

European Economics

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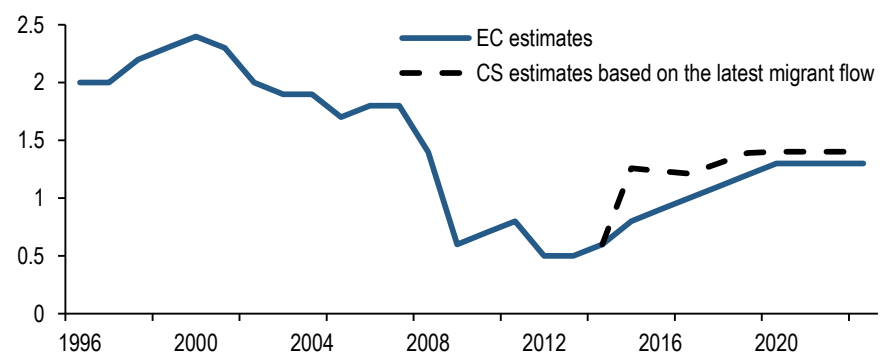
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With Arms Wide Open?

- The European migrant crisis has reached unprecedented levels. Over the next five years we expect net migration to boost the euro area's population by 5m, equivalent to 1.5% of the current 340m population.
- We believe that net migration for the euro area and for Germany is positive for growth.
- In the short term, it should add to economic growth. The multiplier of public outlays required to house, feed and otherwise provide for asylum seekers is roughly equal to one. Fiscal expenditure could thus add 0.2pp-0.3pp to GDP growth next year.
- In the longer term, the fact that migrants are mainly young increases the working age population and addresses worrying demographics and pension dynamics in the euro area.
- We believe potential GDP growth will benefit from a higher contribution from labour input. Compared to the European Commission's baseline, we anticipate potential output growth will be lifted by 0.2 percentage points to 1.3% on average in 2015-2023.
- The initial boost to the working age population means that the impact should be felt more strongly this year and next, with potential output outperforming the baseline by 0.5 percentage points this year, according to our estimates.

Exhibit 1: Migrants should boost euro area's potential growth

Potential GDP growth, y/y%



Source: Eurostat, Credit Suisse

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS.

With Arms Wide Open?

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The largest displacement of people since WWII makes for daily headlines and much of it is on Europe's doorstep. In the usual European style it is still searching for ways to respond to the human crisis in a unified manner and this is likely to continue to take some time. Large numbers of migrants put pressure on countries which are concerned that coveted social welfare systems will become overburdened, and where unemployment has risen sharply and anti-immigration parties are on the rise.

But viewing a large number of net migrants as an economic cost would be a mistake, in our view. Chancellor Merkel is likely to have seen the economic benefits for an economy with a rapidly ageing population. Opening the door to 800K asylum seekers is likely to contribute to Germany's and the euro area's aggregate demand and supply.

Over the longer term, as we show, the increase of working age population is not only likely to lift the euro area's subdued potential growth but also help on the demographic front and thus help pensions.

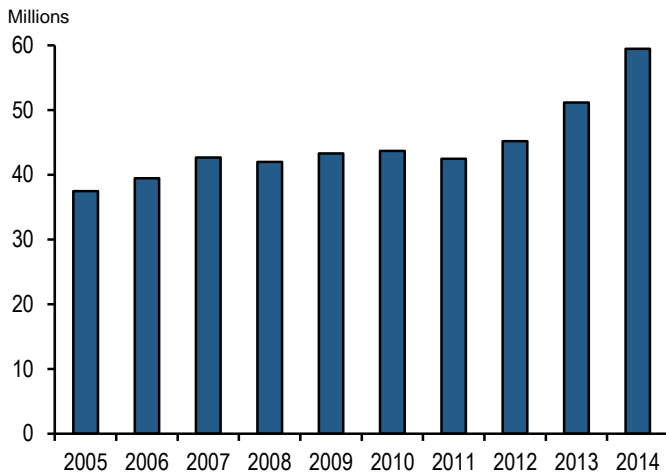
The migrant crisis – record number of people on the move

The global migrant crisis has reached unprecedented levels, with the number of people displaced worldwide by war reaching the highest level on record in 2014. The UNHCR (UN High Commissioner for Refugees) estimates that the number of people forcibly displaced rose to nearly 60m from just over 51m in 2013. This has been the largest leap on record in one year and means that the number of displaced people has increased by more than 60% from one decade ago. As the UNHCR puts it, globally one in every 122 humans is now either a refugee, internally displaced or seeking asylum. Viewed from another angle, if the near to 60m number were a country it would be the world's 24th largest.

