Spain: a 2018 budget on target, if the Commission likes it or not

By Christine Rifflart

With a deficit of 3.1% of GDP in 2017, Spain has cut its deficit by 1.4 points from 2016 and has been meeting its commitments to the European Commission. It should cross the 3% threshold in 2018 without difficulty, making it the latest country to leave the excessive deficit procedure (EDP), after France in 2017. The 2018 budget was first presented to the European Commission on April 30 and then approved by Spain's Congress of Deputies on May 23 amidst a highly tense political situation, which on June 1 led to the dismissal of Spain's President Mariano Rajoy (supported by the Basque nationalist representatives of the PNV Party who had approved the 2018 budget a few days earlier). It should be passed in the Senate soon by another majority vote. The expansionary orientation of the 2018 budget, backed by the government of the new Socialist President Pedro Sanchez, does not satisfy the Commission, which considers the adjustment of public finances insufficient to meet the target of 2.2% of GDP included in the 2018-2021 Stability and Growth Pact (SGP). According to the hypotheses of the previous government, not only would the deficit fall below 3% but the nominal target would be respected.

Admittedly, while, given the strong growth expected in Spain in 2018, the public deficit will easily be below 3% in 2018 and therefore meet the requirements set in the EDP, the new budget act is not in line with the fiscal orthodoxy expected by Brussels. The lack of a People's Party majority in Congress led ex-President Mariano Rajoy into strategic alliances with Ciudadanos and the PNV to get the 2018 budget adopted (with the hope, in particular, of avoiding early parliamentary elections), at the price of significant concessions:

– An increase in civil servants' salaries of 1.75%[1] in 2018 and at least 2.5% in 2019, with a larger increase if GDP grows by more than 2.5% (estimated cost of 2.7 billion euros in 2018 and 3.5 billion in 2019 according to the outgoing government);

– Lower taxes for low-income households (via the increase in the minimum tax threshold from 12,000 to 14,000 euros income per year, tax credits for childcare expenses, assistance for disabled people and large families, and a reduction in tax on gross wages between 14,000 and 18,000 euros) (cost 835 million in 2018 and 1.4 billion in 2019);

– The revaluation of pensions by 1.6% in 2018 and by 1.5% in 2019 (cost of 1.5 and 2.2 billion), in addition to a rise of up to 3% in the old age and non-taxpayer minimum, and between 1% and 1.5% for the lowest pensions (cost 1.1 billion in 2018).

According to the former government, these measures will cost a little more than 6 billion euros in 2018 (0.5% of GDP) and nearly 7 billion in 2019 (0.6% of GDP). The revaluation of pensions should be partly covered by the introduction of a tax on digital activities (Google tax) in 2018 and 2019, with revenues of 2.1 billion euros expected. In the end, spending, which was expected to fall by 0.9 GDP point in 2018 based on the undertakings made in the previous 2017-2020 SGP, would fall by only 0.5 GDP point in the 2018-2021 SGP (to 40.5% of GDP) (Table). But above all, despite the tax cuts just introduced, the extra revenue expected from the additional growth should represent 0.1 GDP point (to 38.3% of GDP). In fact, the budget's redistributive character, combined with the downward revision of the impact of the Catalan crisis on the economy (0.1% of GDP according to the AIReF [2]) led all the institutes (Bank of Spain, the Government, the European Commission) to raise their 2018 growth forecasts from last winter by 0.2 or 0.3 GDP point to bring it slightly below 3%

(2.6% for the OFCE according to our April forecasts [3]).

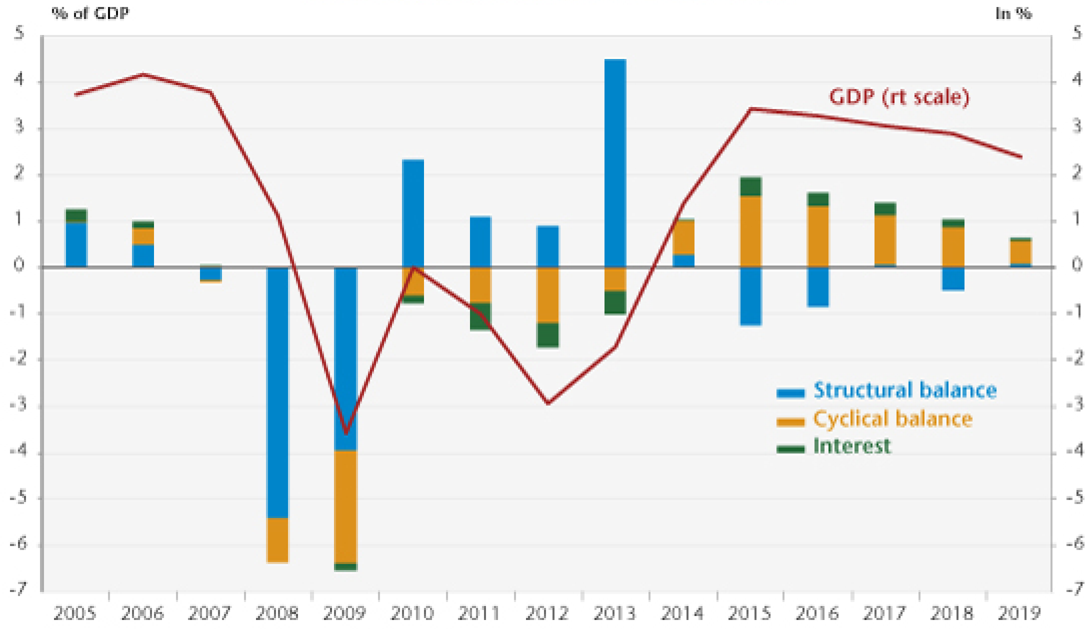
Table. Breakdown of Spanish public finances

% of GDP	2017			2018			2019*		
	Gvt	EC	OFCE	Gvt	EC	OFCE	Gvt	EC	OFCE
GDP	3.1	3.1	3.1	2.7	2.9	2.6	2.4	2.4	1.9
Potential GDP	1.0	1.0	0.9	1.0	1.2	1.1	1.3	1.4	1.1
Output gap	-1.6	-0.2	-2.9	0.1	1.4	-1.4	1.2	2.3	-0.6
Budget balance	-3.1	-3.1	-3.1	-2.2	-2.6	-2.3	-1.3	-1.9	-1.5
Revenue	37.9	37.9		38.3	38.1		38.5	38.1	
Spending	41.0	41.0		40.5	40.7		39.8	40.0	
Cyclical balance	-0.8	-0.1	-1.5	0.0	0.8	-0.7	0.6	1.3	-0.3
Interest	2.6	2.6	2.6	2.4	2.4	2.4	2.3	2.4	2.3
Primary balance adjusted for cycle	0.3	-0.4	1.0	0.2	-1.0	0.8	0.4	-0.8	1.1

* In 2019, the cyclically-adjusted primary balance should improve by 0.2 GDP point due to the elimination of exceptional measures, estimated by the government at 0.2 GDP point.
Sources: European Commission; OFCE – April 2018 forecasts.

