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Deficit reduction at an escargot's pace

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SNEAK PEEK

- **French government approves 2024 budget draft:** ECB unlikely to be too impressed
- **Draghi breaks cover with a heartfelt rallying cry for more fiscal union,** as Europe faces a host of challenges too big for individual countries
- **China reports second-quarter GDP figures,** as scrutiny of its misfiring economic rebound intensifies

Good morning, I hope you all had a pleasant weekend, weather dodging showers or sheltering from the sun. The French government managed to find time over the Bastille Day weekend to agree a budget draft for next year that it will send to parliament in the coming weeks. The good news? The government is finding substantial amounts of money to fund its green ambitions, while actually cutting non-interest spending in absolute terms for the first time in eight years. Energy-related subsidies will fall by €14 billion.

The bad? Well, it's not exactly going to put France on the side of the budgetary angels. The deficit will fall to 4.4 percent of GDP next year from 4.9 percent this year. As after the Great Financial Crisis, Paris isn't going to hurry with deficit and debt reduction. President Emmanuel Macron's government sees debt still at 108 percent of GDP, and the deficit at 3 percent of GDP, by the end of his second term in 2027.

But unlike the post-GFC recovery, France — like the rest of the eurozone — can't reckon with a decade of near-zero interest costs. France — as Jean-Claude Juncker famously observed — is generally able to trust its leverage with the European institutions to ensure that it proceeds at its own pace, but markets may not be so patient. The glacial speed of deficit reduction is, however, likely to be a good indicator of how the Stability and Growth Pact reform talks pan out over the coming months. As long as France proceeds at the pace of the average *escargot*, it would be foolish to imagine the current negotiations resulting in anything strict or enforceable. For more on the fiscal dimension — and from an old and familiar voice — read on.

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POLICY TICKER

ECB 3.75% ↑ — BOE 5% ↑ — FED 5.25% ↑ — SNB 1.75% ↑ — BOJ -0.10% ↓ — RBA 4.10% ↑ — PBOC 3.55% ↓ — CBR 7.5% ↓ — BOC 5% ↑

DRIVING THE DAY

— **China publishes disappointing second-quarter GDP data along with June numbers for industrial output and retail sales.**

— **The ECB hosts a conference on Central and South-Eastern Europe, all day.**

— **Bundesbank publishes July monthly report, 12 p.m.**

China's GDP grew just 0.8 percent in April to June from the previous quarter, according to figures released by the National Bureau of Statistics. Industrial output rose from 3.5 percent in May to 4.4 percent in June. But retail sales in June grew just 3.1 percent, down from a 12.7 percent jump in May. More from [Reuters](#).

President Christine Lagarde, chief economist Philip Lane and board member Frank Elderson are all speaking or moderating at the ECB's annual conference on central and south-eastern Europe.

The Deutsche Bundesbank publishes its monthly report for July after another grim month of data for the eurozone's largest economy.

SPEAKERS' CORNER

DRAGHI URGES TREATY CHANGE, FISCAL CENTRALIZATION: As European leaders argue over reforming the Stability and Growth Pact, Mario Draghi emerged from semi-retirement to [call](#) for a European Treaty change to allow for centralized fiscal powers.

Common challenges need common spending: Faced with rising external threats and common goals, Europe should "take this opportunity to redefine the EU, its fiscal framework and – with further enlargement on table – its decision-making process," Draghi told a conference at the Cambridge, Mass.-based National Bureau for Economic Research.

"Fundamentally wasteful": Europe's asymmetric fiscal space – with some able to spend much more than others – is "fundamentally wasteful" as no single member state can achieve climate or military security alone, Draghi argued. He added that issuing more common debt to finance needed investments could "potentially enlarge the collective fiscal space we have available."

Less sub-optimal: Draghi argued that more centralized fiscal spending powers would essentially settle the ongoing argument over the SGP, which pits the need for automatic and uniform rules to ensure fiscal sustainability against flexibility to allow for necessary public investment. He pointed out that improvements to some of the most obviously 'sub-optimal' aspects of Europe's currency union (labor mobility, banking integration, sovereign yield spread control) have in any case reduced the risk of the kind of rule-busting deficits that are at the heart of that dispute.

Whatever: Draghi titled his speech "Next Flight of the Bumblebee" – a reference to his London speech in 2012, when he promised to do "whatever it takes to save the euro". However, this time, the world's financial markets weren't hanging on his every word.

