



Euro crisis – are we out of the woods?

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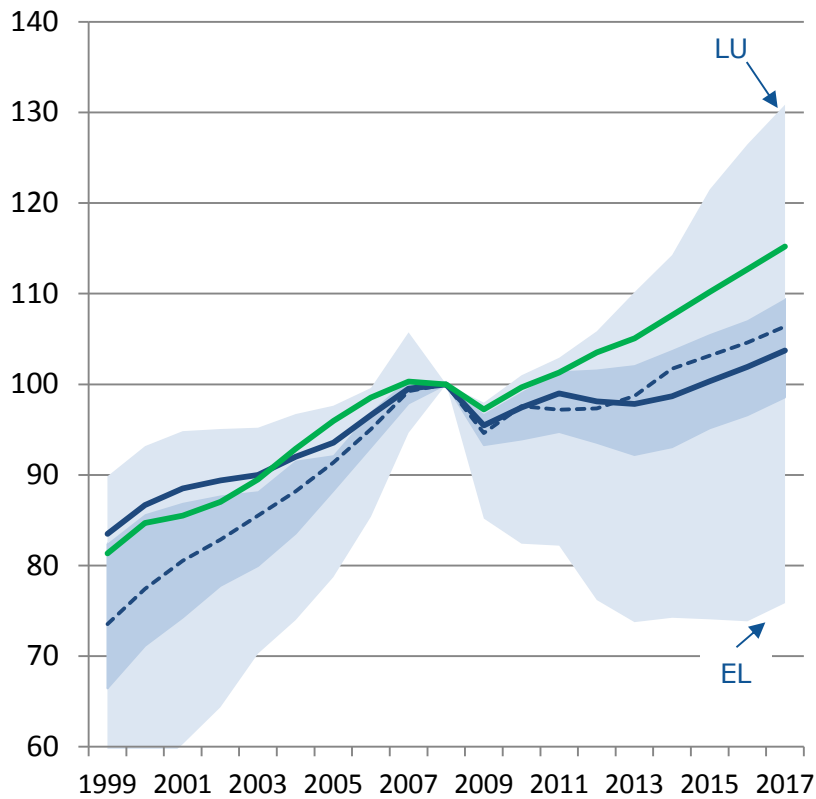
**22nd Dubrovnik Economic Conference
13 June 2016**

Questions

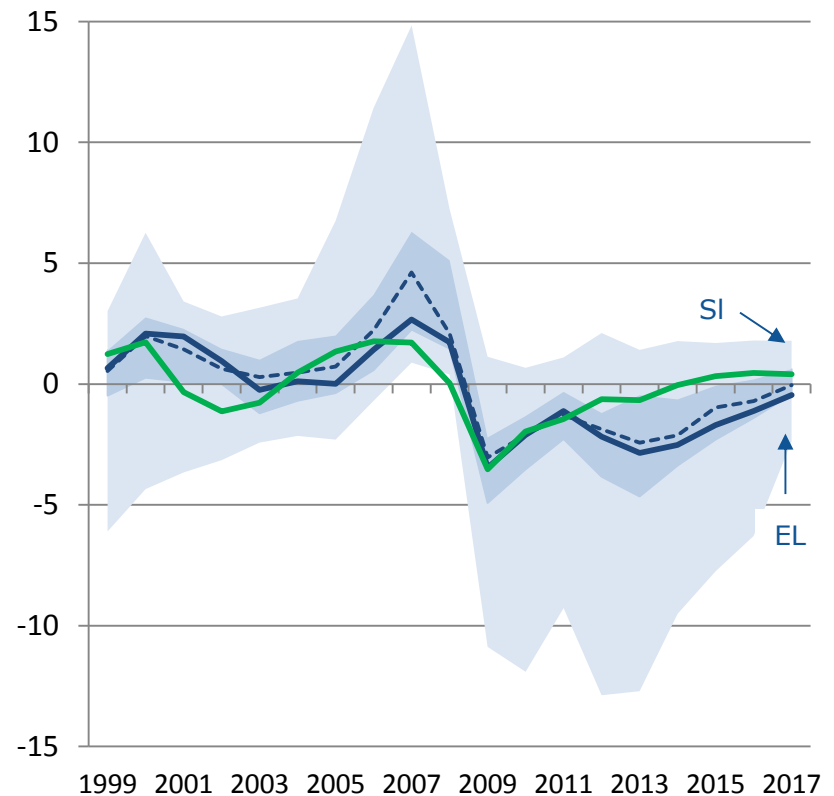
- 1. Economic situation:** *Acute phase of the crisis over, but elevated short-term risks?*
- 2. Vulnerable countries:** *Unwinding of imbalances completed or still on the ropes?*
- 3. Policy response:** *Too little, too late or buffers insufficiently re-established?*
- 4. EMU governance reforms:** *Gone too far or still need to go deeper?*

Lacklustre recovery, output gap still not closed

Real GDP
(index 2008 = 100)



Output gap
(in %)

