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Editorial: Building market confidence through fiscal tightening

This issue of Euren-news focuses on public finances in a very special context: the increased probability of a default in some countries has led the national policy makers to lay down tough fiscal consolidation plans. Measures have also been taken by European Authorities, in order to give financial support to those countries facing market pressure and implementing painful deficit reduction plans. This is the purpose of the EFSF (European Financial Stability Facility). Changes to the EU fiscal governance are also being implemented, in order to reduce the risk of sovereign defaults in the future.

The crisis started four years ago in the banking sector and extended to the real economy. Public finances of the European countries were hit by the consequences of the recession through three main channels: first, the traditional automatic stabilizers; second, in many countries governments adopted expansionary measures to support domestic demand; third, a support to many financial institutions has been given, sometimes bailing them out.

The increase in public deficits and debts of the main industrial countries are the legacy of the crisis to the future. For some countries, market concerns about the fiscal sustainability substantially increased. The risk premium on Greek sovereign bonds started to rise to very high levels in the spring of 2010. Since then, spreads in bond yields sharply increased in other countries: Portugal and Ireland, more recently followed by Spain and Italy. The problem with these last two countries is the amount of their public debt, which raises concerns about the adequacy of the Efsf resources.

The crisis is giving a new shape to the European integration process, creating a two-speed economy within the euro area.

Some economists also wonder if the single currency is sustainable in the medium run, given the lack of a sufficient degree of political and fiscal integration among the member states. One argument is that other European countries not sharing the single currency, as it is the case for the British economy, can manage themselves with the burden of high public deficit and debt.

Fiscal policy is also restrictive in the countries with better fundamentals. As explained in the country pages of this newsletter, Germany is expected to decrease its public deficit from 1,2 to 0,7%; France is also committed to realize a rapid adjustment, bringing the public deficit down to below 5 per cent of GDP within next year, two points less than in 2010. The timing of the fiscal adjustment is the same in the majority of the euro area economies. This is another adverse factor weighing on the PIIGS, since these countries cannot rely on a strong external environment to compensate for the weakness of their domestic demand during the fiscal consolidation.

In the next years fiscal tightening could also be pro-cyclical. In recent months the main economic indicators are already declining and the fiscal stance will accelerate the economic slowdown of the euro area.

Further, monetary policy could find it more difficult to support the cycle because of the worsening of credit conditions that is pointed out by most indicators. There is a risk of a second round of banking crisis due to the depreciation of the sovereign bonds owned by the banks. Countries where the bond spreads

have increased the most are probably facing a credit crunch. However financial institutions of the whole euro area are exposed to the market turmoil, as they hold the sovereign debt of the countries under attack. Therefore, the consequences of the debt crisis are probably affecting the outlook of the whole euro area.

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Public finances in the European Union

Austria: Public deficit will decline moderately

Table 1

Projection of public finances: Austria

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	2.3	3.0	1.3
Nominal GDP	4.1	5.2	3.3
Government outlays	52.5	51.1	51.3
Government receipts	48.1	48.1	48.6
Fiscal balance[1]	-4.4	-3.1	-2.8
Debt Ratio	71.8	72.0	73.8

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

In 2011, public finances improved in Austria. Driven by the favourable economic development in the first half of the year, as well as discretionary consolidation measures, tax revenues increased markedly. On the back of relatively high nominal wage growth in combination with a favourable labour market development, personal income tax revenues grew strongly. Corporate income taxes benefited from rising profits. Lower outlays on unemployment benefits as a result of declining unemployment as well as austerity measures led to a significantly lower growth rate of public expenditures. In 2012, the marked slowdown of economic growth will result in a significant deceleration of public revenue growth.

Despite the improvement of the fiscal balance, the debt ratio increased further and reached almost 72% by the end of 2010. This development resulted from the fiscal stimulus packages and the financial market stabilisation measures which were implemented during the economic and financial crisis 2008/20099.

