Association of European Conjuncture Institutes

AIECE

GENERAL REPORT PART 1

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Outline

The external environment and risks

The outlook for Europe

The Euro Area

Labour market

Inflation development

Non Euro Area countries

Monetary and fiscal policies

An ongoing global economic recovery amid challenges

- In the first half of 2024, global economic activity has continued to show resilience, despite the cumulative effects of several partially overlapping shocks.

- Inflation has decelerated more rapidly than expected, and labour market conditions have remained tight, with unemployment near significant lows.

- According to IMF estimates, global GDP growth in 2023 showed a deceleration (3.2% from 3.5 % in 2022), settling at a rate of expansion that remains below historical levels (2000-2019 average growth 3.8 %).

- Global growth is projected to continue at the same pace in 2024 and 2025.

AIECE Institutes on average display a more pessimistic view than IMF and OECD

TABLE 1.1 GLOBAL GDP GROWTH ACCORDING TO THE AIECE INSTITUTES FORECASTS

	2024	2025
AVERAGE	2.9	3.0
MINIMUM	2.4	2.5
MAXIMUM	3.5	3.5

- AIECE Institutes on average display a more pessimistic view than IMF (and OECD 3.1% and 3.2%). For this year, the Institutes expect on average a slowdown in World GDP which will accelerate only marginally in 2025 (2.9% and 3.0%).
- The most pessimistic Institute expects World GDP to growth by 2.4% and 2.5% in 2024 and 2025, whereas the most optimistic one expects a growth rate of 3.5% in both years.

Decelerating inflation but still above central banks targets

- The IMF estimated a global consumer price inflation rate of 6.8 % in 2023, forecasting a further decline in 2024 and 2025 (to 5.9% and 4.5%, respectively).

- In 2023, consumer prices rose in the United States by 3.6% and in the Area Euro by 6.0%.

- In China, on the contrary, prices growth was negative accentuated by the problems in the real estate sector and subdued domestic demand (0.2% average overall inflation in 2023).

- In 2024 and 2025, according to IMF estimates, inflation will decelerate further in the USA and Area Euro (2.4% and 1.8% and 2.9% and 2.5% respectively) while accelerating gradually in China (1.0% and 2.0%).

Brent price has increased while natural gas has continued to decline …

- Average Brent price in 2023 was $82.6 per barrel, down significantly from 2022 ($99.8).

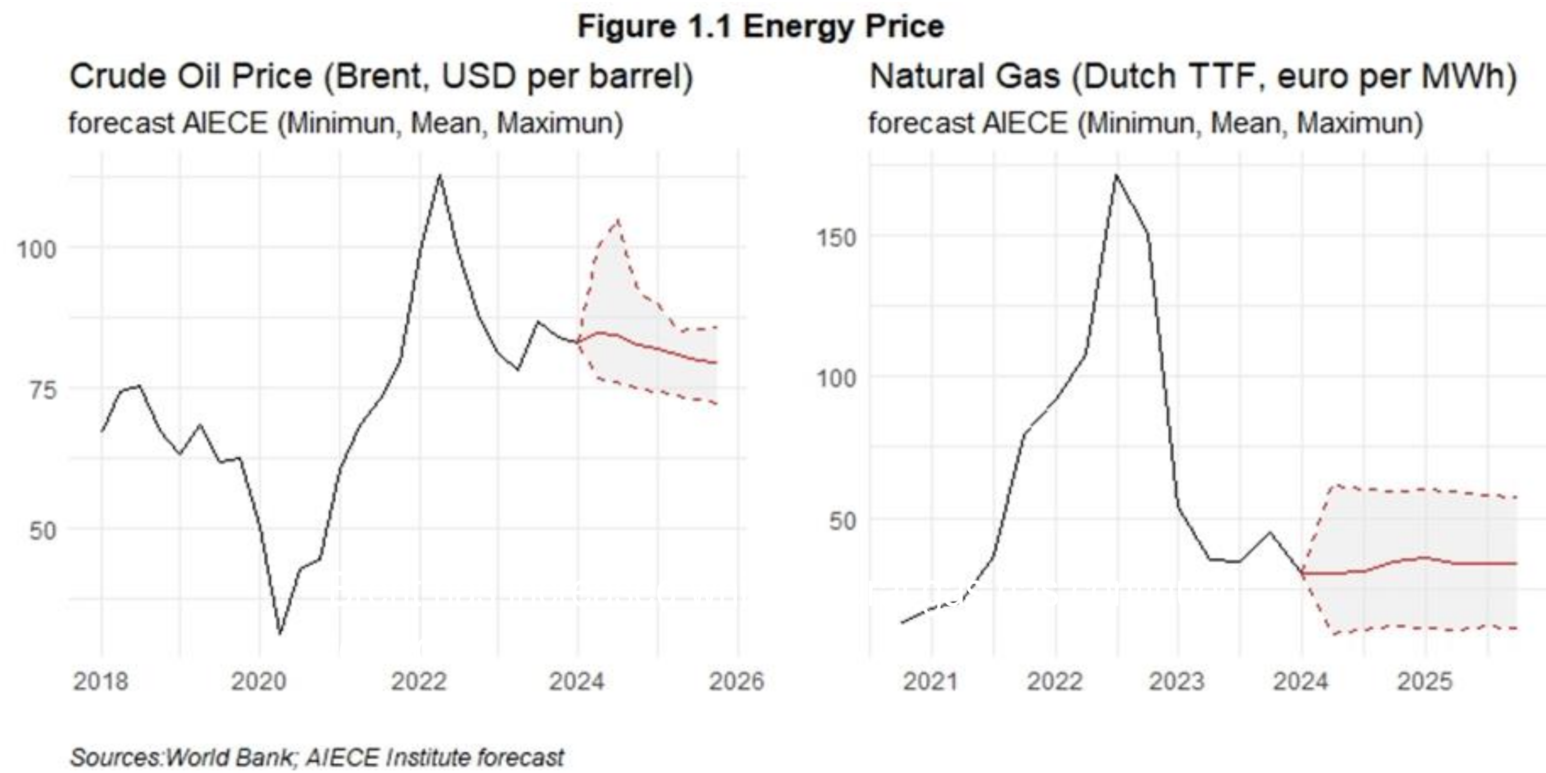
- The gas price, which followed a similar trend in 2023 averaged 42.3 Ducth TTf euro/MWh from its price in 2022 (130.4 euro/MWh).

- In the first four months of 2024, Brent prices resumed their upward trend ($84.9 the average January-April), also driven by the effects of geopolitical tensions, while…

- ….gas price continued to decline (30 euro/MWh the average between January and April).

- AIECE Institutes forecasts are quite heterogeneous especially for oil in 2024, reflecting the high uncertainty which continues to cloud the international environment.