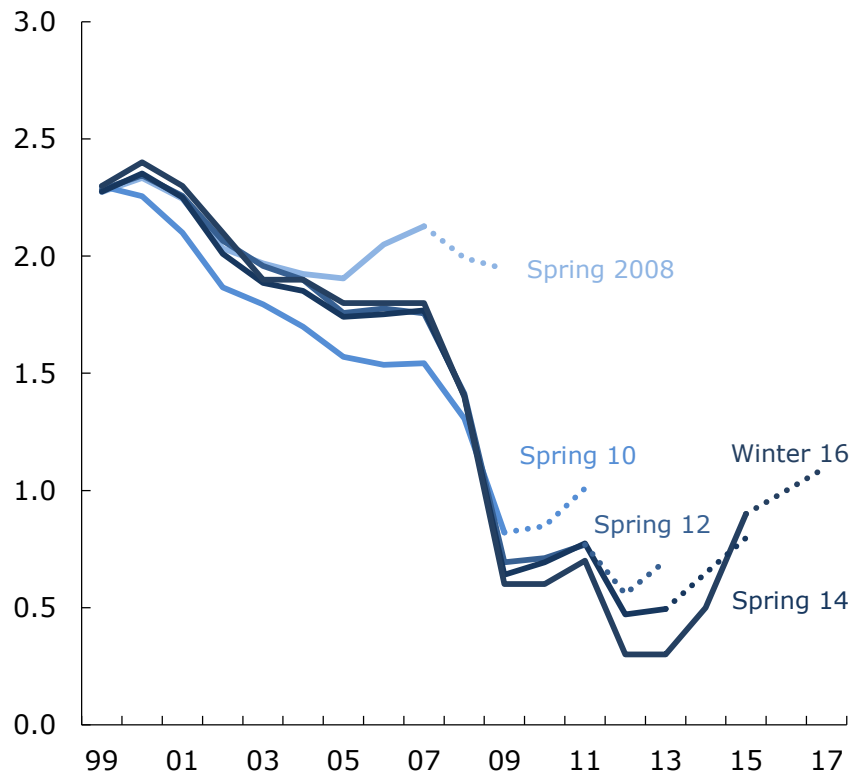


Note: Dark blue line shows the weighted EA-19 average; dotted line shows the simple un-weighted EA-12 average. Light blue area defines the whole range of observed values (from maximum to minimum), while the darker blue area defines the area between the first and second quartile based on un-weighted data for EA-19. Green line shows the US.

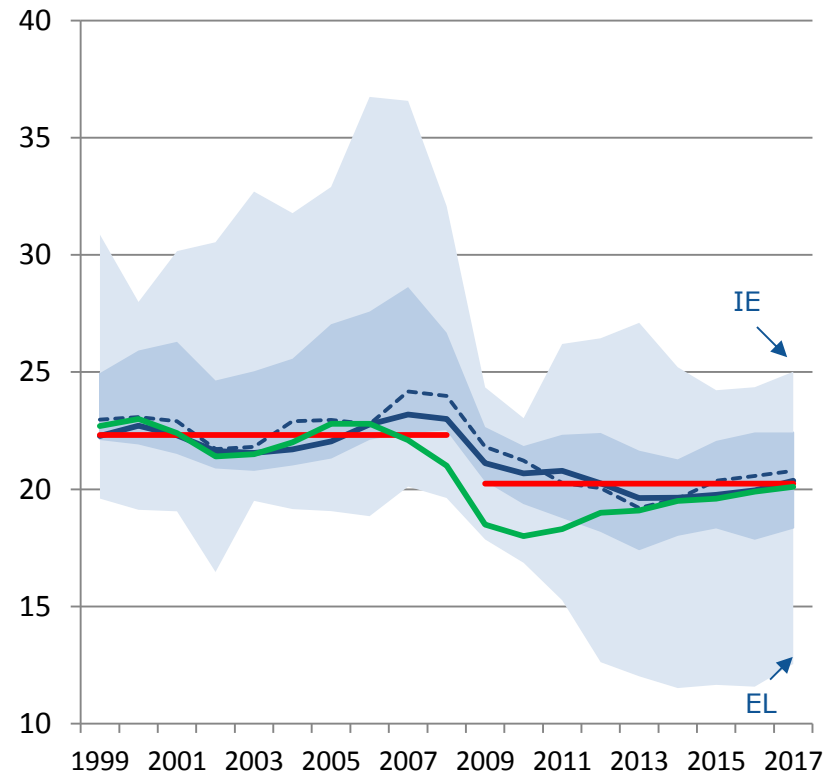
Source: European Commission spring 2016 forecast.

Potential growth weak and steadily revised down, investment gap persistently large

Potential growth forecasts
(in %)



Investment
(% GDP)

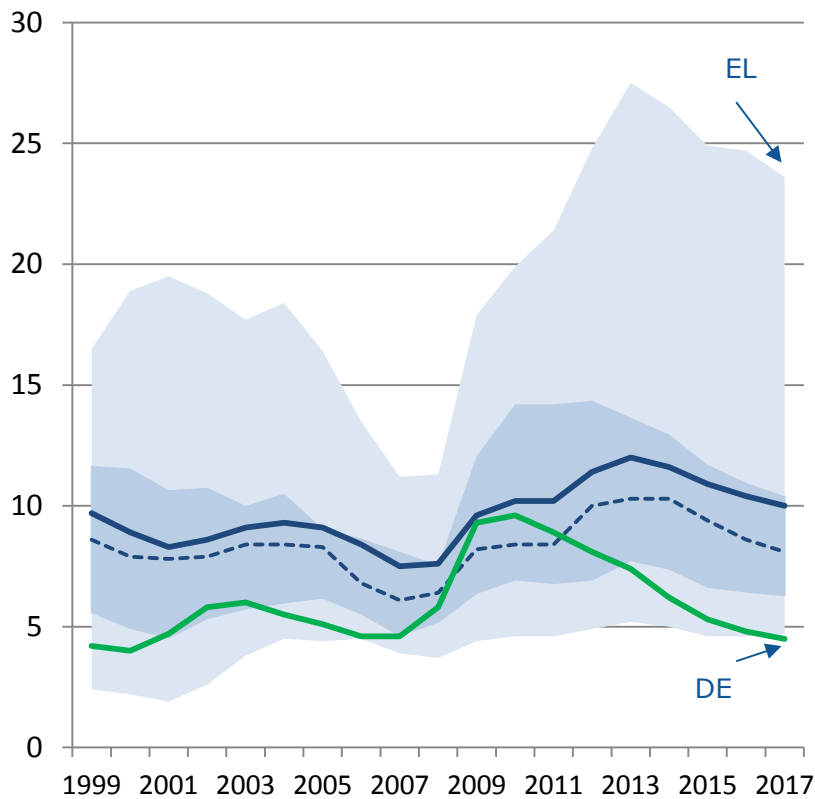


Note: Left side: Euro area based on EA-15 (spring 2008), EA-16 (spring 2010), EA-17 (spring 2012), EA-18 (spring 2014), EA-19 (winter 2016). Right side: Investment measured as gross fixed capital formation. Red lines indicate the pre-crisis (post-crisis) average, ranging from 1999-08 (2009-17).

