1	-0.2	0.0	0.4	-0.7	-0.6	0.2	0.1	0.4	0.2	0.1	0.1	-0.2	0.2	0.0
Oil price – Brent in \$²	34.1	45.6	45.9	49.5	53.8	49.8	52.1	61.0	60.0	60.0	58.0	58.0	43.8	54.2	59.0	60.0
Price of industrial raw materials ²	-17.4	25.6	3.2	11.2	5.8	-7.5	2.5	10.8	-11.7	0.0	-0.1	-0.1	-12.7	19.8	-5.6	-0.4
Exchange rate 1 € = ...\$	1.09	1.14	1.11	1.10	1.06	1.09	1.16	1.20	1.20	1.20	1.20	1.20	1.1	1.1	1.2	1.2
Brent price in €	31.3	40.1	41.2	45.1	50.7	45.6	45.0	50.8	50.0	50.0	48.3	48.3	39.5	46.5	49.2	50.0

1. Change in % from preceding period.

2. In dollars, average over the period.

Sources: EIA (oil), Hamburg HWWA index (industrial raw materials), OFCE calculations and forecasts, October 2017.

[\[1\]](#) The two agreements to cut production concluded at the end of 2016 are the agreement of 30 November 2016 (Vienna Agreement) between the OPEC countries, which provides for pulling 1.2 mbd out of the market compared to October 2016, and the agreement of 10 December 2016, among non-OPEC countries, which provides for cutting production by 0.55 mbd.

European banking regulation: When there's strength in

union

By [Céline Antonin](#), [Sandrine Levasseur](#) and [Vincent Touzé](#)

At a time when America, under the impulse of its new president Donald Trump, is preparing to put an end to the banking regulation adopted in 2010 by the Obama administration [\[1\]](#), Europe is entering a third year of the Banking Union (Antonin et al., 2017) and is readying to introduce new prudential regulations.

What is the Banking Union?

Since November 2014, the Banking Union has established a unified framework that generally aims to strengthen the financial stability of the euro zone [\[2\]](#). It has three specific objectives:

- To guarantee the robustness and resilience of the banks;
- To avoid the need to use public funds to bail out failing banks;
- To harmonize regulations and ensure better regulation and public supervision.

This Union is the culmination of lengthy efforts at regulatory coordination following the establishment of the free movement of capital in Article 67 of the Treaty of Rome (1957): “During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or the place of residence of the parties or on the place where such capital is invested.”

The Banking Union was born out of the crisis. While the Single European Act of 1986 and the 1988 EU Directive allowed the free movement of capital to take effect in 1990, the financial

crisis of 2008 revealed a weakness in Europe's lack of coordination in the banking sphere.

Indeed, the lessons of the financial crisis are threefold:

- A poorly regulated banking and financial system (the American case) can be dangerous for the proper functioning of the real economy, in the country but also beyond;
- Regulation and supervision that is limited to a national perspective (the case of European countries) is not effective in a context where capital movements are globalized and numerous financial transactions are conducted outside a country's borders;
- The banking and sovereign debt crises are linked (Antonin and Touzé, 2013b): on the one hand, bailing out banks by using public funds increases the public deficit, which weakens the State, while the problematic sustainability of the public debt weakens the banks that hold these debt securities in their own funds.

The Banking Union provides a legal and institutional framework for the European banking sector, based on three pillars:

(1) The European Central Bank (ECB) is the sole supervisor of the major banking groups;

(2) A centralized system for the regulation of bank failures includes a common bailout fund (the Single Resolution Fund) and prohibits the use of national public funding;

(3) By 2024, and subject to the definitive agreement of all the members of the Banking Union, a common fund must ensure that bank deposits held by European households are guaranteed for up to 100,000 euros, with deposits guaranteed by each State from 2010.

The Banking Union is not fully completed. The adoption of the third pillar is lagging behind due to the difficulties being

experienced by the banks in Greece and Italy, which have not been entirely resolved due to the continuing risk of default on existing loans. The European deposit guarantee “will have to wait until sufficient progress has been made to reduce and harmonize banking risks” (Antonin et al., 2017).

Towards stronger regulation and greater financial stability

The Banking Union has come into existence alongside the new Basel III prudential regulations that have been adopted by all Europe’s banks since 2014 following a European directive and regulation. The Basel III regulations require banks to maintain a higher level of capital and liquidity by 2019.

The establishment of the Banking Union coupled with the ECB’s highly accommodative monetary policy has helped to put an end to the crises in sovereign debt and the European banking sector. The ECB’s massive asset purchase programme is helping to improve the balance sheet structure of indebted sectors, which is reducing the risk of a bank default. Today, the Member States, business and households are borrowing at historically low interest rates.

The establishment of a stable, efficient European banking and financial space requires further steps to regulate both a unified European capital market and the banks’ financial activities (Antonin et al., 2014).

The main objective of a union of the capital markets is to provide a common regulatory framework to facilitate the financing of European companies by the markets and to channel the abundant savings in the euro area towards long-term investments. This would allow for a more coherent and potentially more demanding level of regulation of the issue of financial securities (equities, bonds, securitization operations).

The Banking Union could also be strengthened by drawing on the 2014 Barnier proposal for a high level of separation of

deposit and speculative activities. The ECB's unique supervisory role (pillar 1) enables it to ensure that speculative activities don't disrupt normal business. This supervisory role could be extended to embrace all financial activities, including the infamous credit system of "shadow banking" that parallels conventional lending. The separation of activities also strengthens the credibility of the common bail-out funds (pillar 2) and guarantee funds (pillar 3). Indeed, it is becoming more difficult for banks to be too big, which reduces the risk of bankruptcies that are costly for savers (internal bailout and limits on common funds).

