ECOWEEK

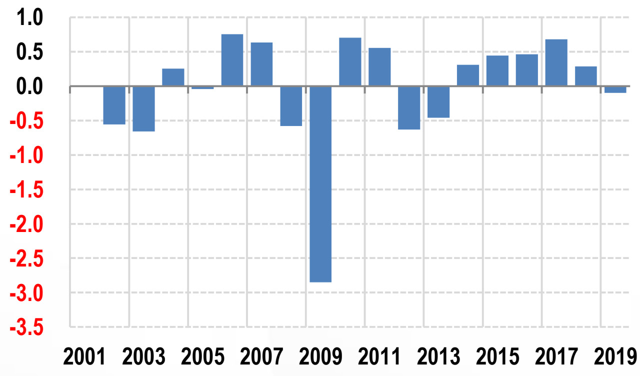
No. 19-43, 22 November 2019

Eurozone: which role for automatic fiscal stabilisers?

■ Automatic fiscal stabilisers help cushion the impact of economic shocks on GDP via changes in government revenues (because of progressive taxes) and expenditures (unemployment insurance) ■ The limited remaining monetary policy leeway in the eurozone is fueling interest in the effectiveness of the automatic stabilisers ■ European Commission research confirms that, to some degree, automatic stabilisers iron out the impact of negative shocks on GDP ■ Whether that is enough is another matter. It warrants a debate on the role of discretionary fiscal policy in case of a recession.

The feeling of panic when sitting in front of a car which is about to get off the road is less overwhelming when you know it is fitted with airbags. Likewise, the presence of automatic fiscal stabilisers should underpin confidence of economic agents when the economy enters a recession. In the presence of progressive taxation, a drop in household income will lead to a smaller decline in after-tax income whereas public expenditures (unemployment insurance) will increase as unemployment picks up. This in turn will limit the drag of unemployment on household income and spending. The theory sounds familiar but to what extent is it the case in practice? Is the cushioning effect sufficient? These questions have gained importance in the context of the latest easing move of the ECB and the feeling that monetary policy leeway to support growth is now very limited. In addition, Mario Draghi has made a plea on the occasion of his September press conference that fiscal policy steps in to boost growth so as to help the central bank in achieving its inflation objective. A third reason for the renewed interest is the debate about a European budget, either to support growth in the long run or as a central cyclical stabilisation tool.

EUROZONE: AUTOMATIC FISCAL STABILISERS



Source: Ameco, BNP Paribas

The size of automatic fiscal stabilisers can be assessed based on the change of the cyclical component of the government budget balance. This corresponds to the difference between the overall budget balance and the cyclically adjusted deficit (or surplus). In a recent paper[i], the European Commission shows that following a positive 1% shock to GDP, about half is absorbed by the automatic stabilisers, essentially because government expenditures change less than GDP. However, a more fundamental question is what difference this makes to the development of spending and GDP when second round effects are taken into account.

…/…

Eco WEEK

ECONOMIC RESEARCH DEPARTMENT

BNP PARIBAS

The bank for a changing world

A counterfactual analysis in an earlier European Commission paper[ii] sheds light on this. The authors simulate a shock of an equivalent size, in terms of GDP contraction, as the Great Recession and compare the medium-term consequences in the presence of automatic stabilisers and in case they are switched off[iii]. They conclude that the degree of stabilisation is fairly significant: "*Our results indicate that automatic stabilisers could have ironed out 13 per cent of the drop of GDP in the euro area compared to a benchmark budget with fixed levels of revenues and expenditure*". The effect is even bigger (27%) compared to a situation where tax revenues and government expenditures are kept constant as a share of GDP.

Although it is far from negligible, whether this cushioning effect is sufficient is debatable. The reaction of households and companies to shocks in income and earnings depends, amongst other things, on whether the impact is considered to be short-lived or longer-lasting. The more overwhelming the policy reaction, the bigger the feeling that the income or earnings drop will be very temporary. This 'shock and awe' approach has been used by the ECB in its comprehensive set of easing measures announced in September: several decisions of limited scope, announced jointly, are supposed to generate a bigger impact than if they were introduced sequentially. Turning to fiscal policy, this raises several questions. Are households sufficiently aware of the existence and potential impact of fiscal stabilisers? Given the automatic nature of the stabilisers, does the absence of an announcement effect, which is present in case of a discretionary fiscal impulse, reduce its effectiveness in supporting confidence? Will economic agents incorporate in their decisions today the expected cumulative impact of the automatic stabilisers? These questions warrant a debate in the eurozone on the role of discretionary fiscal policy, as a complement to automatic stabilisers, in case of a recession: who does what, how much and how quickly?