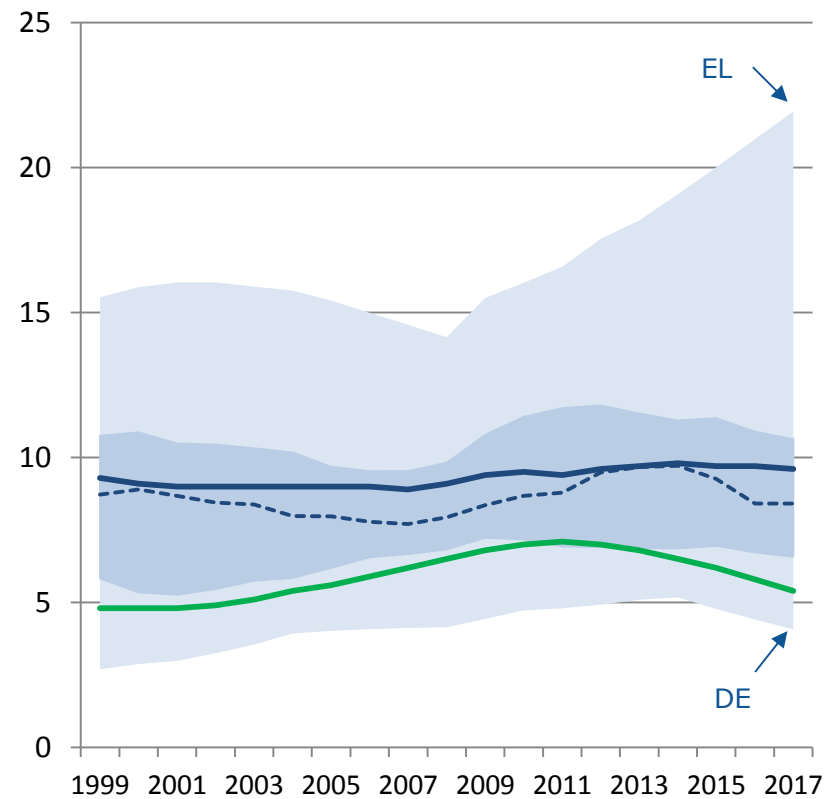
Source: European Commission spring 2016 forecast.

Still high unemployment, increasingly structural

Unemployment rate
(in %)



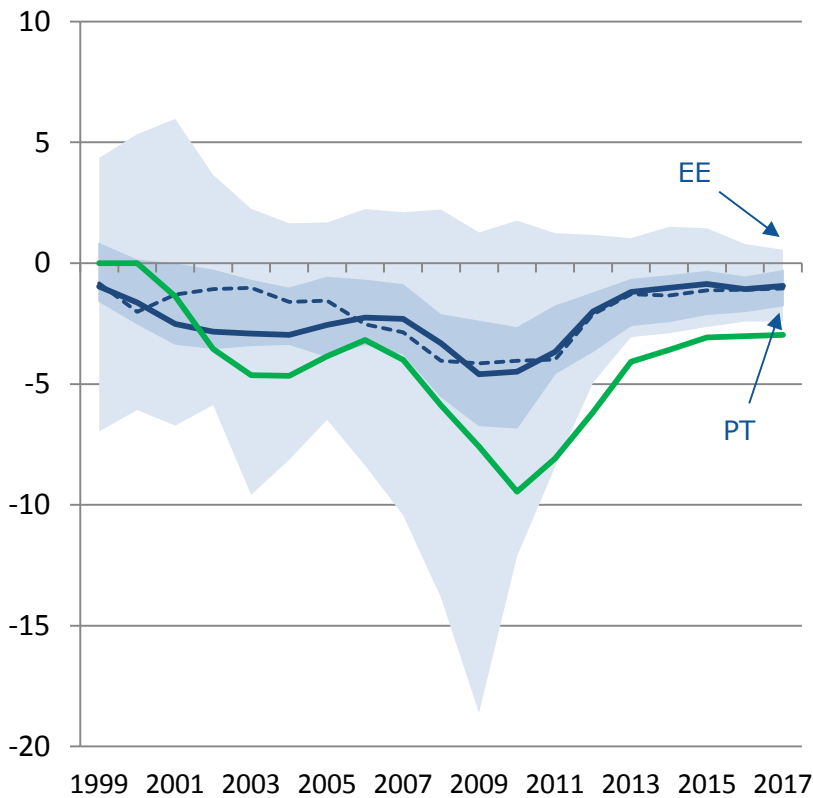
Nawru
(in % labour force)