AIECE Institutes Brent and gas prices forecasts

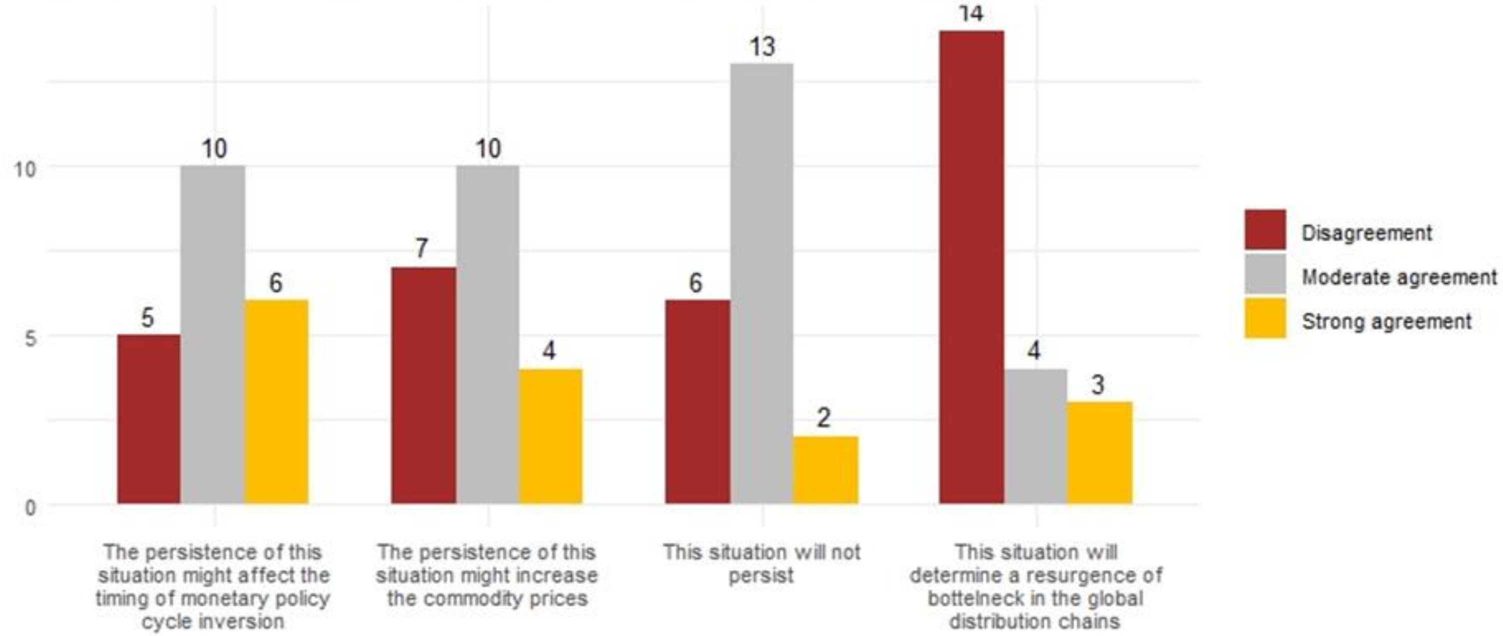


- As for the Brent, on average, the AIECE Institutes forecast that the decreasing trend will continue this year and the next (83.7$ for barrel and 80.6$ respectively)…..
- …..for natural gas a decrease is expected for 2024 followed by a moderate increase in 2025 (31.5 euro/MWh and 34.3 respectively).

Red sea terrorists'attacks persistency and impact (i)

6.1.2 Despite mild upward pressure from higher shipping costs in the wake of Red Sea trade disruptions, underlying inflation continues on a steady downward path with few exceptions. Oil and gas prices, after an initial surge, have settled back below pre-conflict levels, and shipping costs remain below 2021-2022 levels. Do you agree with the following statements?

Figure 4.2 Red Sea terrorist attacks and resurgence of inflation?



Sources:Answer AIECE Institute

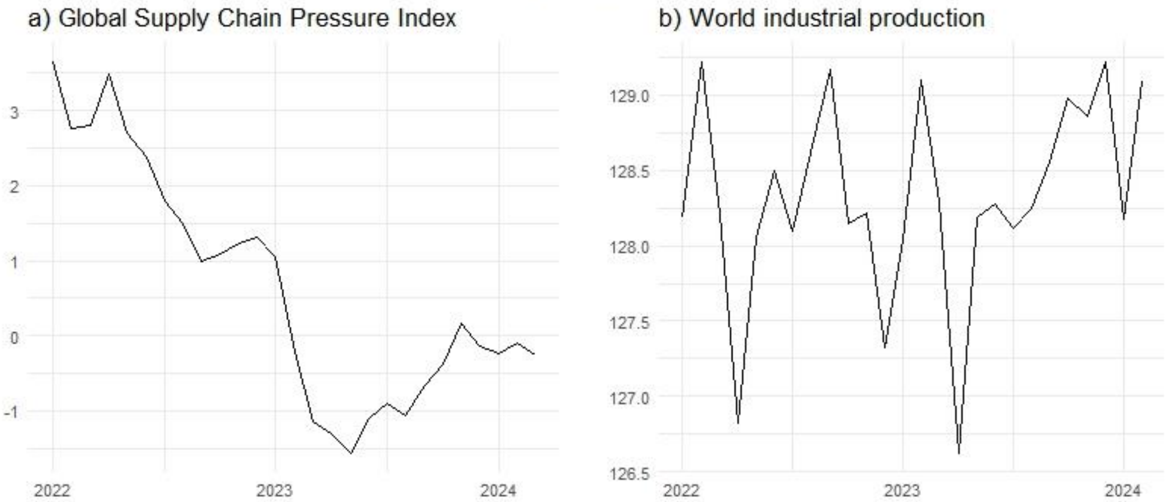
Red sea terrorist attacks persistency and impact (ii)

- The majority of the AIECE institutes (moderate and strong agreement) believes that the terrorist attacks in the Red sea will not persist (71%) and will not determine the resurgence of bottlenecks in the Global Supply Chains (67%).

- The majority of the AIECE institutes (moderate and strong agreement), however, affirms that if persisting this situation could cause commodity prices resurgence (67%) and affect the timing of monetary policy inversion (76%).

