Increasingly Apart – the Euro area and the UK

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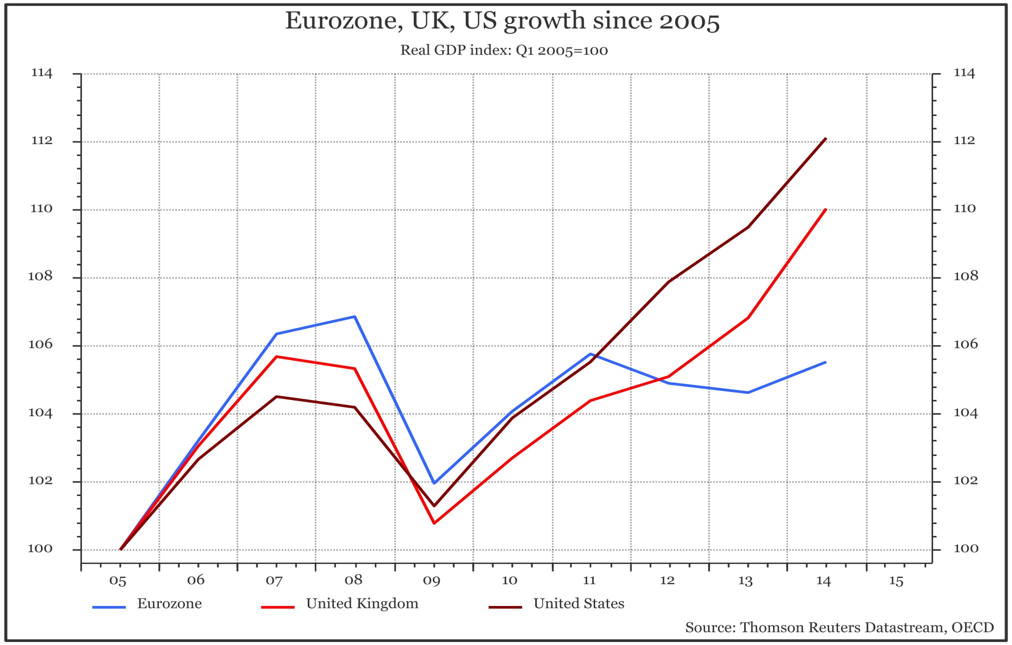
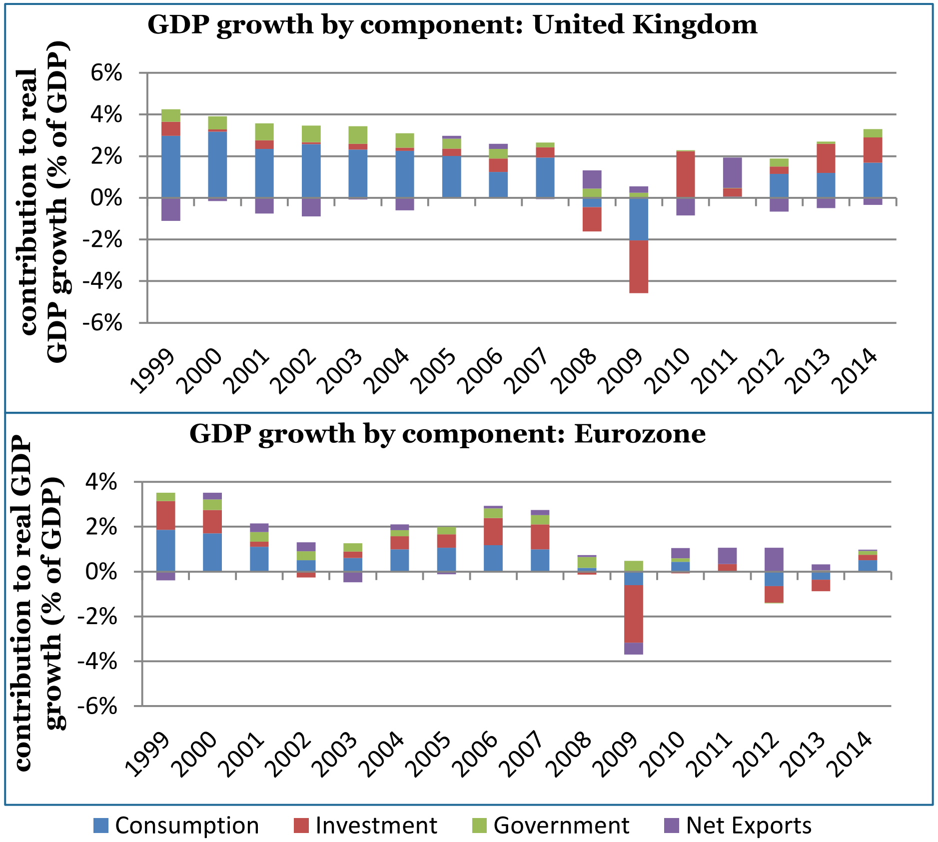
Overview: A tale of two economies