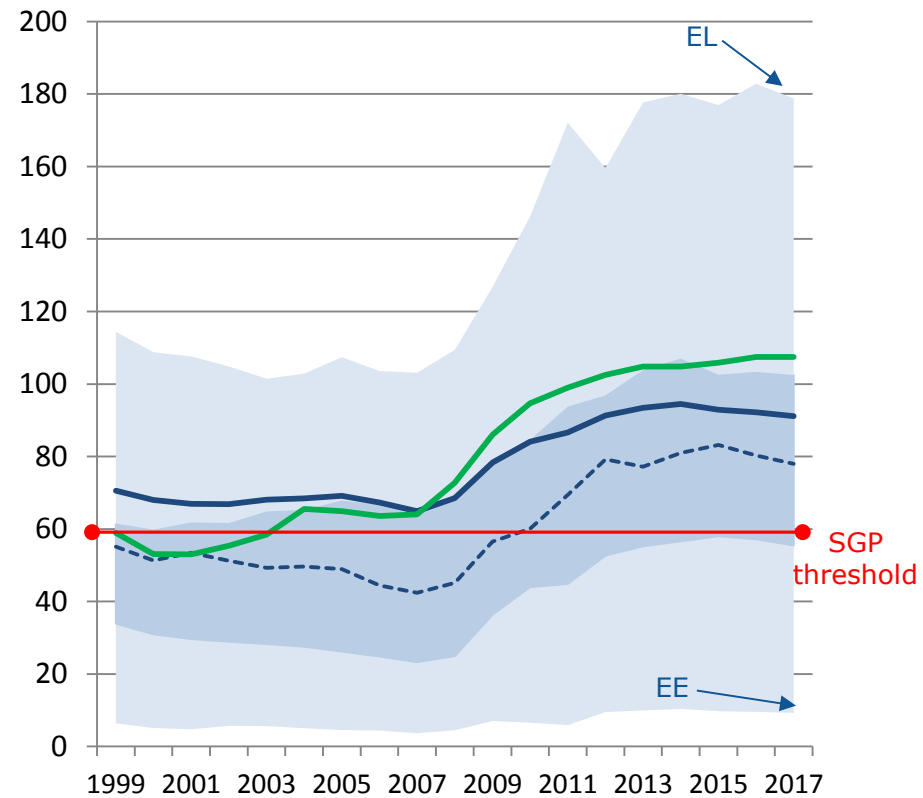
Source: European Commission spring 2016 forecast.

Sizeable fiscal consolidation, but public debt still very high

Structural balance
(in % potential GDP)



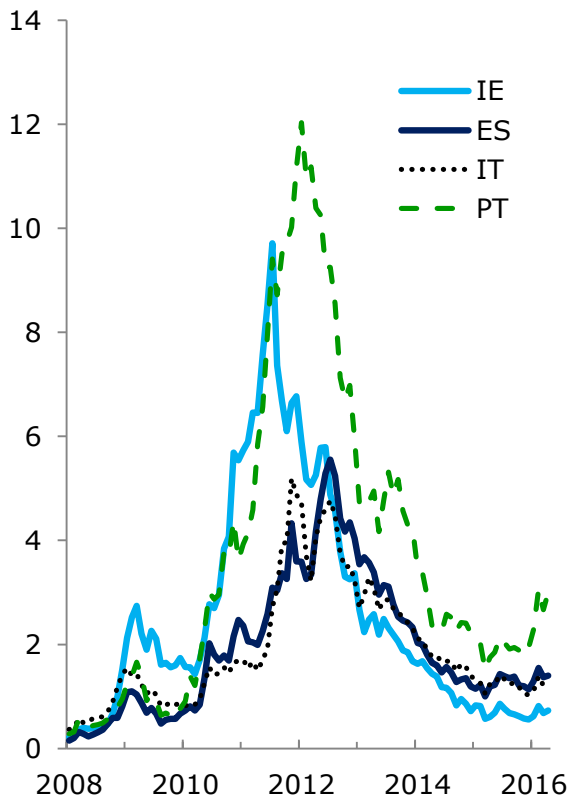
General government gross debt
(% GDP, EDP concept)



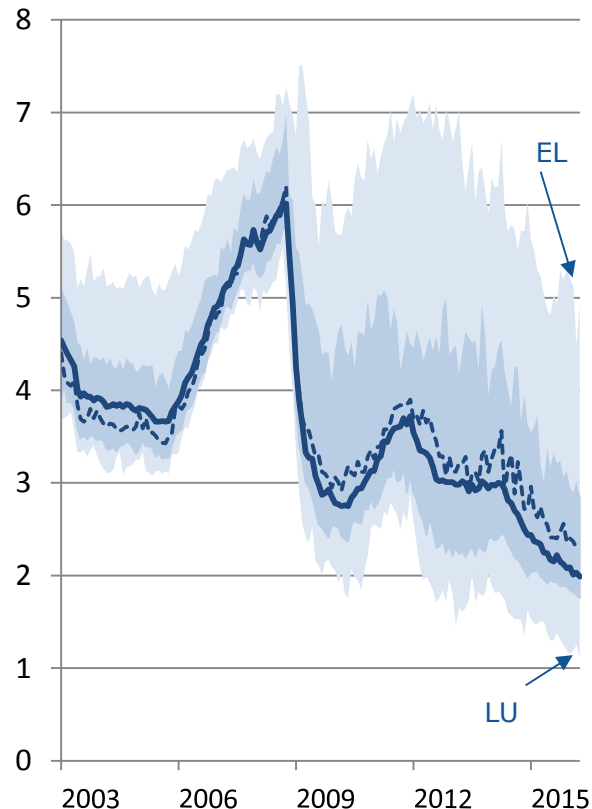
Source: Left side: IMF WEO, April 2016; right side: European Commission spring 2016 forecast.

Reduced financial market pressure, but continued fragmentation and insufficient bank balance sheet repair

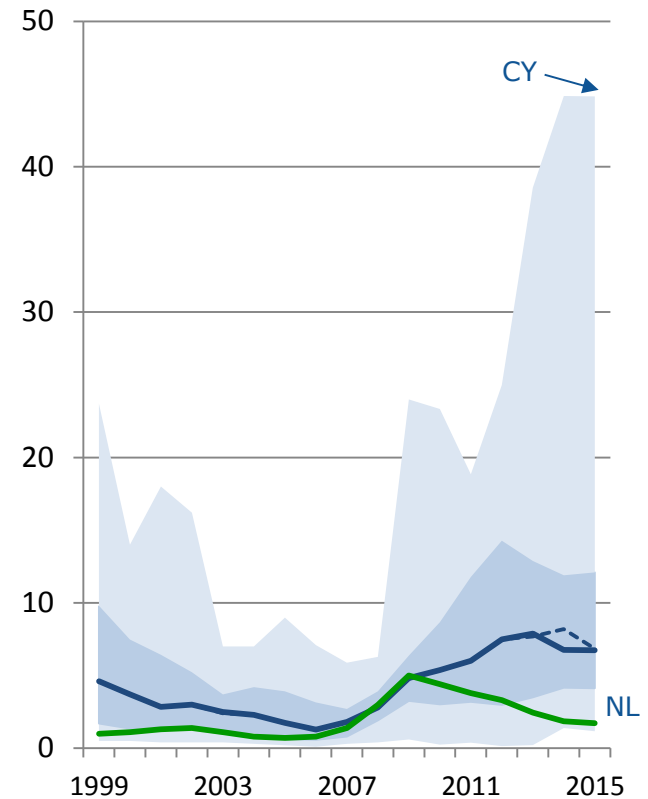
Sovereign bond spreads vis-à-vis the German bund