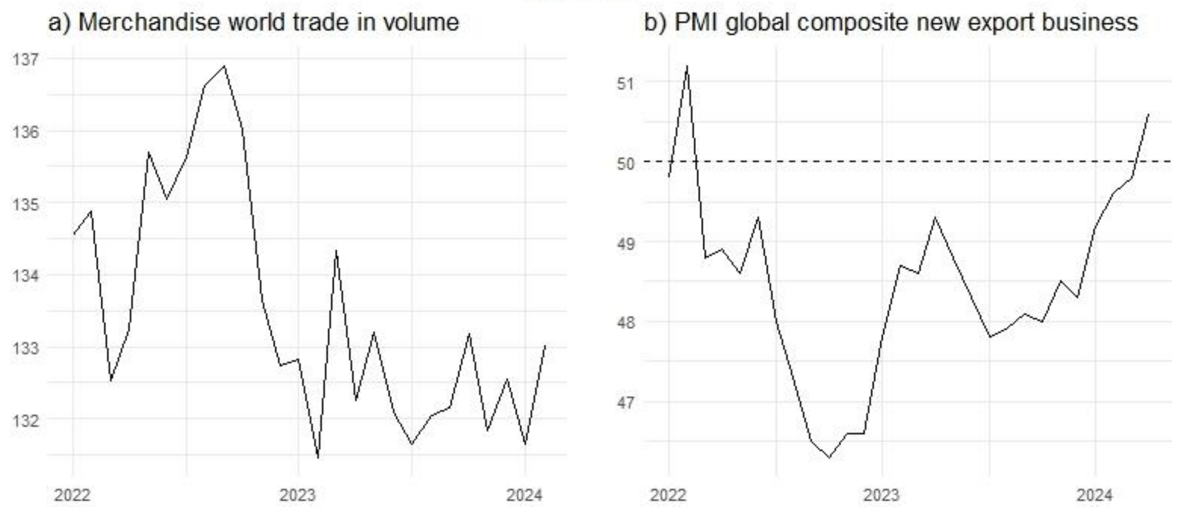
…..so far no bottlenecks in GSC

Figure 1.2



Sources:CPB and Benigno et al 2022

Figure 1.3



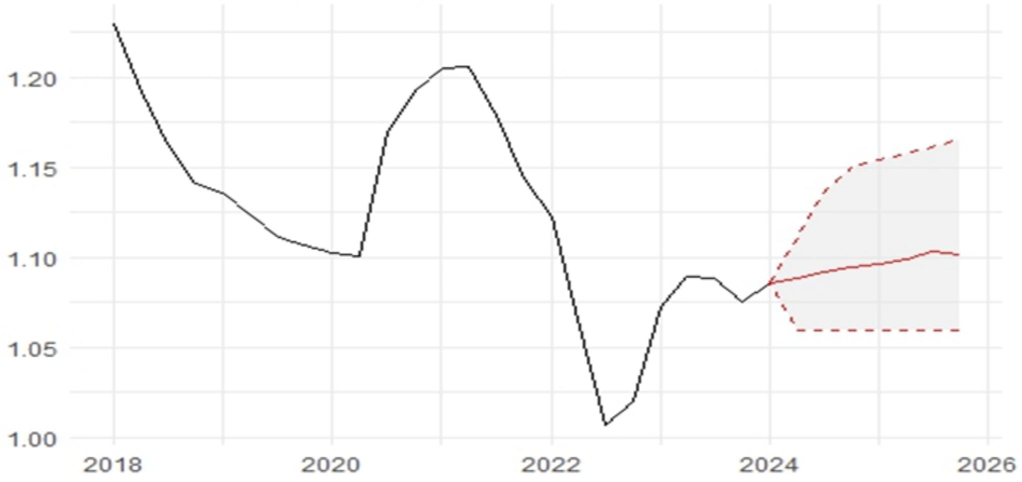
Sources:CPB and Markit IHS

Euro dollar nominal exchange rate despite many shocks remains fairly stable….

- ….and consistent with the different growth prospects and intensities of the monetary tightening process implemented by the respective central banks.
- Euro, on average in 2023, appreciated by 2.6% against the dollar (1.08 dollars per euro from 1.05 in 2022).
- The euro-dollar exchange rate has continued to fluctuate around the 2023 levels (on average 1.08 dollars per euro between January and April 2024).

Figure 1.4 Exchange Rate EUR/USD

forecast AIECE (Minimun, Mean, Maximun)



Sources:World Bank; AIECE Institute forecast

Euro dollar nominal exchange rate will substantially stabilise in 2024-25

- On average, the institutes expect the euro dollar exchange rate to remain substantially stable at 1.09 dollars in 2024 and marginally depreciated at 1.10 dollars in 2025 (1.08 dollars per euro average 2023).

- The most pessimistic Institute (about the relative value of euro) expects dollar to appreciate at 1.07 and 1.06 in 2024 and 2025.

- The most optimistic one expects the euro to appreciate at 1.12 and 1.16 (that would be an appreciation from 2023 average value by respectively 3.7% and 7.4%).

Questions for discussion

- Is the current economic recovery sustainable or will there be another downturn?
- Red sea terrorists'attacks persistency and impact. What do you expect ?
- Will the euro dollar exchange rate remains on its current values or it will become more volatile and appreciated/depreciated?

Risks to the global outlook (i)

- The global economic outlook is experiencing a more balanced risk profile though significant uncertainties remain.

- High geopolitical tensions pose a major near-term threat, particularly if escalating conflicts in the Middle East will disrupt energy and financial markets, leading to higher inflation and lower growth.

- Inflation reduction could be slower than anticipated especially in the service sector. This could delay interest rate reductions, potentially exposing financial vulnerabilities and triggering a slowdown in job markets.

- Another key downside risk lies in the potential for higher real interest rates to have a stronger impact than expected.

- Debt burdens are already high and could rise further as low-interest debt matures and needs refinancing or as fixed-rate borrowing rates are renegotiated.

Risks to the global outlook (ii)

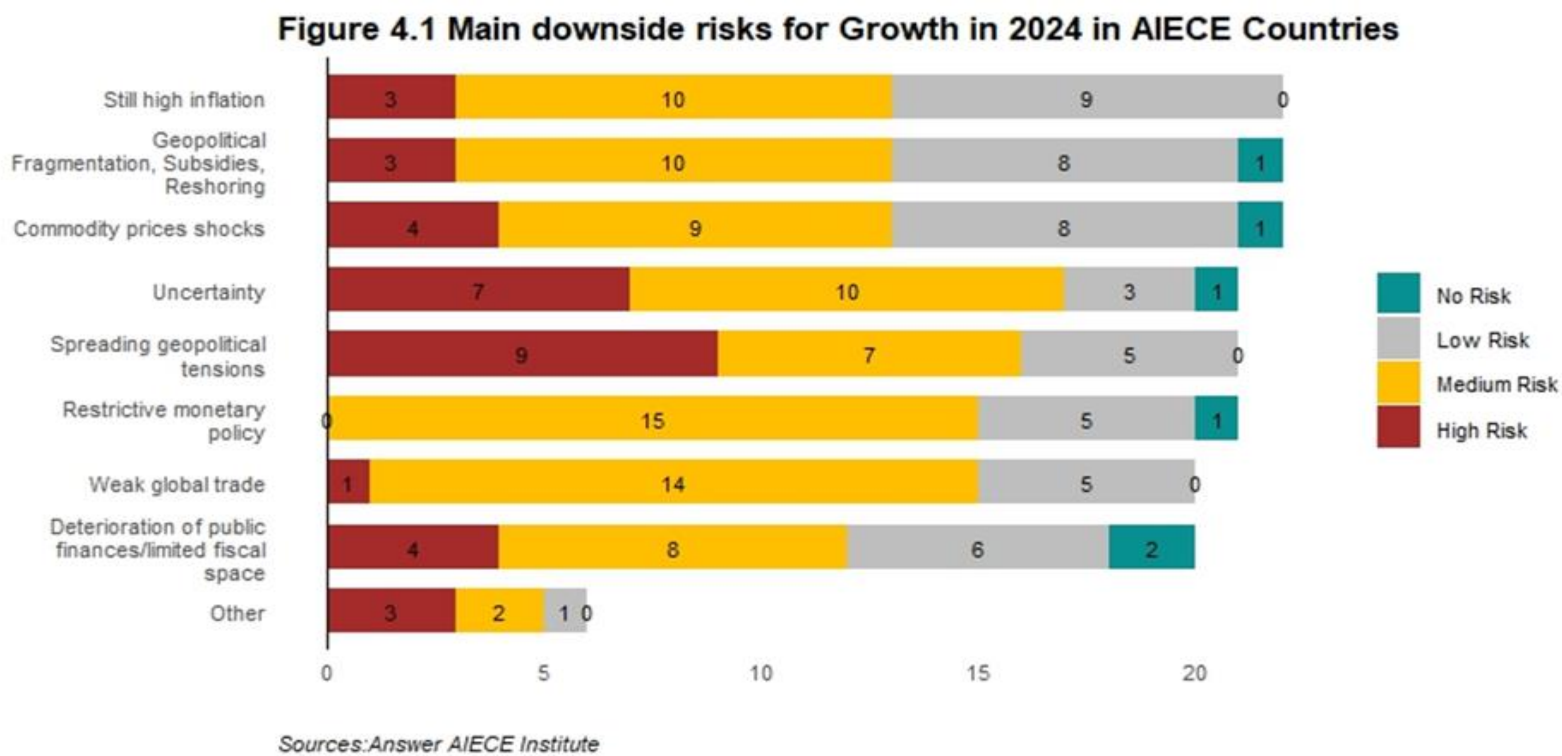
- Productivity, despite being very volatile, has remained on its pre-existing slow growth path in the majority of countries.

