European Economic Network EUREN

EUREN-News

5|2013
7|12|2013

Editorial: Light at the end of the tunnel?

The most recent data on the Euro area economy give reason for optimism that the recession is over and an upswing is ahead. The third quarter of 2013 was the second one in a row showing an increase of GDP. Though being small the expansion stood on a rather solid ground. Eleven out of the seventeen Euro area members depicted positive GDP rates, among which Spain can be found – for the first time after nine quarters of decline.

Monthly indicators support the view that an upswing has begun: Industry production is heading upward since November 2012, although the trend is not very strong yet and the rates are volatile. Production in the construction sector seems having passed its trough in March. Finally, crude steel production, which is closely linked to the manufacturing of capital goods, continued to increase in October which gives reason that the weaker data for September did not mark the end of the upswing.

However, the data so far only support the expectations many forecasters had at the beginning of this year. The European Commission, e.g. now confirmed its previous forecast for the next year. But even this means good news, since it had to revise it downward substantially in the past two years.

Nevertheless, we should not be over-optimistic. The most negative feature of the recent data is that France seems not to be out of the recession yet. The GDP rate fell back into the negative territory in the third quarter, raising fears that the relatively strong increase in the second quarter might be a once off effect. And indeed, monthly indicators here look less promising. A continued weakness in France, however, would have a strong impact of the rest of the Union, since France is the second largest economy in the EU.

The second thing we should not forget when admiring the recent growth rates: The level of economic activity is still low. Production in the construction sector is about 30% below its pre-crisis level, even if the latter might have been exaggerated. And industry production is more than 10% lower. The low activity level is mirrored in the unemployment rate which is more than 4 percentage points above the 2007 level and has – at its best – begun to stabilize. Hence, several years of moderate economic growth will be needed to get back to normal capacity utilization and to see a significant decline of unemployment.

Nevertheless, seeing light at the end of the tunnel is important for various reasons. Firstly, it signals to households and enterprises that the worst could be over which would have a positive effect on investment and consumption. Secondly, even a moderate growth could make fiscal adjustment easier since government receipts would start to increase for cyclical reasons. Finally also creditors could become more optimistic to get back the credits they gave to governments as well as to the private sector.

Therefore we should hope that the light we see gets clearer during the months to come, and that it does not turn out to be a fen light.

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Fiscal Policy in the European Union

According to the latest European Commission forecast the budget balance in the EU has improved in 2013, in nominal terms as well as structurally. For the next year, the budget balance is expected to fall below the 3% threshold for the EU and for the Euro area as a whole. However, only six out of 17 Euro area countries will be below the Maastricht margin. And outside the Euro area, the deficit remains stubbornly high. Furthermore the improvement will be mostly due to cyclical reasons. The structural balance will improve by only 0.2 resp. 0.3 percentage points.

There are still substantial differences between the countries. On the one side stands Germany where the Budget was most probably structurally in surplus in 2013 and the same can be expected for 2014, since the new government intends to give a high priority to a balanced budget. One might doubt to what extent this will be the case, since the new coalitions has also promised to increase expenditures in particular for pensioners. However, most of the improvements promised will not be set in place before 2015 and it remains to be seen what measures will be taken to finance the additional spending.

On the other hand, deficits remain stubbornly high – nominal and structurally – in many other countries. In Spain and Ireland this situation is partially owed to support schemes for the banking sector. However, even in these cases markets have become more confident that the countries can master their problems. The two countries plan the exit from the European support schemes and to go back to the markets to finance their public debt.

Also the two other countries receiving support from the ESM, Greece and Portugal, show progress. According to the EU estimates the structural balance in Greece was in surplus already in 2013 However, it is hard to decide what is structural and what is cyclical, since it is difficult to determine potential growth in a country having experiences a sharp decline of economic activity and undergoing structural reforms.