Defending a European model of banking and financial stability

At a time when the United States is currently abandoning the more stringent regulation of its banks in an effort to boost their short-term profitability, Europe's Banking Union is a remarkable defensive tool for preserving and strengthening the development of its banks while demanding that they maintain a high level of financial security.

While the US courts are not hesitating to impose heavy fines on European banks [\[3\]](#), and China's major banks now occupy four out of the top five positions in global finance (Leplâtre and Grandin de l'Eprevier, 2016), a coordinated approach has become crucial for defending and maintaining a stable and efficient European banking model. In this field, a disunited Europe could seem weak even while its surplus savings make it a global financial power. The crisis has of course hurt many European economies, but we must guard against the short-term temptations of an autarkic withdrawal: a European country that isolates itself becomes easy prey in the face of a changing global banking system.

Bibliography

Antonin C. and V. Touzé (2013a), "The law on the separation of

banking activities: Political symbol or new economic paradigm?”, *OFCE Blog*, 26 February 2013. <http://www.ofce.sciences-po.fr/blog/the-law-on-the-separation-of-banking-activities-political-symbol-or-new-economic-paradigm/>

Antonin C. and V. Touzé (2013b) « Banques européennes : un retour de la confiance à pérenniser » [“Europe’s banks: Sustaining a return of confidence”], *Les notes de l’OFCE*, No. 37, December, pp.1-9. <http://www.ofce.sciences-po.fr/pdf/notes/2013/note37.pdf>

Antonin C., H. Sterdyniak and V. Touzé (2014), “Regulating the financial activities of Europe’s banks: A fourth pillar for the Banking Union”, *OFCE Blog*, 3 February 2014. <http://www.ofce.sciences-po.fr/blog/regulating-financial-activities-europes-banks-fourth-pillar-banking-union/>

Antonin C., S. Levasseur and V. Touzé (2017), « Les deux premières années de l’Union bancaire » [“The first two years of the Banking Union”], in *L’économie européenne 2017* (edited by J. Creel), Repère.

Leplâtre S. and J. Grandin de l’Eprevier (2016), « Les banques chinoises trustent les premières places de la finance mondiale » [“China’s banks monopolize the leading positions in global finance”], *Le Monde*, 29 June 2016. http://www.lemonde.fr/economie/article/2016/06/29/les-banques-chinoises-trustent-les-premieres-places-de-la-finance-mondiale_4960155_3234.html#R1zGPo7VG46YVzQ5.99

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act adopts the Volcker rule “which prohibits banks from ‘playing’ with depositors’ money, which led to a virtual ban

on the proprietary speculative activities of banking entities as well as on investments in hedge funds and private equity funds” (Antonin and Touzé, 2013a).

[2] The Banking Union is compulsory for euro area countries and optional for the other countries.

[3] Recent events have shown that US justice can prove to be extremely severe as large fines are imposed on European banks: 8.9 billion dollars for BNP Paribas in 2014, and 5.3 billion for Credit Suisse and 7.2 billion for Deutsche Bank in 2016.

Italy and the labour market: improvement, with caveats

By Céline Antonin

Since early 2015, the renewal of growth in Italy, the implementation of Act II of Matteo Renzi’s Jobs Act, and the reduction in business charges have undeniably contributed to the improvement on the country’s jobs front. Dynamic job creation, particularly with permanent (CDI) contracts, and an increase in the labour force, could give the impression that (partial) liberalization of Italy’s labour market has resolved the structural weaknesses it has been facing. Nevertheless, in the first half of 2016, the creation of permanent jobs has severely dried up, and what is driving growth in employment now is an increase in fixed-term (CDD) contracts. Moreover, stagnating labour productivity has accompanied more employment-yielding growth, particularly in the services sector. So in the absence of further action to address Italy’s

structural weaknesses, the upturn in the labour market may not last.

A brief review of recent labour market measures

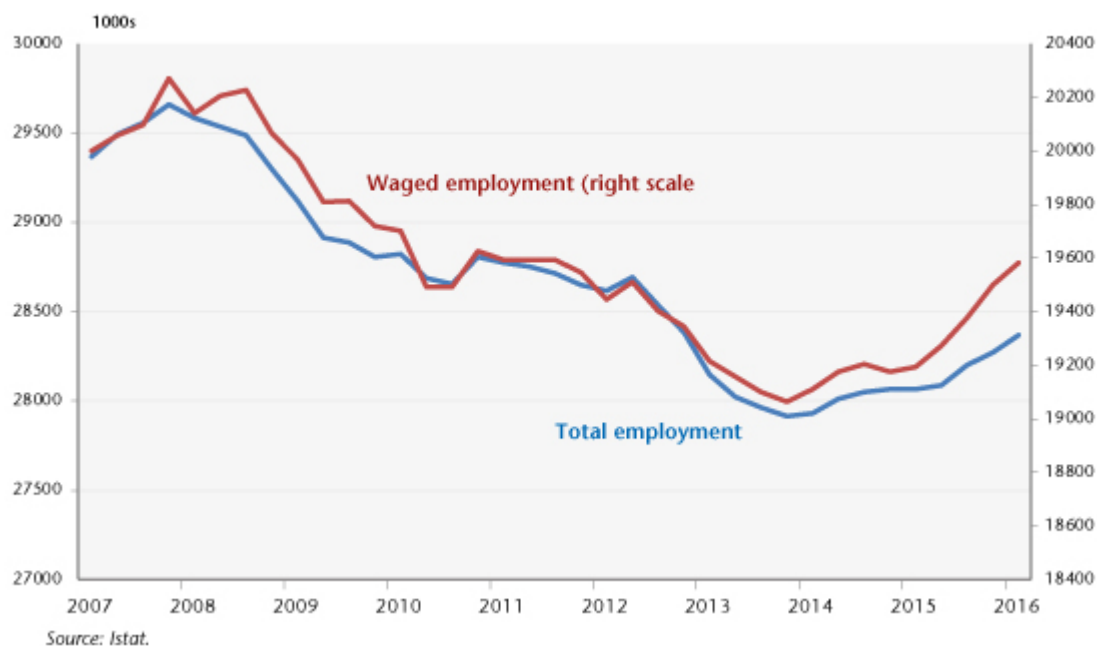
The Jobs Act is a continuation of a series of recent measures put in place since 2012 that are intended to create a more flexible labour market (see [C. Antonin, Matteo Renzi's Jobs Act: A very guarded optimism](#)). In Act I, the Jobs Act led to extending the duration of fixed-term contracts from 12 to 36 months, eliminating waiting periods and allowing more renewal periods, while limiting the proportion of fixed-term contracts within a given company. Act II introduced a new type of permanent contract, with greater protection and severance pay increases in line with seniority. It also abolished the misuse of *contratti di collaborazione*, precarious work contracts often used to disguise an employment relationship. These were to be transformed into employment contracts from 1 January 2016 (1 January 2017 for the public administration).