- China's economic growth could disappoint, either due to persisting weakness in the real estate market or lower-than-anticipated fiscal stimulus in the next two years.

- Artificial intelligence and stronger structural reforms than anticipated could incentive productivity.

Relatively heterogeneous risk assessment across AIECE Institutes…….

- …..however, uncertainty and spreading geopolitical tensions (medium and high risks) remain the main downside risks for the majority of the AIECE institutes (81% and 76%),
- followed by restrictive monetary policy and weak global trade (both 71%).



Industrial policy and EA single market distortion (i)

- *6.1.3 The EU needs to remain competitive in an outlook characterised by intensifying pressures. Lately, US and China are implementing industrial policy measures to give strategic sectors (e.g. semiconductor and AI) an edge. In particular, the US Inflation reduction act might affect production costs in some strategic activities with obvious competitive advantage with respect of EU productions. The EU relaxed state aid rules, but this may generate distortions in the single market, because only deep-pocketed member states might be able to take a real advantage of it. Please indicate level of agreement to the statements below.*

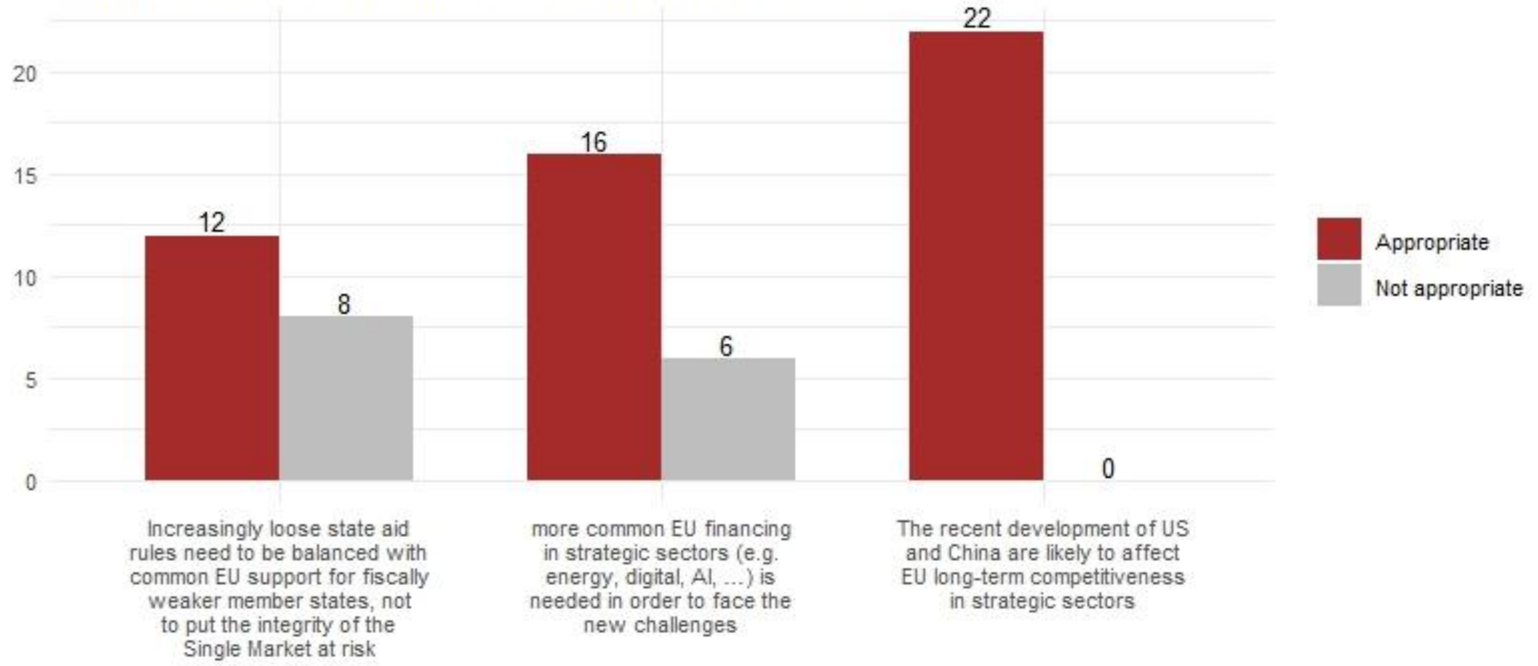
- All the 22 AIECE Institutes which answered to this question acknowledge that US and China are taking steps to boost their strategic sectors, putting pressure on the EU's industrial competitiveness.

- The majority of the Institutes (73%) agrees that the EU should react with larger financial resources devoted to strategic sectors (such as energy, AI, digital) in order to face this challenge.

- However only the 55% of the Institutes believes that increasingly loose state aid rules need to be balanced with common EU support for fiscally weaker member states, not to put the integrity of the Single Market at risk.

Industrial policy and EA Single market distortion (ii)