Syria's ongoing war has made the Middle East the world's largest producer and host of forced displacement. End of 2014 estimates put the number of internally displaced people at 7.6m, with just under 4m displaced into the surrounding region and beyond as refugees. This is roughly half of Syria's pre-war population of 23m. Added to the high totals from Syria there is the estimated displacement of 2.6m people in Iraq and more than 300K newly displaced people in Libya.

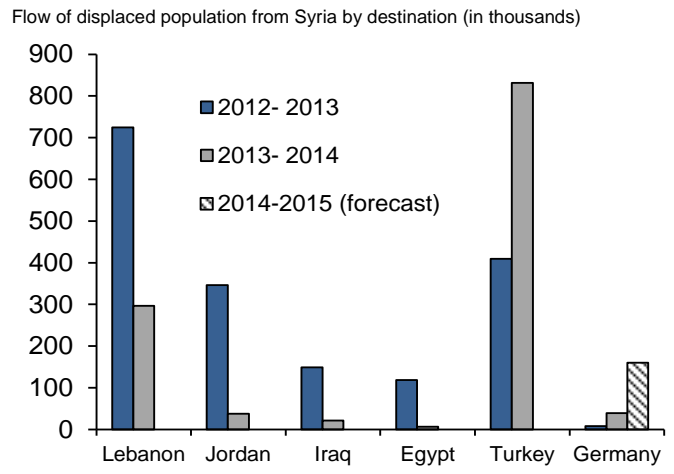
Over the last few months, the outflow has increased. The most recent data suggest that the number of registered Syrian refugees has increased from 3.8m at end-2014 to 4.1m. Moreover, the destination of Syrian refugees has shifted over the past few years. When the crisis started in 2012 the majority of Syrian refugees lived in Jordan and Lebanon. In 2013 they moved to Iraq and more recently to Turkey in order to get access to Europe (Exhibit 3).

Exhibit 2: Tragic record – people displaced by war



Source: UNHCR, Credit Suisse

Exhibit 3: Displaced Syrian population now moving to Turkey and Germany



Source: UNHCR, Credit Suisse

The number of asylum applications to Europe has increased significantly over the last few months as a result (Exhibit 4). In the January-July period this year, the EU 28 had received over 500K applications, a rise of 70% compared to the same period last year. Out of the more than 500K applications, around 40%, i.e., just over 200K, went to Germany, and this is more than double the amount in the same period last year. We expect this trend to accelerate sharply in the remaining months of the year with the German chancellor having committed to take in 800K asylum seekers.

Germany, Hungary and Austria are leading when it comes to the increase in asylum applications (Exhibit 5), and the differences across EU countries are stark. While Germany received just under half of the total new asylum applications in the January-July period this year, Spain only got just over 1% (Exhibit 6).

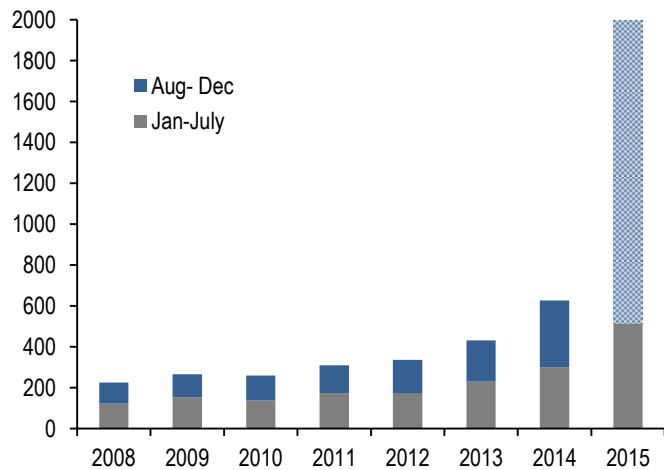
Chancellor Merkel's open arms statement is likely to exacerbate the contrast between Germany and other European countries in the coming months and, although there are no official August estimates yet, the flow into Europe is expected to have risen further. Extending the accelerating trend of asylum applications through the rest of the year suggests that total EU28 asylum applications are likely to rise to 2m this year. We assume that the 800K expected by Germany's chancellor will materialise.