Table 1

Budget Balances in the EU: The European Commission's expectations; in % of GDP

	Budget balance				Structural balance			
	2011	2012	2013	2014	2011	2012	2013	2014
Euro Area	-4.2	-3.7	-3.1	-2.5	-3.6	-2.1	-1,5	-1.3
Austria	-2.5	-2.5	-2.5	-1.9	-2.2	-1.6	-1.6	-1.5
Belgium	-3.7	-4.0	-2.8	-2.6	-3.3	-3.0	-2.2	-1.8
France	-5.3	-4.8	-4.1	-3.8	-4.5	-3.7	-2.7	-2.0
Finland	-0.7	-1.8	-2.2	-2.3	-0.3	-0.7	-0.8	-1.0
Germany	-0.8	0.1	0.0	-0.1	-1.1	0.2	0.5	0.5
Greece	-9.5	-9.0	-13.5	-2.0	-5.8	-1.0	1.2	1.0
Ireland	-13.1	-8.2	-7.4	-5.0	-7.7	-7.6	-6.7	-5.2
Italy	-3.8	-3.0	-3.0	-2.7	-3.7	-1.4	-0.8	-0.7
Netherlands	-4.3	-4.1	-3.3	-3.3	-3.8	-2.7	-2.1	-1.7
Portugal	-4.3	-6.4	-5.9	-4.0	-6.5	-4.1	-3.7	-2.6
Spain	-9.6	-10.6	-6.8	-5.9	-7.2	-5.2	-4.1	-4.2
Slovakia	-5.1	-4.5	-3.0	-3.2	-5.0	-4.0	-2.3	-3.1
Slovenia	-6.3	-3.8	-5.8	-7.1	-4.9	-2.7	-2.9	-2.1
Hungary	-4.3	-2.0	-2.9	-3.0	-4.1	-0.9	-1.4	-2.3
Poland	-5.0	-3.9	-4.8	-4.6	-5.3	-3.7	-4.0	-3.2
Sweden	0.2	-0.2	-0.9	-1.2	0.5	0.8	0.5	-0.2
United Kingdom	-7.7	-6.1	-6.4	-5.3	-6.6	-6.5	-5.7	-4.8
EU	-4.4	-3.9	-3.5	-2.7	-3.9	-2.7	-2.1	-1.8

Source: European Commissiom Forecast Autumn 2013. Including costs of bank re-capitalisation

In many countries, public deficit remains high due to poor growth and, accordingly, an increase in the negative output gap. In France and also in Italy the structural deficit has been reduced considerably, but the budget deficit comes down in small steps only. In Slovenia the deficit is even increase despite of a lower structural deficit.

Country Reports

Austria: New government should stay committed to balance the budget

Table 2

Projection of public finances: Austria

2012 – 2014; Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]
Real GDP	0.9	0.5	1.8
Nominal GDP	2.6	2.6	3.6
Government expenditures[1]	51.7	51.8	50.8
Government revenues[1]	49.2	49.5	49.1
Fiscal balance[1]	-2.5	-2.2	-1.7
Debt Ratio	74.0	74.4	74.0

[f]IHS Forecast- [1]Percent of nominal GDP

In 2012 the deficit ratio in Austria remained at 2.5%, unchanged from the preceding year. The relatively favourable labour market development brought about rising revenues and contained unemployment related expenditures. On the other hand, additional capital injections into the banking sector were necessary.

On the back of further consolidation measures becoming effective at the beginning of 2013, the general budget deficit should decline slightly to 2.2% in relation to GDP. In 2014, the fostering economic recovery supports the decrease of the deficit ratio to 1.7%. Consolidation measures comprise moderate pension increases below inflation, as well as reforms aiming at restrained health care related expenditures. Furthermore, the number of public employees was reduced in 2013 and shall be further reduced in 2014. Public wages were frozen in 2013 and will only moderately rise in 2014. The federal government strategy for the period 2013 to 2017 aims at achieving a balanced budget by 2016 and reducing the debt ratio to 67% in 2017.

The structural deficit is envisaged to increase from 1.4% in relation to GDP in 2012 to 1.8% in 2013. Afterwards it is expected to decline steadily to 0.4% in 2017.

In 2013 the debt ratio is expected to increase slightly further, but to decrease from 2014 onwards. However, due to contingent liabilities and already quite likely further capital injections into the banking sector, the envisaged decrease of the debt ratio as well as the budget deficit is subject to high uncertainty.

