Options for restoring growth in Europe

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Outline

- The road to recovery
- Unresolved imbalances
- Growth and reforms
- Institutional design and governance
- Where do we go from here

Key points

- The outlook for the Euro area has improved, but growth remains problematic in crisis countries
- Structural reforms “to live with the euro and within the euro” remains critical
- Rebalancing the Euro area is not only a matter of domestic policies (and politics), but of policy coordination across EMU
- ‘Full EMU is the only way for the single currency to be sustained and successful
- But governance is essential to manage the current phase

The road to recovery

- The outlook for the Euro area has finally improved
- The recovery, however, appears fragile
- 2013 is likely to be another year of negative growth for the Euro area
- Italy and Spain continue to be in recession
- Growth returns in 2014, but will be modest

GDP growth* - Germany, France, Italy, Spain, Euro area and European Union

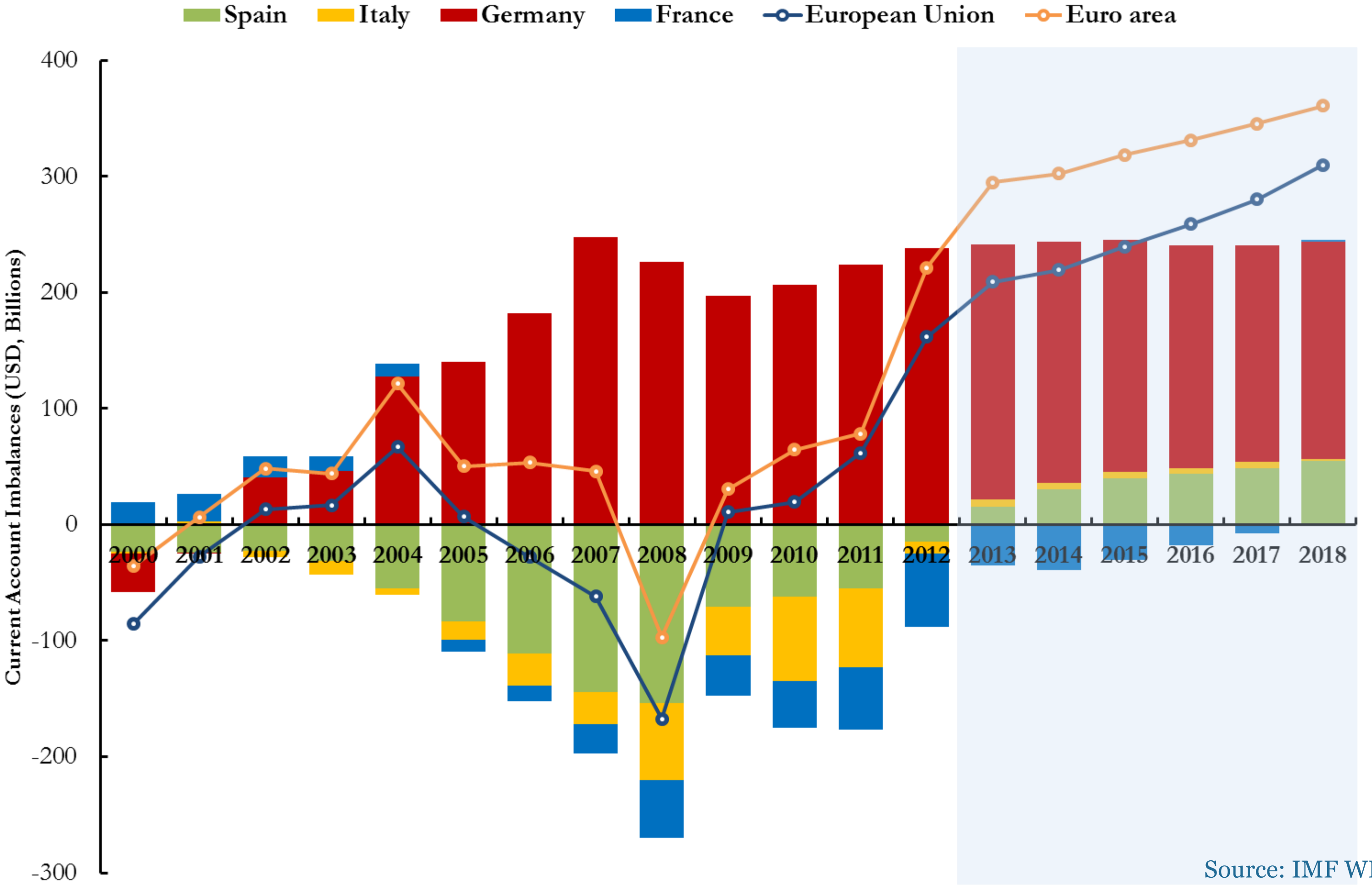
	2013	2014	2015	2016	2017	2018
Italy	-1.5	0.5	1.2	1.4	1.4	1.2
Spain	-1.6	0.7	1.4	1.5	1.5	1.6
France	-0.1	0.9	1.5	1.7	1.8	1.9
Germany	0.6	1.5	1.3	1.3	1.3	1.2
Eurozone	-0.3	1.1	1.4	1.6	1.6	1.6
European Union	0.0	1.3	1.7	1.8	1.9	2.0

Source: IMF * 2013 - 18: forecasts

Unresolved imbalances

- The recession has improved the current account outlook
- The competitiveness gap has narrowed, but not enough
- Labour productivity remains an issue for Italy and Spain
- Italy and Spain continue to be in recession
- Sticky wages prevent adjustment in the labour market