- The UK economy has bounced and continues to grow back while the Eurozone is stagnant (see below)
- The UK is expected to grow at 2.5% in 2015, compared to 1.5% for the Eurozone
- This divergence cannot be explained by monetary policy alone



GDP components – Consumption driven UK vs. Investment driven Eurozone

- The UK economy is more driven by consumption, while the EU was historically more driven by investment (see right).
- Consumption has bounced back somewhat in the UK, but not in the Eurozone
- Investment growth has also been at high levels in the UK, while shrinking in the Eurozone
- Eurozone growth has been driven by exports and government



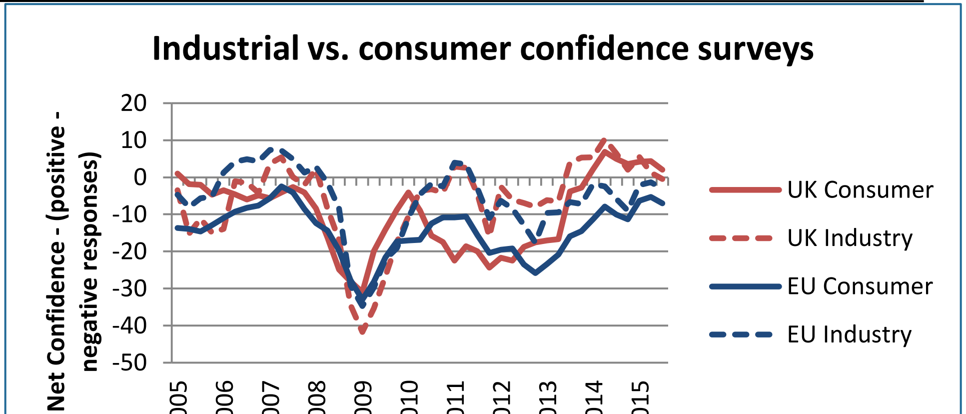
Source: OECD

Different levels of confidence

- Industrial confidence bounced back quickly, but Eurozone confidence was more negative after Eurozone crisis (see above right)
  - Eurozone industrial and consumer confidence has remained below UK levels since 2013

- UK consumer confidence started to rise in late 2013, causes could include
  - FTSE 100 reaching record highs
  - House prices reaching pre-crisis peaks
  - Consistently positive wage growth (see below right)
  - Unemployment rate starting to lower