William De Vijlder

[i] Automatic fiscal stabilisers in the EU: size & effectiveness, European Commission, European Economy, Economic Brief 045, May 2019
[ii] Automatic fiscal stabilisers: What they are and what they do, European Commission, European Economy, Economic Papers 452, April 2012
[iii] The 'switching off' is simulated in two different ways. In one case, the 'automatic' decline in tax revenues and increase in government spending is neutralised by fiscal measures which keep revenues and expenditures at their pre-recession level. In a second scenario, taxes to GDP and government expenditures are kept constant as a share of GDP at their pre-recession level.

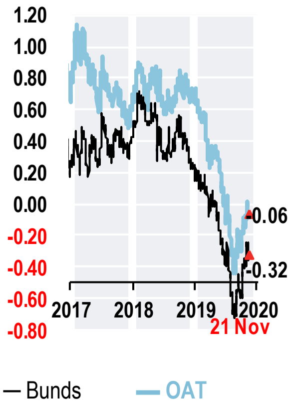
Markets overview

The essentials

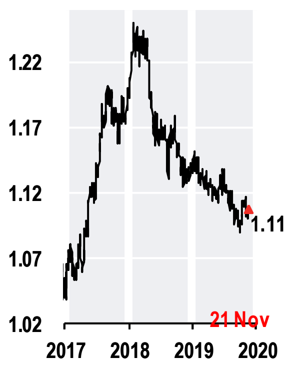
Week 15-11 19 > 21-11-19

↘ **CAC 40**	5 939	▶	**5 881**	**-1.0**	%
↘ **S&P 500**	3 120	▶	**3 104**	**-0.5**	%
↗ Volatility (VIX)	12.1	▶	13.1	+1.1	pb
↘ **Euribor 3M (%)**	-0.40	▶	**-0.41**	**-0.4**	bp
↘ Libor $ 3M (%)	1.90	▶	1.90	-0.4	bp
↘ OAT 10y (%)	-0.06	▶	-0.06	+0.0	bp
↗ Bund 10y (%)	-0.33	▶	-0.32	+1.0	bp
↘ US Tr. 10y (%)	1.84	▶	1.78	-6.0	bp
↗ **Euro vs dollar**	1.11	▶	**1.11**	**+0.2**	%
↗ Gold (ounce, $)	1 467	▶	1 468	+0.1	%
↗ **Oil (Brent, $)**	63.4	▶	**63.4**	**+0.1**	%

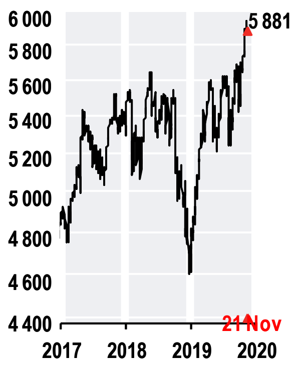
10 y bond yield, OAT vs Bund



Euro-dollar



CAC 40



Money & Bond Markets

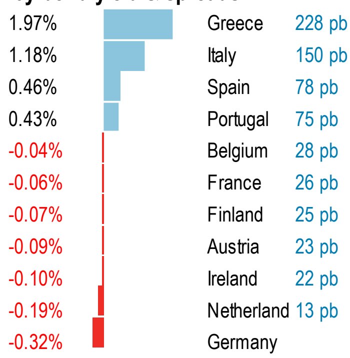
Interest Rates		highest' 19		lowest' 19	
€ ECB	**0.00**	0.00	at 01/01	0.00	at 01/01
Eonia	**-0.43**	-0.25	at 07/06	-0.47	at 03/10
Euribor 3M	**-0.41**	-0.31	at 24/01	-0.45	at 03/09
Euribor 12M	**-0.28**	-0.11	at 06/02	-0.40	at 21/08
$ FED	**1.75**	2.50	at 01/01	1.75	at 31/10
Libor 3M	**1.90**	2.81	at 01/01	1.89	at 01/11
Libor 12M	**1.91**	3.04	at 21/01	1.85	at 04/10
£ BoE	**0.75**	0.75	at 01/01	0.75	at 01/01
Libor 3M	**0.80**	0.93	at 29/01	0.75	at 29/08
Libor 12M	**0.96**	1.19	at 11/01	0.81	at 03/09