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France: a strong consolidation process largely based on additional receipts

Albeit less pronounced than in Southern European countries, French fiscal stance has turned restrictive in 2012-2013. The government has planned to reduce the structural deficit by 1,3 % of GDP in 2013 after already 1,1 % in 2012. This reduction will account for another 0,9 % of GDP in 2014 and probably 2015. Such an effort may help French economy to reach the level of 3,6 % of GDP for public deficit (4,1 % in 2013) while public debt may stand a little bit less than 2 points above the 2013 mark, at 95,1 % in 2014 according to the official forecast. Our own forecast are a little bit less optimistic concerning these figures (see table).

The driving forces of the structural improvements, however, will change substantially. After having primarily lied on an increase in taxes, 80 % of the structural effort for 2014 should rely on the expenditure side. Nevertheless, such an effort does not imply a reduced level of public expenditures but a slowing of the increase (also in real terms) below its trend. This point becomes particularly evident when the expenses for health are considered. They are projected to increase by 2.4 % in nominal terms compared to a trend slightly below 4 %. Some uncertainties still appear whether these reductions will be realised, about 3 bn € out of 15 bn € of projected reduction in public expenses (associated with local government or public agencies expenditures) still have to be specified. All in all, the target for the level of public expenditures as a percentage of GDP stand at 56.7 % for 2014, a small step under the peak of 57.1 % reached in 2013.

Table 3

Projection of public finances: France

2011 – 2013; Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]
Real GDP	0.0	0.2	0.6
Nominal GDP	1.5	1.4	1.4
Government expenditures[1]	56.6	57.0	56.8
Government revenues[1]	51.8	52.8	52.9
Fiscal balance[1]	-4.9	-4.2	-3.8
Debt Ratio	90.2	93.4	96.0

[f]Coe-Rexecode Forecast- [1]Percent of nominal GDP

Even if only 20 % of the planned consolidation will stem from the revenue side in 2014, the main uncertainties about reaching the target come from tax receipts. As it stand bow, they have been particularly disappointing in 2013. A gap of € 20 bn between expected and registered public receipts has appeared, nearly 1 point of GDP. 60 % of this gap reflects the too optimistic scenario for the increase in fiscal base. The other 40 % come from an elasticity of fiscal receipts significantly lower than its conventional estimate at unity made in most forecast. Such a decrease in the tax elasticity comes from a slower increase in gross wages as compared to GDP as well as deceptive VAT receipts possibly explained by a structural deformation of consumption in favour of products taxed with the reduced VAT rate. Evidence of the presence of a Laffer effect still has to be proven. Meanwhile, it is worth to notice that tax receipts coming from corporate income taxes as well as from VAT, two taxes that may be subject to “fiscal optimization” practices were particularly deceptive this year. More significantly, the discrepancy between forecasted and effective public deficit has been translated in a sharp revision of the trajectory for public debt which is expected to reach 91 % in 2017, compared to the last year’s forecast of 83%. This gap represents an increase of 132 bn € in the amount of expected public debt.

Another clear change will take place in 2014 as regards tax legislation. In 2013, the new tax measures induced similar ex-ante increase in the tax burden of enterprises (14,7 bn € in 2013) and of households (13,7 bn €). In 2014, a tax rebate of 10 bn € for enterprises will be enforced, compensated by an increase of the taxation of private households by 11 bn €, (increase in VAT rate on January 1). The fiscal stimulus for companies is thought to restore the profitability of enterprises which is particularly low. It is the milestone of a supply side policy adopted with the objective of promoting productive investment in the medium term. This long expected reward will proceed only by surmounting the pitfall of a still subdued economic growth in France, a rhythm of growth that will probably lag behind the modest recovery expected for Euro area as a whole. Such a gap reflects the delay in structural adjustment of public deficit that is proceeding later in France than in other Euro area countries.

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Germany: New coalition emphasizes the goal of a balanced budget

Formally speaking, the stance of fiscal policy in Germany is still an open question. The talks between the Christian Democrats and the Social democrats about forming a new government took quite a long time, and a new government will not be installed before mid of December. Therefore no decisions on fiscal policy have been taken yet. At a second glance, however, one can expect that at least for the next years the deviations from the former government's projections will be small.

This is at least the way you can interpret the coalition treaty the two parties forming the next government have signed. In this treaty, you find only view cases where higher expenditures are announced in concrete. Thus, additional entitlements for the time of child care and a minimum pension will be introduced. The fiscal effect of the first measure – though costly in the long run - will be limited in the short run. The minimum pension is granted under relatively restrictive conditions which curbing the fiscal effect.