- High confidence coming from macroeconomic indicators creates a virtuous cycle

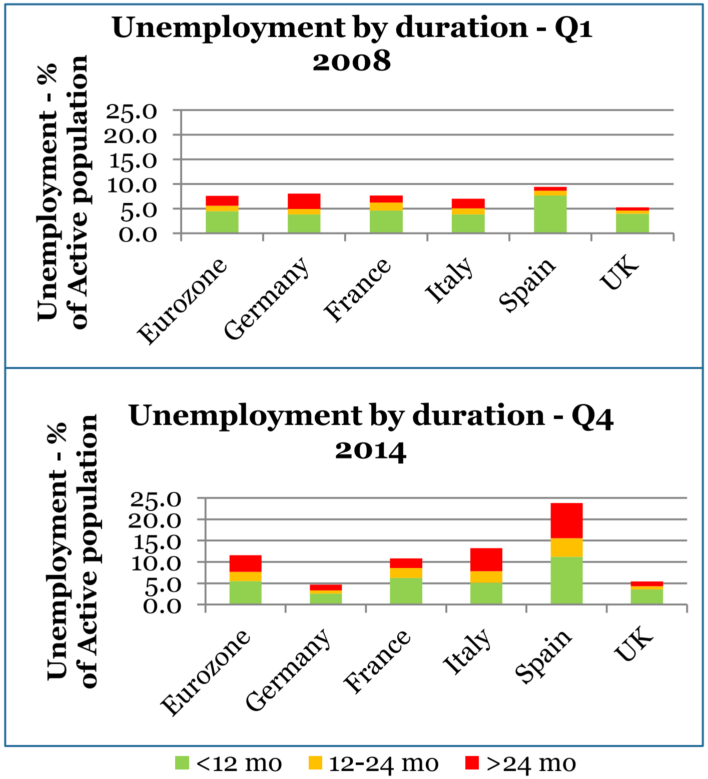


Source: DG ECOFIN

Source: Thomson Reuters Datastream, ONS

Labour markets – responsive or stagnant

- UK labour market has always been more robust than EU, lower unemployment and long-term unemployment rates (see right)
- Flexible labour markets make it easier for out-of-work individuals to return to employment after shocks
- High long-term unemployment in European countries may become permanent – lead to significant hysteresis
    - May be addressed with reform, but has a record of being politically unpopular, ex: Germany 2004
- However, UK labourers did not gain in productivity since 2008, while EU countries workers have become more productive (exception: Italy)



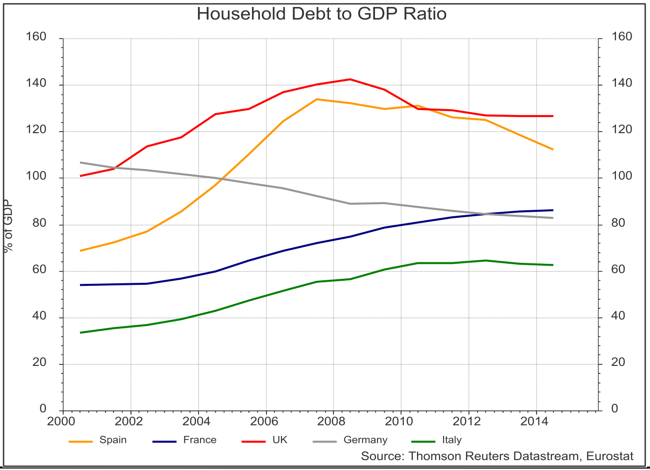
Source: Eurostat

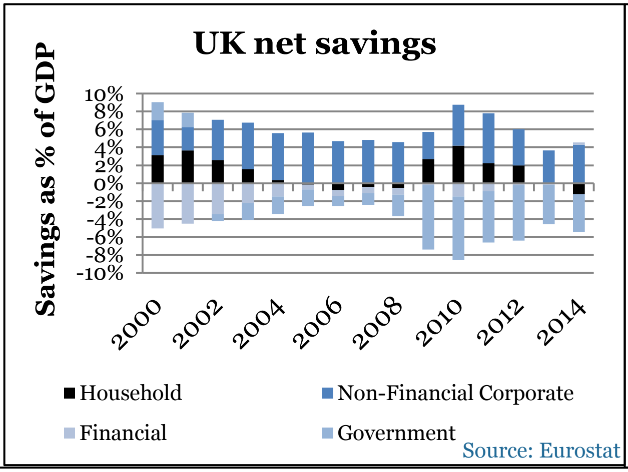
Deleveraging, but how much?

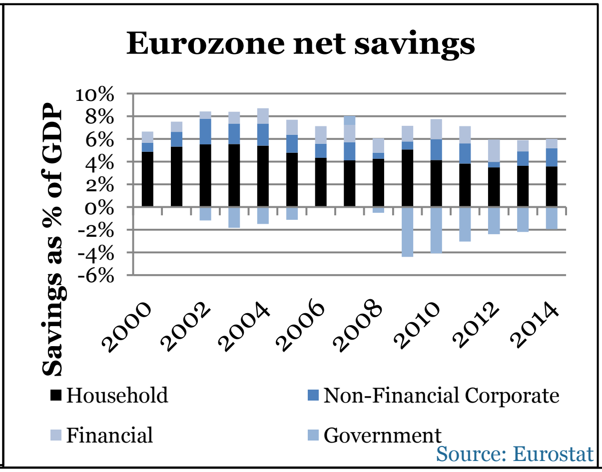
- UK had highest household debt-GDP ratio pre-crisis, at 140% and negative savings rate
  - Leveraging has diminished – HH debt/GDP has since fallen to 126%, but still highest in Europe (see below left)
  - HH savings were positive during the crisis, but have started to return to negative levels (see below centre)