Current account imbalances for the four countries, EA and EU



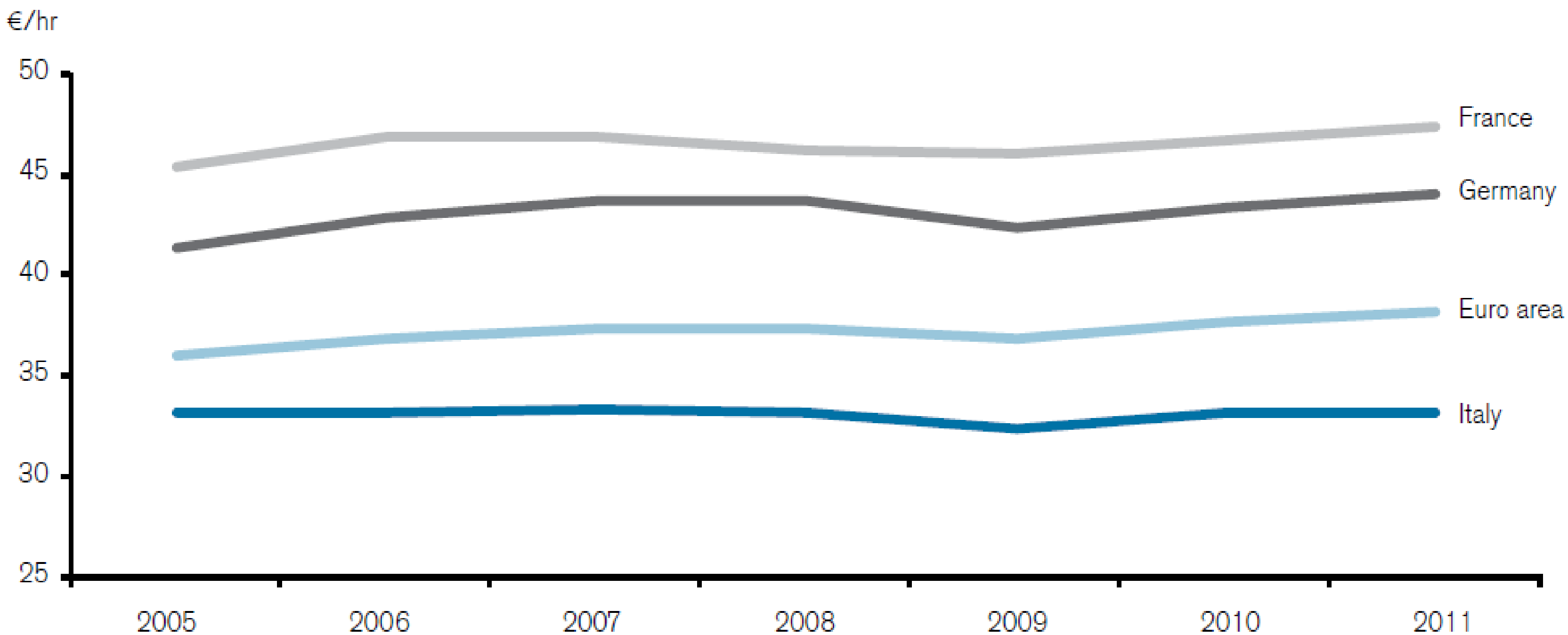
Source: IMF WEO, 2013

Percentage change since peak (mid-2008) in unit labour costs to Q1 2013

	Unit labour costs	Labour Compensation per Employee	Labour Productivity	Employment	Real GDP
Ireland	-16.4	-8.8	9.1	-11.1	-3.0
Greece	-15.3	-13.2	-2.8	-18.9	-16.8
Spain	-8.1	0.7	9.5	-11.1	-2.6
Portugal	-5.5	2.4	8.3	-12.0	-4.7
Cyprus	-1.4	0.6	2.1	-6.8	-4.9
Italy	4.3	5.4	1.0	-2.7	-1.8