Lending rates for NFC (Jan 2003 – Apr 2016, in %)



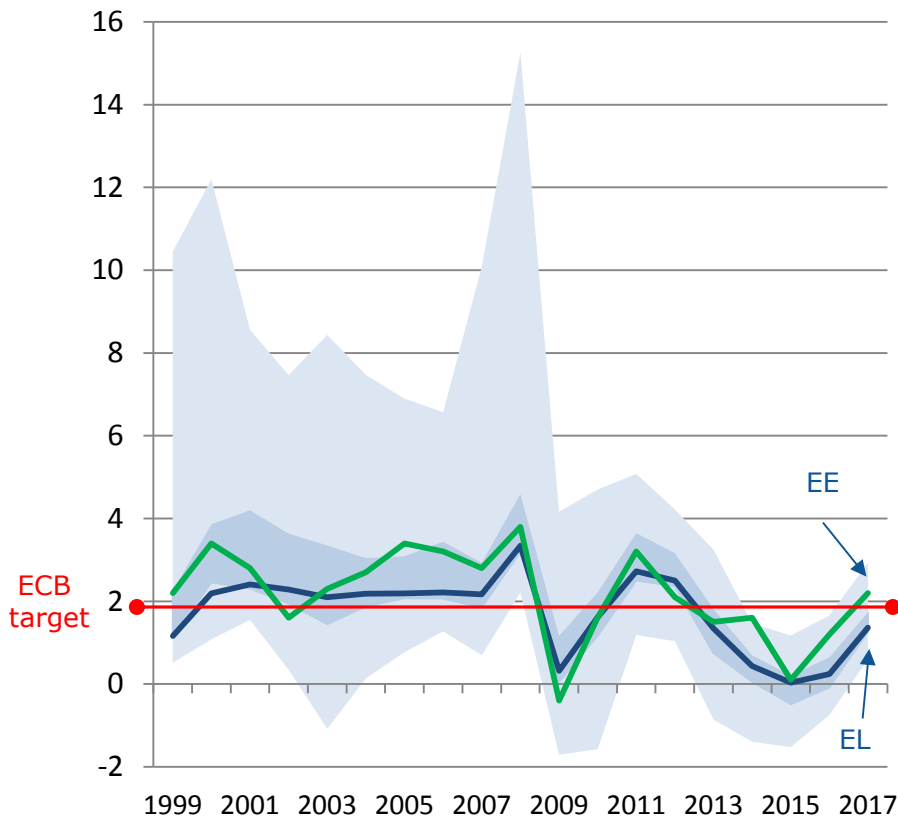
Bank non-performing loans to gross loans (in %)



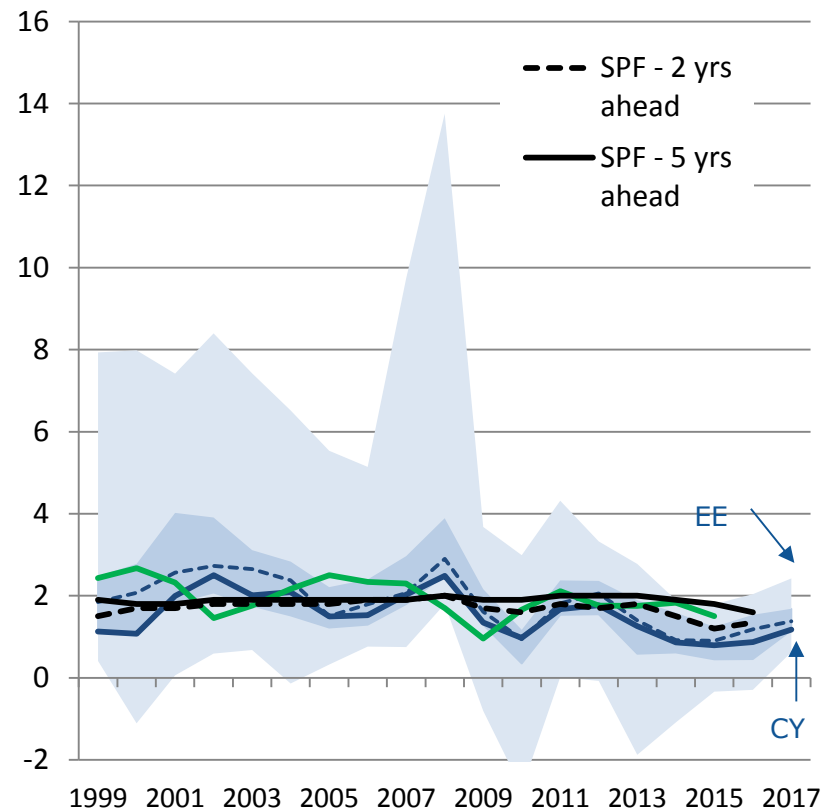
Source: Left side: Eurostat, monthly data, last observation April 2016; chart in the middle: ECB; right side: World Bank World Development Indicators.