- Policy initiatives such as macroprudential regulation may prevent the same level of overleveraging in the future

- EU had high savings before, have diminished as individuals and especially governments draw down savings (see below right) – has led to Government debt/GDP ratios of

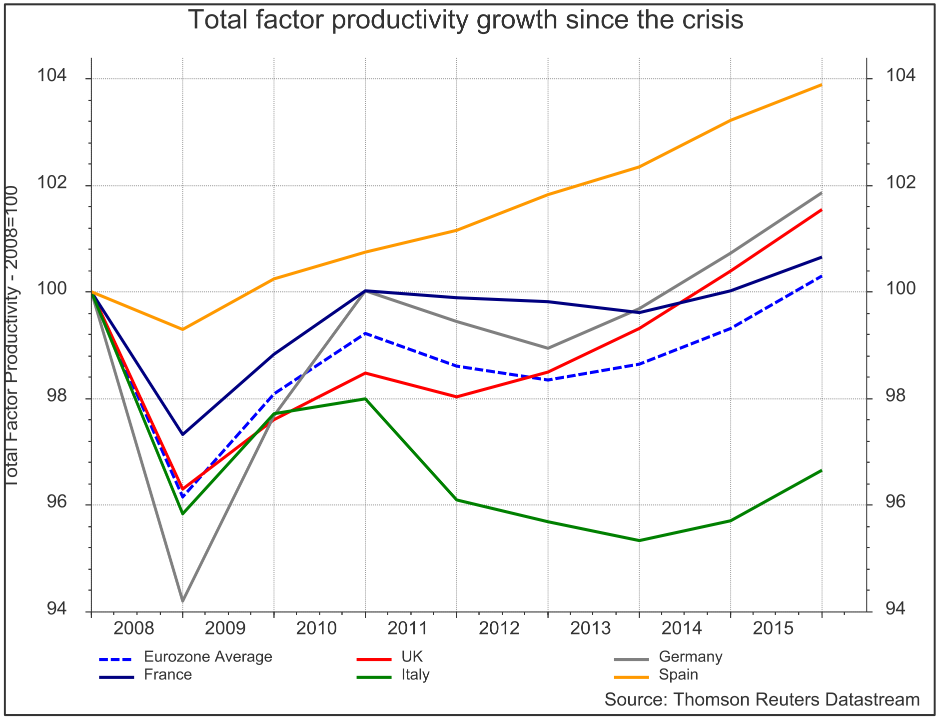






Cleavages within the Eurozone

- Within the Eurozone there is substantial divergence, some peripheral countries are recovering, some core countries are stagnating:
- Spain has rebounded from very poor macroeconomic position
- Germany continues slow steady growth, based on exports
- French employment, TFP, growth post-crisis is worse than during the crisis
- Italy continues to lag behind
- TFP growth shows this divergence (see right)