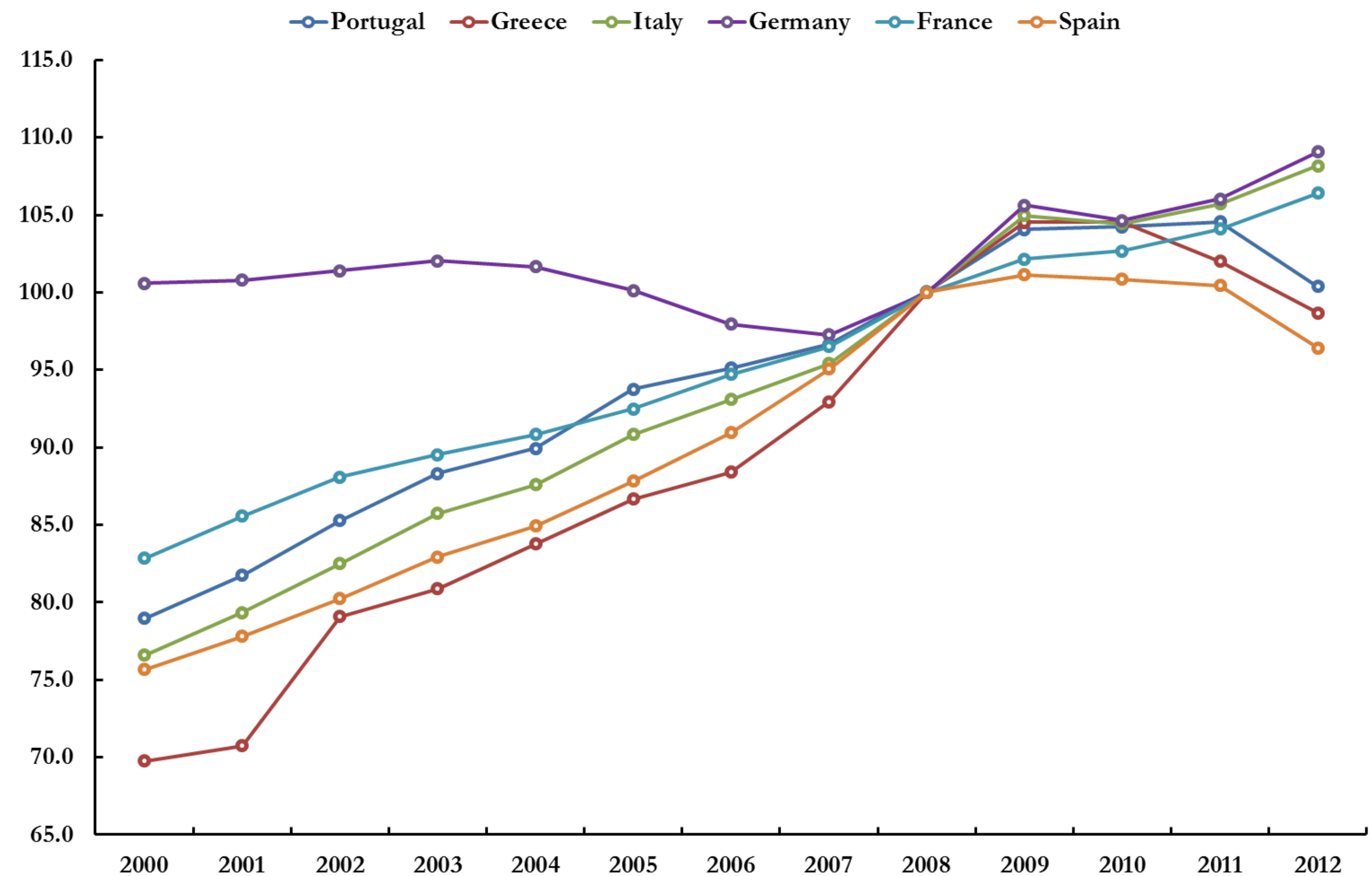
Source: Moody's, 2013

Real labour productivity per hour worked, 2005-11



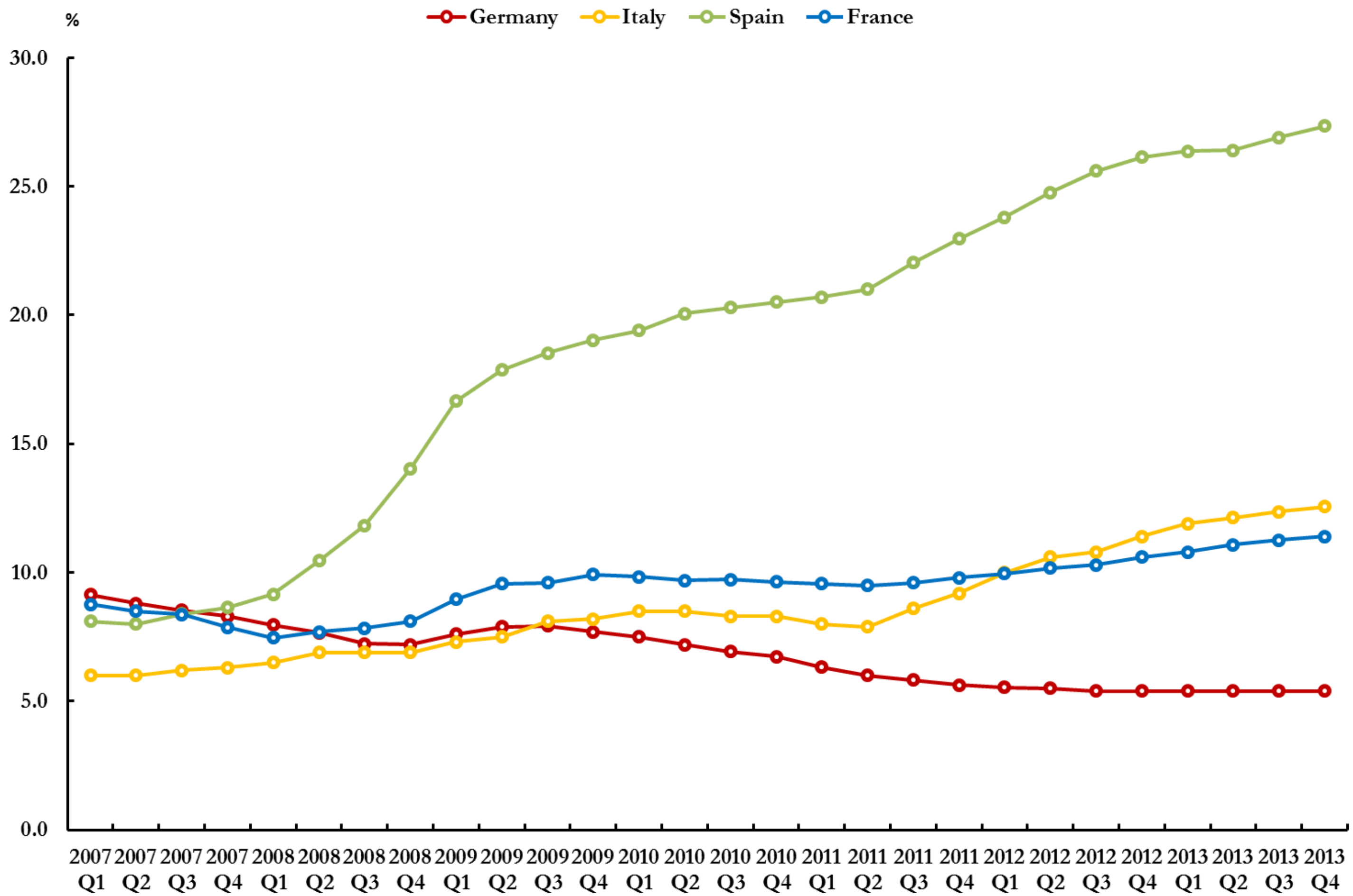
Source: Subacchi and Tentori (2013)