Furthermore, Italy has opted for cutting the taxation of labour: in 2015, the wage share of the IRAP (regional tax on productive activities) for employees on permanent contracts was removed. Above all, the 2015 Finance Act abolished social security contributions for 3 years on the new form of permanent contracts with greater protection, up to a limit of 8,060 euros per year for new hires between 1 January and 31 December 2015 who had not been on permanent contracts in the six months preceding their employment. The total cost to the budget was 1.8 billion euros. The programme was partially extended in 2016: companies taking on employees on the new permanent contracts in 2016 will be exempted from 40% of their social contributions for 2 years, and the cap on the exemption from contributions was reduced to 3,250 euros per employee.

A sharp increase in the number of jobs created, but stagnation in the creation of permanent jobs in 2016 ...

Since the beginning of 2015, the number of jobs grew strongly in Italy (Figure 1), but still falls far short of the pre-crisis level: between the first quarter of 2015 and the first quarter of 2016, the number of jobs grew by 304,000 (+391,000 permanent jobs).

Figure 1. Waged employment and total employment



A breakdown of these figures (Table 1) reveals a major difference between 2015 and the first half of 2016: the number of new CDI jobs exploded in 2015 (+281,000 between January and December 2015), before drying up in the first half of 2016 (-18,000 from January to June 2016). In 2015, the dramatic increase in the number of CDI contracts is partly explained by the replacement of precarious jobs by permanent jobs with progressive guarantees. Thus, of the 2.0 million CDI jobs created in 2015, there were 1.4 million new CDIs and 575,000 fixed-term (CDD) contracts converted into CDIs (source: INPS). 60.8% of these new contracts benefited from the exemption from social security contributions. However, the number of new CDI contracts dropped by 33% in the first half of 2016 compared to the first half of 2015, as a result of the reduced creation of CDIs *ex nihilo* and a sharp fall in the conversion of CDDs into CDIs (-37%). There was nevertheless a sharp increase in the number of the self-employed in 2016, after two consecutive

years of decline.

Table 1. Creation of jobs by category (flows)

1000s of jobs

	Jan-Dec 2015	Jan-Jun 2015	Jan-Jun 2016
Waged jobs	316	194	61
In CDI	281	143	-18
In CDD	35	51	79
Self-employed	-135	-80	126
Total employment	181	114	187

Source : Istat, Author's calculations.

Thus, the zeal for CDIs mainly occurred in 2015, before withering in 2016. One of the reasons is the following: **the reduction in social contributions for new hires on permanent contracts had a stronger impact than the Jobs Act itself.** In fact, the reduction in social contributions applied only to contracts concluded in 2015. These were renewed for 2016, but on a much more limited scale (two years compared with three, with the cap on the exemption from payroll taxes cut by more than half), which may well explain the decline in enthusiasm. Moreover, an anticipation effect can be seen for the month of December 2015 (Table 2), with a steep increase in the number of CDIs fully exempt (they more than quadrupled compared to the average of the preceding eleven months). In the first half of 2016, there were on average 42,000 people hired per month who benefited from the two-year exemption on contributions, or 31% of total permanent CDI contracts^[1], compared with 128,000 in 2015 (taking into account December). In 2015, the exempt contracts accounted for 61% of the total.