Table 4

Projection of public finances: Germany

2011 – 2013; Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]
Real GDP	0,7	0.4	1.5
Nominal GDP	2.2	2.6	3.3
Government expenditures[1]	44.7	44.6	44.5
Government revenues[1]	44.8	44.9	44.8
Fiscal balance[1]	0.1	0.3	0.3
Debt Ratio	81.2	79.4	76.3

RWI Forecast- [1]Percent of nominal GDP.

Other measures such as additional spending on public investment in the infrastructure or on a better funding of the communities are intended to be compensated by savings on other parts of the budget. The federal budget is planned to be balanced in surplus in 2015. The Länder have to present a structurally balanced budget in 2020 according to the constitutional debt brake. Thus, their fiscal policy will be restrictive, too. The additional social benefits planned to be introduced in the next years will curb the surplus of the social insurance, which was the main source of the budget surplus in the recent years.

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Greece: Targeted fiscal consolidation is kept on track and prospects are improving

Fiscal consolidation continues to be implemented in large scale in Greece, even though still accompanied by severe recessionary conditions. The 2012 fiscal balance target was outperformed, when excluding the impact of the financial support to the financial institutions. Debt was reduced in 2012 as a percentage of GDP due to the positive impact of the voluntary bonds exchange under the Private Sector Involvement (PSI) programme and the bond buyback agreement.

For 2013, without taking into account the effect of the financial institutions support, the General Government deficit is expected to be significantly reduced and close around 2.6% of GDP. At the same time, the achievement of a General Government primary balance surplus in 2013 can be now considered as given and is estimated to lie marginally below the Medium Term Fiscal Strategy Target. Still, the evolution of both government outlays and receipts is characterized by divergences from targets in several cases, mostly related to the unfavourable economic and employment conditions, tax evasion, social contribution evasion and cumulated deficits of social security funds. Both in 2013 and 2014 fiscal adjustment will rely more on interventions on the part of expenditure, whereas returning to positive GDP growth rates in 2014 will positively impact on the revenue side as well.

Public debt is expected to rise again in 2013 mainly due to the recapitalization of Greek banks and the ongoing recession. However, a decline of public debt is anticipated for the first time for 2014, linked to the achievement of a primary surplus, the restraint in interest rates expenditure and progress expected in the field of privatizations. The capability to further reduce Greek public debt will crucially depend upon the impact of the relation between interest rates and rate of change of the GDP.

Table 5

Projection of public finances: Greece

2012– 2014;

Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]
Real GDP	-6.4	-3.5	0.4
Nominal GDP	-7.1	-4.7	0.0
Government outlays[1]	53.6	49.4	48.2
Government receipts[1]	44.6	45.2	45.0
Fiscal balance[1]	-6.2*	-2.6*	-2.4*
Debt Ratio[1]	156.9	175.0	174.0

*[f]KEPE Forecasts- [1]Percent of nominal GDP. *Excluding the impact of the support to financial institutions.*

Short-term prospects for Greek public finances now appear to improve significantly for the first time in several years. Commitment to strict implementation of the Medium Term Fiscal Strategy Programme and all the necessary fiscal structural reforms, along with speeding up the process of utilization of state owned property assets can induce additional positive effects.

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Hungary: No new austerity measures on the horizon

The 2013 budget had a rocky career: even before the beginning of the year, the government had to embark on three austerity packages, announced in rapid succession in the course of October and November 2012, to make the deficit target (2.7% of GDP) look realistic. These packages included a jump in the "special" taxes on the energy and gambling sectors, and made a temporary bank tax permanent. Even so, another fiscal package was necessary – announced in May – to ensure that the EU's Excessive Deficit Procedure against Hungary is lifted, and yet another package was announced in June, to prevent an overshooting of the deficit target. The first package entailed an expenditure freeze, worth HUF 92.9 billion in the 2013 budget; the second package entailed, among others, a new health care charge on interest incomes and an increase in the financial transaction tax rates.

The fiscal developments, however, are not completely without problems, even after the aforementioned fiscal measures. There have been considerable shortfalls in the revenues from corporate taxes and taxes on consumption (among the latter, the revenues from the financial transaction tax) in the first three quartes of 2013. The revenue problem was only partly alleviated by the relatively high revenue inflows in the extra budgetary funds and the social security funds.