Nominal Unit Wages of whole economy (Index, 2008 = 100)



Source: Oxford Economics, 2013

Unemployment Rate - Selected Euro area countries

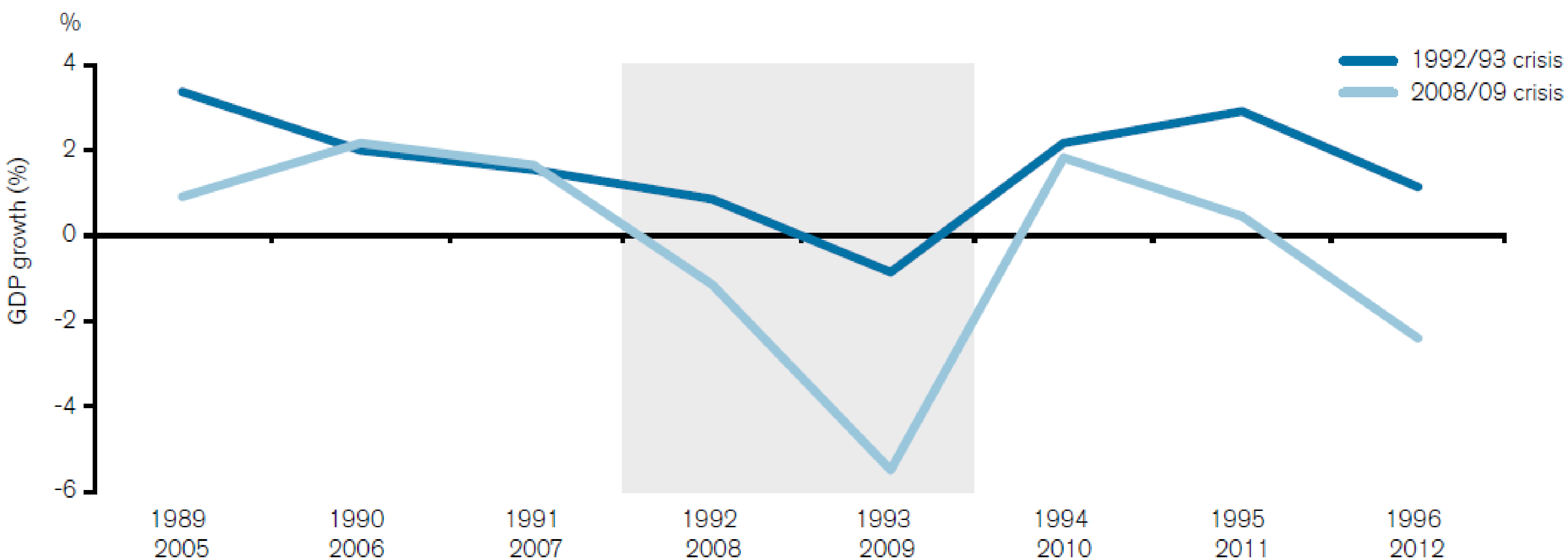


Source: Oxford Economics, 2013

Focus on Italy

- Long-standing problems and problematic fiscal position pre-date EMU
- Years of inappropriate policies constraint have reduced fiscal space and flexibility
- It is therefore more difficult to respond to crises
- High unemployment and duality in the labour market
- Crisis of manufacturing

Italy's GDP growth performance during the economic crises of 1992-93 and 2008-09 (%)