The euro area has tended to account for around 70% of total EU28 asylum applications in the past. Assuming this proportion is maintained, we expect total asylum applications to rise to near 1.4m this year. Adding the yearly average of 200K economic migrants we arrive at a total of 1.6m net migrants entering the euro area this year.

We also expect to see the peak in asylum applications this year, but only expect a moderate decline in 2016 with the euro area still getting just over 1m asylum applications. Over the next five years we expect net migration to boost the euro area's population by 5m, equivalent to 1.5% of the current 340m population.

Exhibit 4: Asylum applications have risen significantly over the last few months in Europe

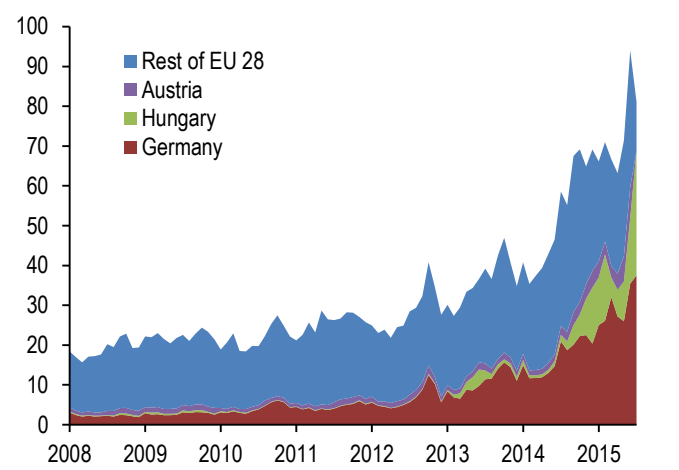
Asylum applications to EU 28 (Aug-Dec 2015 is an estimate), in thousands



Source: Eurostat, Credit Suisse

Exhibit 5: Led mainly by Germany

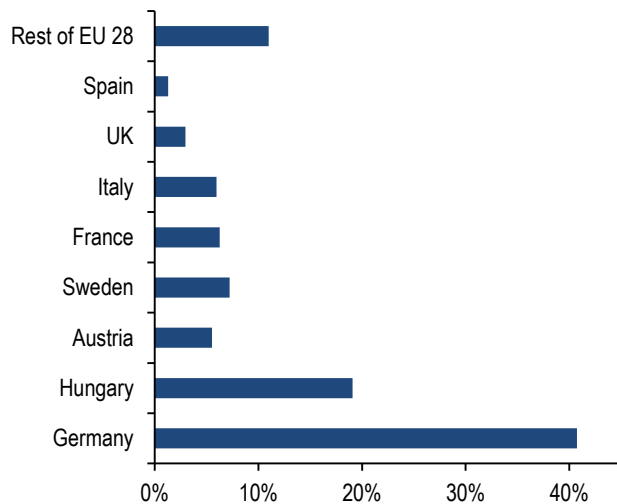
Monthly asylum applications to EU 28 countries in thousands



Source: Eurostat, Credit Suisse

Exhibit 6: Differences across EU28 are stark

Asylum applications during January- July 2015 to EU 28 countries (Share %)



Source: Eurostat, Credit Suisse

Exhibit 7: Highest number of asylum applicants in EU28 are from Syria

Top 3 citizenships of asylum applications (year to date), 000s

EU 28		Germany		Italy	
Syria	101015	Syria	40920	Nigeria	4830
Kosovo	64490	Kosovo	32620	Gambia	3980
Afghanistan	55290	Albania	29745	Senegal	3105
Total	513580	Total	209315	Total	30535

France		UK		Spain	
Kosovo	2875	Eritrea	1480	Syria	3160
DR Congo	1905	Pakistan	1435	Ukraine	1310
Russia	1650	Iran	1140	Palestine	250
Total	32155	Total	15105	Total	6655

Source: Eurostat, Credit Suisse

Migration and the effect on the economy

Large numbers of migrants generate controversy. They have an impact on societies, which is magnified if the cultures that need to be integrated are more divergent. There is also plenty of controversy when it comes to the economic impact. Here the question is whether immigrants are an economic burden or a benefit.

