

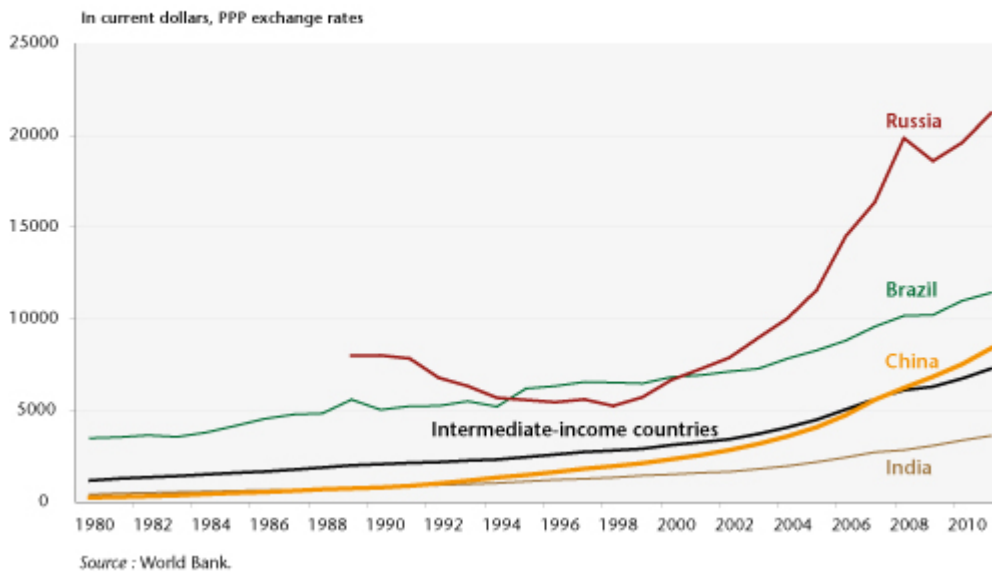
# When Brazil's youth dream of something besides football...

By Christine Rifflart

The rise in public transport prices had barely been in force for two weeks when this lit the fire of revolt and led to a new twist in the so-called "Brazilian development model". With its aspirations for high-quality public services (education, health, transport, etc.), the new middle class that formed during the last decade is claiming its rights and reminding the government that the money put up to host major sports events (2014 World Cup, 2016 Olympics) should not be spent to the detriment of other priorities, especially when growth has ceased and budget constraints demand savings.

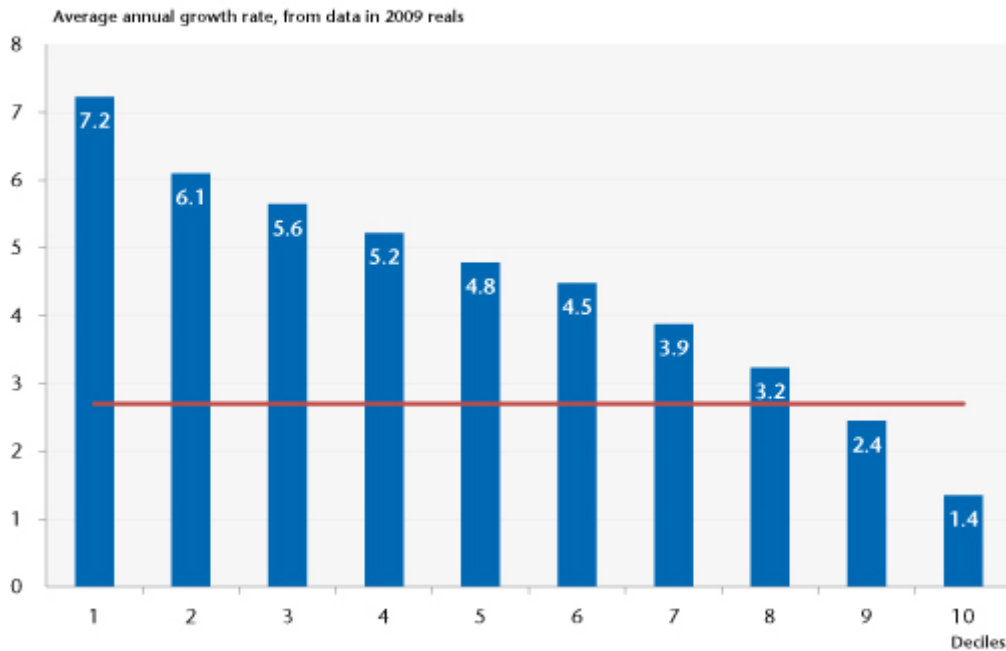
Over the years, Brazil's growth accelerated from 2.5% per year in the 1980s and 1990s to almost 4% between 2001 and 2011. More importantly, for the first time the growth benefited a population that had traditionally been left out. Up to then, the slow growth of per capita income had gone hand in hand with rising inequality (the [Gini coefficient](#) for the period, at over 0.6, is one of the highest in the world) and an increase in poverty rates, which exceeded 40% during the 1980s. As hyperinflation was finally defeated by the 1994 "Plan Real", growth resumed but remained fragile due to the series of external shocks that have hit the country (impact of the Asian crisis of 1997 and the Argentine crisis of 2001).