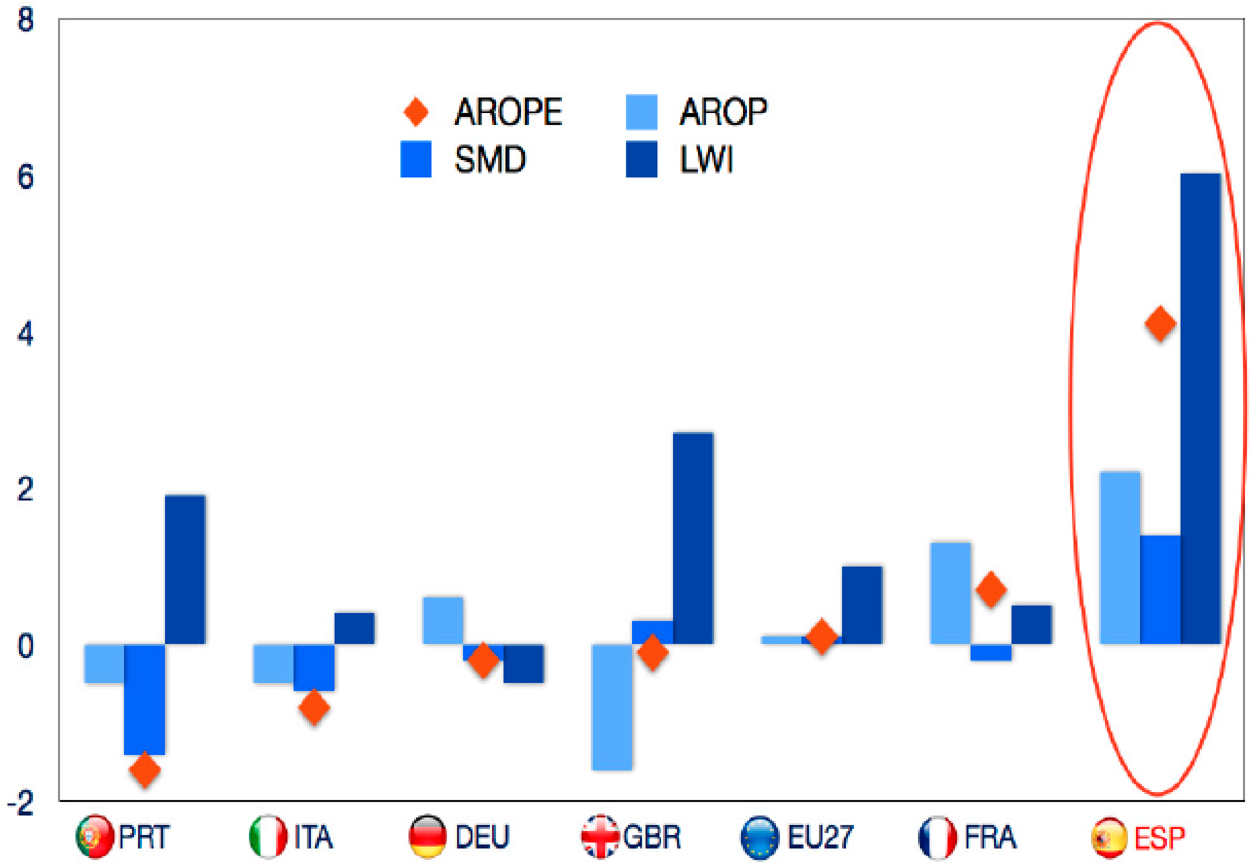


Source: Subacchi and Tentori (2013)

The social impact of the crisis

- Focus on Italy and Spain (but even more dramatic impact on Greece)
- High unemployment and drop in disposable income dent into consumer confidence
- Deleveraging and decline in savings
- Impact on investment and consumer demand
- Discontent and 'dysfunctional' politics

Risk of poverty and social exclusion and its components (percentage change between 2008 and 2011)

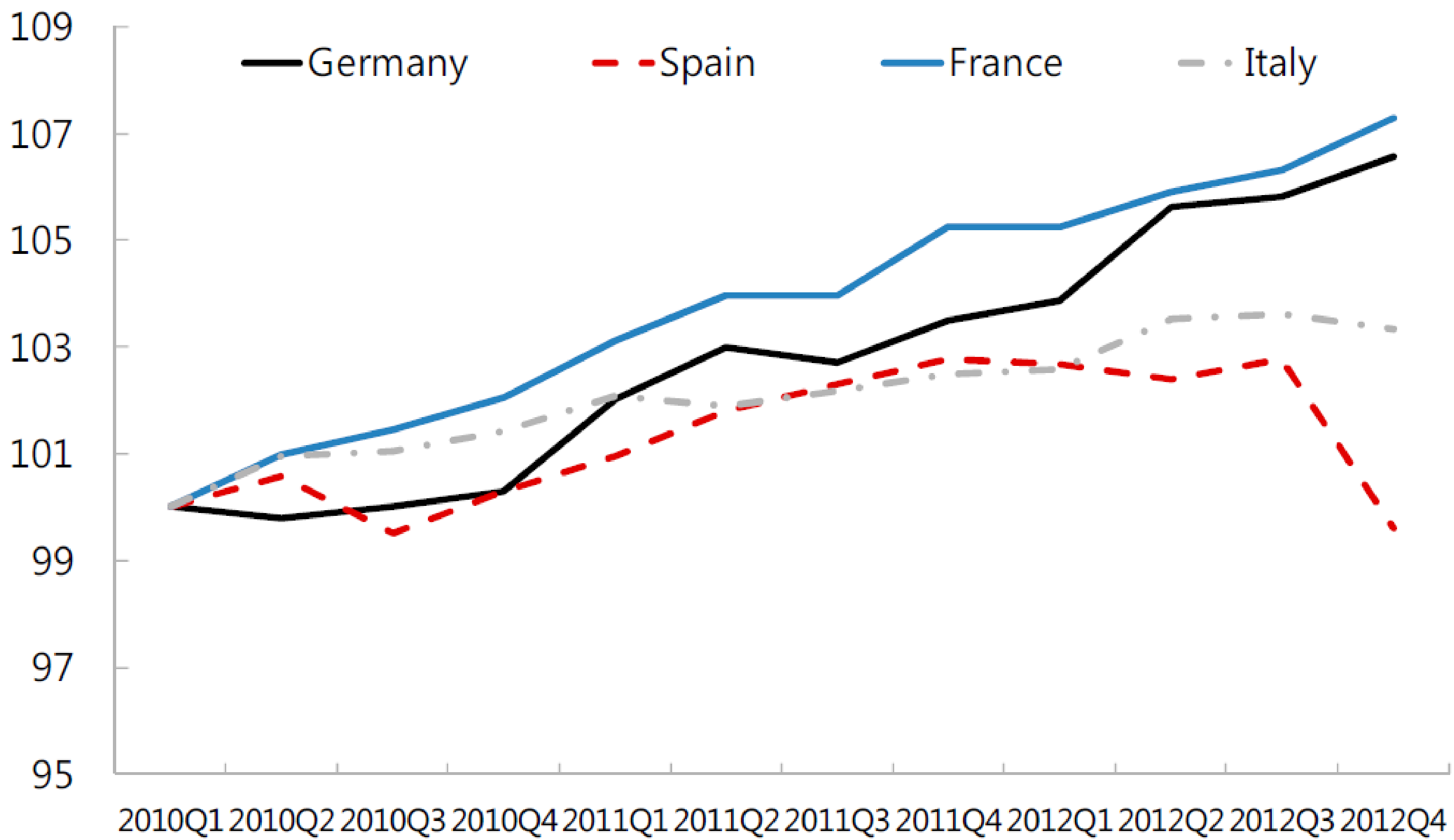


Source: IMF 2013
Note: AROP: at-risk-of poverty rate (60% of median income); SMD: severe material deprivation; LWI: people (0 – 59 not students) living in households with zero or very low work intensity; AROPE: at-risk of poverty or exclusion rate (union of all three indicators).

