A new Great Moderation?

by Analysis and Forecasting Department

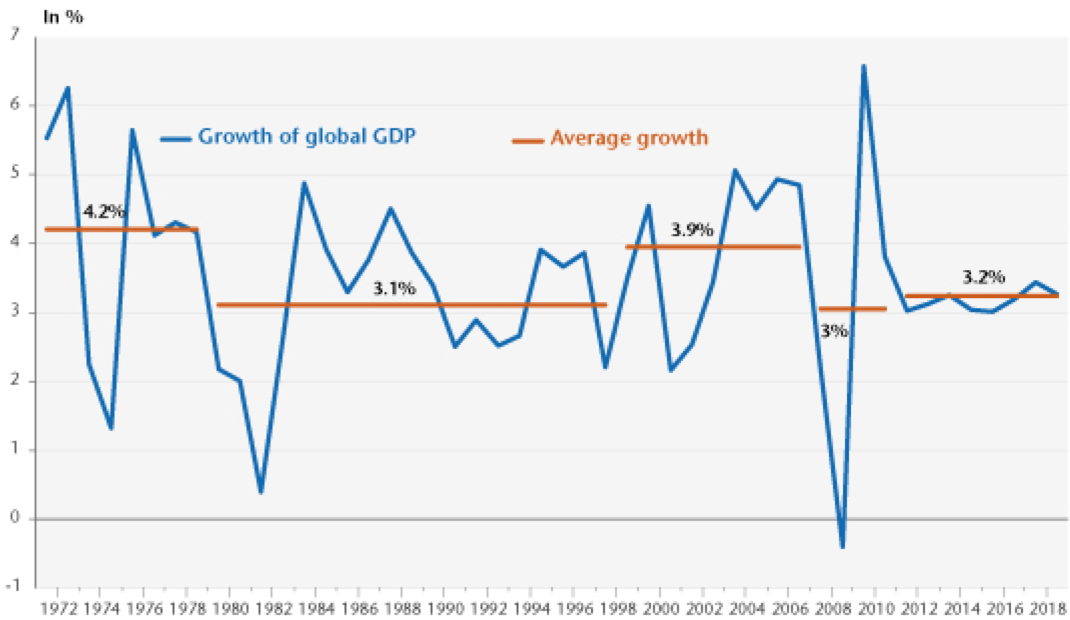
This text summarizes the OFCE’s 2017-2019 forecast for the global economy and the euro zone; the full version can be found here.

Ten years after the financial crisis broke out in the summer of 2007, the world economy finally seems to be embarking on a trajectory of more solid growth in both the industrialized and most of the emerging countries. The figures for the first half of 2017 indicate that global growth is accelerating, which should result in GDP growth of 3.3% over the year as a whole, up 0.3 percentage point over the previous year. Some uncertainty remains, of course, in particular concerning the outcome of Brexit and the ability of the Chinese authorities to control their economic slowdown, but these are the types of irreducible uncertainties characteristic of an economic system that is subject to political, technological, economic and financial shocks[1]. Beyond these risks, which should not be underestimated, lies the question of the ability of the world’s economies to reduce the imbalances inherited from the crisis. While current growth is sufficient to bring down the unemployment rate and improve the employment rate, it needs to be long-lasting enough to get back to full employment, reduce inequalities, and promote debt reduction.

In this respect, not all the doubts have been lifted by the current upturn in the world’s economic situation. First, growth has remained moderate in light of the past recession and previous episodes of recovery. Since 2012, the global economy has grown at an average rate of 3.2%, which is lower than in the 2000s (graphic). The growth trajectory seems to be closer to what was observed in the 1980s and 1990s. This period, the so-called Great Moderation, was characterized by lower macroeconomic volatility and a disinflationary trend, first in the advanced countries, then in the emerging countries. This second element is also an important point in the global economic situation today. Indeed, the pick-up in growth is not translating into renewed inflation. The low rate of inflation reflects the persistence of underemployment in the labor market, which is holding back wage growth. It also illustrates the difficulties the central banks are having in (re)-anchoring inflation expectations on their target.

Finally, there is the matter of the growth potential. Despite numerous uncertainties about measuring growth potential, many estimates are converging on a projection of weaker long-term growth, due mainly to a slowdown in trend productivity. It should be noted, however, that the methods used to determine this growth trajectory sometimes lead to prolonging recent trends, and can therefore become self-fulfilling if they lead private and public agents to reduce their spending in anticipation of a slowdown in growth. Conversely, boosting future growth requires private and public investment. Economic policies must therefore continue to play a leading role in supporting the recovery and creating the conditions for future growth.

Figure. The recovery of the global economy



Sources: National accounts, OFCE calculations, October 2017.