As a reaction to the increased deficit and debt, the Austrian government implemented consolidation measures, both on the expenditure and the revenue side of the public budget. The focus was set on the expenditure side by decelerating the growth of spending. Important subjects like education and research, homeland security and active labour market policy will be less affected by consolidation than others. Savings are made on subsidies and projects. On the revenue side, a bank levy and a flight ticket charge were introduced. In addition, some exemptions on the capital income tax were abolished, and various taxes and excise duties (mineral oil tax, carbon premium on new cars, tobacco tax) were increased. These measured help to reduce the deficit ratio to slightly more than 3% in 2011 and to somewhat under this threshold in 2012. According to the medium-term fiscal projection of the Ministry of Finance, after 2012 the gradual reduction of the public deficit should continue, and in 2015 the deficit ratio should reach 2.0%. Despite the improvement of the fiscal balance, the debt ratio will only start to decline in 2014. Due to the relatively slow pace of the deficit reduction, it will take several years until the debt ratio will fall below the 60% reference level.

In 2009 a medium-term expenditure framework (MTEF) was introduced for the central government. The MTEF contains legally bind-

ing expenditure ceilings four years in advance on a rolling basis. The ceilings apply to five groups of chapters. Each of these chapters has its own expenditure ceiling, which add to one ceiling for the federal budget.

On 15 November 2011, the government decided to implement a constitutional debt limit. According to the proposal, from 2017 onwards the structural budget deficit of the central government shall not exceed 0.35% of GP, and the Federal States (*Länder*) as well as the municipalities must have balanced budgets. It has to be seen in which final form the debt limit will become effective after the parliamentary negotiations with the *Länder* and the opposition.

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France: Consolidation by higher receipts

Table 2

Projection of public finances: France

2009 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	1.4	1.7	1.2
Nominal GDP	2.2	3.3	3.1
Government outlays	2.1	2.3	2.4
Government receipts	3.1	4.9	4.3
Fiscal deficit[1]	-7.1	-5.7	-4.8
Debt Ratio	82.4	85.8	88.2

[f]COE-Rexecode Forecast September 2011- [1]Percent of nominal GDP

In 2012, we expect the public deficit to be reduced to 4.8% of GDP, around one percentage point below the result for 2011. This would mean a cut by around 1.2 of the structural deficit. Further cuts of structural deficit are expected in subsequent years, bringing the government balance to 3% of GDP in 2013, with a medium-term target to reach the equilibrium in 2016.

Three main factors will impact public finance in the near future: i/ The presidential election, although the candidate of the opposition committed himself to reach the same global target for public finances (3% of deficit in 2013 and the equilibrium in 2017 (instead of 2016)). ii/ The level of interest rates will be crucial. The level of bonds rate has recently risen (over 3.5% mid November), the spread between France and Germany increasing substantially. The annual cost of an increase of the bond rates by 40 basis point is about 1 bn Euro. iii/ The level of GDP growth would also affect public finances.

Regarding this latter point, the government announced early November that it revises its growth forecast from 1.75% to 1% in 2012. It has been decided to revise the budget to stay in line with the deficit target. New restrictive measures have been added for a total amount of 7 bn Euro in 2012 and an additional 4.5 bn in 2013, in order to cover the loss of receipts due the revision of the economic growth assumption. Main decisions concern: no indexation of the income tax scale, increase in income tax for companies with a €250m turnover, increasing the lower VAT rate from 5.5% to 7% except for some items. The increase in the retirement age will also be accelerated. All those measures are expected to produce €65bn cumulative savings by 2016.

In August, a first series of measures were announced (mainly consisting in higher taxes and a reduction of tax exemptions) amounting to 1 bn Euro in 2011 and a further 10.5 billion in 2012 to compensate a first revision of growth forecast.

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Germany: Public finances will continue to improve

The fiscal policy aims to consolidate public budgets. As part of the consolidation package (called Zukunftspaket), the federal government raised taxes and cut expenditures: by

this the fiscal deficit will be reduced by € 8bn this year. Moreover, Länder and many communities have adopted measures to consolidate. Finally, the contribution rates for unemployment insurance and statutory health insurance were raised. All in all, the restrictive fiscal impulse to GDP ratio is estimated to reach 0.6% in 2011. In the next year, the restrictive fiscal impulse could amount to only 0.2% of GDP because the contribution rate to the pension system will be lowered at the beginning of 2012.