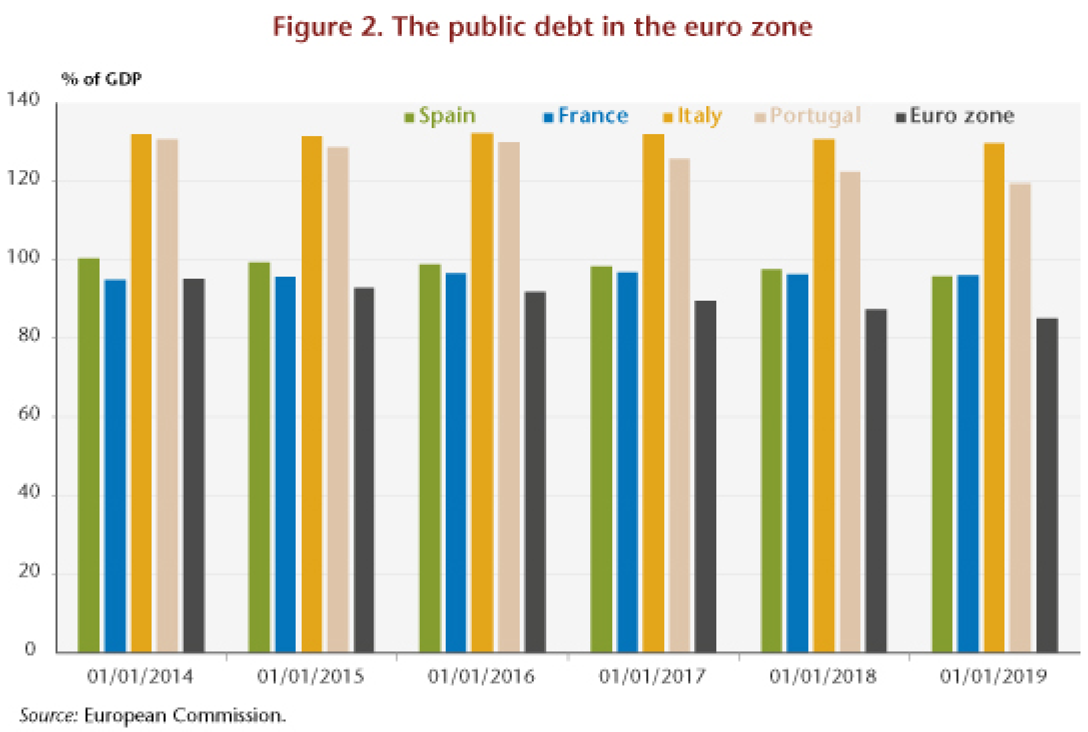
Nevertheless, beyond the shared optimism about Spanish growth, the calculations of the cost of the new measures differ between the Spanish authorities and the Commission. According to the government, the increase in growth should, as we have said, boost tax revenues and neutralize the expected cost of new spending. In 2018, the 0.9 percentage point reduction in the deficit (from 3.1% to 2.2%) would therefore be achieved by the 0.8 GDP point growth in the cyclical balance, combined with the 0.2 point fall in debt charges, with the structural balance remaining stable (fiscal policy would become neutral rather than restrictive as set out in the earlier version of the Pact). But this scenario is not shared by Brussels[4], for whom the cost of the measures, and in particular of the increase in civil servants' salaries, is underestimated. Expenditures are expected to be 0.2 GDP point higher and revenue 0.2 GDP point higher than the government has announced. According to the Commission, the cyclical balance is expected to improve by 0.9 GDP point, but the fiscal impulse would worsen the structural balance by 0.6 GDP point. In these conditions, the deficit would bypass the 3% mark, but fiscal policy would clearly become expansionary and the 2.2% target would not be hit. The public deficit stood at 2.6% in 2018 (Figure 1).

Figure 1. Breakdown of the public balance, as % of GDP, according to the European Commission



Source: European Commission.

This more expansionary orientation of the 2018 budget results above all from the political considerations of the former Rajoy government and its effort to deal with the impossibility of governing (facts have demonstrated the fragility of this position). Nevertheless, the timing is ideal – because the only budget commitment required in 2018 is to cross the 3% deficit threshold in order to get out of the corrective arm of the SGP. The year 2018 therefore makes it possible to implement a generous fiscal policy, while crossing the 3% mark, without exposing the country to sanctions. The situation will be more delicate in 2019, when EU rules aimed at reducing a debt that is still well above 60% of GDP will be applied, notably by adjusting the structural balance (Figure 2).



[1] https://www.boe.es/boe/dias/2018/03/26/pdfs/BOE-A-2018-4222.pdf

[2] https://elpais.com/economia/2018/04/17/actualidad/1523949570_477094.html?rel=str_articulo#1526464987471

[3] See the Spain part of the dossier: https://www.ofce.sciences-po.fr/pdf/revue/11-155OFCE.pdf , pp 137-141.

[4] Nor by the AIReF.

Trump's budget policy:

Mortgaging the future?

By Christophe Blot

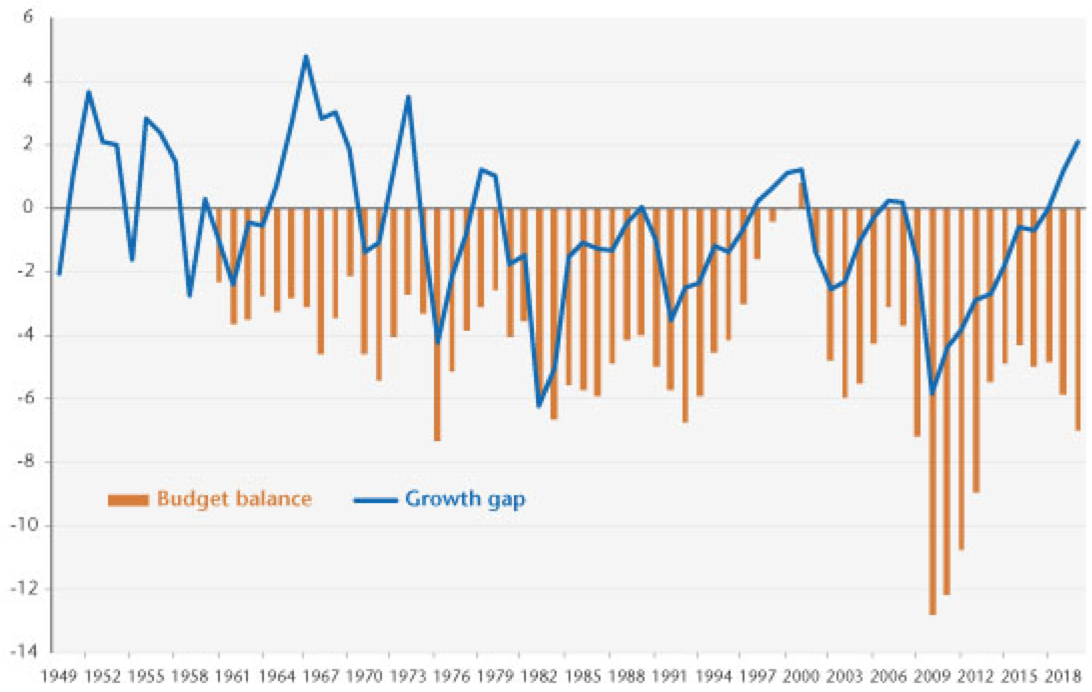
While the momentum for growth has lost steam in some countries – Germany, France and Japan in particular – GDP in the United States is continuing to rise at a steady pace. Growth could even pick up pace in the course of the year as a highly expansionary fiscal policy is implemented. In 2018 and 2019, the fiscal stimulus approved by the Trump administration – in December 2017 for the revenue component, and in February 2018 for the expenditure side – would amount to 2.9 GDP points. This level of fiscal impulse would come close to that implemented by Obama for 2008. However, Trump's choice has been made in a very different context, since the unemployment rate in the United States fell back below the 4% mark in April 2018, whereas it was accelerating 10 years ago, peaking at 9.9% in 2009. The US economy should benefit from the stimulus, but at the cost of accumulating additional debt.

Donald Trump had made fiscal shock one of the central elements of his presidential campaign. Work was begun in this direction at the beginning of his mandate, and came to fruition in December 2017 with the passing of a major tax reform, the Tax Cuts and Jobs Act [1], which provided for a reduction in household income tax – in particular by reducing the maximum marginal income tax rate – and corporation tax, whose effective rate would fall from 21% to 9% by 2018 [2]. In addition to this initial stimulus, expenditure will also rise in accordance with the agreement reached with the Democrats in February 2018, which should lead to raising federal spending by USD 320 billion (1.7 GDP points) over two years. These choices will push up domestic demand through boosting household disposable income and corporate profitability, which should stimulate consumption and investment. The multiplier effect – which measures the impact on GDP of a one dollar increase in public spending or a one dollar cut in taxes –

will nevertheless be relatively small (0.5) because of the US position in the cycle.

Moreover, the public deficit will expand sharply, to reach a historically high level outside a period of crisis or war (graph). It will come to 5.8% of GDP in 2018 and 7.0% in 2019, while the growth gap will become positive [3]. While the risk of overheating seems limited in the short term, the fact remains that the fiscal strategy being implemented could push the Federal Reserve to tighten monetary policy more quickly. However, an excessive rise in interest rates in a context of high public debt would provoke a snowball effect. Above all, by choosing to re-launch the economy in a favourable environment, the government risks being forced to make adjustments later when the economic situation deteriorates. This pro-cyclical stance in fiscal policy risks amplifying the cycle by accelerating growth today while taking the risk of accentuating a future slowdown. With a deficit of 7% in 2019, fiscal policy’s manoeuvring room will actually shrink.

Figure. A pro-cyclical budget policy



Sources: CBO and NIPA, OFCE April 2018 forecasts.

[1] See the section on Budget policy: Crisis-free acceleration ["Politiques budgétaires : accélération sans crise"] in our April 2017 forecast for greater detail.

[2] See here for more on this.

[3] The growth gap expresses – as a % of potential GDP – the difference between observed GDP and potential GDP. Recall that potential GDP is not observed but estimated. The method of calculation used by the Congressional Budget Office (CBO) is explained here.

The French economy: Lasting or transitory slowdown?

