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SUPPLEMENTARY MATERIAL

- ***Role of the Government***[1]

Trudeau's Message: Let Government Spending Do the Work

- Canadian prime minister warns against balanced-budget 'trap'
- Fiscal boost comes amid talk monetary policy has lost bite

Canadian Prime Minister Justin Trudeau is urging global leaders to rely more on government spending and less on monetary policy to spur growth as he prepares a budget that will push his country into deficit.
In a wide-ranging interview Wednesday in Vancouver, Trudeau highlighted the importance of infrastructure spending and measures to bolster incomes of middle classes he says are critical to driving growth. He also defended his plan to go willingly into the red.
"My message to other government leaders is don't fall into the trap that thinking that balancing the books" is an end in itself, he said. "It's a means to an end."

Trudeau's arrival on the global scene and his endorsement of deficits marks a sharp about face from his predecessor, Stephen Harper. Along with German Chancellor Angela Merkel and U.K. Prime Minister David Cameron, Harper championed the budget austerity alliance within the Group of Seven that often clashed with the U.S. on fiscal policy.

President Barack Obama will hear a new message next week when he hosts a state dinner for Trudeau at the White House. The Canadian leader's debut also coincides with an increasing sense in global circles that monetary policy is reaching its limit, fueled in part by Japan's surprise move to adopt negative interest rates that caused turmoil in currency markets.

"Making sure monetary policy and fiscal policy are aligned and complementary is obviously a benefit to any economy. But at the same time I don't want to be overly preachy," Trudeau said. Other countries should consider balanced budgets when feasible "but don't make it the be-all and end-all because you may be missing out on opportunities to grow your economy -- to help citizens prosper -- that too much rigidity would actually interfere with."

G-20 Consensus

At a Group of 20 meeting in Shanghai last week attended by Trudeau's finance minister, Bill Morneau, officials from the world's top economies committed their governments to doing more to boost growth amid mounting concerns over the potency of monetary policy.

Trudeau, 44, hinted he is considering expanding on pledges that have his country on pace for a deficit of nearly C$30 billion ($22.3 billion) in the fiscal year that begins April 1. Having promised C$10.5 billion in new spending during the campaign, Morneau delivered a fiscal update last month

[1] Extracted from http://www.bloomberg.com/news/articles/2016-03-03/trudeau-s-message-to-world-let-government-spending-do-the-work

showing the government is starting from a deficit of C$18.4 billion as Canada grapples with the oil-price shock.

"It's to me even more of a reason why we need to be investing intelligently in infrastructure, in money in the pockets of the middle class, to grow the economy," Trudeau said of the fiscal situation he inherited after his majority win in the Oct. 19 election.

Debut Budget

He offered no detail on what new spending may be included in the budget, due March 22, but ruled out big-ticket surprises. "I don't think we need massive stimulus," he said. "There's a limit on how much you can flow infrastructure dollars in a short time frame from a standing start."

A C$30 billion deficit would be 1.5 percent of gross domestic product. That's a swing of 1.4 percentage points, from an expected deficit of 0.1 percent of GDP in the current year. Since the end of World War II, there have been only four one-year expansionary fiscal swings of more than 1.4 percentage points of GDP.

Erik Hertzberg/Bloomberg

Even with C$30 billion in red ink, Canada's debt-to-GDP ratio would remain among the lowest in the G-7. "That leaves us with more flexibility," Trudeau said. "If we were sitting at 90 percent debt to GDP, we probably wouldn't be contemplating the kinds of things we know we're able to do. If interest rates were radically different -- much higher, to take money to invest in our economy -- we'd be looking at different kinds of investments."

Anemic Growth

The commodities slump prompted the Bank of Canada to cut its overnight rate twice last year, to 0.5 percent, and has dimmed the economic outlook. This week, Statistics Canada reported that output grew just 1.2 percent in 2015, down from 2.5 percent in 2014. To Trudeau, that's a reason to spend more instead of tightening up to eliminate the deficit, as Harper had argued in last year's election campaign.

"Cuts would have been terrible for the economy," Trudeau said.

The new prime minister will stop short, however, of opening the taps endlessly, reiterating a commitment to lowering Canada's debt-to-GDP ratio over time.

"Balancing that fiscal responsibility that Liberals have always had with an understanding that in order to grow we need to invest," he said, "is the balance we're working hard to strike."