## Change in per capita income in the BRICs and in intermediary countries according to the World Bank



Lula's accession to the presidency on 1 January 2003 marked a real turning point in this growth dynamic (Figure 1). While continuing the liberal orthodoxy of his predecessor F. H. Cardoso with respect to macro-economic policy and financial stability (unlike Argentina, for example), the new government took advantage of the renewed growth to better distribute the country's wealth and to try to eradicate poverty. According to household surveys, real household income grew in local currency by 2.7% per year between 2001 and 2009, and the poverty rate fell by almost 15 percentage points to 21.4% of the population by the end of the period. In addition, the real income of the first eight deciles, especially the poorest 20% of the population, has increased much faster than the average income (Figure 2). Ultimately, 29 million Brazilians have joined the ranks of the new middle class, which now numbers 94.9 million (50.5% of the population), while the upper income class has welcomed 6.6 million additional Brazilians (and now represents 10.6% of the population). In contrast, the ranks of the poor decreased by 23 million, to 73.2 million in 2009. In terms of income, the new middle class now accounts for 46.2% of distributed income, more than the richest category, which saw its share decline to 44.1% [1].

### Increase in the real incomes of Brazil's households per decile over the period 2001-2009



Note : the red line is the change in average real income per capita; it was 2.7% over the period.  
Source : IPEA.

This new configuration of Brazilian society is changing consumption patterns and aspirations, particularly in terms of education, access to health care, infrastructure, etc. But while consumer spending has accelerated for 10 years (durables in particular) and stimulated private investment, the wind of democratization is posing a serious challenge to the government. For while the hike in public transport prices was quickly canceled, providing new infrastructure and improving the quality of public services in a country that is 15 times the size of France is not done in a day. In 2012, of 144 countries surveyed, the [\*World Economic Forum \(pp 116-117\)\*](#) ranked Brazil 107<sup>th</sup> for the quality of its infrastructure and 116<sup>th</sup> for the quality of its education system. The authorities must skillfully respond to the legitimate demands of the population, especially the youth [2].

The country has a solid basis for dealing with this and stimulating investment: a stable political and macroeconomic environment, sound public finances, external debt below 15% of GDP, abundant foreign exchange reserves, the confidence of the

financial markets and direct foreign investors, and of course varied and abundant natural resources in agriculture (soybeans, coffee, etc.), mining (iron ore, coal, zinc, bauxite, etc.) and energy (hydroelectricity, oil).

But many difficulties lie ahead. Currently, growth is lacking, and it is even running up against problems with production capacity. In 2012, growth came to only 0.9% (insufficient to increase per capita income) and, even though investment is recovering, the forecasts for 2013 have been regularly revised downwards to around 3%. At the same time, inflation is picking up, driven by strong pressure on the labour market (at 5.5%, the unemployment rate is very low), and since 2008 productivity has stagnated. Inflation, which hit 6.5% in May, is at the top of the range allowed by the monetary authorities. To meet the target of 4.5%, which would mean a reduction of more or less 2 percentage points, in April the central bank raised its key rate from 7.25% to 8%. Monetary policy is nevertheless still very accommodative – the difference between the interest rate and the inflation rate has never been so small – and the moderate growth should lead to calming the inflationary pressures. In addition, the relative support monetary policy is giving to the economy is being offset by a policy of continuing fiscal consolidation. Following a primary surplus of 2.4% of GDP in 2012, the goal for this year is to maintain this at 2.3%. The net public sector debt is continuing to decline: from 60% ten years ago to 43% in 2008, reaching 35% last April.