At 21-11-19

Yield (%)		highest' 19		lowest' 19	
€ AVG 5-7y	**0.00**	0.68	at 09/01	-0.36	at 03/09
Bund 2y	**-0.62**	-0.53	at 05/03	-0.92	at 02/09
Bund 10y	**-0.32**	0.25	at 01/01	-0.72	at 28/08
OAT 10y	**-0.06**	0.73	at 08/01	-0.44	at 28/08
Corp. BBB	**0.96**	2.15	at 08/01	0.64	at 30/08
$ Treas. 2y	**1.61**	2.62	at 18/01	1.39	at 03/10
Treas. 10y	**1.78**	2.78	at 18/01	1.46	at 04/09
Corp. BBB	**3.27**	4.65	at 01/01	3.15	at 04/09
£ Treas. 2y	**0.56**	0.83	at 27/02	0.31	at 08/10
Treas. 10y	**0.76**	1.35	at 18/01	0.33	at 03/09

At 21-11-19

10y bond yield & spreads

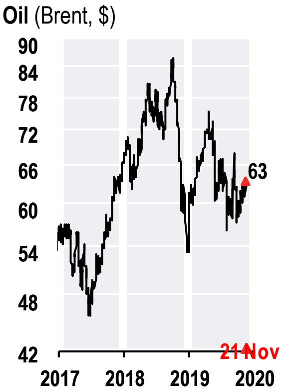


Commodities

Spot price in dollars		lowest' 19			2019(€)
Oil, Brent	**63.4**	53.1	at	01/01	**+23.2%**
Gold (ounce)	**1 468**	1 268	at	02/05	**+18.3%**
Metals, LMEX	**2 745**	2 718	at	07/08	**+1.1%**
Copper (ton)	**5 810**	5 585	at	03/09	**+0.8%**
CRB Foods	**327**	312	at	11/09	**+4.1%**
wheat (ton)	**204**	166	at	30/08	**+6.7%**
Corn (ton)	**142**	128	at	24/04	**+7.7%**

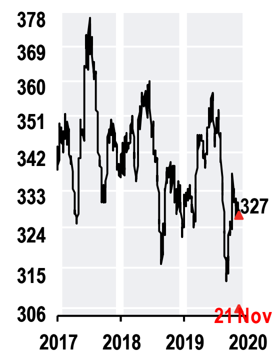
At 21-11-19 *Variations*

Oil (Brent, $)



Gold (Ounce, $)

CRB Foods



Exchange Rates

1€ =		highest' 19			lowest' 19			2019
USD	**1.11**	1.15	at	10/01	1.09	at	30/09	-3.1%
GBP	**0.86**	0.93	at	12/08	0.85	at	14/03	-4.5%
CHF	**1.10**	1.14	at	23/04	1.08	at	04/09	-2.6%
JPY	**120.20**	127.43	at	01/03	116.08	at	03/09	-4.2%
AUD	**1.63**	1.66	at	07/08	1.57	at	18/04	+0.4%
CNY	**7.79**	7.96	at	27/08	7.51	at	25/04	-0.7%
BRL	**4.67**	4.67	at	19/11	4.18	at	31/01	+5.3%
RUB	**70.57**	79.30	at	01/01	70.22	at	24/09	-11.0%
INR	**79.49**	82.00	at	04/02	76.37	at	01/08	-0.4%

At 21-11-19 *Variations*

Equity indices

	Index	highest' 19			lowest' 19			2019	2019(€)
CAC 40	**5 881**	5 939	at	15/11	4 611	at	03/01	+24.3%	**+24.3%**
S&P500	**3 104**	3 122	at	18/11	2 448	at	03/01	+23.8%	**+27.8%**
DAX	**13 138**	13 289	at	07/11	10 417	at	03/01	+24.4%	**+24.4%**
Nikkei	**23 039**	23 520	at	12/11	19 562	at	04/01	+15.1%	**+20.1%**
China*	**78**	86	at	09/04	68	at	03/01	+10.6%	**+14.1%**
India*	**578**	612	at	03/06	526	at	22/08	+6.6%	**+7.0%**
Brazil*	**2 127**	2 354	at	10/07	1 862	at	17/05	+18.9%	**+12.9%**
Russia*	**764**	793	at	07/11	572	at	01/01	+24.1%	**+37.9%**