Table 2. New CDIs by category (exempt from charges or not)

In monthly average

	Average Jan-Nov 2015	Dec. 2015	Average Jan-Jun 2016
New exempt CDIs (a)	78 324	248 919	32 802
Converted from CDD into exempt CDIs (b)	27 921	130 324	9 205
Total CDIs exempt (a+b)	106 245	379 243	42 008
Total CDIs created	186 495	450 186	133 532
% CDIs exempt of total CDIs	57 %	84 %	31 %

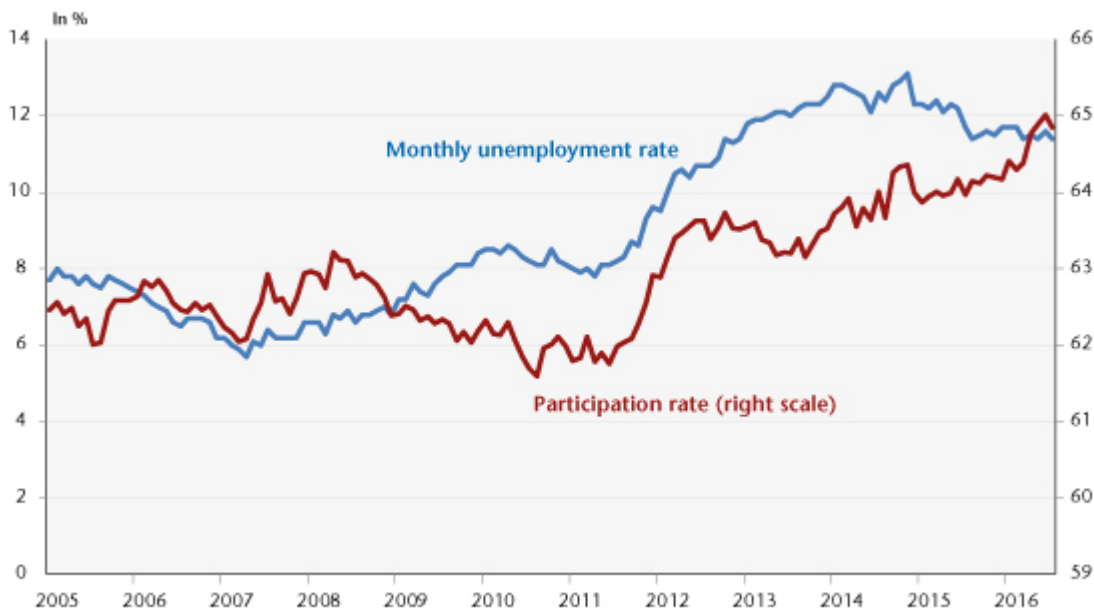
Note: The month of December was considered separately due to the sharp increase in the number of CDIs signed in that period.
Source: INPS, author's calculations.

... but stagnation in the number of jobless due to the growth in the workforce ...

Despite the dynamic jobs market, unemployment has stagnated in Italy since mid-2015 at a level of 11.6% (Figure 2). This paradox is explained by the increase in the active population: between July 2015 and July 2016, the workforce expanded by 307,000 people. Several phenomena are behind this:

1. The pension reform, which has led to seniors staying in their jobs;
2. A “flexion” or bending effect: with the return of growth and the improvement in the labour market, discouraged workers have begun looking for jobs again;
3. Immigration: positive net migration has had an impact on the labour market. The share of foreigners in Italy's labour force rose from 10.7% to 11.1% between first quarter 2014 and first quarter 2016.

Figure 2. Unemployment rate and participation rate, 2005-June 2016



Source: Istat.

In conclusion, although it is not reflected in the unemployment figures, there has been an undeniable improvement in Italy's labour market, with a great deal of job creation and marked growth in the workforce. This improvement is attributable not just to the Jobs Act, but to three combined factors: 1) the return of growth since 2015, driven by the ultra-accommodative policy of the European Central Bank, less fiscal austerity and falling oil prices; 2) the reduction in labour taxes introduced in 2015 and extended in part in 2016; and 3) the implementation of the Jobs Act. In the light of Table 2, it can also be assumed that the reduction of business social charges had a stronger impact than the Jobs Act per se.

After the upturn in 2015, the figures for the first half of 2016 call for caution. The drying up of the creation of permanent jobs in 2016 shows that the Renzi reform did not resolve the underlying problem, namely the structural weaknesses of Italy's labour market, in particular labour productivity. To restore growth and employment, Italy really needs to address the issue of structural reform, including the poor level of innovation, research and development, the low level of competitiveness and the undercapitalization of its SMEs.

[1] including the conversion of CDD contracts into CDIs.

Matteo Renzi's Jobs Act: A very guarded optimism

By Céline Antonin

At a time when the subject of labour market reform has aroused passionate debate in France, Italy is drawing some initial lessons from the reform it introduced a year ago. It should be noted that the labour market reform, dubbed the Jobs Act, had been one of Matteo Renzi's campaign promises. The Italian labour market has indeed been suffering from chronic weaknesses, including segmentation, a duality between employees with and without social protection, high youth unemployment, and a mismatch between costs and labour productivity. Renzi's reform takes a social-liberal approach, advocating flexicurity, with the introduction of a new permanent employment contract with graduated protection, lower social charges on companies, and better compensation and support for the unemployed. Although the initial assessment is surely positive in terms of both unemployment and job creation, there's no cause for hasty triumphalism: the reform has been implemented in especially favourable circumstances, marked by a return of growth, an accommodative policy mix, and a stagnating work force.

Jobs Act Italian-style: The key points

The Jobs Act is actually the latest in a series of measures adopted since the Fornero Act of 2012 that are aimed at a more

flexible labour market. Act I of the Jobs Act, the Poletti Decree (DL 34/2014), was adopted on 12 May 2014, but went relatively unnoticed because it targeted fixed-term contracts and apprenticeships. It allowed in particular extending the duration of fixed-term contracts from 12 to 36 months, suppressing gap periods, and allowing for more fixed-term contracts to be renewed, all while limiting the proportion of fixed-term contracts within a single company[1].