France as a pivot

- Output flatlined in 2012
- Recovery expected in 2013, but hampered by lack of flexibility
- Labour costs higher, and risen faster, than in Italy and Spain

Labour Cost per Hour - Selected Euro Area Countries
(Index, 2010Q1=100, total economy)

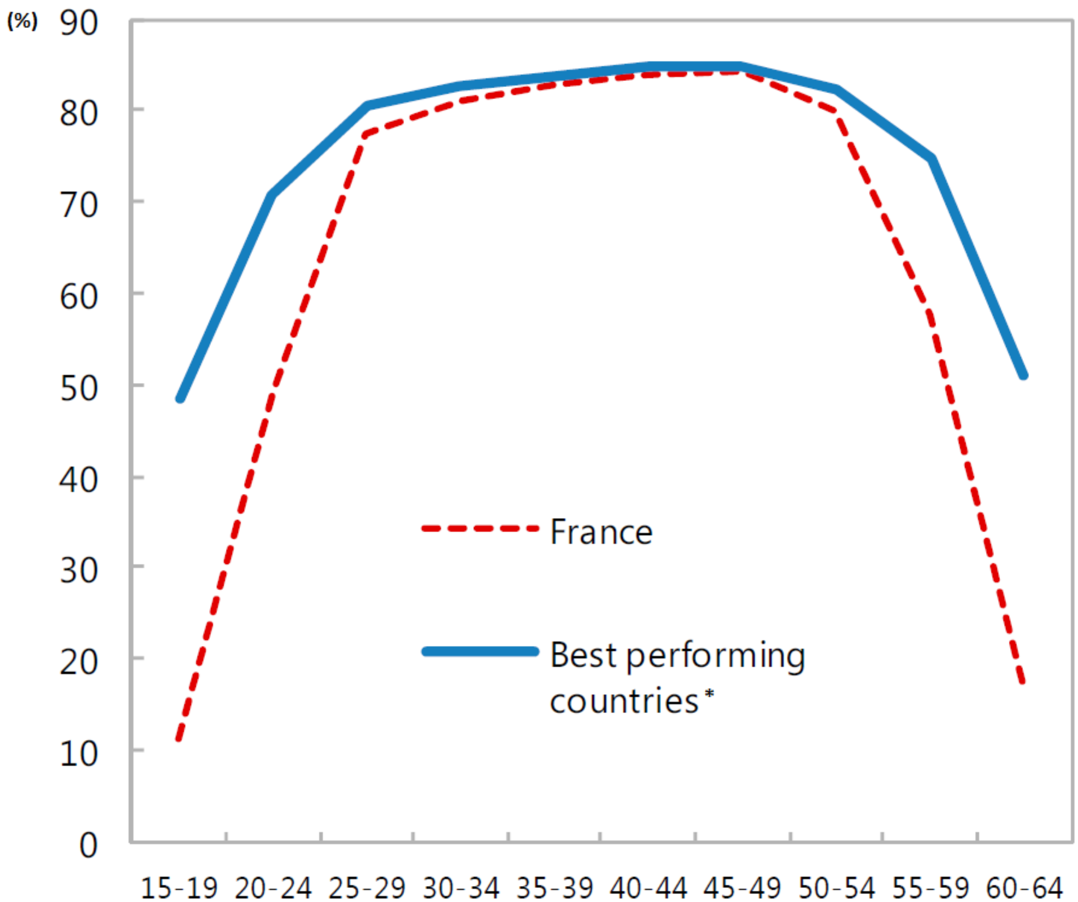


Source: IMF, 2013

France losing competitiveness

- Current account deficit widening
- Market share falling
- Employment rate for younger and older workers poor
- But some progress on structural reforms to the labour market

Employment Rates by Age Group
(Employment in percent of the population age group, average2005-2011)