By the OFCE France team

On Friday, April 27, the INSEE published the national accounts for the first quarter of 2018. With growth of 0.3%, the French economy seems to be slowing down, even though after five years of sluggish growth (0.8% on average over the period 2012-16) a recovery finally materialized in 2017 when GDP rose 2%. While the quarterly profile of GDP growth in 2018 will be marked by the timing of fiscal measures, which will affect purchasing power (rise in indirect taxation and the CSG tax) and thus the trajectory of household consumption, the impact, which is anticipated in our spring forecast (Table), should be only provisional. Household purchasing power should increase in the following quarters, with a sharp acceleration at the end of the year driven by the fall in the housing tax and the second tranche of reductions in social security contributions.

The increase in consumption, weak in the first half and strong in the second, will therefore lead growth to pick up pace through the year, from 0.3% in the first quarter to 0.7% by year end. In 2019, as a result of the rise in the tax measures to shore up household purchasing power, the latter will increase by 2.4% (from 1.6% in 2018), boosting consumption for the year as a whole (2.2% in 2019 after 1.5% in 2018), despite a further rise in indirect taxation.

Business investment is expected to continue its robust growth in 2018 and 2019, supported by the ongoing improvement in profit rates, the continued low cost of capital, and growing demand, which is keeping the utilization rate at a high level. After shrinking for several years, general government investment is set to rise again in 2018 and 2019, with the gradual roll-out of the Grand Plan d'Investissement [Major Investment Plan] and the goal of maintaining investment by local authorities. Household investment should slow, as indicated by the downturn in housing demand surveys and the outlook for housing starts, probably in connection with the reduction in budget allocations for housing and with the wait-and-see attitude on the construction market following the discussion to be expected about the ELAN bill.

A pick-up in exports, confirmed by favorable survey trends, record levels of exporter margins and strong productive investment will translate into strengthening export market shares. Given the dynamic economic environment in the euro zone, foreign trade will no longer be a drag on France's growth in 2018 and 2019.

Given this robust growth in 2018 and 2019, job creation, driven by the market sector, will remain dynamic (+194,000 in 2018 and +254,000 in 2019), which will push down the unemployment rate to 8.4% by the end of 2018 and to 7.9% by the end of 2019 (compared to 8.6% in the fourth quarter of 2017). On the other hand, the sharp fall in new government-assisted contracts in 2018 will slow the pace of the reduction in unemployment, despite the ramp-up of the Plan Formation et de la Garantie jeunes (Training Plan and Youth Guarantee).

The public deficit will be reduced only slowly (2.4% of GDP in 2018 and 2.5% in 2019, after 2.6% in 2017), but this masks a sharp improvement in the government balance, which will reach 1.6% in 2019 excluding the one-off measure related to the conversion of the CICE credit into reductions in social contributions. However, deficit reduction should be sufficient to ensure that France leaves the corrective arm of the Stability Pact and to begin to reduce the public debt (from 97% of GDP in 2017 to 95.4% in 2019).

Tableau. France: Summary of forecasts

	2017				2018				2019				2016	2017	2018	2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0.7	0.6	0.5	0.7	0.3	0.4	0.5	0.7	0.5	0.5	0.5	0.6	1.1	2.0	2.0	2.1
GDP per capita	0.6	0.5	0.4	0.6	0.2	0.3	0.4	0.6	0.4	0.4	0.4	0.5	0.7	1.5	1.6	1.7
Public consumption	0.2	0.3	0.5	0.2	0.2	0.4	0.5	0.8	0.5	0.5	0.5	0.6	2.1	1.3	1.5	2.2
Consumption	0.3	0.5	0.6	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.1	1.2	1.6	1.2	0.6
Total GFCF, of which:	1.7	0.9	0.9	1.1	0.7	0.9	0.9	0.9	0.7	0.7	0.7	0.8	2.7	3.8	3.6	3.1
NFCs & Individual firms	2.4	1.0	1.1	1.5	0.8	1.1	0.9	1.1	0.7	0.7	0.8	0.9	3.4	4.4	4.3	3.5
Households	1.8	1.4	0.9	0.6	0.5	0.4	0.5	0.4	0.2	0.3	0.2	0.2	2.4	5.3	2.5	1.3
Public authorities	-0.6	0.1	-0.2	0.5	0.8	0.9	1.0	1.0	1.0	1.0	1.0	1.0	-0.1	-1.0	2.6	4.0
Exports of goods & services	-0.7	2.2	1.0	2.5	0.6	0.4	0.8	1.0	1.0	0.8	0.9	1.0	1.9	3.3	4.6	3.6
Imports of goods & services	1.2	0.0	2.2	0.3	0.8	0.9	0.8	1.1	1.0	0.7	0.8	0.8	4.2	4.1	3.5	3.6
Contributions:																
Domestic demand excl. inventories	0.6	0.5	0.6	0.5	0.3	0.5	0.5	0.7	0.5	0.5	0.5	0.6	2.0	1.9	2.0	2.1
Change in inventories	0.7	-0.5	0.3	-0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.4	-0.1	0.0
Foreign trade	-0.6	0.7	-0.4	0.7	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	-0.8	-0.3	0.2	0.0
Consumer prices (HCPI)*	1.5	1.0	0.9	1.2	1.6	1.2	1.5	1.4	1,3	1.4	1.7	1.8	0.3	1.2	1.4	1.6
Unemployment rate	9.3	9.1	9.3	8.6	8.6	8.6	8.5	8.4	8.3	8.2	8.1	7.9	9.8	9.1	8.5	8.1
Public deficit, % of GDP													-3.4	-2.6	-2.4	-2.5
Public debt, % of GDP													96.6	97.0	96.6	95.4
Fiscal impulse, GDP points**													0.0	0.2	0.0	-0.2
Euro zone GDP	0.6	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	1.8	2.5	2.3	1.9

* *for the quarters, year on year; for the years, annual average. In grey, OFCE forecasts.*

** *measured as the inverse of the structural fiscal effort.*

Sources: INSEE, OFCE forecasts April 2018.

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 Sienna 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.

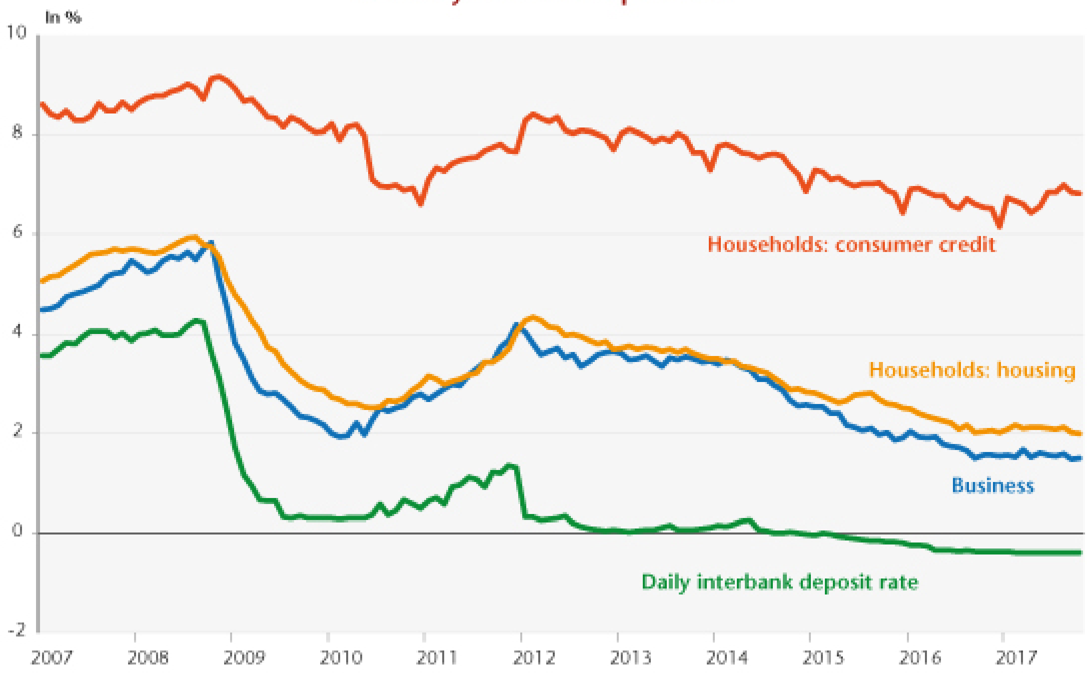
In the third quarter of 2017, the contribution of domestic demand to growth (consumption and investment) reached 0.8 point, but massive destocking attenuated the impact on growth (-0.6 point). Gross Fixed Capital Formation (GFCF) leapt 3% in the third quarter of 2017, returning to its 2012 level, thanks 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].