For the euro area the sharp increase in net migrants is a benefit, in our view. We look at the economic impact from two angles:

- In the short term, the fiscal stance and the effect on euro area GDP growth, and
- In the longer term, the impact on the euro area's labour market, demographics and potential GDP growth.

In the short term, the sheer amount of asylum seekers should generate an increase in public expenditure. But we believe the multiplier of this expenditure to be roughly equal to one since all money spent on migrants' basic necessities is likely to fully find its way back into the economy.

Germany is expecting the arrival of 800K asylum seekers this year, which is roughly equivalent to 1% of the German population. The federal government is estimating an increase in federal expenditure of €1bn this year and €6bn (0.2% of GDP) in 2016. Half of next year's estimated €6bn is likely to be channeled to states and local governments. But the allocation between federal government, states and local governments is still being discussed, with states and local governments estimating that the total cost – including the federal government – is likely to amount to €10bn-€12bn (0.3%-0.4% of GDP) next year.

Germany's Finance Minister Schäuble does not want to jeopardize the balanced federal budget target. Instead of boosting the anticipated surplus thanks to larger than anticipated tax revenues, he expects to use the excess revenue to fund the crisis. But staff at the Ministry of Finance are reportedly not excluding a small deficit after an average surplus of 0.2% of GDP over the last three years. Since we believe that the money spent on asylum seekers is immediately going to find its way back into the economy through public infrastructure and basic necessities and hence add to tax revenues, this view might be too pessimistic.

But the migrant crisis is likely to be used by member states to ask for more leniency from Brussels when it comes to meeting fiscal targets. Austria, Italy and France have already raised the fact that the anticipated increase in public expenditure needs to be viewed in the light of the external migrant shock.

Fiscal expenditure could thus add 0.2-0.3 percentage points to euro area GDP growth next year.

In the longer-term, we believe the effect of a large number of migrants on euro area public finances, pensions, demographics and potential growth should be positive.

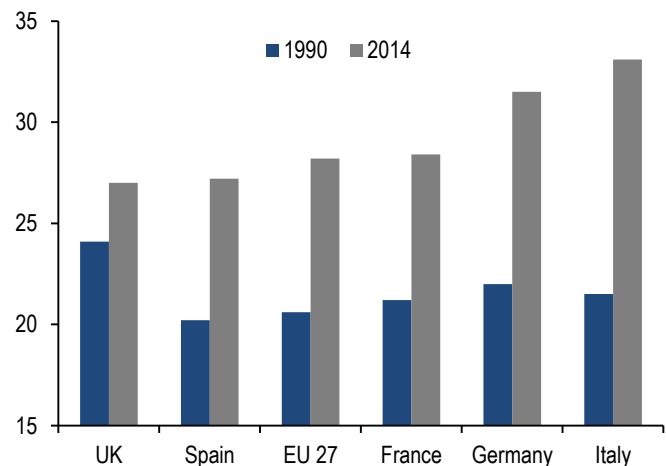
On the public finances front, national as well as OECD studies show that migrants contribute more in taxes and social contributions than they receive in benefits. These studies show that employment is the biggest single determinant of migrants' net fiscal contribution and it is thus crucial to integrate migrants quickly into the host countries' labour forces. Efforts to better integrate immigrants should thus be seen as an investment rather than a cost.

Germany's industrial sector is lobbying to make it easier and speedier for qualified migrant workers to enter the traditionally rather restrictive German labour market. Separate KfW and German chamber of industry and commerce (DIHK) studies also show that persons with a migrant background are highly entrepreneurial. One-fifth of them have established a business in Germany. The DIHK estimates that start-ups by people with a migrant background will account for 20% of the roughly 230K total new jobs created by start-ups this year. These start-ups have been found to take more risks by employing workers from the outset. While over half of migrant background start-ups create jobs from the moment they are established, less than one-third of start-ups run by native Germans do so.

Net migration is also a positive in countries where populations are in decline. It is well known that Germany, alongside other European countries including Italy, has an ageing population that engenders an increasing dependency ratio. The old age dependency ratio has increased across all European countries, with the fastest increases seen in Germany and Italy. Italy in fact has the second highest old age dependency ratio in the world and Germany the fifth highest. The fertility rates in these countries are below the replacement fertility rate of 2.1 children per woman.