On the whole, we expect that the government will be able to keep the deficit under the 3% threshold (as a percentage of GDP) both in 2013 and 2014; the fact that the GDP will grow at a slightly higher pace in 2013 (0.5%) than previously expected makes this more feasible. Yet, due to the mounting risks, we now expect a deficit of 2.9% of GDP for 2013, as opposed to the official projection of 2.7-2.8%.

The outlook for 2014 is riddled with uncertainties. The budget bill assumes GDP growth of 2% and an inflation rate of 2.4%, of which the first is overly optimistic, the latter is realistic. At the same time, the government has raised the deficit target from 2.7% to 2.9%. The Fiscal Council has warned against the overly optimistic planning of VAT revenues, which is a recurring problem in the Hungarian fiscal planning. In our baseline scenario, we assume that the government will manage to keep the fiscal deficit below 3%, which is necessary to avoid the re-activation of the Excessive Deficit Procedure. The government seems to be confident that there will be no further fiscal adjustment necessary to reach that goal. Considering the unrealistic official economic growth target for 2014, however, which in turn implies unrealistic target of fiscal revenues, the possibility that the need for some budget-freezing or ad hoc revenue boosting measures will arise in the course of 2014 remains real. The government may also keep finding creative ways to increase the cash flow deficit without affecting the ESA deficit.

Table 6

Projection of public finances: Hungary 2013 – 2014; Percentage changes unless otherwise indicated

	2012	2013f	2014f
Real GDP	-1.7	0.5	1.5
Nominal GDP	1.4	1.9	3.5
Government outlays[1]	48.6	50.1	50.3
Government receipts[1]	46.6	47.2	47.4
Fiscal balance[1]	2.0	-2.9	-2.9
Debt Ratio	79.2	81.0	80.0

[f]Kopint Forecast- [1]Percent of nominal GDP.

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Italy: Deficit reduction may not be sufficient

Over the last year, Italy reduced its public deficit below 3% of GDP and therefore exited the Excessive Deficit Procedure (EDP) Although Italy's fiscal position thus has improved drastically after public deficit had dropped to 5.4 percent of GDP in 2009, prospects are still rather uncertain.

Thanks to the last year's consolidation efforts, the general outlook of Italy public finances seems quite good at a first glance. Nevertheless, the observed deficit reduction may not be sufficient to meet European targets. This could imply some additional consolidation measures in next years, bearing the risk that the recovery will be delayed once again.

Much of the consolidation that Italy achieved since 2010 was mainly due to higher revenues and linear expenditure cuts, mostly focused on civil servants. Goverment spending review and efficiency gains in public sector only played a secondary role.

However, exit from EDP in June created some room for fiscal manoeuvre: the government accelerated arrear payments to the private sector, and cancelled the first payment of a property tax. Although these measures negatively affected deficit in the short term (up by 0.5% of GDP), they are supposed to revive the economy by injecting liquidity into the private sector. But worsening macroeconomic conditions over the summer brought the government to revise downward its forecasts, and implement further measures of fiscal austerity to meet EC's target. Deficit is being reduced through linear cuts at the local and central level, and through the sale of public estates.

REF Ricerche estimates that, Italy's deficit will reach 3.2 % of GDP in 2013, while Government's projections are more favourable and expect to reach 3 %, thereby meeting EC's deficit target. Projections diverge even further for the next years, as the Government expects to meet EC's target of a structurally balanced budget by 2015, while REF forecasts a much slower reduction of Italy's deficit. Government forecasts are based on the one hand, on an overly optimistic GDP growth, which is presumed to boost tax revenues; and on the other hand, on the unreasonable assumption that expenditures remain stable, thanks in particular to public salaries freezes. The divergence between Government's and our forecasts is quite high for the years after(?) 2015, as in the Government expects GDP to grow slightly less than 2 per cent per year, while in the REF scenario a growth rate close to 1 per cent per year is assumed. It is worth noting that the Government's forecast is also more optimistic than the average of Italian independent Institutes.

Italy's public debt has worsened in 2013, and has reached a new peak at 133% of GDP. On a more positive note, Italy's bond yields have drastically decreased after the summer of 2012, and are now at pre-crisis level, decreasing Government borrowing costs. Italy's Government expects that debt will start falling next year, while REF estimates that the decrease will only begin in 2015.