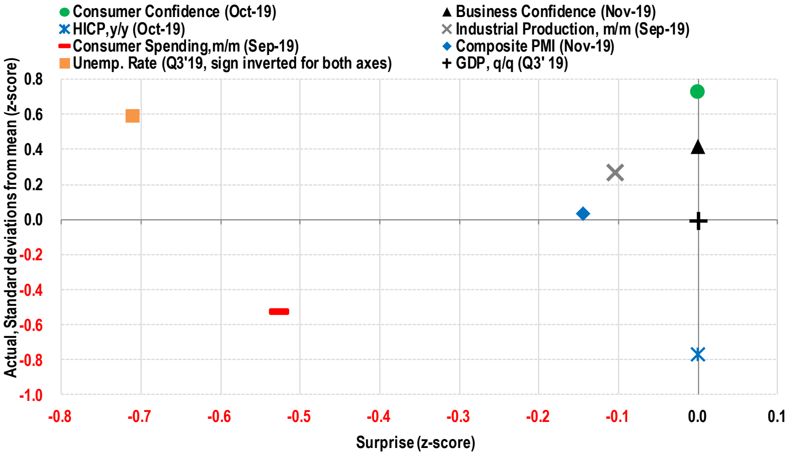
At 21-11-19 *Variations*

* MSCI index

Pulse

France: business confidence holding up well in November

Our Pulse indicators leave a misleading negative impression. Indeed, with a 0.3% q/q print in Q3 2019 (first estimate), French growth continues to prove remarkably resilient and stable. And Q4 prospects look similarly positive judging by the October and November results of INSEE business confidence surveys and Markit PMIs. Admittedly, the composite indices were almost unchanged in November but they stand at a relatively high level (105 and 53, respectively). Besides, the headline figures mask more positive details, like, for instance, the improvement in the industry sector (whose confidence index, it is worth emphasizing, stands in the expansion zone contrary to Germany where it is in recession) and the rise in the employment and new export orders components.



Note: z-score is a score which indicates how many standard deviations an observation is from the mean: z=(x-μ)/σ where x: observation, μ: mean, σ: standard deviation. On the X-axis, x corresponds at the last known surprise for each indictor represented on the graph, μ and σ corresponds respectively to the mean and the standard deviation of the last 24 value for monthly data and the last 8 quarters for quarterly data. On the Y-axis, x corresponds at the last known value of indicator, μ and σ corresponds respectively to the mean and the standard deviation for this indicator since 2000 (for China since 2011).

Indicators preview

Highlights of next week are the ifo business climate in Germany, consumer confidence in several countries and, for the eurozone, economic confidence, business climate, inflation and the unemployment rate. In the US we will see the publication of several regional activity surveys, as well as the trade balance and durable goods orders. The Federal Reserve will publish its beige book, which provides a description of the economic situation in different parts of the US.

Date	Country/Region	Event	Period	Survey	Prior
11/25/2019	Germany	ifo Business Climate	Nov	--	94.6
11/25/2019	United States	Chicago Fed Nat Activity Index	Oct	--	-0.45
11/25/2019	United States	Dallas Fed Manf. Activity	Nov	-2.0	-5.1
11/26/2019	Germany	GfK Consumer Confidence	Dec	--	9.6
11/26/2019	United States	Advance Goods Trade Balance	Oct	7.1e+10	7.04e+10
11/26/2019	United States	Richmond Fed Manufact. Index	Nov	--	--
11/26/2019	United States	Conf. Board Consumer Confidence	Nov	126.1	125.9
11/26/2019	United States	New Home Sales MoM	Oct	0.6%	-0.7%
11/26/2019	United States	Conf. Board Present Situation	Nov	--	172.3
11/27/2019	France	Consumer Confidence	Nov	--	104
11/27/2019	United States	MBA Mortgage Applications	Nov	--	--
11/27/2019	United States	GDP Annualized QoQ	3Q	1.9%	1.9%
11/27/2019	United States	Durable Goods Orders	Oct	-0.7%	-1.2%
11/27/2019	United States	Personal Income	Oct	0.3%	0.3%
11/27/2019	United States	Personal Spending	Oct	0.3%	0.2%
11/27/2019	United States	U.S. Federal Reserve Releases Beige Book			
11/28/2019	Eurozone	M3 Money Supply YoY	Oct	--	5.5%
11/28/2019	Eurozone	Economic Confidence	Nov	--	100.8
11/28/2019	Eurozone	Business Climate Indicator	Nov	--	-0.19
11/28/2019	Eurozone	Consumer Confidence	Nov	--	--
11/28/2019	Germany	CPI EU Harmonized YoY	Nov	--	0.9%
11/29/2019	United Kingdom	GfK Consumer Confidence	Nov	--	-14
11/29/2019	France	CPI EU Harmonized YoY	Nov	--	0.9%
11/29/2019	France	GDP QoQ	3Q	--	0.3%
11/29/2019	Germany	Unemployment Change (000's)	Nov	--	6000
11/29/2019	Eurozone	Unemployment Rate	Oct	--	7.5%
11/29/2019	Eurozone	CPI MoM	Nov	--	0.1%