Inflation persistently low, risk of unanchored inflation expectations

HICP inflation
(yoy % change)



HICP inflation excl. energy & unproc. food
(yoy % change)

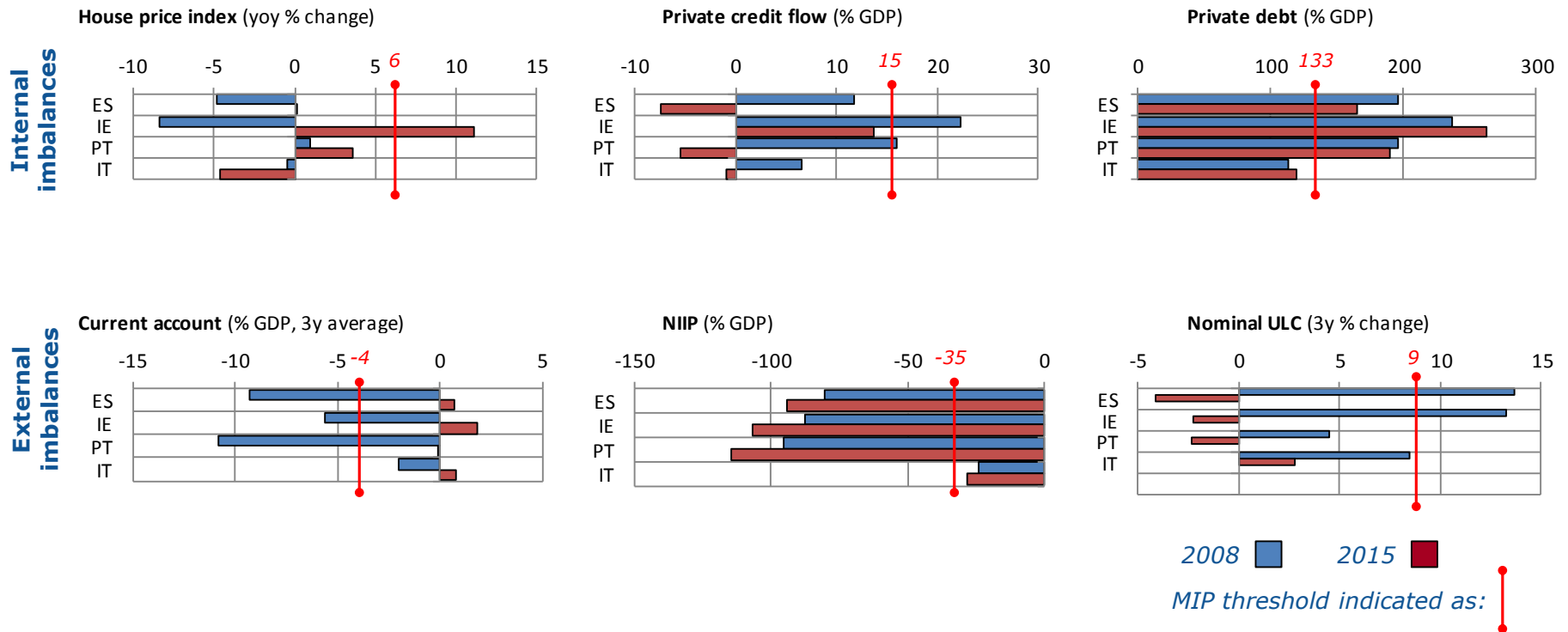


Note: Right side: Black lines show the 2-year- (dotted line) and 5-year- (straight line) ahead inflation expectations according to the ECB Survey of Professional Forecasters (SPF).

Source: European Commission spring 2016 forecast.

Imbalances in vulnerable countries: unwinding but still a long way to go

Selected MIP scoreboard indicators 2008 versus 2015



Note: Data for private debt and private credit flow are only available until 2014.

Source: Eurostat.

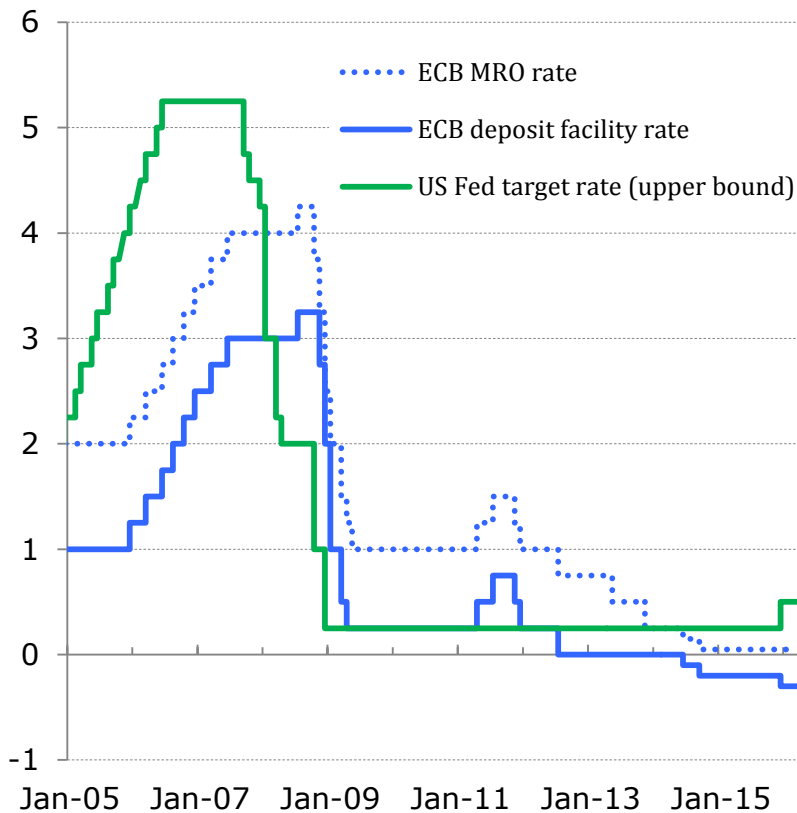
Adjustment capacity in vulnerable countries: slow, insufficient progress