Table 3

Projection of public finances: Germany

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	3.7	2.9	1.0
Nominal GDP	4.3	3.4	2.3
Government outlays	3.8	-1.7	2.0
Government receipts	1.3	5.2	3.0
General government fiscal balance [1]	-4.3	-1.2	-0.7
Debt Ratio[1]	84.0	81.5	80.2

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

In spring 2011 the Federal Government presented an updated German Stability Programme. According to the programme, the deficit ratio will fall to 2½% in 2011 and to 1½% in 2012. But the public finances are in this year in a better shape than expected, mainly due to the economy's dynamic growth. The favorable macroeconomic development leads to additional revenues. Also labor market expenditures are falling due to cyclical factors. The increase in revenue is also a result of various tax increases (in particular: nuclear fuel tax, air traffic tax, tobacco tax and a reduction in the energy tax concessions) and of raising the contribution rates to the statutory health insurance and unemployment insurance. Moreover, government spending decreases as a result of savings as part of consolidation package.

The RWI estimates a significant decline in the deficit ratio as a result of the implementation of consolidation measures and of the economic recovery. The general government deficit will this year amount to 1.2% and next year to 0.7% in relation to nominal GDP (Table 3). As a consequence of the lower deficit a reversal of the debt ratio trend is in view; the debt ratio is expected to decrease to 80% in 2012.

Despite the favorable financial developments the fiscal consolidation is not complete. The general government deficit is even in the economic upturn substantial. When the production capacity utilization have reached normal levels in this year, the structural deficit ratio will be around 1¼%. Moreover the debt ratio is with more than 81% in 2011 very high; it clearly exceeds the reference value of 60% in the European Stability and Growth Pact.

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Greece: Situation will remain critical

The Greek public finances' situation for 2011 remains critical, as it becomes evident that the target of -7.8% set for the fiscal balance will be missed and the public debt, projected to close above 162% of GDP, will continue to surge.

Table 4

Projection of public finances: Greece

2010– 2012;
Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	-3.5	-5.5	-2.5
Nominal GDP	-1.9	-4.2	-2.2
Government outlays[1]	50.1	50.4	49.8
Government receipts[1]	39.5	41.4	42.8
Fiscal balance[1]	-10.6	-9.0	-7.0
Debt Ratio	144.9	162.8*	180.7*

*[f]Kepe Forecast- [1]Percent of nominal GDP- *Does not take into account the 50% nominal discount on Greek debt through PSI.*

Despite the considerable fiscal consolidation efforts, there has been a slippage in revenue performance owing to a number of factors including the deepening economic recession, several deficiencies and delays. On the expenditure side, there has been a cut in compensa-

tion of employees, but expenditure increases in social transfers and interest payments, among others, are expected to lead to an increase in total expenditure as a percentage of GDP in 2011. At the same time, the 2011 debt ratio is projected to remain at a very high level, as the effects of the initiated privatization efforts and the growth-response of the implemented structural reforms have not yet materialized.

The improvement of the fiscal situation in 2012 will, on the one hand, depend heavily on the strict implementation of the medium-term fiscal strategy (MTFS) deficit-reducing measures adopted in June 2011 and additional measures decided by the Greek government. These measures concern the implementation of the uniform wage grid for employees in the public sector, the labour reserve for the staff close to retirement age, the new property tax and the further widening of the personal income tax base. On the other hand, the sustainability of the debt is closely related, among other things, to the features and settings of the Private Sector Involvement (PSI), which, according to the decisions of the October 2011 Euro summit, is planned to provide a 50% nominal discount on Greek debt held by private investors through a voluntary bond exchange.

The short-term and medium-term prospects for Greek public finances remain fragile, further eroding market confidence, as the non-closing fiscal gap and the surging public debt remain a concern. To restore fiscal sustainability and ensure financial stability, the Greek authorities must keep up their efforts on the fiscal front. Nevertheless, the improvement of the fiscal position depends on a variety of factors with multiple dimensions. A significant degree of uncertainty is inherent in most of these factors, as they relate not only to vague growth prospects but also to political decisions and stability domestically and at the European level. Since the severity of the fiscal situation reflects, to a sizeable part, the disproportionately huge public sector it is essential that the Greek authorities commit to the series of structural reforms so as to reduce the size of the public sector and provide greater play to market forces.