Source: Bloomberg, BNP Paribas

Economic scenario

UNITED STATES

- Growth is slowing and this trend is expected to continue under the influence of corporate investment (slower profits growth, uncertainty) and housing (declining trend of affordability). Consumer spending should be more resilient. The trade dispute with China acts as an additional drag but recent progress might imply this effect would wane.
- We expect one more Fed Funds target rate cut this year and two additional cuts in 2020.

CHINA

- Economic growth continues to slow and our GDP forecasts have been revised down since June. Industrial activity and exports have been hard hit by US tariff hikes. Domestic demand has also decelerated.
- The central bank is easing liquidity and credit conditions, though the reduction in financial-instability risks should remain a priority and banks seem to remain prudent. Fiscal policy is expansionary through increased infrastructure spending and a rising number of household/corporate tax cuts.
- In the short term, exports and private domestic investment should continue to decelerate. Tax measures should have some success in supporting consumer spending.

EUROZONE

- The economic slowdown is continuing in the eurozone, especially in Germany, due to the international environment and elevated uncertainty. The recent stabilization of business surveys provides some hope but needs to be confirmed.
- Inflation is now expected to decrease while core CPI is hardly moving. The activity slowdown also implies that the pick-up in core inflation should be slower than expected until recently.
- Faced with an outlook of subdued inflation, the very accommodative monetary policy will be maintained as long as inflation hasn't converged sufficiently, in a convincing and lasting way, towards the ECB's objective.

FRANCE

- Growth is slowing although the economy shows resilience. Households' consumption should get a boost from the tax cuts and the jobs recovery. Business investment dynamics remain favourable. The global backdrop is less supportive.
- A slight rise in core inflation is appearing but remains to be confirmed.

INTEREST RATES AND FX RATES

- In the US, we expect the Fed to cut its official rate again in December in reaction to a slowing economy, moderate inflation and high uncertainty. 2020 should see two more cuts. Treasury yields are to decline further in the coming months. Eventually, in the course of 2020 they should move up again in anticipation of a pick-up in growth.
- In the eurozone, the ECB's state-dependent forward guidance and the sluggishness of the inflation process imply that the very accommodative environment will remain in place for a long time. This will exert downward pressure on bond yields, although these will also be influenced by yield movements in the US.
- No policy rate change expected in Japan.
- We expect little change in EUR/USD even though euro's fair value is quite higher than current pricing. The yen should strengthen on the back of stable BoJ policy and high market volatility.

	GDP Growth			Inflation		
%	2018	2019 e	2020 e	2018	2019 e	2020 e
Advanced	**2.2**	**1.6**	**1.0**	**2.1**	**1.4**	**1.3**
United-States	2.9	2.2	1.5	2.4	1.8	1.8
Japan	0.8	1.2	0.2	1.0	0.6	0.3
United-Kingdom	1.4	1.1	0.6	2.5	1.9	1.8
Euro Area	**1.9**	**1.1**	**0.7**	**1.8**	**1.1**	**0.8**
Germany	1.4	0.4	0.2	1.9	1.4	1.0
France	1.7	1.2	1.0	2.1	1.2	1.0
Italy	0.7	0.1	0.0	1.2	0.6	0.5
Spain	2.6	2.2	1.6	1.7	0.8	0.7
Emerging	**4.4**	**3.8**	**4.2**	**4.7**	**4.8**	**4.5**
China	6.6	5.9	5.6	2.1	2.4	2.8
India*	6.8	6.5	6.3	2.9	3.0	3.3
Brazil	1.1	0.5	2.0	3.7	3.7	3.5
Russia	2.3	1.2	2.0	2.9	4.8	3.8