The future of Italy's public finances is largely influenced by the recently approved "Stability Law", which sets budget changes for the following 3 years. In 2014 Italy will sustain a slightly expansionary fiscal policy consisting of € 11.5 bn of which € 9.7 bn are covered through higher taxes and lower expenditures. The expected effect on public deficit is therefore limited at an increase by 0.1 percent of GDP. Thus, 2014 will be the first year of a light fiscal expansion, after 3 years of severe austerity that contracted Italy's budget by more than 100 bn (at ex-ante facial values), with an ex-post deficit correction of 2.5 percent of GDP (40 billions). Recent expansionary measures include a reduction of some labour income taxes, of pensions and health contributions, tax rebates for business estates and firm's new capital. On the expenditure side, Italy will increase funds for already existing welfare programs, for road and rail maintenances and for local governments. Overall, REF deems Italy's effort to revive the economy very weak: most expansionary measures of the Stability Law are limited to one year, and consist of slight changes, that do not bring about the much needed structural reforms. Italy's fiscal policy will takes a restrictive stance again in 2015 and 2016, and most of the resources used to reduce the deficit are likely to come from increased revenues.

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Slovakia: Uncertain public finances

Though Slovakia has made a significant progress in reducing fiscal deficit in last two years, it is still under the Excessive Deficit Procedure. As the primary goal of Slovak government was to decrease the deficit to 2.9% of GDP in 2013, they adopted a consolidation package containing legislative changes mainly in the area of taxes and social contributions. Now the deficit is expected to be tightly below 3% of GDP in 2013. The main headwinds are the lower-than-expected savings of municipalities and revenues from taxes and social contributions as a consequence of a less favourable macroeconomic development, as well as the growing hospital debts.

Table 7

Projection of public finances: Slovakia

2012 – 2014; Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]
Real GDP	1.8	0.9	2.0
Nominal GDP	3.1	2.1	3.1
Government expenditures[1]	37.6	37.6	36.5
Government revenues[1]	33.3	34.6	33.5
Fiscal balance[1]	-4.5	-3.0	-3.0
Debt Ratio	52.4	55.7	58.1

[f]INFOSTAT Forecast - [1]Percent of nominal GDP

For the next years the Slovak government announced extending special taxing to companies doing business in regulated sectors (e.g. in energetics, insurance, pharmacy and others) as part of the government efforts to maintain the budget deficit below the Maastricht limit of 3.0% of GDP. Though the Slovak authorities proclaimed to ensure the sustainability of public finances, the draft budget plan for the next year was questioned by the European Commission, since it is based mainly on one-off measures as one-off dividends from publicly owned companies and the sale of telecommunication licences. Accordingly there is no much real effort to reduce the debt ratio in the near future. Also the Council for Budget Responsibility in Slovakia stated that the budget plan for 2014 worsens the sustainability of public finances and includes risks for structural deficit to be 0.5% of GDP in 2017.

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Spain: a less damaging adjustment.

After the sharp deterioration the fiscal balance experienced since 2008, the Spanish economy is affected by an Excessive Deficit Procedure and, therefore, is subject to the EU rules for budgetary surveillance set in force a a part of the "Two Pack". Thus, Spain has to present a consolidation programme, including all administrations, by 15th October.

The plan presented for 2013, includes all guidelines and changes in the general consolidation targets adopted by the European Council at its meeting on June 21, 2013. At that occasion the targest set out in the previous Stability Programme were revised slightly upward, which means for in 2013 a deficit which is 0.2 percentage points higher in relation to GDP. For 2014, the new deficit target is 0.3 percentage points higher, and 0.2 percentage point in 2015 and 2016 respectively.

The baseline of this consolidation program shows continuity compared to the budgets of 2012 and 2013. On the revenue side, the guidelines focus on a progressive shift of the tax burden from wage income towards taxes more oriented to consumption and environmental. On the expenditure side, it concentrates on restructuring public employment, changing the pension systems pension, and the rationalization the structure of the different levels of government (central, regional and municipalities).

According to the estimates the government submitted to the European Commission, the set of measures would lead to a reduction of the deficit to 3.1 % in relation to GDP in 2013, and further to 1.1% in 2014 and 1.0% in 2015.