The virtual stagnation in growth has been due in particular to a serious problem with competitiveness, which undercut the country's growth potential. In a lackluster international economy, higher production costs and a seemingly overvalued currency have resulted in a drop in export performance, a reluctance to invest, and greater recourse to imports. The current account balance deteriorated by 1 GDP point in one year, reaching 3% in April.

To deal with this supply-side problem, Brazil's central bank is intervening more and more to counter the adverse effects of capital inflows – attracted by high interest rates – on the exchange rate, while the government is seeking to boost investment. The investment rate, which has been under 20% of GDP over the last 20 years and close to 15% between 1996 and 2006, is structurally insufficient to lead the economy back onto a path of virtuous growth. For comparison, the investment rate over the past five years has been 44% in China, 38% in India and 24% in Russia. To lift Brazil's investment rate towards a target of around 23%-25%, in 2007 the government introduced a “growth acceleration programme” (PAC), based on the implementation of major infrastructure projects.

In four years, public investment rose from 1.6% of GDP to 3.3%. The year 2011 saw the launch of the second phase of the PAC, which is slated to receive a budget of 1% of GDP per year for 4 years. There are also other investment programmes whose benefits, though disappointing in 2012, should still help resolve some of the problems. But the efforts being made are still insufficient. According to a 2010 study by Morgan Stanley [3], Brazil would need to invest 6 to 8% of its GDP in infrastructure every year for 20 years to catch up with the level of the infrastructure in South Korea, and 4% to catch that of Chile, the benchmark in the field in South America!

By improving the productive supply and by stimulating demand through increased public investment, the authorities' objective is therefore to make up some of the delay built up from the past. But is it possible to carry out large-scale investment projects while simultaneously pursuing a policy of debt reduction when net public debt is close to 35% of GDP? The authorities should speed up the reform process to spur private investment, in particular by promoting the development of a national long-term savings programme (pension reform, etc.) while stimulating financial intermediation, which goes hand in hand with this.

The volume of loans granted by the financial sector to the non-financial sector represented only 54.7% of GDP in May. A little less than half of these are earmarked loans (rural credit, National Development Bank, etc.) at heavily subsidized interest rates (0.5% in real terms against 12% for non-subsidized loans to business, and 0.2% against 27.7% respectively for individuals). But the state must also reform a cumbersome and corrupt government.

Brazil has been an emerging country for over four decades. With an income of 11,500 dollars (PPP) per capita, it is time that this great country reaches adulthood by providing developed country quality standards for its public services and by refocusing its new development model on its new middle class, whose needs are still going unmet.

---

[1]See [The Agenda of the New Middle Class | Portal FGV](#) on the site of the Fondation Gétulio Vargas.

[2]<http://www.oecd.org/eco/outlook/48930900.pdf>

[3]See the study by Morgan Stanley [Paving the way](#), 2010.

---

## **Housing and the city: the new challenges**

By Sabine Le Bayon, [Sandrine Levasseur](#) and Christine Rifflart

The residential real estate market is a market like no other. Since access to housing is a right and since inequalities in

housing are increasing, the role of government is crucial to better regulate how the market functions. France has a large stock of social housing. Should it be expanded further? Should it have a regulatory role in the overall functioning of the housing market? Should our neighbours' systems of social housing, in particular the Dutch and British systems, be taken as models? On the private market, the higher prices of home purchases and rentals illustrate the lack of housing supply in the country's most attractive areas. At the individual level, the residential market is becoming less fluid: moving is difficult due to problems finding housing suited to career and family needs. It is therefore necessary to develop appropriate policies to enhance residential mobility and reduce imbalances by stimulating the supply of new housing.

Housing is also an integral part of our landscape, both urban and rural. It distinguishes our cities of today and of tomorrow. The commitments made in the framework of the Grenelle environmental consultation process demand a real revolution in land use as well as in technical standards for construction. To ensure more housing, should undeveloped land be used or should developed land be exploited more intensely? How should a housing stock that has become obsolete in terms of energy standards be renovated, and how should this be financed?