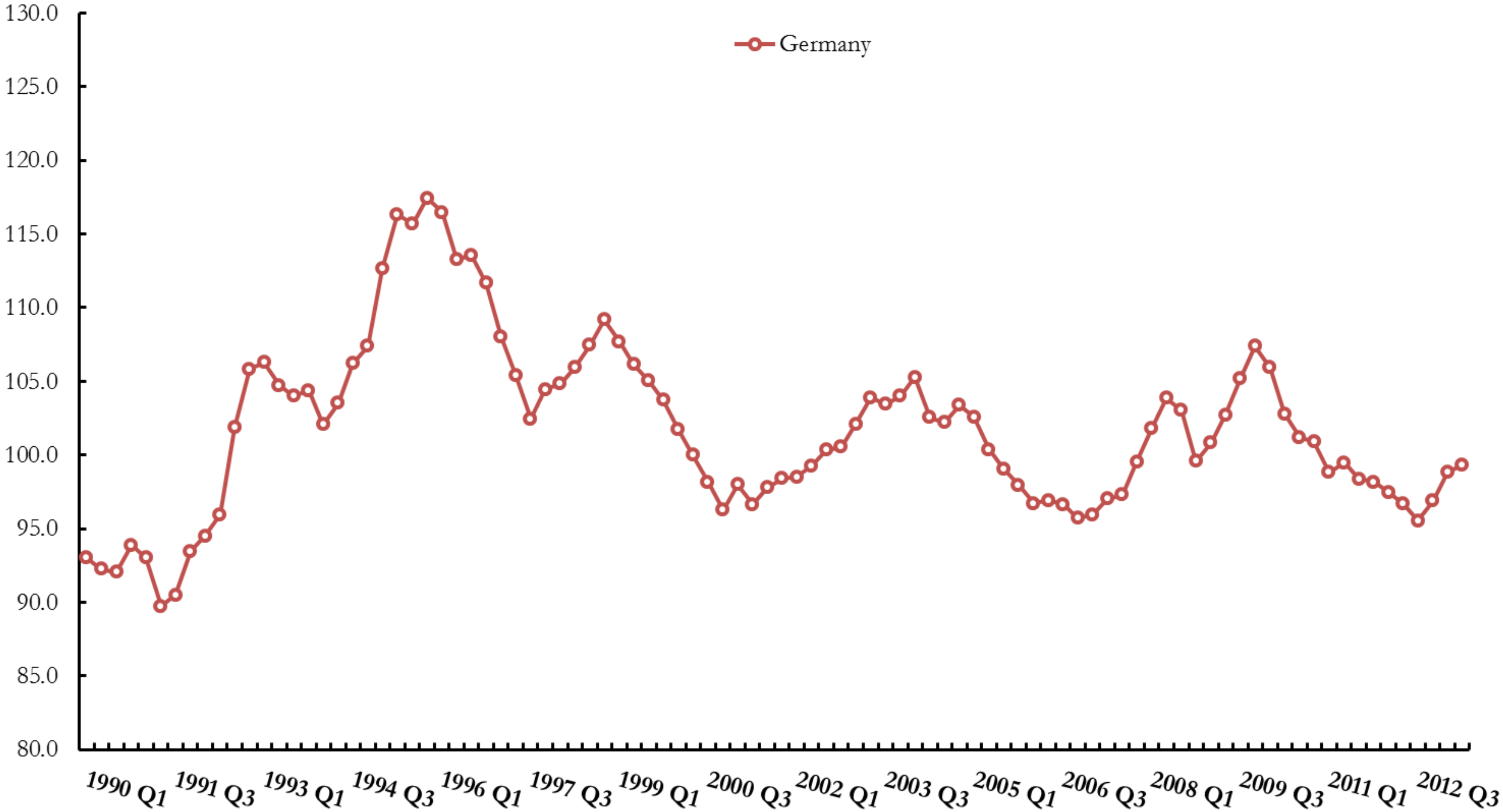


Source: IMF, 2013
Note: * Best performing countries include Australia, Canada, Denmark, Iceland, New Zealand, Norway, the Netherlands, Switzerland, and the UK.

Germany: from the sick man of Europe to the dynamo of growth

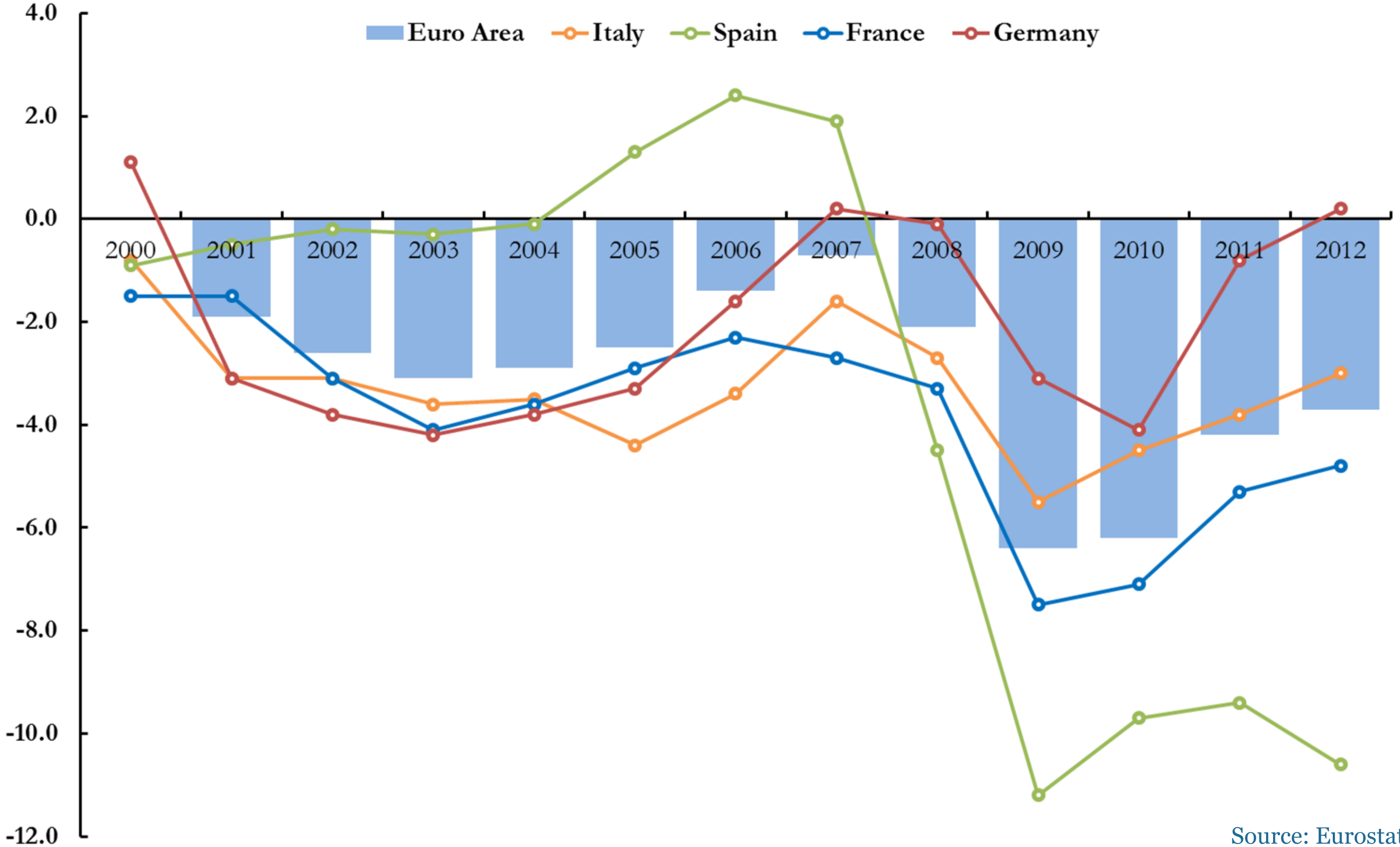
- Painful reforms in the 2000s put Germany in a strong competitive position
- Contracting out to the East reinforced this
- And the single currency avoided erosion of those gains
- Export-driven growth resulted in a current account surplus of 7% of GDP