In 2013 and 2014 most of the reduction would result from an increase of revenue by 2% in 2013 and 0.7% in 2014. For 2015 the measures would mainly focus on expenditure cuts of around 0.7 points of GDP, with special emphasis on the local authorities (regions and municipalities).

Table 8

Projection of public finances: Spain

2012 – 2014; Percentage changes unless otherwise indicated

	2012	2013[f]	2014[f]	2015[f]
Real GDP	-1,6	-1,2	1,0	2,3
Nominal GDP	-1,7	-0,5	1,8	4,3
Government outlays1	42,8	42,0	41,8	40,8
Government receipts1	32,1	35,1	35,5	36,0
Fiscal balance1	-10,6	-6,9	-6,4	-4,9
Debt Ratio1	85,9	96,1	98,5	97,1

[f]CEPREDE Forecasts- [1]Percent of nominal GDP.

As a result of these tax policies and according to our own estimates, the total public deficit would be reduced to around 4.9%of GDP in 2015, while the total debt to GDP ratio would approach 100%, which would mean a slight upward deviation from the committed targets of about two tenths of GDP.

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UK: Encouraging news on the fiscal front ahead of the Autumn Statement

The Chancellor is due to present the Autumn Statement, an update on the state of the public finances, on 5th December and the backdrop is far more promising than in previous years. The strength of the recovery in activity has surprised on the upside which is likely to force the Office for Budget Responsibility (OBR) to make substantial upgrades to their forecasts for GDP growth. Back in March they forecast growth of 0.6% for 2013 and 1.8% for 2014, but our latest forecasts are 1.4% for 2013 and 2.5% for 2014.

Stronger economic growth has brought with it a substantial improvement in the public finances, with tax revenues growing robustly. Stripping out one-off effects – the yield from the Swiss capital tax and the repatriation of proceeds from the Bank of England's Asset Purchase Facility – central government tax revenues were up 3.4% over the first half of fiscal year 2013-14, well ahead of the full-year forecast of 2.3%. And with momentum continuing to build behind the recovery, it looks likely that this gap will continue to widen over the second half of the year.

The strength of revenues has meant that PSNBX (public sector net borrowing excluding financial interventions) is running almost £6bn below last year's figures. What's more, last year's borrowing total has been revised down substantially since the OBR made its last set of projections in March. Those projections had shown borrowing barely lower in 2013-14 than in 2012-13, so those figures look set to be beaten comfortably; we expect borrowing to come in at around £99bn (6.1% of GDP), some £9bn below the OBR's forecast.

This improvement relative to the OBR's forecasts should persist in future years which, at face value, would appear to offer the Chancellor greater room for manoeuvre in terms of policy. However, given that he has chosen to base his fiscal rules on a cyclically-adjusted measure of borrowing, and that the bulk of the undershoot in borrowing is likely to be judged as cyclical, it will do little to impact on the overall fiscal judgement. We expect the OBR to pronounce that the Government is on track to balance the cyclically adjusted current budget within the chosen five-year horizon, but not to give the Chancellor any meaningful room to loosen the pace of austerity.

As such, the Autumn Statement is likely to be fairly low key in terms of policy announcements. The coalition has made several small scale policy commitments since the Budget – including looking to switch the burden of funding some green energy measures from domestic energy bills to general taxation, to provide free school meals to younger children and to provide a tax break for married couples – but none are large enough to have any significant impact on the public finances.

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Impressum

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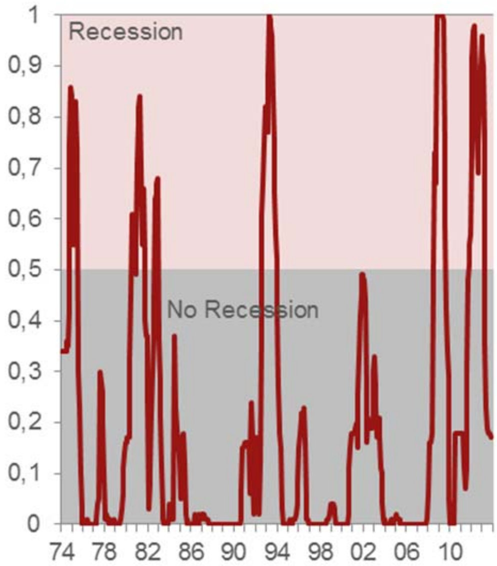
Coe-Rexecode Start-End Recession Index: The recession seems over