Figure 4.3 Industrial policies and market distortions

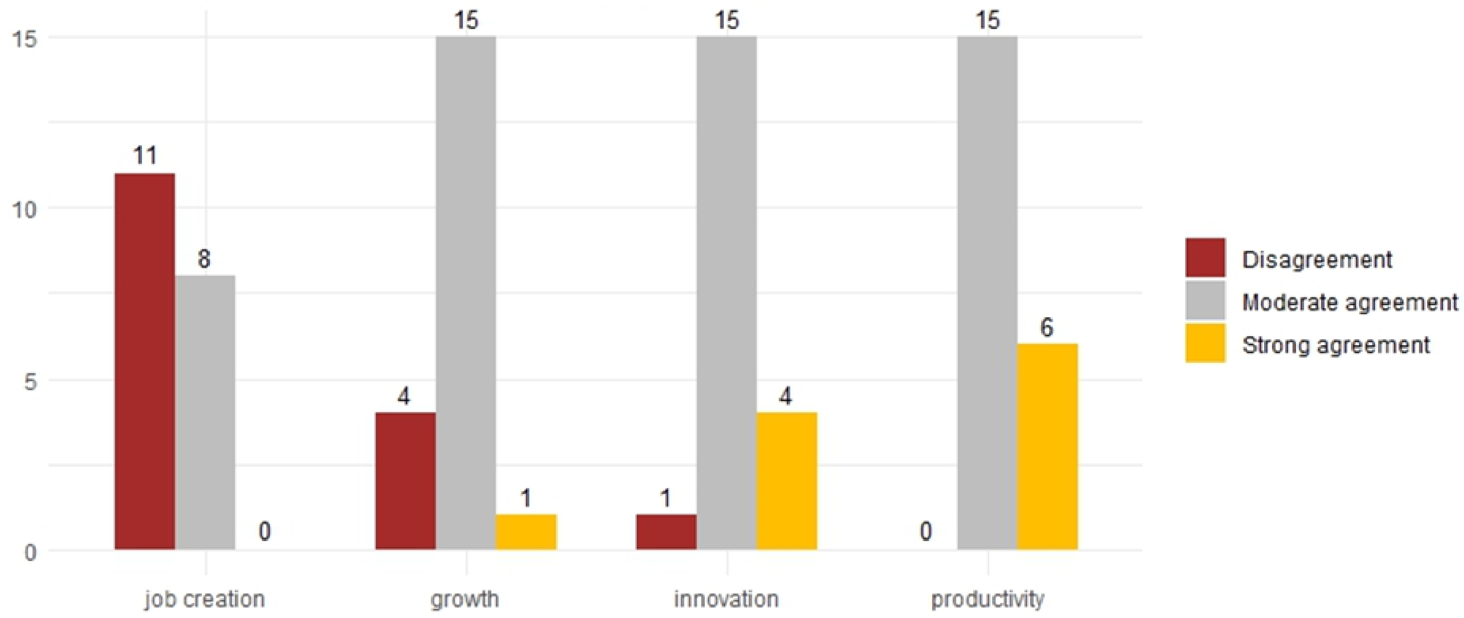


Sources:Answer AIECE Institute

Artificial intelligence impact (i)

- *6.2.2 Artificial intelligence (AI) will profoundly affect the ways in which businesses and governments engage with consumers and citizens alike. However, the adoption of AI is happening at a different pace in the various countries/regions. Over the next five years, do you expect AI to improve each of the following areas of operations as they relate to your industry/country?*

Figure 4.6 Macroeconomic impact of artificial intelligence



Sources:Answer AIECE Institute

Artificial intelligence impact (ii)

- AI has the potential to incentivize productivity growth and accelerate innovation, although estimates of its actual impact remain uncertain.

- While the adoption of AI by businesses has increased rapidly, it's primarily concentrated among large companies.

- The overall effect of AI on productivity will depend on several factors including how widely these new technologies are diffused across businesses and whether AI complements and enhances the work done by humans, or replaces human labour altogether.

- A large majority of AIECE Institutes (moderately and strongly) agrees that AI in the next 5 years will improve, growth (80%), innovation (95%) and productivity (100%) in their country but…..

- …..only the 42% of the Institutes believe that AI will create additional jobs in the future.

Istat

Questions for discussion

- How do you expect will be the productivity growth rate in your country in the next 3 years and why?

- What do you expect will be the AI impact on the labour market?

- Will China's economic slowdown continue, and how will it impact the global economy? Will the Chinese stimulus measures be effective?

Motetary and fiscal policies challenged by very high uncertainty

- Inflation is still above the ECB's target, while high key interest rates have risen at a record pace.

- The central bank's quantitative tightening of the past years has made financing conditions very restrictive for households and businesses.

- Uncertainties related mainly to the impact of the full transmission of past interest rate hikes and to global economic and geopolitical developments contribute to a challenging growth environment dominated by downside risks.

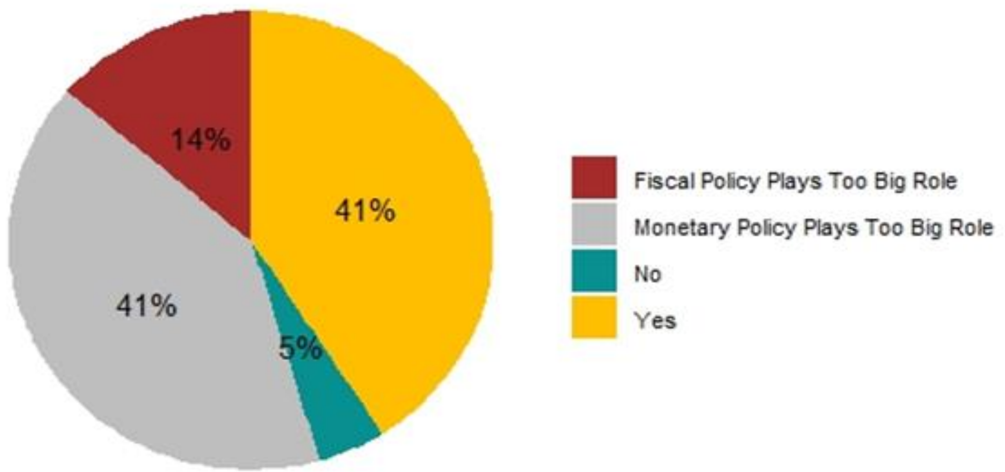
- Fiscal space is reduced, due to the “new” SGP that entered in force at the end of April 2024, and large structural deficits and high debt levels generated by the pandemic and energy shocks.

Rebalancing fiscal and monetary policies is considered relevant

- 41% of respondents believe that the current balance between fiscal and monetary policy is appropriate for their country.

- 41% believe that monetary policy plays a role too important, 14% that fiscal policy does.

Figure 3.1 Appropriateness of the current balance between fiscal and monetary policy in the home country



Sources:Answer AIECE Institute

Istat

Gradual easying of monetary policy and tightening of fiscal policy

- The policies rebalancing corrections indicated by respondents are mostly gradual monetary easing and, but with some divergent views, tightening of fiscal policy.

- There is emerging concern that, at the EA level, monetary policy in 2024 will be too restrictive (over 54% of respondents)…..

- ….. while there is greater confidence in the appropriateness of Euro Area fiscal stance (59% of respondents believes it will be appropriately restrictive).

Heterogeneous opinions on fiscal policy stance in 2024

- The respondents' assessment of the appropriateness of the fiscal policy stance, (whether it is considered appropriate, too expansionary or too restrictive) is quite heterogeneous.

- Although the expectation of restrictive fiscal policies is significant (38%) and the restrictive stance is indicated as appropriate (48%)……

- …..a large share of respondents (29%) believes that the appropriate fiscal policy should still be expansionary and 24% believe it should be neutral.

Expected and suitable fiscal policies in AIECE countries and in EA (i)

- To assess the extent to which respondents believe that fiscal policies in 2024 will be appropriate, the expected and suitable policies are compared for each institute.

- 38% of respondents believe that fiscal policies in the home country will continue to be too expansionary, while 33% are confident that appropriate policies will be implemented.

- However, only 18% believe that the impact of fiscal policies for the euro area as a whole will be too expansionary, while 60% believe it will be appropriate.

- This would seem to indicate that respondents are less confident that restrictive fiscal policies will be implemented in their own country, but that they believe that other countries will implement the necessary restrictions to achieve an adequate stance at the area level.

- The results also indicate that a high percentage of respondents fear that fiscal policies will be too restrictive, both at country level (29%) and for the EA as a whole (23%).