- ***Inflation***[2]

Is Inflation Really Just A 'Sensation'?

Are price increases a short-term consequence of removing currency controls or a long-term trend that could spiral out of control?

By **Bianca Fernet** -

Jan 20, 2016 at 14:34

If you've noticed a dramatic increase in prices this month, allow me to assure you that it is not your imagination. Inflation has accelerated dramatically since President Mauricio Macri took office on December 10. That's a fact. The big question is whether this is a short-term consequence of removing currency controls and reunifying the Argentine peso, or a long-term trend that could spiral out of control. Argentina has an unshakable problem with inflation, or persistently rising price levels and the subsequent deterioration of the value of the currency, that will be hard for the new government to shake.

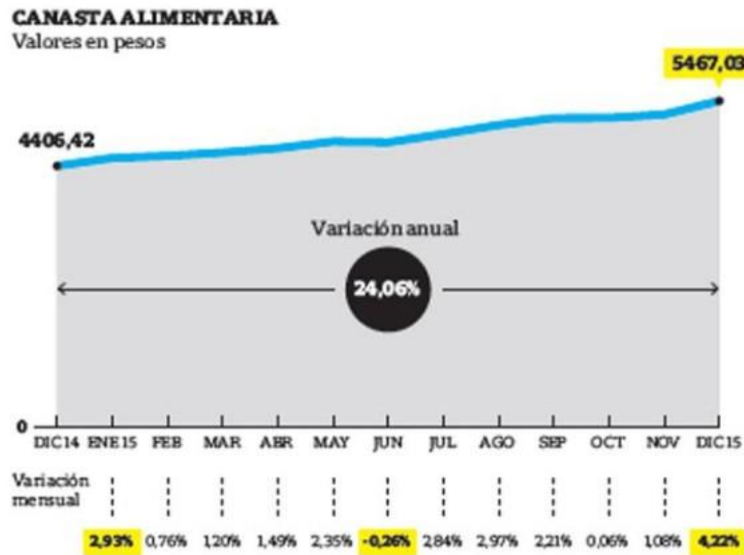
The Struggle Is Real

Estimates for how much prices have gone up vary, but this is undeniably the highest inflation in two years, since the major devaluation when Axel Kicillof became Economy Minster in 2014.

According to the Buenos Aires City Government, December inflation clocked in at 4.22 percent as measured by the increase in a basket of basic food goods calculated based on the necessities of a family of four. Anecdotal and independent estimates of inflation

[2] Extracted from http://www.bubblear.com/inflation-sensation/

both in the City and across the rest of the country show increases within a similar range, so for simplicity's sake let's take Buenos Aires City official statistics as a reasonable starting point for addressing the problem:



[3]

Price increases were led by inflation in the price of meat, which increased by a whopping 13 percent.

[4]

[3] Source: La Nacion
[4] Source: La Nacion

Besides food, almost every aspect of the economy experienced a price increase with a striking 12.23 percent increase in the price of healthcare-related expenses.

[5]

While there is no contention over December's high inflation, the story diverges when we get to January.

The government claims that December's high inflation numbers were a short-lived phenomenon in response to *expectations* of price increases resulting from the end of currency restrictions. In other words, a self-fulfilling emotional prophesy unavoidable in disentangling the currency web weaved by former President Cristina Fernández de Kirchner. Secretary of Commerce Augusto Costa and Minister of Production Francisco Cabrera point to the fact that prices rose by 1 percent the first week of December, but only 0.9 percent the second and 0.6 percent the third as evidence.

Economy Minister Alfonso Prat-Gay stated that the increases were just a "sensation" and that, "we are coming down in the first 15 days of January to inflation levels more or less similar to what we experienced in October [1.5 percent] and September [1.7 percent]."

Private estimates of inflation during the first 15 days of January show a figure between between 2.5 and 4 percent for the month, or double the number estimated by the Economy Minister.

Prat-Gay goes on to estimate that by February the impact of lifting the currency controls will have run its course, and inflation will be below 1 percent per month. Most private estimates suggest that in 2016, inflation will be between 25 and 30 percent.

[5] Source: La Nacion

Methinks Mister Prat-Gay would benefit from a calculator and a healthy dose of reality.