Germany's REER based on relative unit labour cost
(Index, 2005=100)



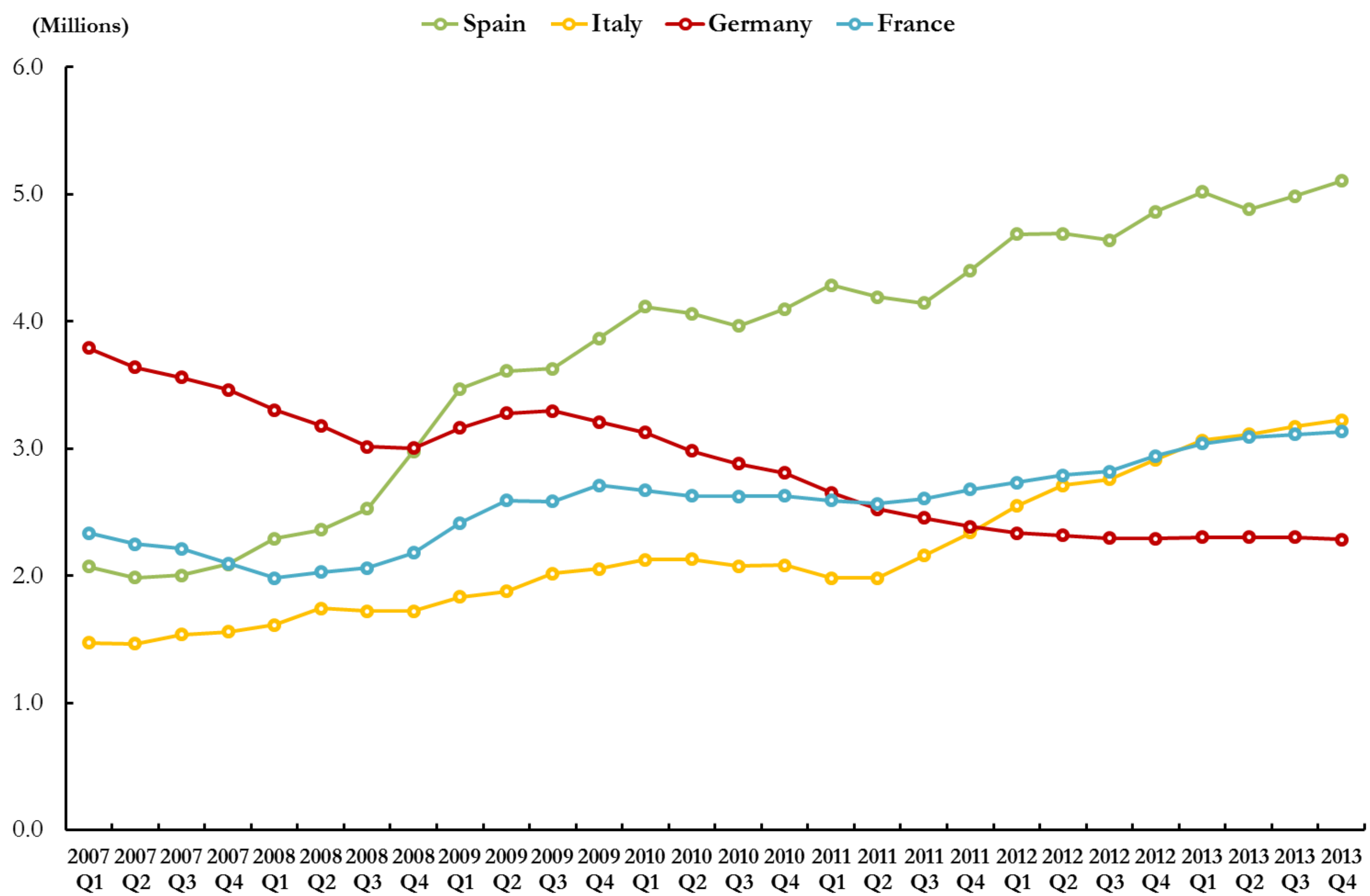
Source: IMF International Financial Statistics, 2013

Government Deficit/Surplus as % of GDP (actual)



Source: Eurostat

Unemployment - Selected Euro Area Countries



Source: Oxford Economics, 2013

Euro Area design issues

- Break-up of the euro seems unlikely
- But the euro also needs to work better to deliver sustainable growth
- Fiscal policy should be better coordinated across the area to avoid a deflationary bias
- Well-functioning monetary policy requires greater convergence across the area
- ‘Banking union’ will entail fiscal burden-sharing to resolve failing institutions
- Coordination of structural policies will remain largely a national matter, but the Commission may need stronger powers to limit negative spillovers

Conclusions

- Restoring growth is key to the stability of the euro
- Italy and Spain will continue to find the constraints of the single currency difficult
- Germany, as the largest member and the greatest beneficiary from the euro, faces a special responsibility
- France also needs changes to the euro to support the domestic policy changes it requires
- Without fundamental changes to the governance of the euro area, it is likely to face prolonged slow growth and periodic crises. ‘Full’ EMU is probably the only solution.

Thank you!