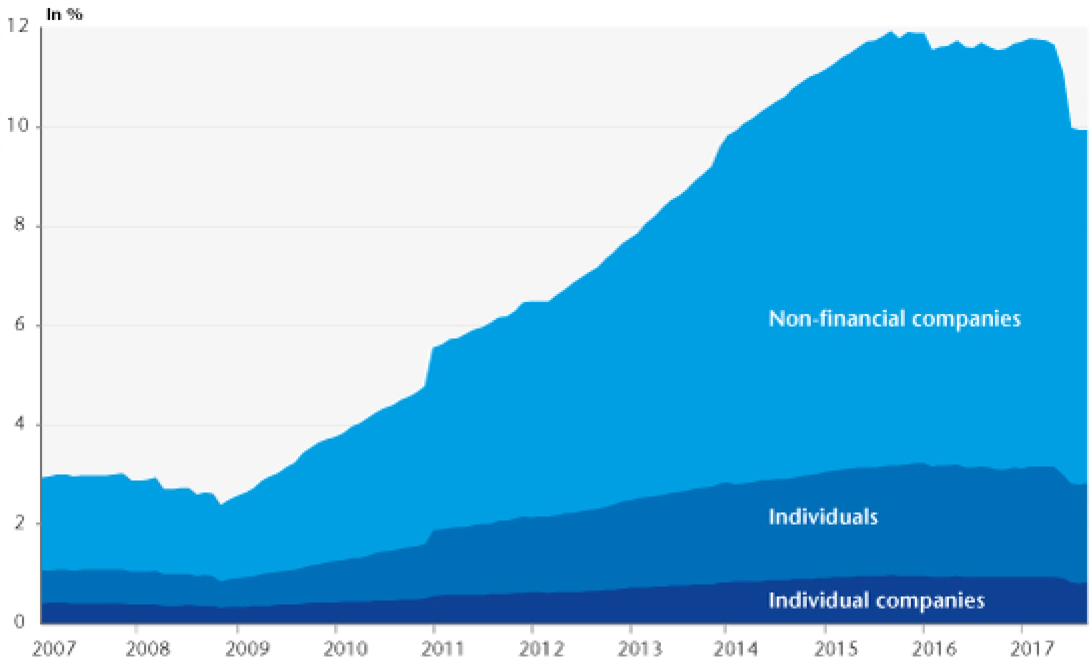
Moreover, the productive investment rate recovered strongly in the third quarter of 2017: it should continue to rise in 2018 and 2019, thanks in particular to a higher pace of extra-depreciation, to the ECB’s quantitative easing programme and to clearing up the situation of the banks, which should allow 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.

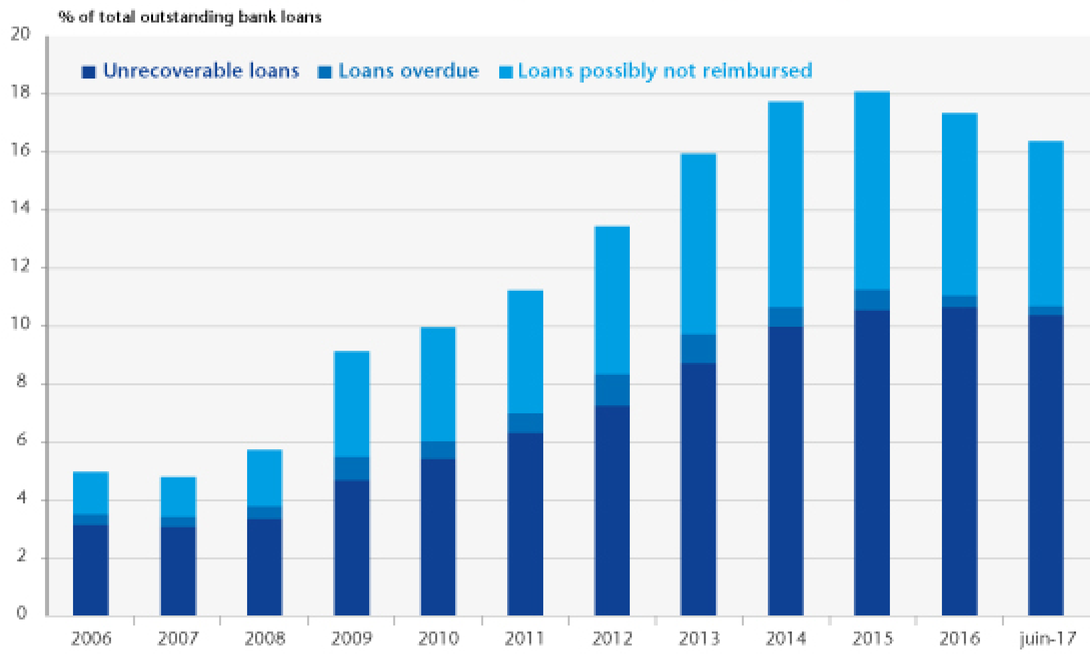
In 2017, it was domestic demand that was driving growth; the contribution of foreign trade was zero because of the dynamism of imports and the absence of any improvement in price competitiveness. We anticipate that the contribution of foreign trade will be null in 2018 and slightly positive in 2019 thanks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



Note: Non-performing loans can be broken down into three mutually exclusive categories:
- Unrecoverable loans, which designates exposure to a debtor who's insolvent;
- Loans possibly not reimbursed, which designates exposure to a debtor who has little chance of reimbursing in full without some action such as the invoking of guarantees;
- Loans with overdue repayments, which designates any exposure where the delay in reimbursement exceeds 90 days.

Sources: Bank of Italy, Financial stability reports.

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 Sienna 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
Contributions:												
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 Sienna

[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.

Brexit: What are the lessons for Europe?

By Catherine Mathieu and Henri Sterdyniak

The British vote to leave the European Union is aggravating the political crisis in Europe and in many European countries. Leaving the EU has become a possible alternative for the peoples of Europe, which may encourage parties advocating national sovereignty. The United Kingdom's departure automatically increases the weight of the Franco-German couple, which could destabilize Europe. If Scotland leaves the UK to join the EU, independence movements in other regions (Catalonia, Corsica, etc.) could seek a similar outcome. But the fragility of Europe also stems from the failure of the strategy of "fiscal discipline / structural reforms".

The departure of the United Kingdom, a fierce advocate of economic liberalism and opponent of any increase in the European budget and in the powers of Europe's institutions, as well as of a social Europe, could change the dynamics of the debate in Europe, but some East European countries, the Netherlands and Germany have always had the same position as the UK. The departure will not, by itself, cause a shift in European policy. On the other hand, the liberalization of services and the financial sector, which the UK has been pushing for, could be slowed. The British Commissioner, Jonathan Hill, head of financial services and capital markets, should be promptly replaced. This will raise the sensitive issue of British EU officials, who in any case can no longer occupy positions of responsibility.

This will also open up a period of economic and financial uncertainty. The reaction of the financial markets, which do not like uncertainty and are in any case volatile, should not be accorded an excessive importance. The pound sterling has of course rapidly depreciated by 10% against the euro, but it was probably overvalued, as evidenced by the British current account deficit of around 6.5% of GDP in 2015.

According to Article 50 of the European Constitution, any country that decides to leave the EU should negotiate a withdrawal agreement, which sets the exit date[1]. Otherwise, after two years the country is automatically outside the Union. The negotiations will be delicate, and must of necessity deal with all the issues. During this period, the UK will remain in the EU. European countries will have to choose between two attitudes. An understanding attitude would be to sign a free trade agreement quickly, with the goal of maintaining trade and financial relations with the UK as a privileged partner of Europe. This would minimize the economic consequences of Brexit for both the EU and the UK. However, it seems difficult to see how the UK could simultaneously enjoy both complete freedom for its own economic organization and full access to Europe’s markets. The UK should not enjoy more favourable conditions than those of the current members of the European Free Trade Association (EFTA – Norway, Iceland and Liechtenstein) and Switzerland; like them, it should undoubtedly integrate the single market legislation (in particular the free movement of persons) and contribute to the EU budget. The issue of standards, such as the European passport for financial institutions (this is now granted to the EFTA countries, but not to Switzerland), etc., would be posed very quickly. The UK may have to choose whether to comply with European standards on which it will not have a say or to be subject to regulatory barriers. The negotiations will of course be open-ended. The UK could argue for a Europe that is more open to countries outside the EU. But how much weight will it have once it’s out?

A tough attitude intended to punish London so as to set an example and deter future candidates from leaving would instead require the UK to renegotiate all trade treaties from scratch (i.e. from WTO rules) so as to encourage multinational companies to relocate their factories and headquarters to mainland Europe and close British banks’ access to the European market in order to push them to repatriate euro zone banking and financial activity to Paris or Frankfurt. But it would be difficult for Europe, a supporter of the free movement of goods, services, people and business, to start erecting barriers against the UK. The euro zone has a current account surplus of 130 billion euros with the UK: does it want to call this into question? European companies that export to the UK would oppose this. Industrial cooperation agreements (Airbus, arms, energy, etc.) could only be challenged with difficulty. A priori it would seem unlikely that London would erect tariff barriers against European products, unless in retaliation. Conversely, London could play the card of setting up tax and regulatory havens, particularly in financial matters. It could not, however, avoid international constraints (agreements such as at COP21, on the fight against tax avoidance, on the international exchange of tax and banking information, etc.). The risk would be to start a costly game of mutual reprisals (one that it would be difficult for Europe, divided between countries with different interests, to lead).