		2008				2015			
		ES	IE	PT	IT	ES	IE	PT	IT
Financial	High bond spreads ¹	Red	Red	Red	Red	Green	Green	Yellow	Green
	High NPL ratios	Yellow	Red	Yellow	Red	Yellow	Red	Red	Red
Macro	External imbalances	Red	Red	Red	Red	Yellow	Yellow	Yellow	Yellow
	Internal imbalances	Yellow	Yellow	Red	Yellow	Red	Red	Red	Red
	Sluggish potential growth ²	Green	Green	Yellow	Yellow	Yellow	Green	Red	Red
Structural	Rigid labour markets	Red	Yellow	Red	Red	Red	Yellow	Red	Red
	Rigid product markets	Red	Yellow	Red	Red	Red	Yellow	Red	Red
Fiscal	Sizeable budget deficits	Red	Red	Red	Red	Red	Yellow	Red	Yellow
	High public debt-to-GDP ratios	Green	Green	Red	Red	Red	Red	Red	Red

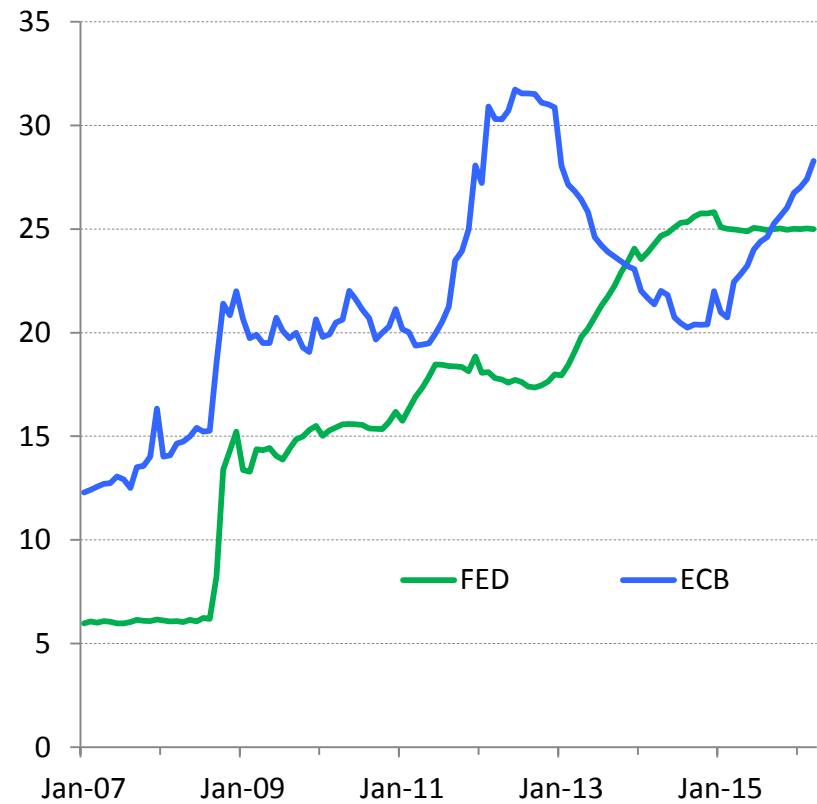
Note: Green / orange / red stand for a low / medium / high degree of vulnerability. Comparisons made between 2015 and 2008 indicators except for: ¹ 2009-2011 period; ² longer-term average for the pre- (1999-2008) and post-crisis (2009-15) period to take into account for the longer-term nature of potential growth.

Limited leeway towards a more accomodative monetary policy

Policy rates set by the ECB and US Fed
(in %)



ECB and Fed balance sheet expansion
(in % of annual nominal GDP)