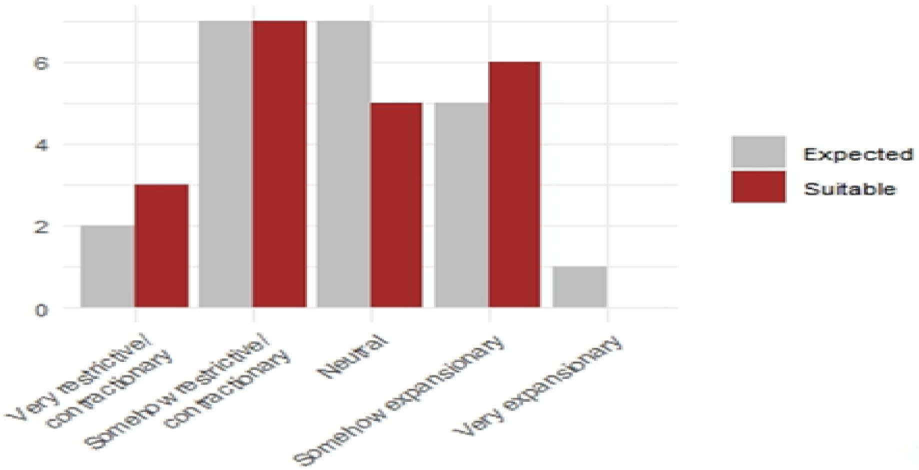
- These results might also reflect uncertainty about how the new European fiscal governance rules will work.

- In fact, 41% of institutes do not answer the question "*What do you think will be the impact of the new Stability and Growth Pact on your country's public finances*";

- another 41% indicate that at the national level they do not expect relevant effects or none at all, while the remaining 18% of responses are evenly distributed between expectations of more restrictive and more expansionary effects (9% and 9%).

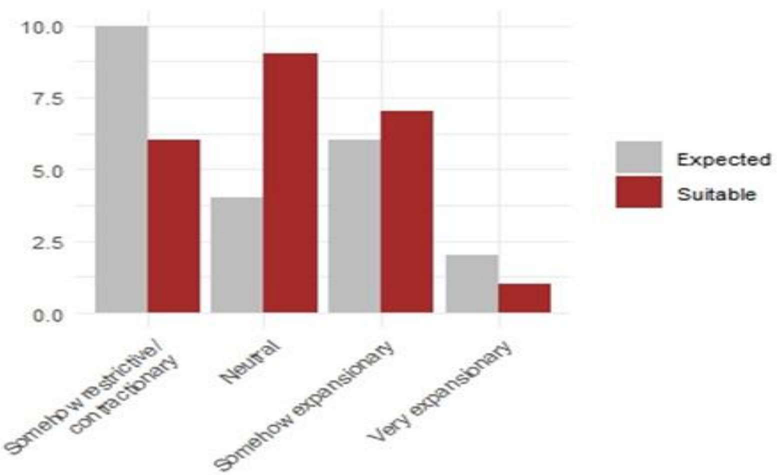
Expected and suitable fiscal policies in AIECE countries and in EA (iii)

Figure 3.2 Fiscal Stance in AIECE Countries



Sources:Answer AIECE Institute

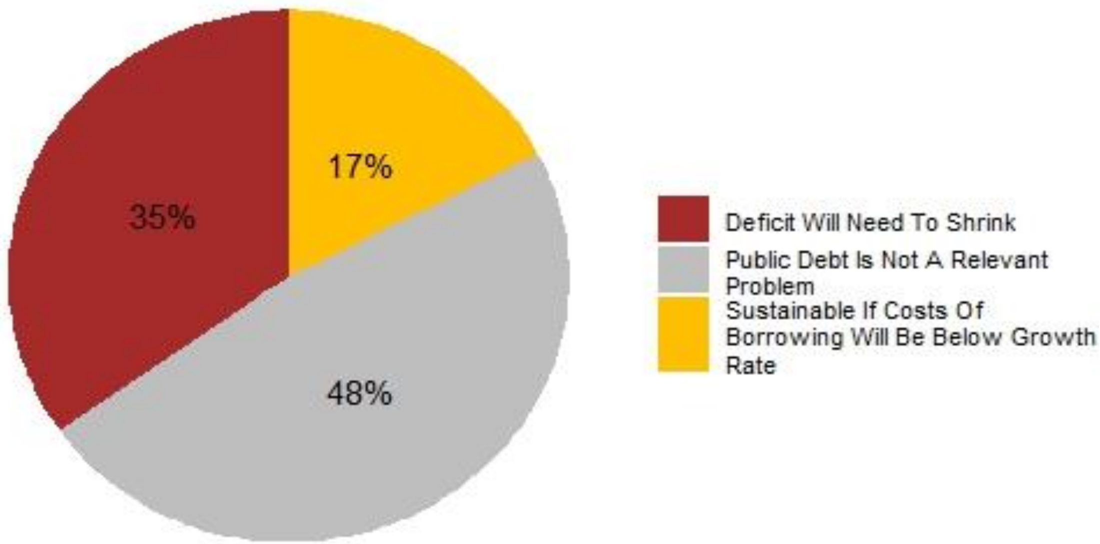
Figure 3.3 Fiscal Stance in Euro Area



Sources:Answer AIECE Institute

- …however no institutes perceives risks of debt unsustainability.
- 48% of respondents does not see debt sustainability as a problem, while 35% highlights the need to reduce the deficit and 17% to keep economic growth above the cost of public debt.

Figure 3.4 Medium term sustainability of public debt in the home country

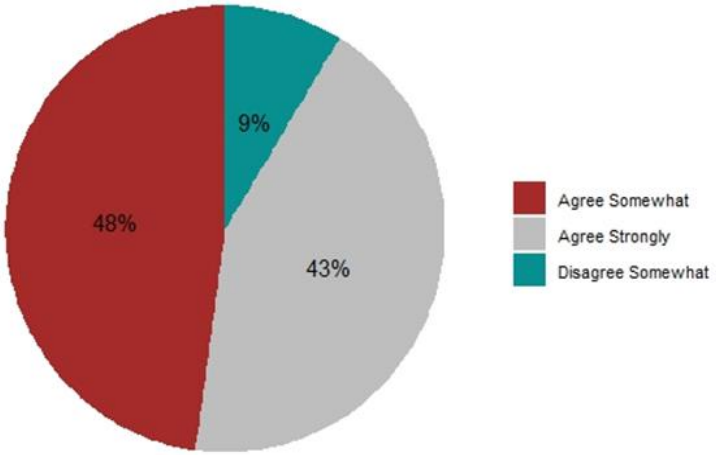


Sources:Answer AIECE Institute

Macroeconomic impact of elections in 2024 (i)

- *6.1.4 2024 is a historic election year, with elections in a large number of countries. Elections will have a macroeconomic impact on the various countries and thus on global economy. New governments may implement structural reforms, and new policies or induce shifts in their geopolitical stance, potentially shaping priorities of some several strategic economies. Many aspects of the global economy are dependent on the outcomes of these elections (e.g., trade agreements, environmental policies).*

Figure 4.4 Macroeconomic impacts of elections in 2024



Sources:Answer AIECE Institute

Overall with very few exceptions, the AIECE Institutes (91%) agree that many macroeconomic aspects of globally are dependent on the outcomes of these elections.