Upon leaving the European Union, the United Kingdom, a net contributor to the EU, would a priori save about 9 billion euros per year, or 0.35% of its GDP. However, the EFTA countries and Switzerland contribute to the EU budget as part of the single market. Again, everything depends on the negotiations. It would seem that the savings for the UK will be only about 4.5 billion euros, which the other Member countries will have to make up (at a cost of around 0.5 billion euros for France).

Given the uncertainty of the negotiations (and of exchange rate trends), all assessments of Brexit's impact on other EU countries can only be very tentative. Moreover, this will necessarily have only a second-order impact on the EU countries: if tariff or non-tariff barriers reduce French exports of cars to the UK and of British cars to France, French manufacturers can supply their national markets while facing less competition and can also turn to third countries. It is nevertheless useful to have an order of magnitude: in 2015, exports from France (from the EU) to the UK represented 1.45% of GDP (respectively 2.2%); exports from the UK to the EU represented 7.1% of British GDP. A priori, an equivalent impact on UK / EU trade will have 3.2 times less impact on the EU than on the UK.

According to the OECD[2], the fall in EU GDP will come to 0.8% by 2023 (against 2.5% for the UK), whereas remaining in the EU, participating in the deepening of the single market and signing free trade agreements with the rest of the world would lead to a rise in GDP for all EU countries. But how credible is this last assertion, given the euro zone's current poor performance and the cost for the economic and social cohesion of European countries of opening the borders? But if Europe is functioning poorly, then leaving should improve market prospects. The UK's foreign trade would suffer a contraction, which would hurt its long-term productivity, but despite its openness the British economy's productivity is already weak. The OECD does not raise the question of principle: should a country give up its political sovereignty to benefit from the potential positive effects of trade liberalization?

According to the Bertelsmann Foundation[3], the reduction in EU GDP (excluding the UK) in 2030 would range from 0.10% in the case of a soft exit (the UK having a status similar to that of Norway) to 0.36% in the worst case (the UK having to renegotiate all its trade treaties); France would be little affected (-0.06% to -0.27%), but Ireland, Belgium and Luxembourg more so. The study multiplied these figures by five to incorporate medium-term dynamics, with the reduction in foreign trade expected to have adverse effects on productivity.

Euler-Hermes also reported very weak figures for the EU countries: a fall of 0.4% in GDP with a free trade agreement and of 0.6% without an agreement. The impact would be greater for the Netherlands, Ireland and Belgium.

Europe needs to rebound, with or without the United Kingdom…

Europe must learn the lessons from the British crisis, which follows on the debt crisis of the southern European countries, the Greek crisis, and austerity, as well as from the migrant crisis. It will not be easy. There is a need to rethink both the content of EU policies and their institutional framework. Is the EU up to the challenge?

The imbalances between EU Member countries grew from 1999 to 2007. Since 2010, the euro zone has not been able to develop a coordinated strategy enabling it to restore a satisfactory level of employment and reduce the imbalances between Member states. The economic performance of many euro zone countries has been poor, and downright catastrophic in southern Europe. The strategy implemented in the euro zone since 1999, and strengthened since 2010 – "fiscal discipline / structural reforms" – has hardly produced satisfactory results socially or economically. On the contrary, it gives people the feeling of being dispossessed of any democratic power. This is especially true for countries that benefited from assistance from the Troika (Greece, Portugal, Ireland) or the European Central Bank (Italy, Spain). The Juncker plan that was intended to boost investment in Europe marked a turning point in 2015, but it remains timid and poorly taken up: it was not accompanied by a review of macroeconomic and structural policy. There are important disagreements in Europe both between nations and between political and social forces. In the current situation, Europe needs a strong economic strategy, but it has not been possible to agree on one collectively in today's Europe.

There are two fundamental reasons for this morass. The first concerns all the developed countries. Globalization is creating a deeper and deeper divide between those who benefit from it and those who lose[4]. Inequalities in income and status are widening. Stable, well-paid jobs are disappearing. The working classes are the direct victims of competition from low-wage countries (Asian countries and former Soviet bloc countries). They are being asked to accept cuts in wages, social benefits, and employment rights. In this situation, the elite and the ruling classes can be open-spirited, globalist and pro-European, while the people are protectionist and nationalist. This same phenomenon underlies the rise of France's National Front, Germany's AFD, UKIP, and in the US the Republican Donald Trump.

Europe is currently operated according to a liberal, technocratic federalism, which seeks to impose on people policies and reforms that they are refusing, sometimes for reasons that are legitimate, sometimes questionable, and sometimes contradictory. The fact is that Europe in its current state is undermining solidarity and national cohesion and preventing countries from choosing a specific strategy. The return to national sovereignty is a general temptation.

Furthermore, Europe is not a country. There are significant differences in interests, situations, institutions and ideologies between peoples, which render progress difficult. Because of the differences in national situations, many arrangements (the single monetary policy, the free movement of capital and people) pose problems. Rules that had no real economic foundation were introduced in the Stability Pact and the Budgetary Treaty: these did not come into question after the financial crisis. In many countries, the ruling classes, political leaders and senior civil servants have chosen to minimize these problems, so as not to upset European construction. Crucial issues concerning the harmonization of taxes, social welfare, wages and regulations have been deliberately forgotten. How can convergence towards a social Europe and a fiscal Europe be achieved between countries whose peoples are attached to structurally different systems? Given the difficulties of monetary Europe, who would wish for a budgetary Europe, which would take Europe further from democracy?

In the UK-EU Agreement of 19 February, the UK has recalled the principles of subsidiarity. It is understandable that countries concerned about national sovereignty are annoyed (if not more) by the EU’s relentless intrusions into areas that fall under national jurisdiction, where European intervention does not bring added value. It is also understandable that these countries refuse to constantly justify their economic policies and their economic, social or legal rules to Brussels when these have no impact on the other Member states. The UK noted that the issues of justice, security and individual liberties are still subject to national competence. Europe needs to take this feeling of exasperation into account. After the British departure, it needs to decide between two strategies: to strengthen Europe at the risk of further fuelling people's sense of being powerless, or to scale down the ambition of European construction.

The departure of the United Kingdom, the de facto distancing of some Central European countries (Poland, Hungary) and the reticence of Denmark and Sweden could lead to an explicit switch to a two-tiered EU. Many national or European intellectuals and politicians think that this crisis could provide just such an opportunity. Europe would be explicitly divided into three groupings. The first would bring together the countries of the euro zone, which would all agree to new transfers of sovereignty and to build a stronger budgetary, fiscal, social and political union. A second grouping would bring together the European countries that do not wish to participate in such a union. The last grouping would include countries linked to Europe through a free trade agreement (currently Norway, Iceland, Liechtenstein and Switzerland, and later the UK and other countries).

Such a project would, however, pose many problems. Europe's institutions would have to be split between euro zone institutions operating on a federal basis (which need to be made more democratic) and EU institutions continuing to operate in the Union manner of the Member states. Many countries currently outside the euro zone are opposed to this kind of change, which they feel would marginalize them as "second-class" members. The functioning of Europe would become even more complicated if there were both a European Parliament and a euro zone Parliament, euro zone commissioners, euro zone and EU financial transfers, and so on. This is already the case for instance with the European Banking Agency and the European Central Bank. Many questions would have to be decided two or three times (once in the euro zone, again at the EU level, and again for the free trade area).

Depending on the issue, the Member country could choose its grouping, and things would quickly head towards an à la carte union. This is hardly compatible with the democratization of Europe, as soon there would be a Parliament for every question.

The members of the third grouping would then be in an even more difficult situation, with the obligation to comply with regulations over which they had no power. Should our partner countries be placed in the dilemma of either accepting heavy losses of sovereignty (in political and social matters) or being denied the benefits of free trade?

There is clearly no agreement between the peoples of Europe, even within the euro zone, on moving towards a federal Europe, with all the convergences that this would imply. In the recent period, the five Council Presidents and the Commission proposed new steps towards European federalism: creating a European Budget Committee, establishing independent Competitiveness Councils, conditioning the granting of Structural Funds on respect for budgetary discipline and the implementation of structural reforms, establishing a European Treasury and a euro zone minister of finance, moving towards a financial union, and partially unifying the unemployment insurance systems. These developments would reinforce the technocratic bodies to the detriment of democratically elected governments. It would be unpleasant if these were implemented, as is already partially the case, without the people being consulted.