These are the challenges addressed by the contributions collected in the new book [Ville et Logement](#) in the *Débats et politiques* series of the *Revue de l'OFCE*, edited by Sabine Le Bayon, Sandrine Levasseur and Christine Rifflart. With authors from a variety of disciplines (economics, sociology, political science, urban planning) and backgrounds (researchers as well as institutional players), this review aims to improve our understanding of the issues related to housing and the city.

---

# Has monetary policy become ineffective?

By [Christophe Blot](#), [Catherine Mathieu](#) and Christine Riffart

This text summarizes the [special study](#) of the October 2012 forecast.

Since the summer of 2007, the central banks of the industrialized countries have intervened regularly to counter the negative impact of the financial crisis on the functioning of the banking and financial system and to help kick-start growth. Initially, key interest rates were lowered considerably, and then maintained at a level close to 0 [\[1\]](#). In a second phase, from the beginning of 2009, the central banks implemented what are called unconventional measures. While these policies may differ from one central bank to another, they all result in an increase in the size of their balance sheets as well as a change in the composition of their balance sheet assets. However, three years after the economies in the United States, the euro zone and the United Kingdom hit bottom, it is clear that recovery is still a ways off, with unemployment at a high level everywhere. In Europe, a new recession is threatening [\[2\]](#). Does this call into question the effectiveness of monetary policy and of unconventional measures more specifically?

For almost four years, a wealth of research has been conducted on the impact of unconventional monetary policies [\[3\]](#). Cecioni, Ferrero and Sacchi (2011) [\[4\]](#) have presented a review of recent literature on the subject. The majority of these studies focus on the impact of the various measures taken by the central banks on financial variables, in particular on



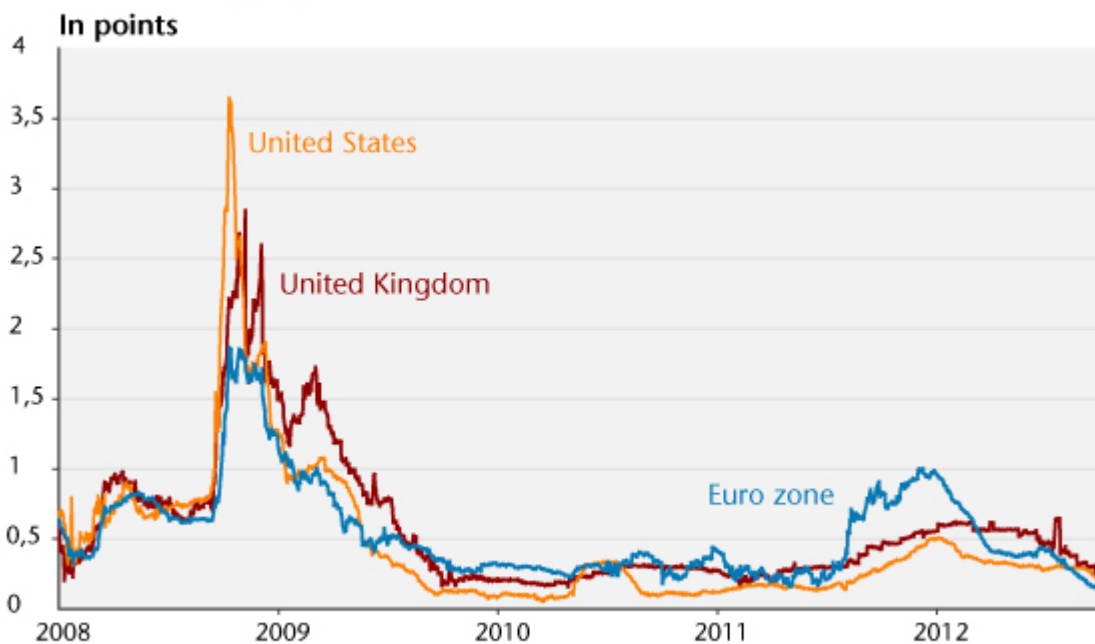
money market rates and bond yields. Given the role of the money market in the transmission of monetary policy, the ability of central banks to ease the pressures that have emerged since the beginning of the financial crisis constitutes a key vector for effective intervention. More recently, this was also one of the reasons motivating the ECB to conduct an exceptional refinancing operation in two stages, with a maturity of 3 years. This intervention has indeed helped to reduce the tensions on the interbank market that had reappeared in late 2011 in the euro zone, and to a lesser extent in the United States and the United Kingdom (see graph). This episode seems to confirm that central bank action can be effective when it is dealing with a liquidity crisis.