Macroeconomic impact of elections in 2024 (ii)

- 2024 is a historic election year, with elections in a large number of (strategic) countries, and potential macroeconomic consequences for individual countries and the entire World economy.

- The concept of the political business cycle (PBC) has long been established in economic theory. Nordhaus's (1975) pioneering model proposes that governments will increase spending and loosen monetary policy in the year before an election, hoping to boost output and employment, thereby enhancing their popularity.

- The potential downsides, such as increased debt and inflation, are often deferred until after the election. Nordhaus (1975) also predicted a phenomenon known as the foreign exchange cycle, which is particularly relevant for emerging market economies (EMDEs).

- This theory suggests that countries may attempt to artificially revaluate their currencies before an election, potentially by reducing foreign exchange reserves. However, this is often followed by a devaluation after the election.

Rebalancing of public finances vs investments in green and digital transitions

- 6.2.3 *As for fiscal policies, there is broad recognition of the fact that governments are facing a trade-off between the need for fiscal consolidation and the necessity to catalyse investment in green and digital transitions. Do you believe is it possible to overcome the trade-off between the need for fiscal consolidation and the necessity to catalyse investment in the green and digital transitions?*

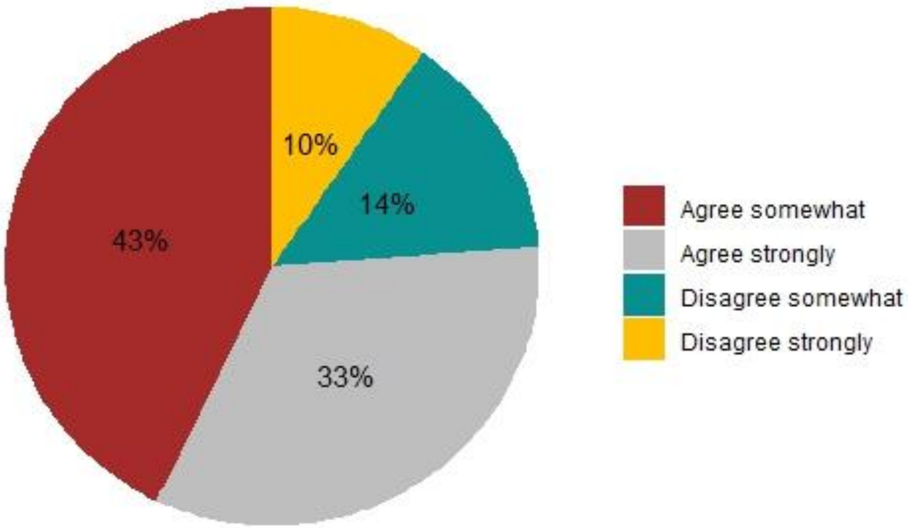
- Governments are facing a trade-off: the need to reduce budget deficits while also stimulating investment in green technologies and digitalization.

- To improve public finances, clear and growth-oriented medium-term fiscal plans are crucial. However, in a slowing global economy, it's important to avoid pro-cyclical cutbacks that could further dampen growth.

- Simultaneously, promoting long-term economic sustainability requires continued investment from both public and private sectors. Environmental protection, the energy transition, and digitalization should remain top priorities in this regard.

- A large majority of AIECE Institutes (76%) agrees that it possible to overcome the trade-off between the need for fiscal consolidation and the necessity to catalyse investment in the green and digital transitions.

Figure 4.7 Governments fiscal challenges: control spending vs allocate resources towards the digital anc



Sources:Answer AIECE Institute

Questions for discussion

- **Europe is committed to a green transition, but how can this be achieved while maintaining competitiveness and ensuring a just transition for workers in carbon-intensive industries?**

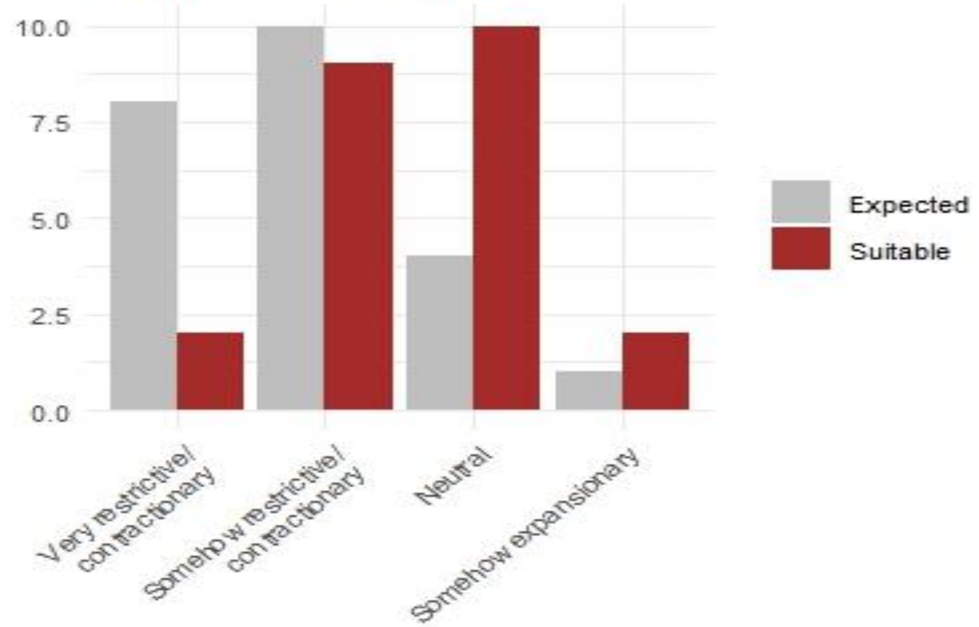
- **What can be the major macroeconomic effects of political elections in strategic countries in 2024?**

- **How can policy makers ensure that a soft-landing scenario continues to prevail, while preserving fiscal sustainability as well as price and financial stability?**

Assessments on monetary policy are more uniform than on fiscal policy

- The prevailing view is that it is appropriate for the ECB to move cautiously and implement a gradual easing of monetary policy conditions, maintaining a restrictive stance through 2024.
- Most respondents expect monetary policy to be very or somewhat restrictive (76% at the national level and 82% at the EA level) and believe that the restrictive stance is appropriate in 2024 (50% and 57%, respectively).

Figure 3.5 Monetary stance in AIECE Countries



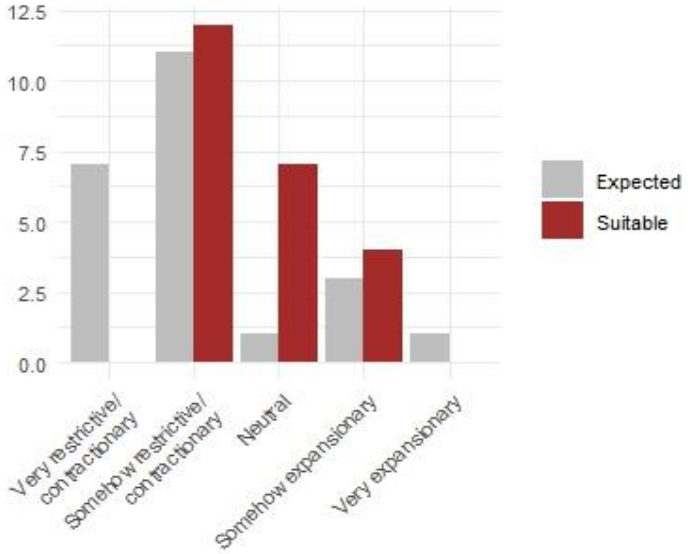
Sources:Answer AIECE Institute

Further monetary policy tightening is ruled out …..