The Political Impossibility Of Fiscal Readjustment

In a phrase, Prat-Gay's economic strategy consists of monetary shock combined with fiscal gradualism. In plain English that means he is moving quickly to remove controls related to the currency, which have a comparatively minimal impact on the average person, whereas the government is slowly reducing government spending, which can make or break someone's day-to-day economic well-being.

Mauricio Macri's government inherited a macroeconomic nightmare consisting of three entangled areas:

1. A Central Bank (BCRA) with no cash that owed billions of dollars to importers and holders of bogus futures contracts
2. A system of parallel currency rates characterized by a market (blue, "blue chip swap," *contado con liquidation)* rate that exceeded the official rate by margins of up to 70 percent
3. A bloated public sector in which the state employees close to 25 percent of the population across the country (closer to half in some provinces), and the general population has come to rely on energy subsidies and price controls to get by

The first two concerns are part of monetary policy, while the third and most complicated is part of the country's fiscal policy. Taxes don't come close to paying for the third, so Argentina's government spends far more money than it takes in. Even when you strip away the alleged shameless graft of the previous administration, there simply isn't money to pay for number three.

Macri's economic team led by Prat-Gay has been quick and unapologetic in addressing the country's monetary problems. Within weeks of taking office they removed the myriad of currency controls and allowed the Argentine peso to float, regardless of the jarring impact this has on the Argentine business community who are coping with continuing unpredictability as the various mechanisms and workarounds that developed in response to the controls slowly unravel.

This "rip the bandaid" strategy cannot be applied to fiscal spending, which in addition to being politically unpopular to cut, must pass through legislative budget approval processes in Congress. To make matters worse, we are in the midst of the baffling annual union wage increase bargaining sessions known as the *paritarias*. Labor leaders smell the looming fiscal cuts especially in light of the recent controversial firing of thousands of public workers and are demanding salary increases between 28 and 35 percent to compensate for the upcoming year's expected inflation.

Will Inflation Stay High?

By removing currency controls and allowing the Argentine peso to float without also correcting the fiscal imbalance so abruptly, Argentina is left with two options:

1. Monetize the fiscal deficit by printing money to cover the expenses, AKA inflation
2. Finance the fiscal deficit by raising debt, AKA selling bonds, and attracting investment

Option 1 is not good. High inflation deters investment, exacerbates poverty and leads to instability.

Option 2 is off the table in a real way until the Macri administration finds a way to settle with the holdout creditors known as the "vulture funds." As of last week the prospects were not as rosy as we would like; however, *Cronista* reported today that JP Morgan sees the negotiations moving in the right direction and predicts a resolution that pays the holdouts between 70 and 80 percent of the face value of the defaulted bonds in the form of additional bonds. Until a settlement is reached, President Macri can go to as many meetings at the World Economic Forum in Davos as he wants, it won't change the fact that the majority of global capital is risk averse capital and will avoid Argentina like the plague.

Furthermore, global conditions are not on Argentina's side when it comes to attracting international investment. While the government has predicted a 0.5 percent increase in GDP for 2016, international banks and the IMF have adamantly contradicted this figure, predicting a recession of -0.7 percent in 2016 and meager growth of 0.2 percent in 2017. This is due to China's slowdown, low commodity prices and a deteriorating situation in Brazil, a major destination for Argentine exports.

Give It To Us Straight

Argentina grew tired enough of former President Cristina Fernández de Kirchner's economic fantasy land to elect Macri, partially based on his promises to restore reliability to Argentina's economic statistics agency INDEC and to end the bombastic and downright dishonest management style of his predecessor.

Admitting that inflation would temporarily rise upon the removal of capital controls and realignment of the currency was laudable; calling dramatic price increases a sensation and claiming they will be over by February is not so much. While INDEC understandably will need until September to publish official inflation statistics, in the meantime the Government should either outsource the task to a reliable third party or establish a less-than-perfect estimate based on private sources.

Currently, Economy Minister Prat-Gay's minimization of the real problems that high inflation causes in the lives of Argentines makes him come off as dismissive, flippant and disconnected. Like when he dismissed monthly electricity cost increases of AR$350 as negligible, or only "the cost of two pizzas," he runs the risk of losing touch with the economic needs of the people that it is his responsibility to promote and protect.

Inflation's latest tear is a real reminder that just because people can now buy dollars and imported goods doesn't mean Argentina's economic woes are over.