Another critical area of debate concerns the ability of unconventional measures to lower interest rates in the long term and thereby to stimulate activity. This is in fact an important lever for the transmission of monetary policy. The findings on this issue are more mixed. Nevertheless, for the United States, a study by Meaning and Zhu (2012) [\[5\]](#) suggests that Federal Reserve programs to purchase securities have contributed to lowering the rates on 10-year US Treasury bills: by 60 points for the first “Large-scale asset purchase” program (LSAP1) and by 156 points for LSAP2. As for the euro zone, Peersman [\[6\]](#) (2011) shows that the impact of unconventional measures on activity has in general closely resembled the effect of lowering the key interest rate, and Gianone, Lenza, Pill and Reichlin [\[7\]](#) (2012 ) suggest that the various measures taken by the ECB since the beginning of the crisis have helped offset the rise in the unemployment rate, although the impact is limited to 0.6 point.

Under these conditions, how is it possible to explain the weakness or outright absence of a recovery? One answer evokes the hypothesis of a liquidity trap [\[8\]](#). Uncertainty is still prevalent, and the financial system is still so fragile that agents are continuing to express a preference for liquidity

and safety, which explains their reluctance to undertake risky projects. Thus, even if financing conditions are favourable, monetary policy will not be sufficient to stimulate a business recovery. This hypothesis probably explains the timidity of the recovery in the United States. But in the euro zone and the United Kingdom this hypothesis needs to be supplemented with a second explanation that recognizes the impact of restrictive fiscal policies in holding back recovery. The euro zone countries, like the UK, are pursuing a strategy of fiscal consolidation that is undermining demand. While monetary policy is indeed expansionary, it is not able to offset the downward pressure of fiscal policy on growth.

**Graphique. Tensions on the interbank markets\***



\* The tensions are measured by the spread between the interbank rates (Libor ou Euribor) and the overnight interest rate swap (OIS).

Source : Datastream.

---

[\[1\]](#) One should not, however, forget the exception of the ECB, which prematurely raised its key interest rate twice in 2011. Since then it has reversed these decisions and lowered the key rate, which has stood at 0.75% since July 2012.

[\[2\]](#) The first estimate of UK GDP for the third quarter of 2012 indicates an upturn in growth following three quarters of

decline. However, this rebound is due to unusual circumstances (see [Royaume-Uni: l'enlissement](#)), and activity will decline again in the fourth quarter.

[3] Unconventional monetary policies have already been analyzed repeatedly in the case of the Bank of Japan. The implementation of equivalent measures in the United States, the United Kingdom and the euro zone has contributed to greatly amplifying the interest in these issues.

[4] "[Unconventional monetary policy in theory and in practice](#)", *Banca d'Italia Occasional Papers*, no.102.

[5] "[The impact of Federal Reserve asset purchase programmes: another twist](#)", *BIS Quarterly Review*, March, pp. 23-30.

[6] "[Macroeconomic effects of unconventional monetary policy in the euro area](#)", ECB Working Paper no.1397.

[7] "[The ECB and the interbank market](#)", CEPR Discussion Paper no. 8844.

[8] See [OFCE](#) (2010) for an analysis of this hypothesis.

---

## Rent control: What is the expected impact?

Sabine Le Bayon, Pierre Madec and Christine Rifflart

[The decree on rent control](#), which was published in the *Journal officiel* on 21 July, takes effect on 1 August 2012 for one

year. The measure was announced in January 2012 during François Hollande's presidential campaign. It has now been adopted, while awaiting the major reform of landlord-tenant rental relations that is scheduled for 2013.

Difficulties in finding housing and deteriorating living conditions for an increasing share of the population point to growing inequality in housing. This inequality is undermining social cohesion, which is already being hit by the economic crisis. For many people, homeownership is becoming a problematic proposition due to the rising cost of buying, while applications for the allocation of social housing remain on hold for lack of space, and the private rental market is becoming increasingly expensive in large cities because of the soaring price of property. Rent control in these cities is serving as an emergency measure to slow the price increases. This poses a challenge of keeping investors in the private rental market, which is already characterized by a shortage in housing supply and very low rental returns (1.3% in Paris after capital depreciation).