The start-end recession indicator (IESR) for the Euro area did cross the 0.5 threshold last April, sending a signal of recession ending. The first quarter of 2013 seems a good candidate for the business cycle trough, showing a slight delay of one quarter in the April IESR signal. Despite the 0.3 % and 0.1% rebounds of the euro area GDP growth in the second and third quarters of 2013, the CEPR which met early October considered it was too early to call for an ending of the recession in the euro area. It even put forward the possibility for a pause in the recession. This statement is not surprising in view of the average delay of around 15 months which were needed by the NBER and the CEPR to date past troughs. Therefore, dating should not be possible until April 2014.

The recent disappointing performance in the industrial sector of several large countries shows however a fragile situation. Any negative external shock may put the current recovery and the business and financial markets' renewed confidence at risk.



Updated December 10, 2013

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Forecast of the EUREN/CEPREDE High Frequency Model

Last update: November 19th, 2012

	13 Q1	13 Q2	13-Q3	13_Q4	14-Q1	14_Q2	2012	2013	2014
Sep-12	-0,6;*0,1*	-0,5;*0,1*	-0,3;*0,1*	0,2;*0,1*			-0,5	-0,3	
Oct-12	-1,0;*-0,1*	-0,9;*-0,1*	-0,5;*0,2*	0,3;*0,2*			-0,5	-0,5	
Nov-12	-1,2;*-0,3*	-1,0;*0,0*	-0,7;*0,1*	0,2;*0,4*			-0,5	-0,7	
Dec-12	-1,1;*-0,2*	-1,1;*-0,1*	-0,6;*0,3*	0,1;*0,1*			-0,5	-0,7	
Jan-13	-1,2;*-0,3*	-1,1;*-0,1*	-0,7;*0,2*	-0,1;*0,0*			-0,5	-0,8	
Feb-13	-1,1;*-0,3*	-1,1;*-0,0*	-0,6;*0,4*	0,0;*0,0*			[-0,5]	-0,7	
Mar-13	-1,1;*-0,3*	-1,1;*-0,1*	-0,7;*0,3*	0,0;*0,1*			[-0,5]	-0,7	
Apr-13	-1,0;*-0,2*	-0,8;*0,1*	-0,6;*0,1*	0,0;*0,0*			[-0,5]	-0,6	
May-13	-1,0;*-0,2*	-0,8;*0,1*	-0,6;*0,0*	-0,5;*-0,5*			[-0,5]	-0,7	
Jun-13	[-1,0;-0,2]	-0,8;*0,1*	-0,4;*0,3*	0,2;*0,0*			[-0,5]	-0,5	
Jul-13	[-1,0;-0,2]	-0,7;*0,3*	-0,3;*0,3*	0,1;*-0,3*			[-0,5]	-0,5	
Sep-13	[-1,0;-0,2]	[-0,7;0,3]	-0,2;*0,4*	0,2;*-0,2*	0,4;*0,0*	0,8;*0,7*	[-0,5]	-0,5	0,8
Oct-13	[-1,0;-0,2]	[-0,7;0,3]	-0,1;*0,5*	0,3;*-0,2*	0,5;*-0,1*	0,7;*0,5*	[-0,5]	-0,4	0,8
Nov-13	[-1,1;-0,3]	[-0,7;0,3]	[-0,4;0,1]	0,6;*0,5*	1,0;*0,2*	1,0;*0,3*	[-0,5]	-0,4	1,1

In brackets; GDP-Data published by EUROSTAT. In italics: quarter on quarter rates.

On November 14, Eurostat published the flash estimate for GDP growth rate in the third quarter of 2013. It marks a slight stagnation in the process of recovery for the Euro area economy that would have grown two tenths less than in the previous quarter. According to the indicators included in our model, this slight slowdown would has concentrated between the months of July and August, although the data already known for September and October have turned back to a recovery trend more in line with previous months. For the next quarters the high frequency model is indicating a major recovery during the last months of 2013 which would generate a GDP rate of -0.4% . For 2014 a rate of 1% is expected

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