Source : BNP Paribas Group Economic Research (e: Estimates & forecasts)
* Fiscal year from April 1st of year n to March 31st of year n+1

Interest rates, %		2019						
End of period		Q1	Q2	Q3	Q4e	2018	2019e	2020e
US	Fed Funds	2.50	2.50	2.00	1.50	2.50	1.50	1.00
	Libor 3m $	2.60	2.32	2.09	1.70	2.81	1.70	1.25
	T-Notes 10y	2.42	2.00	1.67	1.00	2.69	1.00	1.50
Ezone	deposit rate	-0.40	-0.40	-0.50	-0.60	-0.40	-0.60	-0.60
	Euribor 3m	-0.31	-0.35	-0.42	-0.60	-0.31	-0.60	-0.60
	Bund 10y	-0.07	-0.32	-0.57	-0.80	0.25	-0.80	-0.50
	OAT 10y	0.26	-0.01	-0.28	-0.55	0.71	-0.55	-0.30
UK	Base rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75
	Gilts 10y	1.00	0.84	0.40	0.55	1.27	0.55	0.75
Japan	BoJ Rate	-0.06	-0.08	-0.06	-0.10	-0.07	-0.10	-0.10
	JGB 10y	-0.09	-0.16	-0.22	-0.40	0.00	-0.40	-0.25

Source : BNP Paribas GlobalMarkets (e: Forecasts)

Exchange Rates		2019						
End of period		Q1	Q2	Q3	Q4e	2018	2019e	2020e
USD	EUR / USD	1.12	1.14	1.09	1.11	1.14	1.11	1.14
	USD / JPY	111	108	108	102	110	102	96
	GBP / USD	1.30	1.27	1.23	1.23	1.27	1.23	1.36
	USD / CHF	1.00	0.98	1.00	0.99	0.99	0.99	1.00
EUR	EUR / GBP	0.85	0.89	0.89	0.90	0.90	0.90	0.84
	EUR / CHF	1.12	1.11	1.09	1.10	1.13	1.10	1.14
	EUR / JPY	124	123	118	113	125	113	109

Source : BNP Paribas GlobalMarkets (e: Forecasts)

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com
ADVANCED ECONOMIES AND STATISTICS		
Jean-Luc Proutat Head – United States, United Kingdom	+33 1 58 16 73 32	jeanluc.proutat@bnpparibas.com
Hélène Baudchon France – Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset European Central Bank watch, Euro area global view, Japan	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Spain, Portugal	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
Catherine Stephan Nordic countries – World trade – Education, health, social conditions	+33 1 55 77 71 89	catherine.stephan@bnpparibas.com
Raymond Van Der Putten Germany, Netherlands, Austria, Switzerland – Energy, climate – Long-term projections	+33 1 42 98 53 99	raymond.vanderputten@bnpparibas.com
Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com
BANKING ECONOMICS		
Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+ 33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+ 33 1 40 14 30 77	thomas.humblot@bnpparibas.com
EMERGING ECONOMIES AND COUNTRY RISK		
François Faure Head	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Sylvain Bellefontaine Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	sylvain.bellefontaine@bnpparibas.com
Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	sara.confalonieri@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
CONTACT MEDIA		
Michel Bernardini	+33 1 42 98 05 71	michel.bernardini@bnpparibas.com

OUR PUBLICATIONS

CONJONCTURE

Structural or in news flow, two issues analysed in depth

EMERGING

Analyses and forecasts for a selection of emerging economies

PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed

ECOFLASH

Data releases, major economic events. Our detailed views...

ECOWEEK

Weekly economic news and much more...

ECOTV

In this monthly web TV, our economists make sense of economic news

ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy

POUR RECEVOIR NOS PUBLICATIONS

VOUS POUVEZ VOUS ABONNER SUR NOTRE SITE ONGLET ABONNEMENT
http://economic-research.bnpparibas.com

ET

NOUS SUIVRE SUR LINKEDIN
https://www.linkedin.com/showcase/bnp--paribas-economic-research/
OU TWITTER
https://twitter.com/EtudesEco_BNPP

Prepared by Economic Research – BNP PARIBAS
Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tel: +33 (0) 1.42.98.12.34 – Internet :
www.group.bnpparibas.com
Publisher: Jean Lemierre. Editor: William De Vijlder