Overall, a prerequisite for the improvement of Greek public finances is the commitment to the fiscal consolidation, reform and privatization programmes with the aim to achieve primary surpluses from 2012 onwards and to gradually bring the public debt down to the target of 120% by 2020. Admittedly, the transition from a regime characterized by persistent high deficits and a huge public sector to a regime of fiscal austerity will be difficult, painful and time-consuming.

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Hungary: New restrictive measures ahead

The situation in respect of public finances is in case of Hungary rather special this year, as due to some exceptional measures like channelling the wealth of private pension funds into the state budget, the revenue side of the budget improved. However, on the expenditure side previous commitments (e.g. the consolidation of state owned firms like the Hungarian Railways or the Budapest Transport Corporation, as well as the paying of real yields on contributions paid into the private pension funds by members, as well as the consequences of the introduction of the new flat rate personal income tax) mean substantial burdens. Taken as a whole there will be an improvement of the fiscal situation this year, but the government will introduce new restrictions in different areas.

According to the budget plan for 2012, revenues will increase by HUF 1,000 billion at current prices, while expenditures are to grow by only HUF 370 billion, compared to the 2011

target. As a result, fiscal deficit should go down by HUF 607 billion, from HUF 1,184 billion to HUF 576 billion.

Table 5

Projection of public finances: Hungary

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	1.2	1.5	0.5
Nominal GDP	4.7	4.5	4.2
Government outlays	49.5	50.6	49.8
Government receipts	45.2	46.4	47.9
Fiscal balance[1]	-4.2	-2.9	-2.5*
Debt Ratio	80.2	74.0	73.0

*[f]Kopint Forecast- [1]Percent of nominal GDP. – *forecast of the Hungarian Government. Because of recent developments a soon revision of the forecast is most likely.*

The budget appears to be based on overly optimistic macroeconomic assumptions: the bill envisages a real growth rate of 1.5% and an inflation rate of 4.2%. Our forecast is lower GDP growth and higher inflation.

Both the revenue and the expenditure targets suggest that the 2012 budget plan is highly contractionary. Growing centralization of incomes is accompanied by a decrease in the scope of fiscal redistribution. Most of the expenditure lines - with some curious exceptions – will decrease in real terms, and some of them even in nominal terms. The new budget bill tries to distribute the burden widely, the downside of which is that the fiscal contraction will be felt in all segments of the economy.

The VAT revenues are expected to increase, due to marginally lower sales and acceleration of inflation (to 4.6%), combined with an increased VAT rate (from 25% to 27%).

As for the PIT and employee contribution revenues, the announced changes, combined with the nominal growth of gross wages (roughly 6%), will add approximately HUF 100 bn to the budget.

At this point, it is difficult to assess whether the targets are realistic, since important details about the tax reform are still missing. On the other hand, it can be assumed that the tax system will be eventually altered in a way that ensures compliance with the targets.

However, against the background of recent developments (like reopening consultation with the IMF, the renewed downgrading of Hungary's government bonds' rating, the massive depreciation of the Forint, and the further deterioration of both the macroeconomic and external climate) it seems that even a more rigorous fiscal tightening will be necessary than originally planned.

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Italy: Ambitious austerity package

In 2010 the public deficit was reduced to 4.6% of GDP from the negative peak of 5.4 in 2009, as a result of weak dynamics of revenues and a contraction of expenditures, mainly due to cuts in public investment.

During the summer the Government approved a very ambitious austerity package, that aims a balanced budget in 2013, increasing the size and partially bringing forward the original plan laid down in April, that aimed at a balanced budget by 2014 only. The plan amounts to € 60 bn for 2011-2014 (of which 40 in higher taxes and lower tax reliefs), and adds up to the previous dispositions issued in 2010 for 2010-2013 (€ 25 bn mainly based on expenditure cuts and contrast to tax evasion).

According to the Government's latest projections, the deficit will be reduced to 3.9% of GDP in 2011, to 1.6% in 2012 and to 0.1% in 2013, and will turn into a 0.2% surplus in 2014. Government's projections for public debt see the ratio with GDP starting to decline in 2012, to reach 112.6% in 2014.