[1] See OFCE (2017): La routine de l'incertitude [in French].

France: growth as inheritance

by OFCE Department of Analysis and Forecasting (France team)

This text summarizes the OFCE's 2017-2019 forecast for the French economy; the full version can be found here.

After five years of sluggish growth (0.8% on average over the period 2012-16), a recovery is finally taking shape in France, with GDP expected to rise by 1.8% in 2017, 1.7% in 2018 and 1.9% in 2019. Some negative factors that affected 2016 (a fall in agricultural production, impact of terrorist attacks on tourism, etc.) were no longer at work in 2017, and the economy should now feel the full benefit of the supply-side policies implemented during the Hollande presidency. Added to this is the ripple effect from stronger growth in the European economies. Fiscal consolidation should be at a lower level in the coming two years[1] (0.3 GDP point over 2018-2019), and should not jeopardize the ongoing recovery or the fall in unemployment that started in 2015. In total, by incorporating the delayed impact of past supply-side policies, fiscal policy will have a neutral impact on GDP growth in 2018 and a slightly positive one in 2019 (+0.2 GDP point). The reduction of the public deficit will be slow (2.9% of GDP in 2017, 2.6% in 2018 and 2.9% in 2019), but this masks a sharp improvement in the public balance in 2019, excluding the one-off impact from the conversion of the CICE tax credit. The reduction should be sufficient to stay below the 3% mark and ensure the exit from the corrective arm of the Stability Pact.

The brighter financial prospects for French business and the pick-up in productive investment since 2015 should boost export market shares. Given the more buoyant economic environment in the euro zone, foreign trade should no longer be a drag on France's growth. Ultimately, economic growth will be relatively robust, creating jobs in the commercial sector (247,000 in 2017, 161,000 in 2018 and 223,000 in 2019) and bringing down the unemployment rate in metropolitan France to 9.2% by the end of the second quarter 2017, to 8.9% by the end of 2018 and to 8.5% by the end of 2019. But the sharp decline in new subsidized contracts in the second half of 2017, which will continue in 2018 (falling from 320,000 in 2017 to 200,000 in 2018) and the completion of the implementation of tax plans to enrich job growth (the CICE, Liability pact), and sometimes their elimination (hiring bonus), will be a significant drag on efforts to cut unemployment in 2018.

[1] This forecast does not take into account measures included in the 2018 supplemental Budget Bill (PLFR).

The ECB on neutral ground?

By Christophe Blot and Jérôme Creel

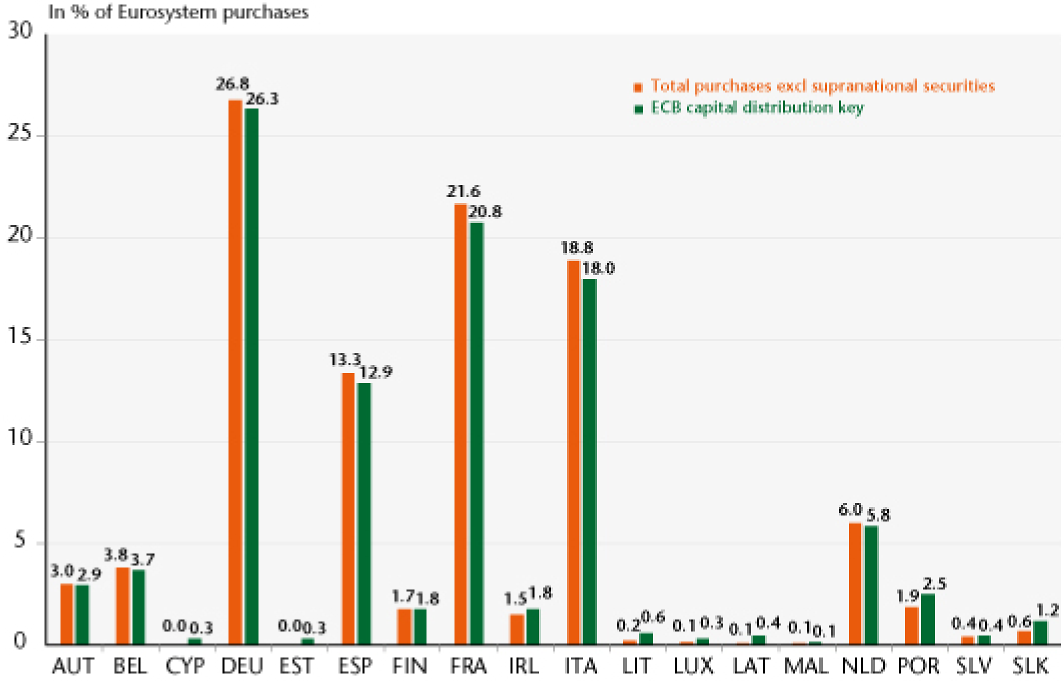
The involvement of the European Central Bank (ECB) in the fiscal management of the euro area member states has been a subject of ongoing controversy. Since the implementation of the ECB programme to purchase sovereign debt, it has been accused of profiting off of troubled states and taking the risk of socializing losses. The rise of these controversies results from the difficulty in understanding the relationship between the ECB, the national central banks (NCBs), and the governments. The European monetary architecture comes down to a sequence of delegations of power. Decisions on the conduct of monetary policy in the euro area are delegated to an independent institution, the European Central Bank (ECB). But, under the European subsidiarity principle, the implementation of monetary policy is then delegated to the national central banks (NCBs) of the euro area member states: the ECB and NCBs taken together are called the Eurosystem. While up to now this dimension of the organization of the euro area's monetary policy has not attracted much attention, debate has recently arisen in the course of the implementation of the quantitative easing programme. According to commentators and journalists, some national central banks are profiting more than others from the policy of buying and supporting their national public debts, which are riskier than the debt in more "virtuous" countries[1]. The profiting banks are viewed as escaping the ECB's control and not strictly applying the policy decided in Frankfurt.