The real change came with Act II of the Jobs Act, for which the Italian Senate passed enabling legislation on 10 December 2014. The eight implementing decrees adopted in the first half 2015 have four key points:

- The elimination of Article 18 of the Labour Code, which allowed reinstatement in cases of manifestly unfair dismissal: the reinstatement requirement was replaced by a requirement for indemnification that is capped[2], with reinstatement still being required in case of a dismissal involving discrimination;
- The creation of a new form of permanent (open-ended) contract and graduated protection, lying between permanent contracts and fixed-term contracts: dismissal was facilitated during the first three years on the job, with severance pay that increases with employee seniority;
- The suppression of the abuse of what are called “collaboration contracts”, [3]precarious contracts that are often used to disguise an actual employment relationship, affecting about 200,000 people. These contracts will be transformed into wage labour contracts from 1 January 2016 (1 January 2017 for public administrations), except for a few limited cases;
- The reform of unemployment insurance, with an extension of compensation schemes. The benefit period, for instance, is extended to two years (from 12 months previously). As for

compensation for short-time working (“technical unemployment”), this is extended to cover apprentices and companies with 5-15 employees[4]. A National Employment Agency (ANPAL), which introduces a one-stop system that helps to link training and employment, was also established.

Note that only measures related to experimentation with a national minimum wage[5], which are contained in the enabling law in December 2014, were not addressed.

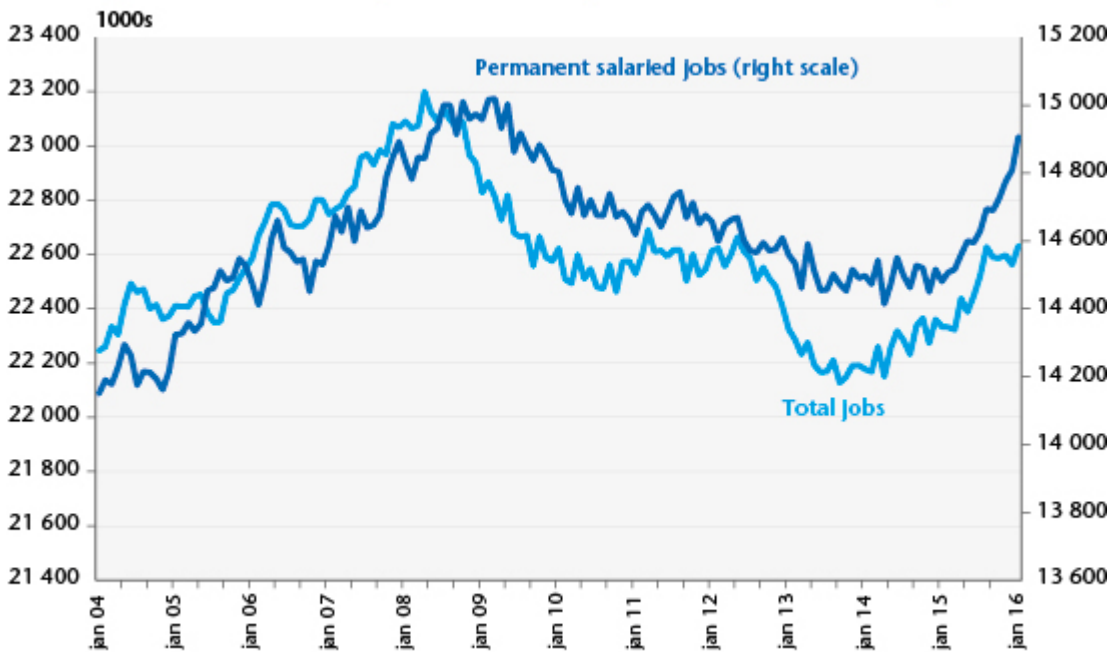
Alongside the Jobs Act, Italy opted to lower taxes on labour: in 2015, the wage part of the IRAP (equivalent to a business tax) for those employed on permanent contracts was eliminated, reducing the amount of the IRAP by about one-third. Above all, Italy’s 2015 Budget Act eliminates social security contributions for 3 years on the new open-ended contracts with graduated protection, up to a limit of 8,060 euros per year for new hires taken on between January 1 and December 31, 2015 who did not have permanent job contracts in the six months preceding their hiring. This measure is expected to cost 3.5 billion euros between now and 2018. It was extended in 2016: companies that hire employees on the new permanent contracts in 2016 will be exempt from 40% of social security contributions for 2 years.

Strong jobs growth and a lower unemployment rate

There has been strong growth in employment, in particular permanent jobs, since the start of 2015: between January 2015 and January 2016, the number of employed increased by 229,000, with strong growth in the number of salaried employees (+377,000) and a decline in the number of self-employed (-148,000). Among employees, there was a sharp increase in the number of permanent positions (+328,000). The number of permanent employees has now returned to the 2009 level of 22.6 million (Figure 1); as for total employment, even if it has not yet reached its pre-crisis level, the decline in the 2012-2014 period has been overcome. At the same time, the