Furthermore, no one knows how to proceed with convergence on tax and social matters. Upwards or downwards? Some proposals call for a political union in which decisions are taken democratically by a euro zone government and parliament. But can anyone imagine a federal authority, even a democratic one, that is able to take into account national specificities in a Europe composed of heterogeneous countries? What about decisions concerning the French pension system taken by a

European Parliament? Or a finance minister for the zone imposing spending cuts on Member countries (as the Troika did in Greece)? Or automatic standards on public deficits? In our opinion, given the current disparity in Europe, economic policies must be coordinated between countries, not decided by a central authority.

Europe needs to reflect on its future. Using the current crisis to move forward towards an "ever closer union" without more thought would be dangerous. Europe must live with a contradiction: the national sovereignties that peoples are attached to have to be respected as much as possible, while Europe must implement a strong and consistent macroeconomic and social strategy. Europe has no meaning in itself, but only in so far as it implements the project of defending a specific model of society, developing it to integrate the ecological transition, eradicating mass unemployment, and solving the imbalances within Europe in a concerted and united manner. But there is no agreement within Europe on the strategy needed to achieve these goals. Europe, which has been unable to generally lead the Member countries out of recession or to implement a coherent strategy to deal with globalization, has become unpopular. Only after a successful change of policies will it regain the support of the peoples and be able to make institutional progress.

[1] See in particular the report of the French Senate by Albéric de Montgolfier*: Les conséquences économiques et budgétaires d'une éventuelle sortie du Royaume-Uni de l'Union Européenne [The economic and budgetary consequences of a future withdrawal of the United Kingdom from the European Union],* June 2016.

[2] OECD, 2016, *The Economic Consequences of Brexit: A Taxing Decision*, April. Note that to treat leaving the euro as a tax increase does not make economic sense and represents a communication that is unworthy of the OECD.

[3] *Brexit – potential economic consequences if the UK exits the EU*, Policy Brief, 2015/05.

[4] See, for example, Joseph E. Stiglitz, 2014, "Le prix de l'inégalité", *Les Liens qui libèrent*, Paris.

The effects of the oil counter-shock: The best is yet to come!

By Eric Heyer and Paul Hubert

After falling sharply over the past two years, oil prices have been rising once again since the start of the year. While a barrel came in at around 110 dollars in early 2014 and 31 dollars in early 2016, it is now close to 50 dollars.

Will this rise in oil prices put a question mark over the gradual recovery that seems to have begun in France in 2016?

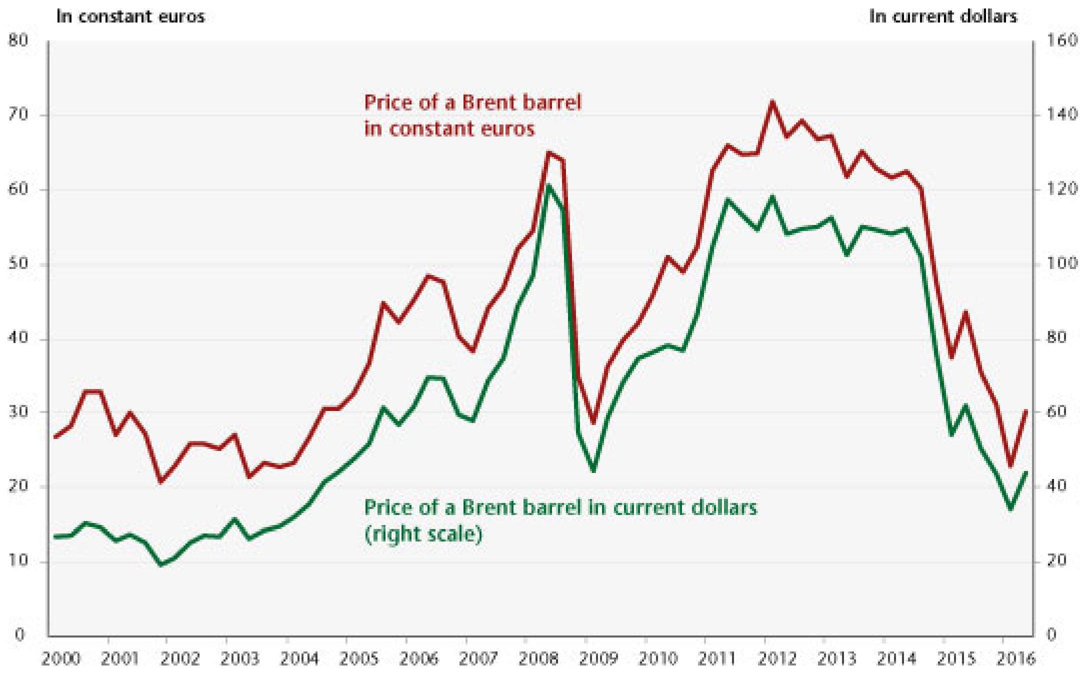
In a recent study, we attempted to answer three questions about the impact of oil prices on French growth: will a change in oil prices have an immediate effect, or is there a time lag between the change and the impact on GDP? Are the effects of rises and falls in oil prices asymmetrical? And do these effects depend on the business cycle? The main results of our study can be summarized as follows:

1. There is a time lag in the impact of oil price variations on French GDP. Over the period 1985-2015 the lag was on average about 4 quarters;

1. The impact, whether downward or upward, is significant only for variations in oil prices greater than 1 standard deviation;
2. The asymmetric effect is extremely small: the elasticity of growth to oil prices is the same whether the price rises or falls. Only the speed at which the impact is transmitted differs (3 quarters in the case of a rise, but 4 in the case of a fall);
3. Finally, the impact of oil price changes on economic activity depends on the phase in the business cycle: the elasticity does not differ significantly from zero in situations of a “crisis” or a “boom”. However, the elasticity is much greater in absolute terms when the economy is growing slowly (an economic slump).

Let us now apply these results to the situation since 2012. Between the first quarter of 2012 and first quarter of 2016, the price of a barrel of Brent crude plummeted from 118 dollars to 34 dollars, a fall of 84 dollars in four years. If we factor in the euro/dollar exchange rate and changes in consumer prices in France, the fall amounts to a 49 euro reduction over the period (Figure 1).

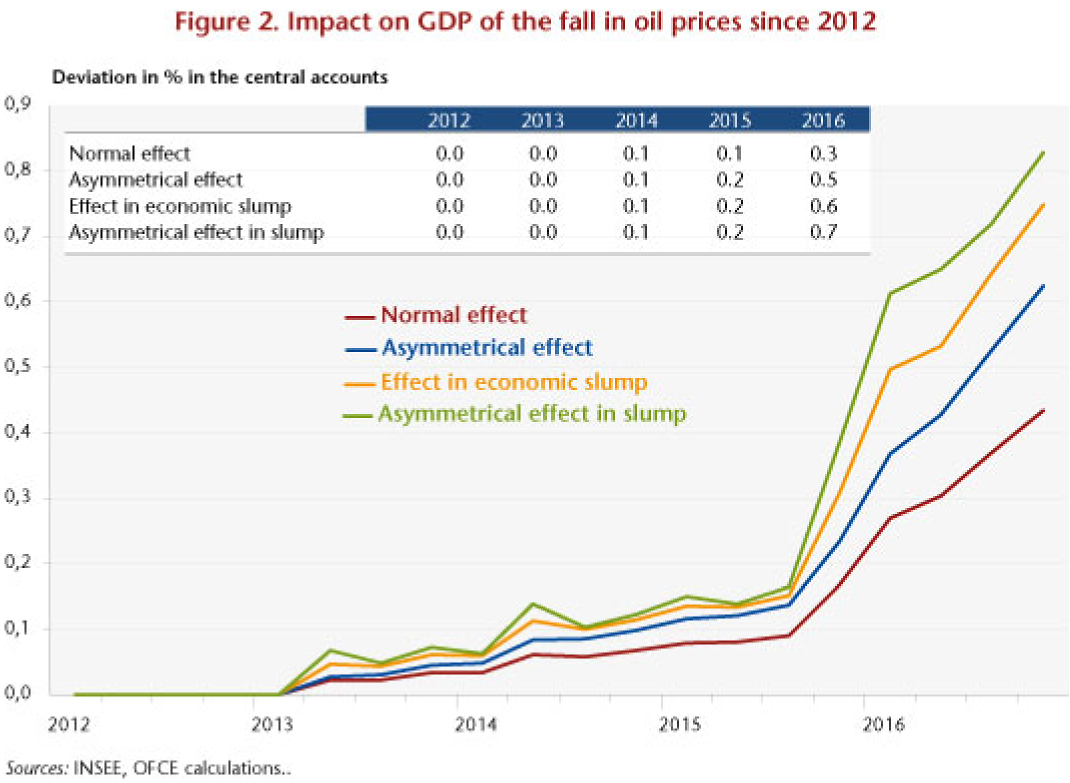
Figure 1. Changes in the price of a barrel of Brent crude



Sources: INSEE, OFCE calculations..