The decree aims to significantly lower market rents [2], which are being driven up by rents at the time of re-letting, *i.e.* during a change of tenant. Unlike rent during the lease period or upon renewal of a lease, which are indexed to the IRL rental benchmark, until 31 July 2012 rents for new tenants were set freely. In 2010, this applied to nearly 50% of re-lettings in the Paris area (60% in Paris). Now, in the absence of major renovations, these will be subject to control. Only rents for new housing that is being let for the first time or renovated properties (where the renovation represents more than one year's rent) will remain uncontrolled (Table 1).

**Table 1. The method of setting rent under current law**

Legal framework set by	Renewal of lease	Re-letting	First letting and new housing
Act of 6 July 1989 as modified	- Indexed to the IRL - In case of obvious under valuation, re-evaluation over 3 years or 6 years if the difference is greater than 10% - In case of renovations, increase agreed in advance between the landlord and tenant	Uncontrolle	Uncontrolle
Decree for the Paris region	- Indexed to the IRL - In case of obvious under-or renovation for an amount at least greater than 1 year's rent, authorized increase of half the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.)	Uncontrolle	Uncontrolle
Decree of 21 July 2012 (applicable in the relevant municipalities)	- Indexed to the IRL - In case of obvious under-valuation or of renovation for an amount at least greater than 1 year's rent in the private or common areas, authorized increase of either half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.)	- Indexed to the IRL - In case of an obvious under-valuation or of renovation for an amount between 6 month's rent and 1 years' rent in the private or common areas, authorized increase either of half of the difference between the last rent and the market rent or of 15% of the actual cost of the renovation (tax incl.) - Uncontrolled if renovation of at least 1 year's rent	Uncontrolle

By using the [data from the Observatoire des Loyers de l'Agglomération Parisienne](#), along with the hypotheses set out in the [OFCE Note \(no. 23 of 26 July 2012\)](#), "Rent control: what is the expected impact?", we evaluated the impact this decree would have had if it had been implemented on 1 January 2007 and made permanent until 2010. According to our calculations, this decree would have resulted not only in sharply slowing increases in rents for re-lettings during the first year it was applied (+1.3% in the Paris area, against 6.4% observed), but also in stabilizing or even reducing rents at the time of the next re-letting, *i.e.* in our example, three years later (in 2010, 0% in Paris and -0.6% in the Paris region). Finally, in 2010, rents would have been 12.4% lower in Paris and 10.7% lower in the Paris region than they would have been in the absence of the measure. This means that in Paris, rents would have been about €20.1 per sq.m instead of the rate of €22.6 per sq.m actually observed (Table 2). For an average size dwelling (46 sq.m) re-let in Paris, the monthly rent would thus have been €924 instead of €1,039, a savings for the tenant of €115 per month. For the Paris region as a whole, using the same assumptions, the rent upon re-letting would have fallen on average to €15.9 per sq.m, instead of the

actual €17.8 per sq.m. For an average rental area upon re-letting of 50 sq.m, the gain would be €95 per month!

Over the longer term, the decree would make it possible to reduce the gap between sitting tenants in place for more than 10 years and new tenants (a gap of 30% in 2010 in the Paris region and 38% in Paris itself), and to improve market fluidity.

Currently, what possibility is there of moving if the mere fact that a couple has children increases the price per sq.m by over 15% in the Paris region? Similarly, the financial incentive to move for a couple living in a four-room 80 sq.m dwelling whose children have left home is zero, because the rent for a 60 sq.m unit with 3 rooms would cost just as much. This premium on being sedentary increases the pressure on the rental market and encourages households to stay in properties that are not suited to their needs, and even hampers labour market mobility.

Can this measure encourage mobility and restore household purchasing power? In the short term, it will certainly benefit the most mobile households by limiting the increase in the share of their budget spent on housing [3]. But these are the households facing the least constraints on income, that is to say, those with high incomes or a relatively low share of income spent on housing. It will also benefit households that are forced to move or those who are running up against the limits on their finances. For all these households, the increase in the share of income on housing will be lower than it would have been without the decree. In contrast, for low-income households whose share is already high [4], the decree won't change anything, because they can ill afford the additional cost of re-letting.