ECONOMIC INDICATORS

BANK OF ITALY LIFTS GDP FORECAST: The Bank of Italy more than doubled its estimate for GDP this year to 1.3 percent, citing strong consumer demand. It also expects the negative effects of higher interest rates to be offset by lower inflation and by increased public investment under the national recovery plan. The bank's inflation forecast was also more benign than its previous one in January. Prices are now seen increasing by 6 percent this year and 2.3 percent next, as the energy price spike reverses. The inflation forecast for 2025 was unchanged at 2.0 percent.

Not all roses: In less positive remarks, the Bol said growth came to a standstill in spring, according to its own estimates, with a strong service sector offset by a slump in manufacturing. The bank also cut its growth forecasts for 2024 and 2025. They now stand at around 1.0 percent, down from 1.2 for both years previously.

Don't trust the core: In a dedicated box the central bank was also keen to reiterate a message that has become a bit of a trend of late: core inflation is a lagging indicator (*Ciao, Isabel!*). Even after stripping out the direct effects of food and energy, the bank reckons that over one third of *core* inflation in the euro area (almost 2 percentage points) was to be attributed to the past energy shock in the first quarter of this year. This suggests that the recent normalization of energy prices should push core inflation lower in the months to come, the bulletin concludes, somewhat glossing over the fact that oil prices just hit a three-month high on signs of production cuts in Saudi Arabia and Russia finally biting.

HEAT, DON'T EAT: There were more signs of easing price pressures from Germany on Friday, where wholesale prices posted the sharpest drop in three years, Prices fell 2.9 percent on the year in June, Germany's statistics office

[said](#). Big war-related drops in energy and cereal prices were offset by sharp rises in prices for fruit and vegetables and livestock.

BALANCED TRADE: The eurozone's trade deficit narrowed to €0.3 billion in May as the value of imported energy products fell, non-adjusted Eurostat data [showed](#). A year earlier the deficit was a whopping €30.3 billion as Russia's war on Ukraine sent energy prices spiraling. The improvement in the current account balance has been one of the factors underpinning the euro's rebound over the last year.

Freezing out Russia: The EU's imports from Russia have tumbled this year due to the effective boycott of Russian energy and metals. Imports from Russia in the first five months of the year were only a quarter of last year's level, at €26 billion.

Decent U.S. demand: EU exports to the U.S. held up again, despite the effects of higher Fed interest rates. They're down only 0.2 percent from 2022 year-to-date. By contrast, Chinese exports to the U.S. were down 14 percent on the year in June.

APPOINTMENTS

LOWE AND BEHOLD: Michele Bullock will be Australia's first central bank governor, after the Liberal government of Anthony Albanese tapped her to succeed Philip Lowe, whose term ends in September.

Political flirtation: The pain caused by Lowe's suite of interest rate hikes over the last year had made the succession issue a political football, with the government openly flirting with the possibility of parachuting one of its own into the position.

Hamlet says hi: However, Bullock's appointment is another victory for continuity, and another acknowledgement that the costs of overriding central bank independence can outweigh its benefits. That makes governments rather bear those ills they have, than fly to others they know not of.

Put the cart before the Bullock: As it is, Lowe has already signalled the end in sight for the current tightening cycle, so Albanese's government may soon be able to take the credit for Bullock's first cuts without suffering any opprobrium from the markets in the meantime.

EXIT BULLARD: James Bullard, the outspoken President of the Federal Reserve Bank of St. Louis, announced he'll step down next month to become the inaugural dean of the Mitchell E. Daniels, Jr. School of Business at Purdue University. He leaves having comfortably outlasted the Hull City midfielder with whom he shares a name, a coincidence that was the source of repeated newswire newsroom confusion on Fridays and Mondays a decade ago. But I digress.

Ear to the ground, mouth to the mike: Bullard's journey from being one of the most dovish members of the Federal Open Markets Committee to one of its most hawkish has been among the more eye-catching spectacles of recent years in central banking, and a good illustration of how regional officials often pick up on changes in trends faster than staff at headquarters. However, it wouldn't be too much to suggest that the value of Bullard's commentary suffered in recent months from supply outstripping demand.

DIGITAL CURRENCY

DIGITAL EURO HELPLINE: The ECB is looking at setting up a support line that companies can call if they're struggling to safeguard the digital euro against scam artists and fraud. The Frankfurt-based institution outlined its idea for helpline in its fourth progress report on the digital euro, which it sent round to MEPs and eurozone finance ministers last week. You might have missed it. But you can find the 15-page update is online [here](#).

The report outlines a few design features for the project, which will soon be in the hands of Brussels legislators after the European Commission [proposed](#) the digital euro's legal framework last month. The report is nonbinding but it's clear the ECB thinks its ideas are amazing and should be taken onboard.