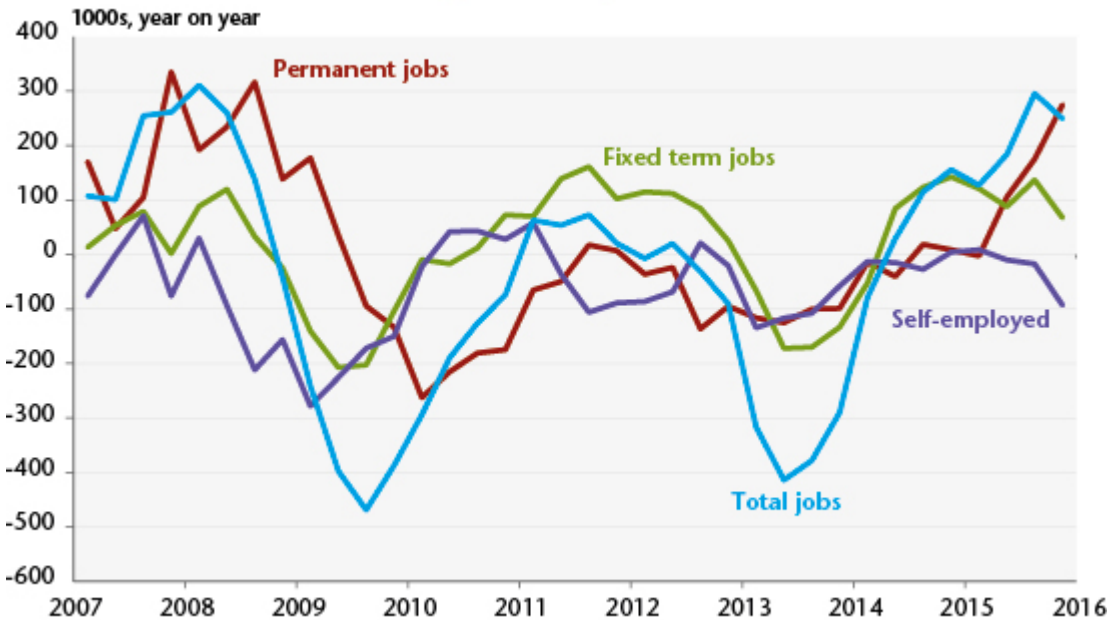
annual rate of job creation has returned to its pre-crisis level, with growth of about 250,000 per year (Figure 2).

Figure 1. Number of jobs (total and permanent), 2004-January 2016



Sources : Istat, author's calculations.

Figure 2. Annual change in number of jobs by contract type, Q1 2007 – Q4 2015



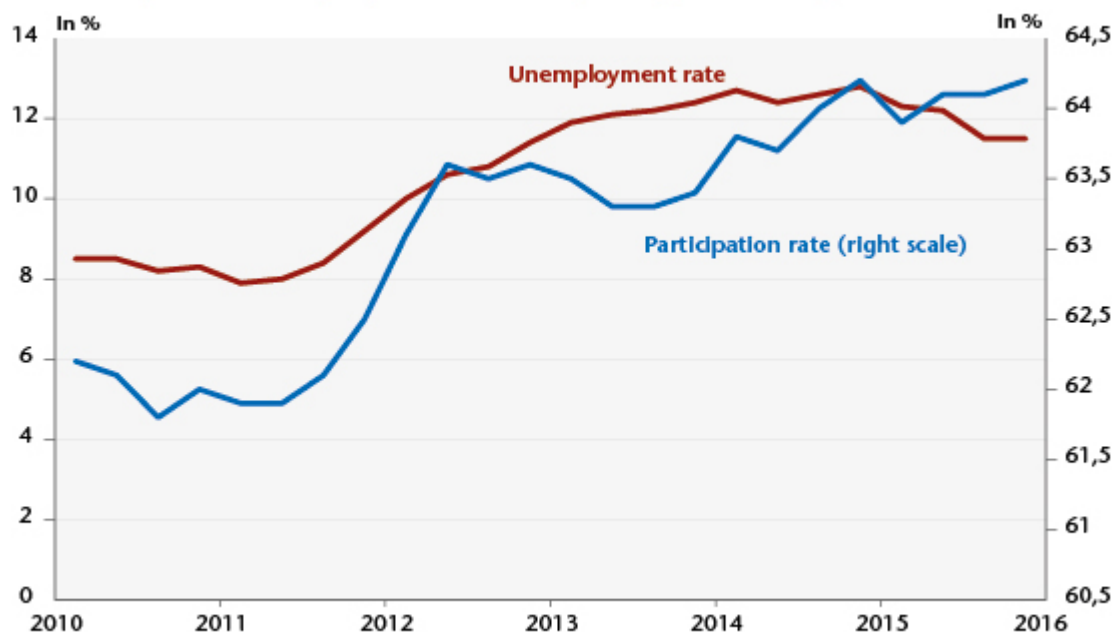
Sources : Istat, author's calculations.

In addition to new hires on permanent contracts, the Jobs Act has led to replacing precarious jobs with permanent jobs with increasing guarantees. Thus, 5.4 million new jobs were created

in 2015 (+11% compared to 2014) [6], mainly permanent jobs. Of the 2.4 million permanent jobs created, there were 1.9 million new open-ended contracts and 500,000 fixed-term contracts that were converted into open-ended contracts (including 85,000 apprenticeship contracts), up sharply from 2014. There were also fewer collaboration contracts (a 45% decrease from Q3 2014 to Q3 2015) and apprenticeship contracts (-24.6%). Note also the 4.3% increase in the number of resignations and the 6.9% decrease in layoffs.

The corollary to this jobs growth is a marked fall in the unemployment rate (Figure 3), which fell to 11.4% in the last quarter of 2015 (from 12.8% one year earlier). However, the decline in unemployment was also due to stagnation in the labour force in 2015, unlike previous years that were marked by the pension reform.

Figure 3. Unemployment rate and participation rates, 2010-2015



Sources : Istat, author's calculations.

Uncertainties remain

Matteo Renzi seems to have won his bet. Yet this fall in unemployment should not be over-interpreted, as a number of positive factors have undoubtedly contributed to strengthening this trend.