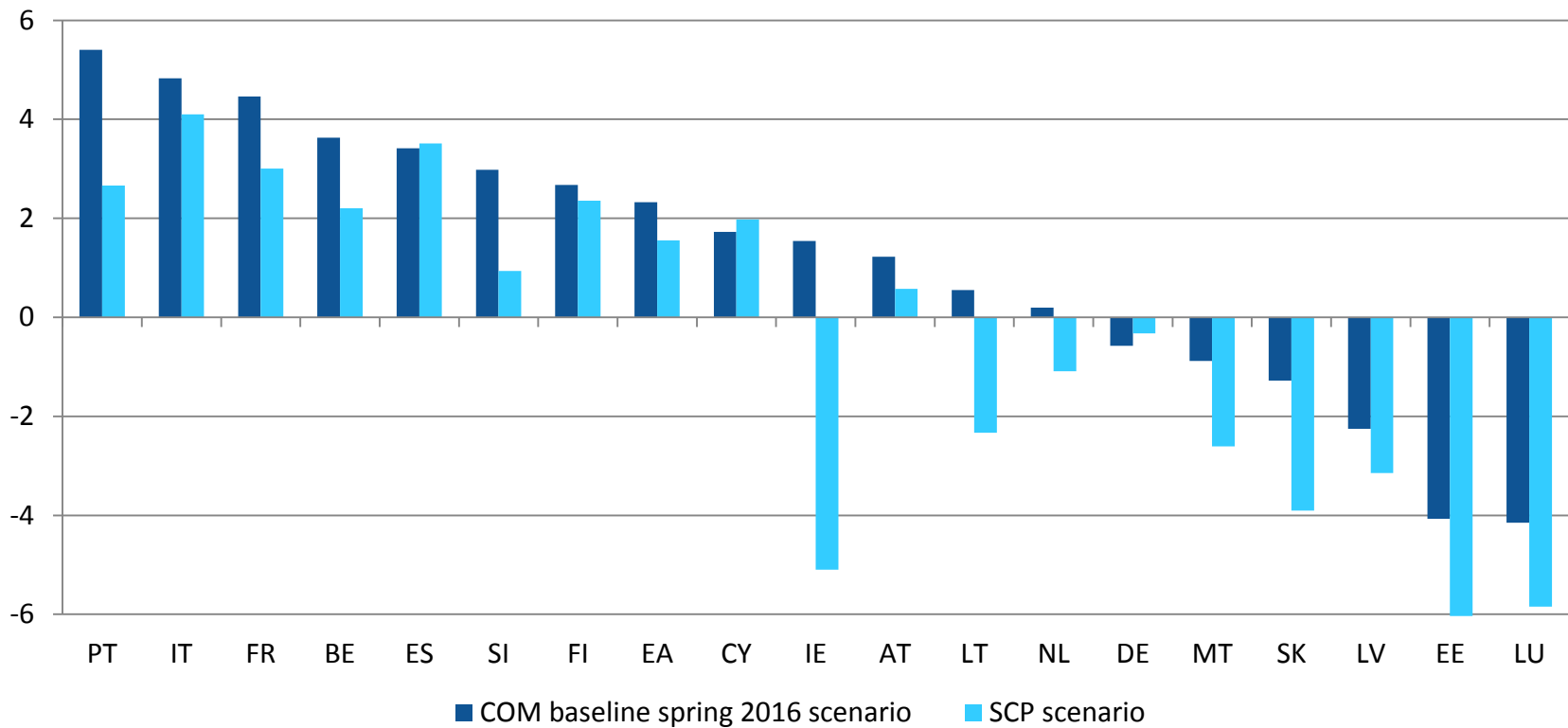


Source: Left side: IHS, last observation 15 March 2016; right side: Datastream, last observation 31 March 2016.

Limited fiscal buffers

S1 indicator

Fiscal adjustment required (in % of GDP) to reach a 60% public debt-to-GDP ratio by 2030



Source: Commission services. 2016 Stability and Convergence Programmes (SCP).

Weak resilience to economic shocks

Financial sector	• Leverage and risk taking	Red
	• Liquidity and currency mismatches	Orange
	• Interconnectedness and common exposures	Orange
Non-financial sector	• Excessive household debt	Red
	• Excessive corporate debt	Red
Asset markets	• Housing booms	Orange
	• Stock market booms	Orange
Structural	• Labour market flexibility	Red
	• Product market flexibility	Red
Institutional	• Efficient administration	Orange
	• Government effectiveness	Orange
Political	• Stable governments	Orange
	• Degree of fractionalisation in parliaments	Red

Note: This assessment only serves for indicative purposes. Green / orange / red stands for a low / medium / high degree of vulnerability.
Source: Inspired by: Röhn et al. (2015): Economic resilience: A new set of vulnerability indicators for OECD countries, OECD Economics Department Working Papers, No.1249.

Substantial changes in the EA governance framework

Fiscal	<i>Stronger preventive arm SGP</i>	<ul style="list-style-type: none"> • Introduction of an expenditure rule (6-P) and balanced budget rule (TSCG) • Possibility of imposing sanctions (6-P) • Surveillance of draft budgetary plans by Commission (2-P)
	<i>Stronger corrective arm SGP</i>	<ul style="list-style-type: none"> • Introduction of a numerical debt benchmark (6-P) • Earlier and more gradual sanctions (6-P) • More automaticity in decision-making via new voting scheme (TSCG) • Enhanced surveillance for MS threatened with financial difficulties (2-P)
	<i>National fiscal frameworks</i>	<ul style="list-style-type: none"> • Mandatory minimum requirements at the national level (accounting & statistics, forecasts, fiscal rules monitored by independent bodies, transparency)
Macro	<i>MIP</i>	<ul style="list-style-type: none"> • Prevention and correction of macroeconomic imbalances via the introduction of the Macroeconomic Imbalance Procedure (MIP) (6-P)
Crisis resolution mechanism	<i>ESM, ECB OMT</i>	<ul style="list-style-type: none"> • European Stability Mechanism (ESM) • OMT programme by the European Central Bank (ECB)
Financial	<i>Eur. System of Financial Supervision</i>	<ul style="list-style-type: none"> • Macro-prudential: European Systemic Risk Board (ESRB) • Micro-prudential: European Supervisory Authorities (ESAs) with EBA (for banks), ESMA (securities), EIOPA (insurance), national authorities etc.
	<i>Banking Union</i>	<ul style="list-style-type: none"> • Single Supervisory Mechanism (SSM) • Single Resolution Board (ERB) and Single Resolution Fund (SRB) • Under construction: Common deposit insurance scheme

Note: Key reforms steps taken in the area of fiscal and macroeconomic policies are shown in italics in brackets, namely 6-Pack (6-P), Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), 2-Pack (2-P).

Minimum governance requirements for a viable EMU

		Included in 5PR?	Possible w/o Treaty change?	Political support?
Monetary	<ul style="list-style-type: none"> • ECB as a lender of last resort 	Red	Red	Red
Banking	<ul style="list-style-type: none"> • Establish a common European Deposit Insurance Scheme 	Green	Green	Yellow
	<ul style="list-style-type: none"> • Implement a common backstop to the SRF 	Green	Green	Yellow
	<ul style="list-style-type: none"> • Improve the effectiveness of direct bank recapitalisation in the ESM 	Green	Green	Yellow
	<ul style="list-style-type: none"> • Create a European safe asset 	Red	Green	Red
Fiscal	<ul style="list-style-type: none"> • Restore a credible no bail-out clause 	Red	Green	Yellow
	<ul style="list-style-type: none"> • Create a centralised fiscal capacity 	Green	Yellow	Red
	<ul style="list-style-type: none"> • Establish a sovereign debt restructuring mechanism 	Red	Red	Red
	<ul style="list-style-type: none"> • Establish a debt redemption fund 	Red	Red	Red
Economic	<ul style="list-style-type: none"> • Foster convergence towards similarly resilient economic structure 	Green	Yellow	Yellow

Note: This assessment only serves for indicative purposes. Inspired by Baldwin and Giavazzi (2016): How to fix the Eurozone: Views of leading economists, 12 February 2016, VoxEU.