- A high share of respondents trusts in the implementation of an appropriate monetary policy (57% at the national level and 36% at the EA level) but….
- …. concerns emerge on monetary policy being too restrictive than appropriate (43% domestically and 54% for the EA).
- Although most respondents expect a still-restrictive monetary policy stance in 2024 (76%), only 51% consider it appropriate

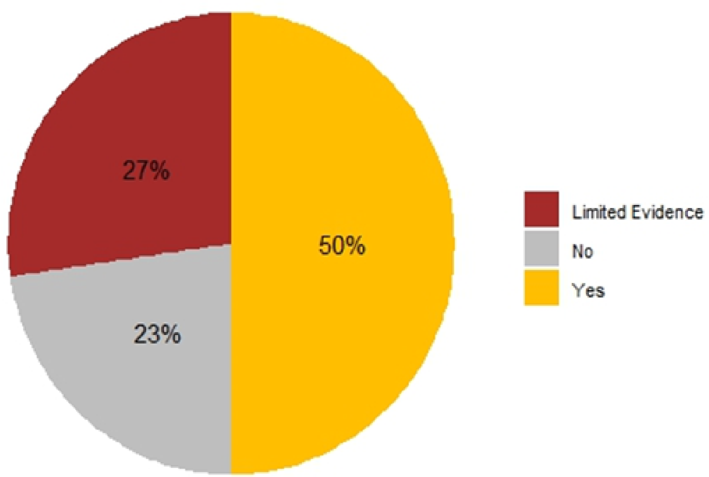
- 77% of respondents say that high interest rates have already had a negative impact (50% evident, 27% limited) on their country's economic system (Fig. 3.5).

Figure 3.6 Monetary stance in Euro Area



Sources:Answer AIECE Institute

Figure 3.7 Evidence of negative effects due to persisting high interest rates in the AIECE Countries



Sources:Answer AIECE Institute

Negative impact of high interest rates on AIECE countries (i)

- *6.2.1 To what extent has the rise in interest rates affected your country's business sector, taking into account the cumulative effect from 2023 to 2024?*
- There is still uncertainty about the start of the interest rate cut cycle in the main industrialized countries, weighed down by the growing geopolitical tensions which could generate new rises in the cost of energy.

- Moreover, the extraordinary global resilience of the economy, despite the long period of monetary tightening, has fuelled the spread of a new vision among central banks and markets regarding the ability of economic systems to sustain a higher level of interest rates.

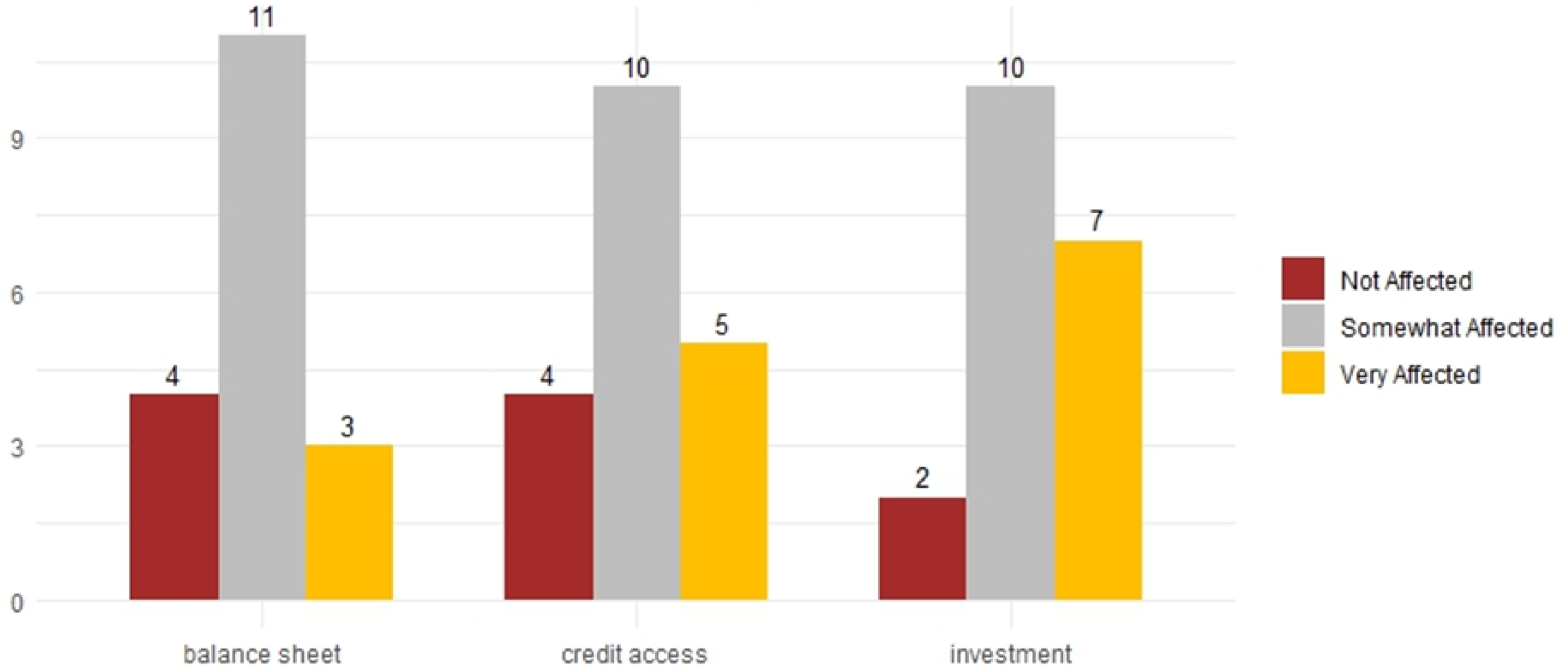
- This new vision could encourage central banks to keep nominal rates high for too long, risking depressive effects on aggregate demand.

- The effects of the tightening of monetary policy in the last two years may not have unfolded in a linear way fuelling uncertainty about intensity and timing of the impact on overall activity.

Negative impact of high interest rates on AIECE countries (ii)

- A large majority of AIECE Institutes believes that its domestic business sector (balance sheet 78%, credit access 79% and especially investments 90%) has been (somehow and very) negatively affected by high interest rates.

Figure 4.5 Cumulative effect of high interest rates in the past two years



Sources:Answer AIECE Institute

Istat

Questions for discussion

- **What might be the consequences of a different rhythm in European central bank and Federal Reserve monetary policies? Do you believe there might be a decoupling?**

- **In case of decoupling of ECB and Fed monetary policies, which transmission channel do you think would be more important: the impact of the exchange rate or that of the bond market?**

Thank you for your attention

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