- ***Unemployment*** [6]

Young people and work

Jobs for the boys and girls

Youth unemployment, the scourge of much of Europe, has plummeted

Mar 12th 2016

[6] Extracted from http://www.economist.com/news/britain/21694558-youth-unemployment-scourge-much-europe-has-plummeted-jobs-boys-and-girls

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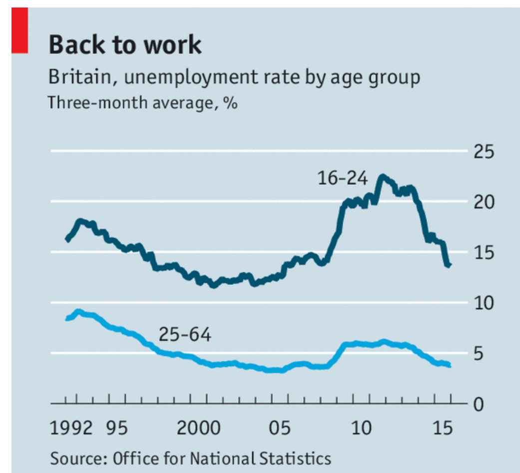

A FEW years ago Britain was in a panic about youth unemployment. As the economy sank, companies stopped hiring and let go of workers with the least bargaining power. The unemployment rate among 16- to 24-year-olds therefore soared (see chart). In many rich countries, the rise in youth unemployment has proved to be long-lasting: across the EU it has fallen by a mere 1.3 percentage points since 2011 and in countries like the Netherlands and Norway it has risen, raising fears that swathes of youngsters are structurally excluded from the labour market. Yet in Britain it has nosedived. The employment rate of young people not in full-time education is now at its highest since 2004. Why?

The government credits its "long-term economic plan". True, it helpfully raised the age at which people leave education to 18 last year, thus moving youngsters off the dole and into the classroom. Yet many programmes have fallen flat. A £300m ($425m) scheme whereby employers received a payment of up to £2,275 for hiring an unemployed young person closed in 2014 after low take-up. A £30m "Innovation Fund", announced in 2011, rewarded investors who funded programmes to improve youngsters' skills. It too closed to new entrants in November; the Department for Work and Pensions (DWP) has released no quantitative analysis of the scheme's value for money.

The DWP has even gone in search of young people online, setting up a page on the BuzzFeed news site with articles such as "7 most obscure excuses given by benefit fraudsters". The target audience seems unimpressed ("Why don't you give the ten worst reasons for stopping a person's benefit and leaving them destitute?" asks one).

Still, other welfare reforms have inadvertently helped the young. Since 2011 private providers of support for unemployed people have been paid according to how many of their clients move

into work. In 2011-15 one-third of 18- to 24-year-olds in the programme moved into a job for a "sustained" period (meaning at least three or six months, depending on the person), compared with one-quarter of 25- to 49-year-olds. The difference may be partly down to this payment-by-results model, says Laura Gardiner of the Resolution Foundation, a think-tank: targeting youngsters, who may pick up skills quicker, has proved more lucrative to the contractors than focusing on harder-to-help claimants, particularly the over-50s and those with disabilities.

Other policies will make young workers more attractive still to employers. In April a "national living wage" comes into force, under which the minimum wage will rise from its current level of £6.70 an hour to around £9 an hour (equal to 60% of median earnings) by 2020. But it does not cover those under 25, and Len Shackleton of Buckingham University says that this may have already created a bias among employers towards hiring youngsters. So has a policy introduced last April under which employers do not pay certain types of national-insurance contributions for workers under 21.

Tech-literate youngsters are also well suited to the "gig" economy, in which short-term employment is arranged online or through apps. Gigs are proliferating: the number of "private hire" vehicles in London, a category that includes Uber taxis, has risen by 26% in the past two years. Uber claims that, in America, its drivers are twice as likely as conventional cabbies to be under 30.

With such a decline in youth unemployment, it is no wonder that wages are buoyant. In 2015 those aged 18-21 saw a 2.8% rise in median hourly pay, compared with a national average increase of 1.6%. Nonetheless, such was the turmoil experienced during the crisis that the inflation-adjusted hourly pay of those aged 22-29 is still 12% below what it was in 2008, a worse performance than any age group above it. Young Britons may be back in work, but they are not yet back in the money.