Exhibit 8: Sharp rise in old age dependency ratio

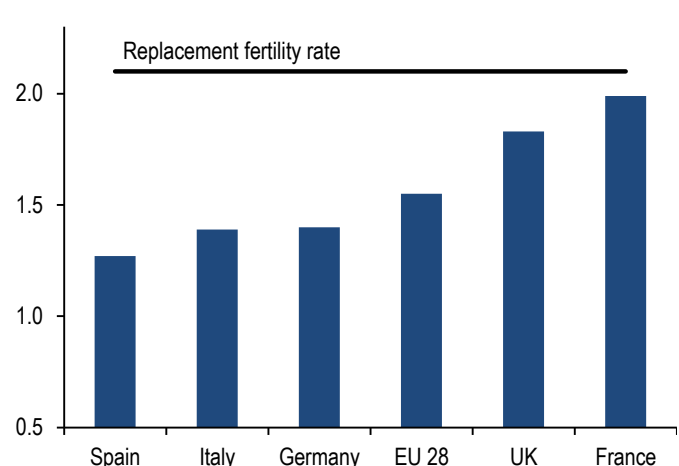
Ratio of population aged 65+ per 100 population 15-64



Source: Eurostat, Credit Suisse

Exhibit 9: Fertility rates below the replacement rate

Children per woman, 2013

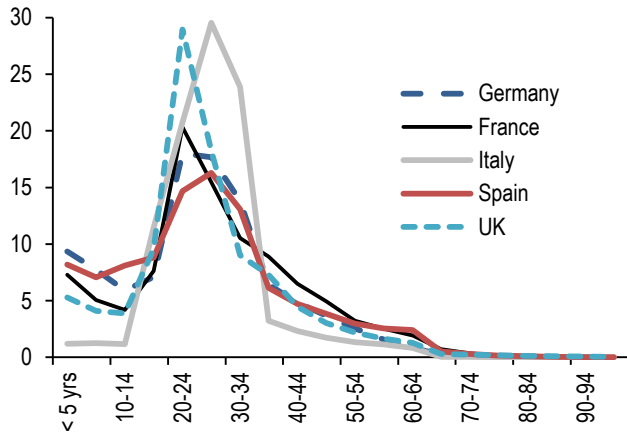


Source: Eurostat, Credit Suisse

The influx of migrants and asylum seekers to Europe is typically young and male. Of those that have entered Germany this year, just over half are aged between 18 and 34 and just over three quarters are of a working age (Exhibit 10). We estimate that over the next five years Germany will receive around 2m asylum seekers. Whilst this is not enough to solve the demographic problem in itself, Germany's population pyramid (Exhibit 11) illustrates the boost to the young adult population that a sustained arrival of asylum seekers would bring.

Exhibit 10: Asylum seekers are young

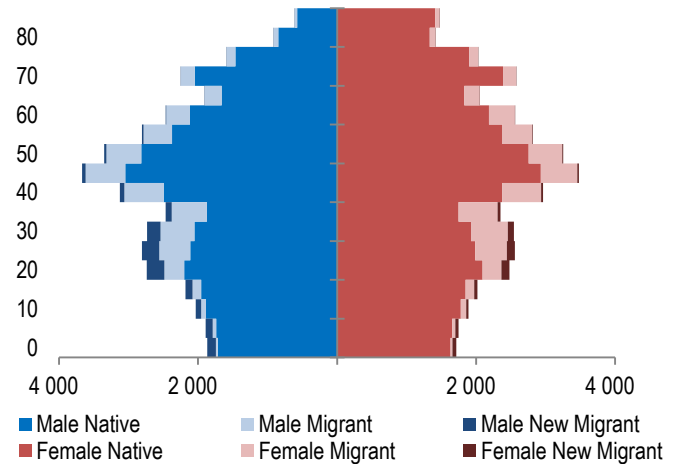
Asylum seekers by age, % of total



Source: Eurostat, Credit Suisse

Exhibit 11: Bulge in the German population pyramid

Male and female population by 5 year age group (000s)- Germany



Source: Statistisches Bundesamt, Eurostat, Credit Suisse

Benefits to potential growth arise from the moment working age migrants enter a country as the labour supply increases. We assume that the euro area will take in roughly 1.6m migrants this year but also estimate that this number will start to diminish towards 1m on average over the next five years. This is still double the average net migration that the euro area has experienced over the past five years.