First, there was a windfall effect related to the announcement of the exemptions on social contributions for hiring new permanent employees, which led some companies to put off new hiring planned for 2014 until 2015 (which led to a rise in unemployment in late 2014). Moreover, part of the fall in unemployment is related to the impact of replacing precarious short-term contracts with the new permanent contracts with graduated protection (see above). The question is whether the new flexibilities allowed by these new contracts will be used over the next three years, and consequently whether there will be an increase in contract terminations.

In addition, the stagnation of the work force (Figure 3) has significantly amplified the downward trend in unemployment. With the improvement observed in the labour market, we expect in the future that the growth in the workforce that began in the last quarter of 2015 will continue due to what is called in French an “effet de flexion”, or “bending effect”, [\[7\]](#) which would absorb some of the impact of the job creation in 2016 and 2017.

Furthermore, the Jobs Act was adopted when the economy was emerging from a recession, with a recovery that, while soft (+0.6% growth in 2015), still exceeded the growth potential [\[8\]](#). The easing of fiscal constraints had a stimulus effect in 2015, which may partially explain the fall in unemployment. As for monetary conditions, they are particularly favourable, as Italy is one of the main beneficiaries of the quantitative easing measures taken by the ECB.

Notwithstanding these qualifications, it is undeniable that the cut in the social contributions level has had a positive impact. The February 2016 report of the National Social Security Institute (INPS) showed that, of the 2.4 million new permanent jobs created in 2015, 1.4 million benefited from exemptions on employer contributions, or almost two-thirds of these new jobs. Moreover, the reduction of precarious job contracts and their replacement by permanent contracts, even

if they offer less protection than before, is a rather encouraging sign for access to long-term employment by groups that have traditionally been more marginal (self-employed, collaboration contracts).

Perhaps the main regret about this reform is the absence of a component aimed explicitly at vocational training, which is one of the main weaknesses of Italy's labour market. The country holds a dismal EU record for the number of young people (15-24) who are neither in employment nor in school or training. Moreover, the workforce has insufficient training, and investment in research and development is low, which results in low productivity. It is legitimate to want to take action on labour costs and the duality of the labour market, but this will not be enough to solve the problem of productivity and the inadequacy of the workforce. Matteo Renzi would therefore do well to foresee an Act III in his labour reforms to finally pull the country out of its stagnation.

[1] See [C. Antonin, Réforme du marché du travail en Italie : Matteo Renzi au pied du mur](#), [Labour market reform in Italy: Matteo Renzi with his back to the wall], *Note de l'OFCE no. 48*.

[2] The monetary payment is determined by a scale based on the employee's seniority. It is equivalent to two months of the final salary per year of service, for a total that cannot be less than 4 months of salary and is capped at 24 months.

[3] "Intermediate status between salaried employment and self-employment, for workers not subject to a hierarchical subordination but 'coordinated' with the company and creator of certain social rights. These are self-employed workers who are, in fact, dependent on a single client company (which exercises limited management powers, for example in terms of the organization of work and the working time)." [E. Prouet](#),

[Contrat de travail, les réformes italiennes](#) [The job contract, the Italian reforms], France Stratégie, *La Note d'Analyse*, no. 30, May 2015.

[4] Other measures concerning short-time work (“chomage technique”) are also planned, including that an employee on short-time work may not have their hours cut by more than 80% of their total work hours. Furthermore, the period during which a company may resort to this procedure is a maximum of 24 months over five rolling years.

[5] There is no national minimum wage in Italy, with minimum wages instead set at the industry level, as was the case in Germany before 2015.

[6] This figure of 5.4 million represents gross job creation, including all forms of employment (including very short-term contracts), and without taking into account job destruction. In terms of net job creation between January 2015 and January 2016, we accept the figure of 229,000.

[7] When unemployment rises, working-age people are discouraged from reporting for the labour market. Conversely, when employment picks up again, some people are encouraged to return to the labour market, slowing the decline in unemployment; this phenomenon is called the “effet de flexion” in French, or the bending effect.

[8] Labour productivity tends to grow relatively slowly in Italy; consequently, an increase in production tends to create more jobs in Italy than in France for example, where labour productivity is higher.

Greece: an agreement, again and again

By [Céline Antonin](#), Raul Sampognaro, [Xavier Timbeau](#), [Sébastien Villemot](#)

<i>... La même nuit que la nuit d'avant</i>	[...The same
night as the night before	
<i>Les mêmes endroits deux fois trop grands</i>	The same
places, twice too big	
<i>T'avances comme dans des couloirs</i>	You
walk through the corridors	
<i>Tu t'arranges pour éviter les miroirs</i>	You
try to avoid the mirrors	
<i>Mais ça continue encore et encore ...</i>	But it
just goes on and on...]	

[Francis Cabrel, *Encore et encore*, 1985.](#)

Just hours before an exceptional EU summit on Greece, an agreement could be signed that would lead to a deal on the second bail-out package for Greece, releasing the final tranche of 7.2 billion euros. Greece could then meet its deadlines in late June with the IMF (1.6 billion euros) as well as those in July and August with the ECB (6.6 billion euros) and again with the IMF (0.45 billion euros). At the end of August, Greece's debt to the IMF could rise by almost 1.5 billion euros, as the IMF is contributing 3.5 billion euros to the 7.2 billion euro tranche.

Greece has to repay a total of 8.6 billion euros by September, and nearly 12 billion by the end of the year, which means funding needs that exceed the 7.2 billion euros covered by the negotiations with the Brussels Group (i.e. the ex-Troika). To deal with this, the Hellenic Financial Stability Fund (HFSF) could be used, to the tune of about 10 billion euros, but it

will no longer be available for recapitalizing the banks.