**Table 2. Simulated change in rents upon re-letting in the Paris region using the hypothesis that the decree took effect on 01 Jan 2007**

	Rents noted letting on 31/12/2006	Rents after re-letting on 01/01/2007	Change in 2007	Rents on 31/12/2009 after indexing to IRL and before re-letting	Rents on 01/01/2010 after letting	Change in 2010	Gap between observed and simulated rents upon re-letting in 2010
PARIS		19 €/m <sup>2</sup>	2.2 %	20.1 €/m <sup>2</sup>	20.1 €/m <sup>2</sup>	0 %	-12.4 %
Actual	18.6 €/m <sup>2</sup>	(20.1 €/m <sup>2</sup> )	(+ 8.3 %)	(20,9 €/m <sup>2</sup> )	( 22,6 €/m <sup>2</sup> )	(+8,3 %)	
PARIS REGION		15.4	1.3%	16 €/m <sup>2</sup>	15.9 €/m <sup>2</sup>	-0.6 %	-10.7 %
Actual	15.2 €/m <sup>2</sup>	(16.2 €/m <sup>2</sup> )	(+ 6.4)	(16.9 €/m <sup>2</sup> )	( 17.8 €/m <sup>2</sup> )	(+5.7 %)	

## What are the risks?

While there are real benefits to be expected, these would still need to be made viable by the application of this decree, or at least by the next Act. Besides the difficulty of implementing the decree (absence both of reliable mechanisms to monitor rents in the areas concerned and of a legal framework to allow tenants to assert their new rights), the impact of this measure will be positive for tenants only if the rental supply does not shrink (by maintaining current investors in the market and continued new investment) and if landlords do not seek to offset future rent control by raising the rent at the time of the first let.

Likewise, the realization of improvements in line with the Grenelle 2 environmental consultation or simply maintenance work could wind up being abandoned due to the lengthening of the amortization period for landlords compared with the previous situation. Conversely, some owners might be encouraged to carry out major renovations (in excess of one year's rent) and "to upgrade the dwelling" in order to be able to freely determine the rent. This would give the landlord a margin of safety to offset any subsequent shortfall. These increases, if they occurred, would penalize less creditworthy tenants and would promote the process of gentrification already at work in the areas under greatest pressure. We could then see increasing differences between the market for

“rundown housing” and that for renovated housing.

This decree should in the short term limit the extent of disparities in the areas under greatest pressure, at no cost to the government. But it will not solve the problem for the poorest households of the share of income going to housing: to do this, it is necessary to increase the stock of social housing, to improve its fluidity and to significantly upgrade housing subsidies [5], which would require a major financial effort. The fundamental problem remains the lack of supply, particularly in urban areas, where by definition the available land is scarce and expensive, with higher rents simply passing on the price of property. However, to ease housing prices, more land needs to be available, with a greater density where possible, transport needs to be developed to facilitate the greater distance travelled between residential areas and workplaces, and so on. These are the levers that need to be used if we are to improve the housing conditions of less well-off households.

---

[1] The decree applies in municipalities where the rent increases seen over the period 2002-2010 were more than double the increase in the IRL benchmark (*i.e.* 3.2% per year) and the market rent per sq.m exceeds the national average outside the Paris region (€11.1 /sq.m) by 5%. This includes nearly 1,400 communes in 38 cities (27 in metropolitan France and 11 in overseas departments).

[2] There are two types of rent: the average rent is the rent of all rental housing, whether vacant or occupied; and the market rent is the rent of all dwellings available on the rental market, *i.e.* new rental accommodation and re-lettings. This is very close to the rent for re-lettings, as residences for first-time lets represent only a small portion of the



available supply.

[3] This share has increased for 15 years for households in the private rental sector, and particularly the less well-off.

[4] In 2010, more than half of private sector tenants spent an income share on housing (net of housing benefit) of over 26.9%, but above all, the share was 33.6% for the poorest 25% of households.

[5] According to the IGAS report "Evaluation of personal housing assistance", in 2010, 86.3% of rents in the private rental sector were greater than the maximum rent taken into account for calculating housing benefit. Any increase in rent is thus borne entirely by the tenant.