Face-to-face help: Another interesting feature is ensuring the digital euro is easily accessible and useable for old folks, who really don't like electronic gadgets. Central banks in the euroclub should make sure that each country has "at least one dedicated and licensed entity," such as a post office or credit union, that can effectively serve as a helpdesk. This could involve face-to-face interactions with anyone who needs help. And if technology just isn't your thing, no problem! Those digital euros can be loaded up onto something akin to a pre-paid card that sits perfectly in

your wallet.

QUOTED

“The consumer is in good shape, spending down the excess cash. This is all tailwinds. If we are going into a recession, we are going in rather good conditions in loan borrowings and house prices. But the headwinds are substantial and somewhat unprecedented. There is war in Ukraine, oil and gas, quantitative tightening, unprecedented fiscal stimulus from government ... I just think people should take a deep breath at that,” JPMorgan CEO Jamie Dimon said during the bank’s quarterly earnings call on Friday.

“I see no reason why the first [of two necessary rate hikes] those two hikes should not occur at our meeting later this month ... If inflation does not continue to show progress and there are no suggestions of a significant slowdown in economic activity, then a second 25-basis-point hike should come sooner rather than later, but that decision is for the future,” **Federal Reserve Governor Chris Waller** said in a speech to The Money Marketeers of New York University late on Thursday.

“The Fed is not going to cut ... They are not going to do what is priced in. “Inflation has come down but it is still too high, and it is probably going to level out where it is,” Bridgewater co-chief investment officer Bob Prince told the [FT](#) in an interview published on Friday.

WHAT WE'RE READING

- Europe's pyrrhic gas victory ([Energy flux](#))
- The global economy is facing a challenging moment (Gita Gopinath's [IMF briefing note](#) for the G20 finance ministers and central bank governors meeting at the weekend)
- EU spars with ECB on plan to tax sanctioned Russian assets ([Bloomberg](#))
- Markets appear convinced the Fed can pull off a soft landing ([WSJ](#))

THE WEEK AHEAD

(Editor's note: this is intended as a selective list, giving precedence to European events). All times CET.

MONDAY, 17th July

ECB publishes research bulletin, 8 a.m.

Italy final June CPI, 10 a.m.

ECB President Lagarde speaks at the ECB's annual CESEE conference, 10:15 a.m.

ECB Chief Economist Lane chairs a panel on “Macroeconomic policy challenges amid a changing geopolitical landscape” at the CESEE conference, 10:30 a.m.

Bundesbank publishes monthly report, 12 p.m.

ECB board member Elderson chairs a panel on “Changing geopolitical landscape – economic implications for central, eastern and south-eastern Europe” at the CESEE conference, 2:15 p.m.

TUESDAY, 18th July

G20 finance ministers and central bank governors meeting concludes.

RBA publishes monetary policy meeting minutes, 3.30 a.m.

U.S. June retail sales, 2:30 p.m.

Canada June CPI, PPI, 2:30 p.m.

U.S. June industrial production, 3:15 p.m.

Federal Reserve Vice-Chair Barr speaks, 4 p.m.

ECB publishes weekly financial statements and updates on the APP/PEPP bond portfolios, 3 p.m.

U.S. NAHB survey, 4 p.m.

WEDNESDAY, 19th July

U.K. June CPI, PPI, 8 a.m.

EU June car registrations, 8 a.m.

Eurozone final June CPI, 11 a.m.

U.S. June housing starts and building permits, 2:30 p.m.

BoE Deputy Governor Ramsden speaks on quantitative tightening, 6 p.m.

THURSDAY, 20th July

Japan June exports, imports, 1:50 a.m.

China PBoC loan prime rate decision, 3:15 a.m.

German June PPI, 8 a.m.

ECB publishes May balance of payments data, 10 a.m.

Turkey monetary policy decisions, 1 p.m.

U.S. weekly jobless claims, 2:30 p.m.

U.S. Philadelphia Fed manufacturing survey, 2:30 p.m.

S. Africa Reserve Bank monetary policy decisions, 3 p.m.

U.S. June existing home sales, 4 p.m.

Eurozone July consumer confidence, 4 p.m.

BoE's executive director for payments Cleland speaks, 7 p.m.

Federal Reserve publishes weekly balance sheet, 10:30 p.m.

FRIDAY, 21st July

U.K. GfK consumer confidence, 1:01 a.m.

Japan final June CPI, 1:50 a.m.

U.K. June retail sales, 8 a.m.

U.K. June Public Sector Borrowing Requirement, 8 a.m.

Central Bank of Russia monetary policy decisions, 12:30 p.m.

Canada June retail sales, 2:30 p.m.

Bank of Spain Governor Pablo Hernandez de Cos speaks on monetary policy and green finance in Bolivia, 3:40 p.m.

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