If an agreement is reached, it will almost certainly be difficult to stick to it. First, Greece will have to face the current bank run (despite the apparent calm in front of the bank branches, more than 6 billion euros were withdrawn last week according to the *Financial Times*). Moreover, even if an agreement can put off for a time the scenario of a Greek exit from the euro zone, the prospect of exceptional taxes or a tax reform could deter the return of funds to the country's banks. Furthermore, the agreement is likely to include a primary surplus of 1% of GDP by the end of 2015. But the [information on the execution of the state budget](#) up to May 2015 (published 18 June 2015) showed that revenue continues to be below the initial forecast (- 1 billion euros), reflecting the country's very poor economic situation since the start of 2015. It is true that the lower tax revenues were more than offset by lower spending (down almost 2 billion). But this is cash basis accounting. The [monthly bulletin](#) for April 2015, published on 8 June 2015, shows that the central government payment arrears have increased by 1.1 billion euros since the beginning of 2015. It seems impossible that, even with an excellent tourist season, the Greek government could make up this lag in six months and generate a primary surplus of 1.8 billion euros calculated on an accrual basis.

A new round of fiscal tightening would penalize activity that is already at half-mast, and it could be even more inefficient in that this would create strong incentives to underreport taxes in a context where access to liquidity will be particularly difficult. The Greek government could try to play with tax collection, but introducing a new austerity plan would be suicidal politically and economically. Discussion needs to get started on a third aid package, including in particular negotiations on the reduction of Greece's debt and with the counterparties to this relief.

Any agreement reached in the coming days risks being very

fragile. Reviving some growth in Greece would require that financing for the economy is functioning once again, and that some confidence was restored. It would also require addressing Greece's problems in depth and finding an agreement that was sustainable over several years, with short-term steps that need to be adapted to the country's current situation. In our study, "[Greece on the tightrope](#) [in French, or the English-language post describing the study at <http://www.ofce.sciences-po.fr/blog/greece-tightrope/>]," we analysed the macroeconomic conditions for the sustainability of the Greek debt. More than ever before, Greece is on the tightrope. And the euro zone with it.

Oil: carbon for growth

By [Céline Antonin](#), [Bruno Ducoudré](#), Hervé Péléraux, Christine Riffart, [Aurélien Saussay](#)

This text is based on the [special study of the same name](#) [Pétrole : du carbone pour la croissance, in French] that accompanies the OFCE's 2015-2016 Forecast for the euro zone and the rest of the world.

The 50% fall in the price of Brent between summer 2014 and January 2015 and its continuing low level over the following months is good news for oil-importing economies. In a context of weak growth, this has resulted in a transfer of wealth to the benefit of the net importing countries through the trade balance, which is stimulating growth and fuelling a recovery. Lower oil prices are boosting household purchasing power and driving a rise in consumption and investment in a context where companies' production costs are down. This has

stimulated exports, with the additional demand from other oil-importing economies more than offsetting the slowdown seen in the exporting economies.

That said, the fall in oil prices is not neutral for the environment. Indeed, the fall in oil prices is making low-carbon transportation and production systems less attractive and could well hold back the much-needed energy transition and the reduction of greenhouse gas emissions (GHG).

This oil counter-shock will have a favourable impact on growth in the net oil-importing countries only if it is sustained. By 2016, the excess supply in the oil market, which has fuelled by the past development of shale oil production in the United States and OPEC's laissez-faire policy, will taper off. Unconventional oil production in the United States, whose profitability is uncertain at prices of under 60 dollars per barrel, will have to adjust to lower prices, but the tapering off expected from the second half of 2015 will not be sufficient to bring prices down to their pre-shock level. Brent crude prices could stay at about 55 dollars a barrel before beginning towards end 2015 to rise to 65 dollars a year later. Prices should therefore remain below the levels of 2013 and early 2014, and despite the expected upward trend the short-term impact on growth will remain positive.

To measure the impact of this shock on the French economy, we have used two macroeconomic models, *e-mod.fr* and *ThreeMe*, to carry out a series of simulations. These models also allow us to assess the macroeconomic impact, the transfers in activity from one sector to another, and the environmental impact of the increased consumption of hydrocarbons. The results are presented in detail in the [special study](#). It turns out that for the French economy a 20 dollar fall in oil prices leads to additional growth of 0.2 GDP point in the first year and 0.1 point in the second, but this is accompanied by a significant environmental cost. After five years, the price fall would lead to additional GHG emissions of 2.94 MtCO₂, or

nearly 1% of France's total emissions in 2013. This volume for France represents nearly 4% of [Europe's goal](#) of reducing emissions by 20% from 1990 levels.

The simulations using the French *e-mod.fr* model can be extended to the major developed economies (Germany, Italy, Spain, the USA and UK) by adapting it to suit characteristics for the consumption, import and production of oil. With the exception of the United States, the oil counter-shock has a substantial positive impact that is relatively similar for all the countries, with Spain benefitting just a little more because of its higher oil intensity. Ultimately, considering the past and projected changes in oil prices (at constant exchange rates), the additional growth expected on average in the major euro zone countries would be 0.6 GDP point in 2015 and 0.1 point in 2016. In the US, the positive impact would be partially offset by the crisis that is hitting the unconventional oil production business^[1]. The impact on GDP would be positive in 2015 (+0.3 point) and negative in 2016 (-0.2 point). While lower oil prices are having a positive impact on global economic growth, this is unfortunately not the case for the environment ...

^[1] See the post, [The US economy at a standstill in Q1 2015 : the impact of shale oil](#), by Aurélien Saussay, from 29 April on the OFCE site.