Table 6

Projection of public finances: Italy

2009 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	1.3	0.6	-0.4
Nominal GDP	1.9	2.0	2.1
Government outlays	-0.5	2.3	1.4
Government receipts	0.9	3.7	3.5
Fiscal deficit[1]	4.6	4.0	3.0
Debt Ratio[1]	118.4	120.9	121.8

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

The table displays Ref's estimates on the outcome of the envisaged plan. The deficit/GDP ratio is expected to fall in the coming years, but to a less extent compared to official projections, leading to a 1.6 percent deficit/GDP ratio in 2014.

The government's plan does not seem realistic for a number of reasons. First, the austerity package is very ambitious in terms of fiscal consolidation, but fails to address the main issues for the Italian economy, i.e. growth and competitiveness. With growth rates close to zero and no structural reforms to stimulate the economy, the debt to GDP ratio is not likely to stabilize. In addition, excessive austerity will depress growth, with a negative impact on the fiscal balance.

The current political and financial turmoil leads to further uncertainty. The spread with German bonds is rising close to 500 bp. As a result, in the next years interest rates expenditure may erode part of the consolidation envisaged. The risk is that the pessimistic mood of the markets becomes self-fulfilling.

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Slovakia: Consolidation will proceed slower than planned

The 2010 elected centre-right government had very ambitious plans for gradually lowering the after-crisis deficit from over 7% of GDP in 2009 and 2010 to 4.9% in 2011 and below 3% in 2013. Conflicts on Slovakia's assent to European Stability Mechanism, however, resulted in collapse of the government and an early election in spring 2012.

This year's goal for fiscal deficit of 4.9% is therefore uncertain and due to tied hands of the leaving government it will probably reach the level above 5% of GDP even though the government still claims the original plan. However, the most recent forecast of the Ministry of Finance announces overshooting of the 2012 goal (3.9%) by 0.9 p.p. This has two main reasons. Firstly, the revenues are estimated at a lower level because of lower GDP growth forecast than the former (1.6% against 3.4%). Secondly, the government has currently little power for introducing restrictive fiscal measures into the budget year 2012.

Table 7

Projection of public finances: Slovakia

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	4.0	3.0	2.1
Nominal GDP	4.5	4.6	3.3
Government outlays	1.5	-3,7	0.0
Government receipts	1.1	3.5	3.5
Fiscal balance[1]	-7.7	-5.8	-4.9
Debt Ratio	41.0	46.0	47.0

[f]INFOSTATForecast- [1]Percent of nominal GDP

The budget is eventually jeopardized by conflicts of political parties which can result in a provisional budget thus freezing contemporary expenditures. This scenario could constitute deficit over 5% given the low GDP growth in 2012.

Projections of the general debt ratio will remain so far under the 50% threshold. Fiscal consolidation will not proceed as planned and the targets of 2011 as well as 2012 will not be met, thus the original plan of lowering the deficit below the 3% reference rate will be probably postponed after 2013. Both left and right political parties claim to stick to the fiscal consolidation commitment, but its speed is questionable.

Delays in consolidation could cause bad position in financial markets or lower ratings. On the other hand both coalition and opposition agreed to support the new constitutional budget responsibility law ensuring commitment of the government to consolidate public finance and maintain stable fiscal debt. The law intends to implement a sanctioning mechanism for government after reaching the debt ratio level above 50%. This could serve as a positive signal for acquiring favourable rates of the government bonds in financial markets.

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Spain: Fiscal consolidation intensified

The Spanish public deficit has remained stuck at around 8% of GDP since the third quarter of 2010, when the raise of the VAT rate managed to reduce this imbalance by almost four percent of GDP.Thus, the effort to contain public spending is being offset by a containment of total revenues led by lower collection from indirect taxes as a percentage of GDP.