We evaluated the impact of a decline like this on France’s quarterly GDP, taking into account the above-mentioned time lag, asymmetry and phase of the business cycle.

Factoring all this in indicates that the oil counter shock ultimately did not show up much in 2015. As illustrated in Figure 2, the impact should make itself felt from the first quarter of 2016, regardless of the hypotheses adopted. The positive effect of the oil counter-shock is yet to come!



Small recovery after a big crisis

By the Analysis and Forecasting Department

[This text summarizes the 2016-2017 outlook for the global economy and the euro zone. Click here to consult the complete version [in French]].

Global growth is once again passing through a zone of turbulence. While growth will take place, it is nevertheless being revised downwards for 2016 and 2017 to 2.9% and 3.1%, respectively. The slowdown is first of all hitting the emerging countries, with the decline in Chinese growth continuing and even worsening (6.1% anticipated for 2017, down from 7.6% on average in 2012-2014). The slowdown in Chinese demand is hitting world trade and fuelling lower oil prices, which in turn is exacerbating the difficulties facing oil and commodity producers. Finally, the prospect for the normalization of US monetary policy is resulting in a reflux of capital. The dollar is appreciating even as the currencies of the emerging countries of Asia and Latin America are depreciating. While the industrialized countries are also suffering from the Chinese slowdown through the demand channel, growth is resilient there thanks to falling oil prices. The support provided by monetary policy is being cut back in the US, but is strengthening in the euro zone, keeping the euro at a low level. Countries are no longer systematically adopting austerity policies. In these conditions, growth will slow in the US, from 2.4% in 2015 to 1.9% in 2016 and then 1.6% in 2017. The recovery will pick up pace slightly in the euro zone, driven mainly by the dynamism of Germany and Spain and the improved outlook in France and Italy. For the euro zone as a whole, growth should come to 1.8% in 2016 and 1.7% in 2017. This will push down the unemployment rate, although by year-end 2017 it will still be 2 points above its pre-crisis level (9.3%, against 7.3% at year-end 2007).

While the United States seems to have avoided the risk of deflation, the euro zone is still under threat. Inflation is close to zero, and the very low level of expectations for long-term inflation reflects the ECB’s difficulty in regaining control of inflation. Persistent unemployment indicates some continuing shortcomings in managing demand in the euro zone, which has in fact been based entirely on monetary policy. While the ECB’s actions are a necessary condition for accelerating growth, they are not sufficient, and must be supplemented by more active fiscal policy.

At the level of the euro zone as a whole, overall fiscal policy is neutral (expansionary in Germany and Italy in 2016 but restrictive in France and even more so in Greece), whereas it needs to be more expansionary in order to bring unemployment down more rapidly and help to avert deflationary risks. Furthermore, the continuing moderate growth is leading to the accumulation of current account surpluses in the euro zone (3.2% in 2015). While imbalances within the euro zone have been corrected to some extent, this mainly took place through adjustments by countries in deficit prior to the crisis. Consequently, the surplus in the euro zone's current account will eventually pose risks to the level of the euro, which could appreciate once the monetary stimulus ends, thereby slowing growth.

Table. Outlook for world growth

Annual growth rate (%)

	Weight in the total(1)	GDP in volume		
		2015	2016	2017
DEU	3,7	1,4	1,9	1,6
FRA	2,6	1,2	1,6	1,6
ITA	2,3	0,6	1,2	1,0
ESP	1,6	3,2	3,3	2,4
EUZ	13,4	1,5	1,8	1,7
GBR	2,4	2,3	2,1	1,7
NPM(2)	2,4	3,8	3,1	3,2
UE 28	18,6	1,9	2,0	1,8
USA	17,2	2,4	1,9	1,7
JPN	4,8	0,5	0,7	0,4
Developed countries	44,5	1,9	1,7	1,6
RUS	3,6	-3,7	-1,0	1,0
CHN	14,9	6,9	6,3	6,1
Other Asian countries	16,6	5,2	5,2	5,4
Latin America	8,8	-0,4	-0,9	1,5
World	100	2,9	2,9	3,1

(1) Weight according to GDP and PPP estimated by the IMF for 2008.
(2) Poland, Hungary, Czech Republic, Romania, Bulgaria and Croatia.
Sources: IMF, OECD, national sources, OFCE calculations and forecast, April 2016.

Measuring well-being and sustainability: A special issue of the Revue de l'OFCE

By Eloi Laurent

This issue of the *Revue de l'OFCE (no. 145, February 2016)* presents some of the best works that are being produced at a rapid clip on indicators of well-being and sustainability.

Why want to measure well-being? Because the idea that economic growth represents human development, in the sense that growth represents a good summary of its various dimensions, is simply false. GDP growth is not a prerequisite for human development; on the contrary, it is now often an impediment (as is illustrated by the exorbitant health costs of air pollution in India and China, two countries that concentrate one-third of the human population).

Achieving growth is not therefore sufficient in itself for human development; there is a need for specific policies that deal directly with education, health, environmental conditions and democratic quality. If the multiple dimensions of well-being are not taken into account, one dimension, typically the economic dimension, is imposed on and crushes the others, mutilating the human development of both individuals and groups (the example of health in the United States is particularly striking in this regard).

Why want to measure sustainability? Because today's global growth rate of 5% is of little importance if the climate, the ecosystems, the water and air that underpin our well-being have irrevocably deteriorated in two or three decades due to the means deployed to achieve that growth. Or to put it in the words of the Chinese Minister of the Environment, Zhou Shengxian, in 2011: “If our land is ravaged and our health destroyed, what benefit does our growth bring?” We need to update our understanding of well-being so that it is not a mirage. Our economic and political systems exist only because they are underpinned by a set of resources that make up the biosphere, whose vitality is the condition for the perpetuation of these systems. To put it bluntly, if ecological crises are not measured and controlled, they will eventually do away with human welfare.

Indicators of well-being and sustainability must therefore enter a new, performative age: after measuring in order to understand, we now need to measure in order to make change – to evaluate in order to evolve. Because the change called for by these new visions of the global economy is considerable. This time of action invariably involves choices and trade-offs that are far from simple. This underscores the dual purpose of this issue of the *Revue de l’OFCE*: to show that indicators of well-being and sustainability have reached maturity and that they now can change not only our vision of the economic world but also the economic world itself; they can make clear the types of choices available to public and private decision-makers so as to carry out the change needed. In this respect the two sections of this special issue clearly highlight the issue of the relevant scale for measuring well-being and sustainability.

The first part of this issue is devoted to the relatively new topic of measuring regional well-being in France. Measuring well-being where it is actually lived presupposes moving down the scale to the local level: the need to measure and improve human well-being as close as possible to people’s lived reality, along with the scale of spatial inequalities in contemporary France, demands a territorial perspective. There are at least two good reasons why territories (regions, cities, *départements*, towns), more than nation-states, are the vectors of choice for the transition towards well-being and sustainability. The first is that they have grown in importance due to the impact of globalization and urbanization. The second is their capacity for social innovation. Following on from the late Elinor Ostrom, we talk about a "polycentric transition" to mean that each level of government can seize on the well-being and sustainability transition without waiting for a push from the top.

Monica Brezzi Luiz de Mello and Eloi Laurent ("Beyond GDP, beneath GDP: Measuring regional well-being in the OECD" – *all* OFCE Revue *articles in French*) gives the initial results of the theoretical and empirical work currently underway in the OECD framework (interactive access on the site http://www.oecdregionalwellbeing.org/) that measures certain dimensions of well-being at the regional level and applies these new indicators to the French case in order to draw useful lessons for public policy.

Robert Reynard ("Quality of life in the French regions") provides an overview of recent findings by the INSEE using regional quality-of-life indicators. These can be used to develop a new typology of French spaces, highlighting eight major types of territories, which are distinguished both by the living conditions of their inhabitants (employment, income, health, education, etc.) and the amenities that these areas provide for their people (living environment, access to services, transport, etc.). The new representation of France that emerges constitutes a valuable decision-making tool for those in charge of policies aimed at promoting equality between the regions.

Kim Antunez, Louise Haran and Vivien Roussez ("Diagnoses of quality of life: Taking into account people's preferences") looks back at the approach developed by France's regional monitoring body (*Observatoire des territoires*) and highlights indicators, offered at appropriate geographical scales, that can be used to account for the multidimensional character of quality of life in France. Here too, regional typologies explore the link between the diverse amenities in people’s environments and the diverse aspirations of the people who live in them, so as to highlight the imbalances that exist and the public policy levers that can be used to reduce these.

Finally, Florence Jany-Catrice (“Measuring regional well-being: Working *on* or *with* the regions?”) discusses a fundamental aspect of the debate about measuring well-being in the French regions: the participation of citizens in defining their own well-being. She shows in particular that the impact of the indicators depends on whether those who develop them work on the regions or with them – it is only in the latter case that the region and its inhabitants become active players in the development of a common vision.