When it comes to potential GDP growth, European demographics are partly to blame for the subdued outlook. The European Commission (EC) estimates growth will average 1.1% over 2015-2023, and this is partly due to the very subdued labour input contribution which the Commission estimates stands at a mere 0.2pp. We examined this component in a previous [weekly](#) and noted that more optimistic assumptions on net migration, female labour force participation rates and working hours for the elderly can push up the labour contribution to potential growth.

In the light of the recent asylum wave entering Europe, we now re-estimate the labour component of the potential growth equation. Adding young migrant labour to the ageing workforce in Europe pushes up its long-term growth potential. As we noted above, more than three-quarters of migrants are of working age and thus provide a boost to labour supply in the potential growth estimates.

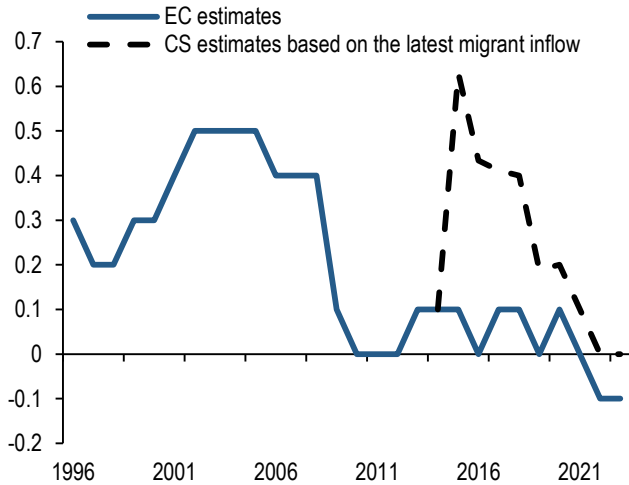
We anticipate growth in the working age population (WAP) will increase by 0.5pp this year to 0.6%, with this growth then slowly tapering off in coming years under the assumption that the flow of net migrants starts to moderate after this year's surge. This compares to an unchanged WAP in the first years of this decade and the average 0.1% increase in the last two years as net migration started to increase (Exhibit 12).

Factoring in sharply higher net migration results in the labour input contribution to potential growth increasing to 0.4pp on average over 2015-2023. This is double the EC's baseline of 0.2pp. Given the initial boost to WAP the impact should be felt more strongly this year and next. For the euro area's potential growth, this suggests an increase of 0.5pp from the EC's baseline this year, which stands at 0.8% compared to our estimate of 1.3%.

Subsequently, the boost to potential growth should moderate, but on average in the 2015-2023 period our estimate of net migration of nearly 5m by 2020 should enable potential output growth to average 1.3%, compared to the EC's baseline of 1.1% over the 2015-2023 period.

Exhibit 12: WAP growth should get a boost from the migrant inflow...

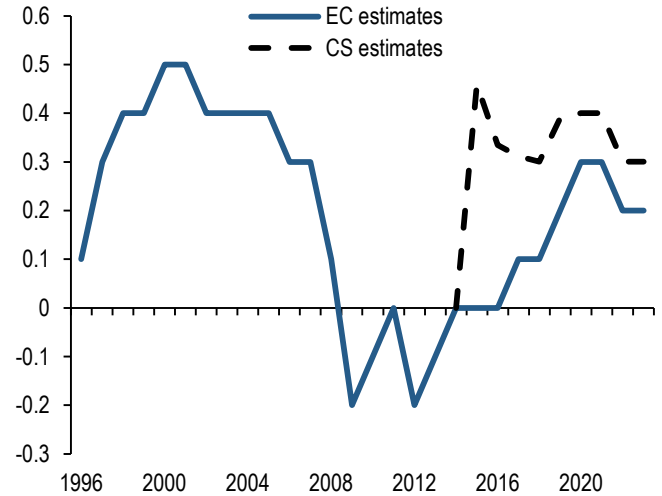
Working age population (annual % change)



Source: Eurostat, Credit Suisse

Exhibit 13: ...which is likely to increase potential growth

Total labour contribution to potential output, percentage points



Source: Eurostat, Credit Suisse

On balance, we believe net migration should be viewed as an additional tailwind to euro area GDP growth, with some of the positive effects likely to be front-loaded given the needs for housing and the fact that the marginal propensity to consume for people who arrive with almost nothing is roughly one. The public expenditure used to support migrants should thus directly find its way into aggregate demand. Economic growth should continue to benefit in coming years as young migrants start to become integrated into the labour market.

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