Table 8

Projection of public finances: Country Spain

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	-0.1	0.6	0.8
Nominal GDP	0.8	2.3	2.5
Government outlays	5.9	4.0	3.0
Government receipts	0.2	-1.6	0.8
Fiscal balance[1]	-9.2	-7.1	-6.2
Debt Ratio	60.1	64.9	69.4

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

From the second quarter 2010 to the second quarter of this year, the total amount of public spending could be reduced by almost two percentage points of GDP, of which one point is due to reduced capital expenditures, 0.6 percentage points to public consumption and another 0.4 to social benefits, while the increase of 0.4 points of GDP in financial costs could be offset by cuts in subsidies and other current transfers.

The maintenance of these deficits is causing an increase of the public debt ratio to GDP of about seven points from last year; of which five points belong to the central administration and the remaining two points to the regional administrations.

Nevertheless, the absolute level still remains just four points above the 60% limit established in the Stability and Growth Pact, which means that, despite the elevation of the required interest rate differentials to the Spanish debt, the finance charge shall be maintained at about 2.2% of GDP.

Looking ahead, the calling of general elections on November 20 has led to a standstill in the approval process of the Budget for 2012 which will mean, in fact, a prorogation of existing budgets.

In any case it is too early to assess additional measures that the new government will impose and, although there is a clear desire to continue with the commitment to fiscal consolidation, the speed and intensity of this final adjustment next year is one of the major factors of risk that threaten the short-term prospects of the Spanish economy.

Thus, in our basic scenario, we anticipate a deficit containment of just over one point per year between 2011 and 2015, which would delay the achievement of the 3% deficit goal two years longer than originally planned.

With these assumptions the average real Spanish GDP growth would stand slightly above 1% during this period (2011-2015). Now, if this process of fiscal consolidation is intensified to achieve the deficit target of 3% of GDP in 2013, the GDP growth could be reduced by around half a percentage point annually, considering that the GDP growth rate would be reduced by 0.5% for every extra point of reduction of the deficit.

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United Kingdom: Reasonable progress

Public finances in the UK have made reasonable progress since the start of the financial year in April 2011. The government's preferred measure, public sector net borrowing excluding financial interventions (PSNBX) is running £7.5 billion lower in the financial year-to-date compared to a year earlier.

The government implemented significant fiscal reforms in 2011. On the revenue side, some of the headline measures included increasing the rate of VAT from 17.5% to 20%, increasing employees' National Insurance contributions by 1% and raising the level of income tax personal allowances. Spending cuts also began in earnest, with the aim of reducing spending by £8.8 billion. In this regard, the pace of job losses in the public sector has been accelerating in recent months.

According to the target set by the Office for Budget Responsibility (OBR), PSNBX needs to come down by about £16 billion in 2011/12, compared to the previous financial year. However, with an escalation of the Eurozone debt crisis and slowdown in growth prospects, the growth outlook for the UK has weakened considerably. We therefore feel that the government will probably miss this target by a small margin.

Table 9

Projection of public finances: United Kingdom

2010 – 2012; Percentage changes unless otherwise indicated

	2010	2011[f]	2012[f]
Real GDP	1.8	0.9	1.1
Nominal GDP	4.6	3.0	2.7
Government outlays	4.3	1.0	1.8
Government receipts	5.8	5.9	8.3
Fiscal deficit[1]	10.3	8.2	5.6
Debt Ratio	73,6	79,0	83,5

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

This could have adverse implications for the government's longer term fiscal mandate of achieving a cyclically-adjusted current balance by the end of 2015/16. However as long as the OBR's estimate of trend output doesn't change, the Chancellor is under no pressure to impose additionally austerity measures yet, as the extra borrowing in the financial year will be classified as cyclical rather than structural. Therefore in the Chancellor's autumn statement to be held on 29th November 2011, we don't expect any significant changes in fiscal policy.

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Impressum

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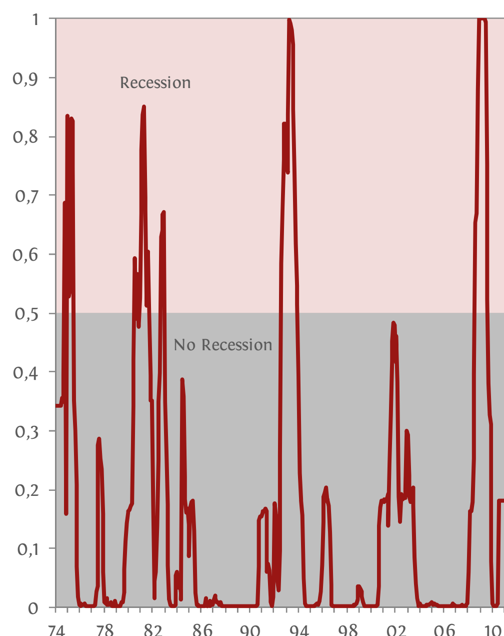
Coe-Rexecode Start-End Recession Index for the Euro Area