In a recent paper prepared as part of the European Parliament's Monetary Dialogue with the ECB, we show that these concerns are unfounded for the simple good reason that, on average, since the beginning of the implementation of this policy, the theoretical distribution key has been respected (graphic). This distribution key stipulates that purchases of bonds by the Eurosystem are to be made pro rata to a state's participation in the ECB's capital. Remember that part of the purchases – 10 of the 60 billion in monthly purchases made under the programme – are made directly by the ECB[2]. The other purchases are made directly by the NCBs. As each central bank buys securities issued by its own government, the NCBs' purchases of public bonds do not entail risk-sharing between member states. Any profits or losses are kept on the NCBs' balance sheets or transferred to the national governments in accordance with the agreements in force in each country.

This distribution of public bond purchases, which is intended to be neutral in terms of risk management, isn't entirely so, but not for the reasons that seem to have worried the European Parliament's Committee on Economic and Monetary Affairs. This distribution favours the maintenance of very low rates of return on the debts of certain member states. In fact, by not basing itself on the financing needs of the member states or on the size of their public debts, it can produce distortions by reducing the supply of public bonds available on the secondary markets. Such may be the case in Germany, Spain and the Netherlands, whose shares of the European public debt are smaller than their respective shares in the ECB's capital (table). Conversely, the purchases of Italian bonds are smaller with the current distribution key than they would be with a distribution key that took into account the relative size of the public debt. The ECB's policy therefore has less impact on the Italian debt market than it does on the German market.

This orientation could also constrain the ECB's decision about continuing quantitative easing beyond December 2017. Let's agree that the ECB's best policy would be to continue the current policy beyond December 2017, but to stop it once and for all in July 2018. Given the current distribution rules, this policy would be subject to all countries having exchangeable government bonds until July 2018, including those who issue public debt only rarely because they have low financing needs. It could be that it is impossible to continue this policy under the rules currently adopted by the ECB, because some countries do not have sufficient debt available. It would then be necessary to implement a different policy by drastically reducing the monthly purchases of short-term securities (say in January 2018), while possibly pursuing this policy for a longer time period (beyond the first half of 2018). The decision not to use risk-sharing in the management of European monetary policy is therefore far from being neutral in the way this policy is actually implemented.

Figure. Distribution by the cumulative securities purchases by the national central banks



Source: BCE.

Table. Weighting by country using different measures

In %

	ECB capital distribution key	Weighting based on relative size of…	
		…GDP	…the public debt
BEL	3.5	3.9	4.6
DEU	25.6	29.2	21.8
EST	0.3	0.2	0.0
IRL	1.6	2.6	2.0
GRC	2.9	1.6	3.2
ESP	12.6	10.3	11.3
FRA	20.1	20.7	21.9
ITA	17.5	15.5	22.6
CYP	0.2	0.2	0.2
LAT	0.4	0.2	0.1
LTH	0.6	0.4	0.2
LUX	0.3	0.5	0.1
MAL	0.1	0.1	0.1
NLD	5.7	6.5	4,4
AUT	2.8	3.2	3.0
PRT	2.5	1.7	2.5
SLV	0.5	0.4	0.3
SLK	1.1	0.8	0.4
FIN	1.8	2.0	1.4

Sources: ECB and Eurostat.

[1] Mario Draghi was questioned about the distribution of the public sector purchase programme (PSPP) at the press conference he held on 8 September 2017.

[2] There is risk-sharing on this sum: the gains or losses are shared by all the NCBs in proportion to their contribution to the ECB’s capital.