But, in contrast to these localized approaches, the measurement of sustainability requires moving up the geographical scale to the national or even global level. This is the subject of the articles in the second part of this issue, which deal with a subject whose importance has been emphasized by the recent law on the energy transition: the circular economy. Here there is a crucial difference to be made between a seemingly circular economy, which concerns a product or business, and genuine economic circularity, which can be understood only by enlarging the loop to develop a systemic vision.

This is what Christian Arnsperger and Dominique Bourg aim to demonstrate (“Towards a truly circular economy: Reflections on the foundations of an indicator of circularity”) by examining the main issues and questions that designers of an indicator of a truly circular economy would need to take into account, if it were ever to be developed formally and technically. They conclude in particular that without a systemic vision oriented towards the reduction, rationing and stationarity intrinsic to the permaculture approach, the notion of the circular economy will forever remain vulnerable to misuse that, however well intentioned, is ultimately short-sighted.

Vincent Aurez and Laurent Georgeault ("Indicators of the circular economy in China") attempt to assess the relevance and the actual scope of the assessment tools developed in recent years by China to flesh out an integrated circular economy policy that aims at ensuring the transition to a low-carbon model with a restrained use of resources. These instruments, which in many respects are unique, but still inadequate, are distinguished by their systemic and multidimensional character, and therefore constitute an original contribution to the field of sustainability indicators.

Finally, Stephan Kampelmann ("Measuring the circular economy at the regional level: A systemic analysis of the management of organic matter in Brussels") draws on the theory of social-ecological systems to carry out a particularly innovative exercise. He uses a battery of indicators to compare the economic, social and environmental impact of two possible pathways for the municipal management of flows of organic matter in Brussels: a centralized treatment using anaerobic digestion, and a process based on decentralized composting.

Thus while well-being is best measured at the local level, to assess sustainability properly, including at the regional level, the impact felt beyond local and national borders has to be taken into account. The trade-offs between these dimensions, including the exploration and possible transformation into synergies at regional and national levels, then turn out to be the most promising projects opened up by the welfare and sustainability transition.

2015-2017 forecasts for the French economy

By Mathieu Plane, Bruno Ducoudré, Pierre Madec, Hervé Péléraux and Raul Sampognaro

This text summarizes the **OFCE's economic forecast for the French economy for 2015-2017**

After a hesitant upturn in the first half of 2015 (with growth rates of 0.7% and 0% respectively in the first and second quarter), the French economy grew slowly in the second half year, with GDP rising by an average of 1.1% for the year as a whole. With a GDP growth rate of 0.3% in the third quarter of 2015 and 0.4% in the fourth quarter, which was equal to the pace of potential growth, the unemployment rate stabilized at 10% at year end. Household consumption (+1.7% in 2015) was boosted by the recovery in purchasing power due in particular to lower oil prices, which will prop up growth in 2015, but the situation of investment by households (-3.6%) and the public administration (-2.6%) will continue to hold back activity. In a context of sluggish growth and moderate fiscal consolidation, the government deficit will continue to fall slowly, to 3.7% of GDP in 2015.

With GDP growth in 2016 of 1.8%, the year will be marked by a recovery, in particular by rising corporate investment rates. Indeed, all the factors for a renewal of investment are coming together: first, a spectacular turnaround in margin rates since mid-2014 due to a fall in the cost of energy supplies and the impact of the CICE tax credit and France's Responsibility Pact; next, the historically low cost of capital, which has been helped by the ECB's unconventional monetary policy; and finally, an improvement in the economic outlook. These factors will lead to an acceleration of business investment in 2016, which will increase by 4% on average over the year. Household consumption should remain strong in 2016 (+1.6%), driven by job creation in the market sector and by a slight fall in the savings rate. Fuelled by the rise in housing starts and building permits, housing investment will pick up (+3%), after shrinking for four years in a row. Foreign trade will be boosted by the impact of the euro’s depreciation and the government’s competitiveness policies, and will make a positive contribution to growth (+0.2 GDP point in 2016, the same as in 2015). Once the impact of the downturn in oil prices has fed through, inflation should be positive in 2016, but still low (1% on an annual average, after two years of virtual stagnation), a rate that is close to underlying inflation. The pace of quarterly GDP growth in 2016 will be between 0.5% and 0.6%: this will trigger a gradual closing of the output gap and a slow fall in the unemployment rate, which will end the year at 9.8%. The public deficit will be cut by 0.5 GDP point, due to savings in public spending, notably through the contraction of public investment (-2.6%), low growth in government spending (+0.9%), and the impact of the rise in tax revenues as the economy recovers.

Assuming that the macroeconomic environment remains favourable, the output gap is expected to continue to close in 2017. With GDP growth of 2%, the government deficit will fall further to 2.7% of GDP, passing below the 3% bar for the first time in 10 years. Under the impact of the government’s employment policies and the absorption of the overstaffing by companies, the unemployment rate will continue to fall, to 9.4% of the active population by the end of 2017.

Unemployment figures: the chill returns in April

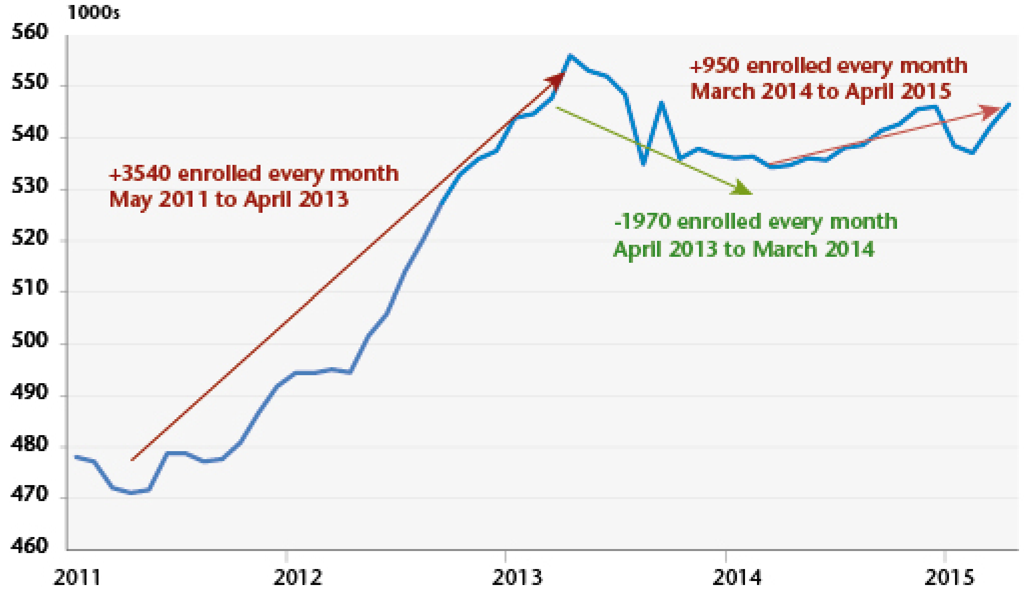
By Analysis and Forecasting Department (OFCE-DAP)

While the slowing increase in the number of job seekers registered with France's Pôle Emploi unemployment agency in the first quarter of 2015 could be seen as the premise of the long-awaited downturn in the unemployment curve, the figures released today once again cast doubt on this prospect, at least in the short term. The registration of 26,200 additional people in category A at the agency in April brings the increase in job seekers back to a high rate, well above the average over the last two years (13,400 per month) and far from the virtual stability seen in the first quarter (+3,000 per month).

While the publication of strong figures for first-quarter GDP growth (+ 0.6%) reaffirmed the prospect of a recovery, the jobless numbers are disappointing. Don't forget, however, that employment does not immediately respond to a pick-up in activity; it will take time to reap the benefits for the labour market of the good growth experienced at the year's beginning, when the recovery has proven to be strong, pushing employers to recruit. For now, companies are still digesting the overstaffing inherited from the period of very low growth between 2011 and 2014. The fall in unemployment that can be foreseen with the recovery will not take place until the second half of 2015. But the acceleration of job centre registrations in April sends a contrary signal.

The situation seems to be generally worsening among all sections of job seekers: men, women, and all age categories. The number of unemployed under age 25 has been rising again the last months (9,500 people). But changes like these are often volatile, and should be treated with caution: they come in counterpoint to an equivalent fall in numbers during the first two months of 2015. Over a one-year period, the increase was only 11,900, and the interruption in the rise in youth unemployment since April 2013 signalled success for the jobs policy targeted at this group (see the figure). The announcement by the Minister of Labour of the creation of 100,000 additional subsidized jobs reflects the government's perhaps belated determination to beef up this programme at a time when the economic outlook is improving.

Figure. Young people under age 25 enrolled in category A at France's Pôle Emploi agency



Sources : DARES, Pôle Emploi, OFCE calculations.