In June 2011, the Coe-Rexecode leading indicator surpassed the 80 threshold and it surged to 96.6 in July, sending a strong signal of an imminent economic downturn. In September 2011, the "underlying" monthly growth in the euro area turned negative from +0.2% in July to -0.4% on an annual basis, and decreased to -0.9% in October. It is therefore important to evaluate the risk of a recession. The Coe-Rexecode Start-End Recession Index is intended to detect the start of a recession in real time. Values below 0.5 indicate a regime of "no-recession"; over 0.5, they mean a change into a recessionary regime. In practice, this signal is given with a delay of one to two quarters. At the start of the past five recessions, the model showed a probability of 0.16% on average. This threshold gave a correct signal at three occasions but there were also four false alarms in 1977, 1984, 1990 and 1995. In September, the indicator surged to 0.17 from 0.06 in August. Consequently, there is a strong probability of a negative growth rate in the last quarter, which does not yet mean an entry in recession, even if the risk is increasing.



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Forecast of the EUREN/CEPREDE High Frequency Model

Last update: November 17th, 2011

	10 Q3	10 Q4	11 Q1	11 Q2	11 Q3	11 Q4	12 Q1	12 Q2	2010	2011
Jun-10	1,5;0,6	1,9;0,5							1,4	
Jul-10	2,0;0,9	2,6;0,7							0,8	
Aug-10	1,9;0,6	2,3;0,5							-0,3	
Sep-10	2,1;0,6	2,7;0,8							-0,1	
Oct-10	2,2;0,1	3,0;1,0	2,9;0,2	2,2;0,3					0,5	2,1
Nov-10	[2,1;0,4]	2,8;0,9	2,6;0,1	1,9;0,3					1,3	1,9
Dec-10	[2,1;0,4]	2,6;0,7	2,3;0,1	1,6;0,3					1,7	1,6
Jan-11	[2,1;0,5]	2,0;0,1	1,5;-0,1	0,9;0,4					1,7	0,5
Feb-11	[2,1;0,5]	[2,0;0,1]	1,5;-0,1	0,9;0,4					1,7	0,9
Mar-11	[2,1;0,5]	[2,0;0,1]	1,5; -0,1	0,9;0,4	0,5;0,2	0,6;0,1			1,7	0,9
Apr-11	[2,1;0,5]	[2,0;0,1]	1,5; -0,1	0,9;0,3	0,5;0,2	0,6;0,2			1,7	0,9
May-11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	2,1;0,5	1,8;0,3	2,0;0,2			1,7	2,1
Jun 11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	2,1;0,6	1,8;0,3	2,0;0,2			1,7	2,1
Jul-11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	2,0;0,5	1,6;0,2	1,7;0,2			1,7	2,0
Sep-11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	[1,7;0,3]	1,6;-0,2	1,7;0,4			1,7	1,6
Okt 11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	[1,7;0,3]	1,2;-0,1	1,4;0,5	1,7;1,2	1,8;0,2	1,7	1,7
Nov-11	[2,1;0,5]	[2,0;0,1]	[2,5;0,8]	[1,7;0,3]	[1,4;0,1]	1,2;0,1	0,7;0,3	0,7;0,3	1,7	1,7

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

The flash estimate published by Eurostat mid- November, shows a qoq increase of 0.1%, which was slightly higher than the rate the HFM had estimates before. Having in mind that expectation indicators have a relatively high weight in our model, it seems to confirm that the actual problems are more closely related to a worsening of expectations than to the real economy. For 2011Q4 the model forecasts another rate close to zero, but no decline. Notwithstanding the 2012 slightly higher rates which are foreseen by the model for the first two quarters in 2012, the prospects remain dimmed.

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