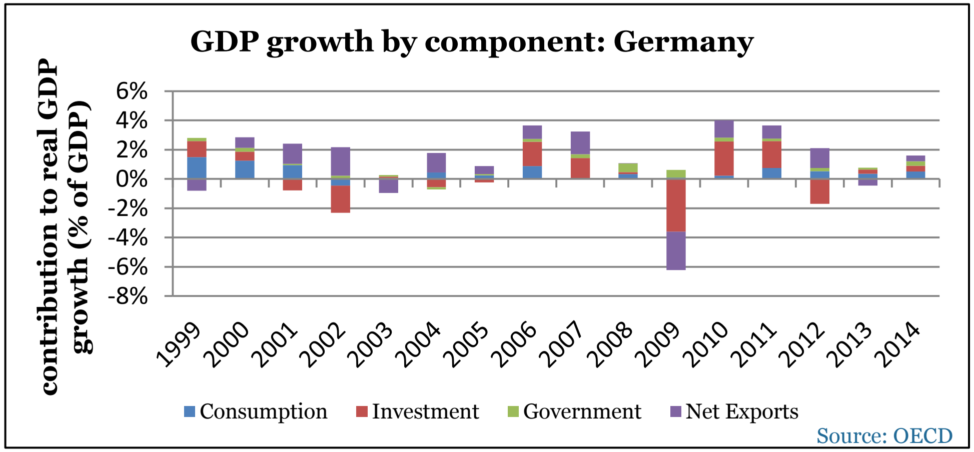


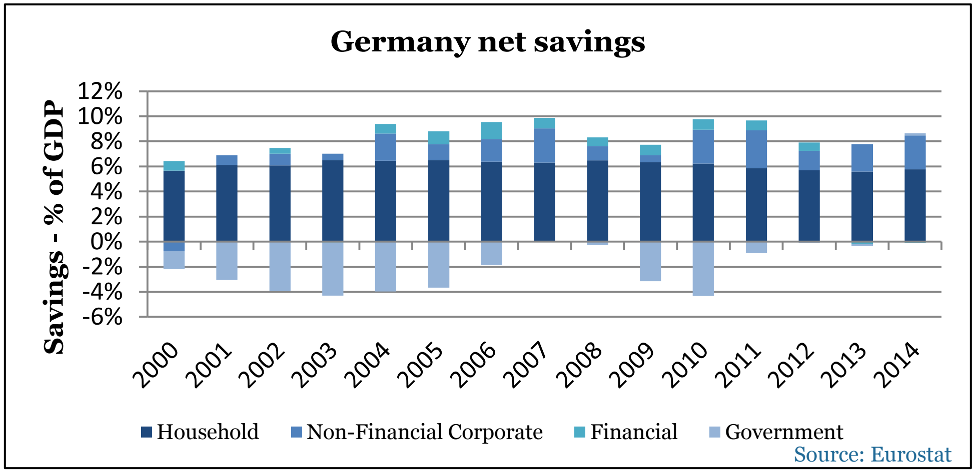
Germany - low consumption, high employment, export-driven growth

Germany has always had low consumption growth, overall GDP growth has been dependent on exports and capital formation (see above)

Investment has declined since the financial crisis, and has yet to fully rebound, currently at 97% of 2008 levels

Growth has allowed household, corporate savings to remain robust, and prevents government dissavings (see below)



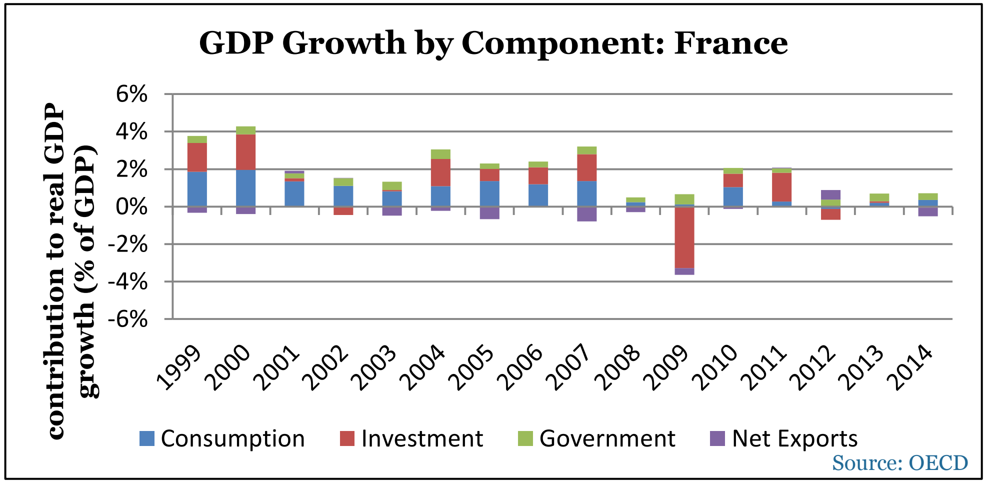


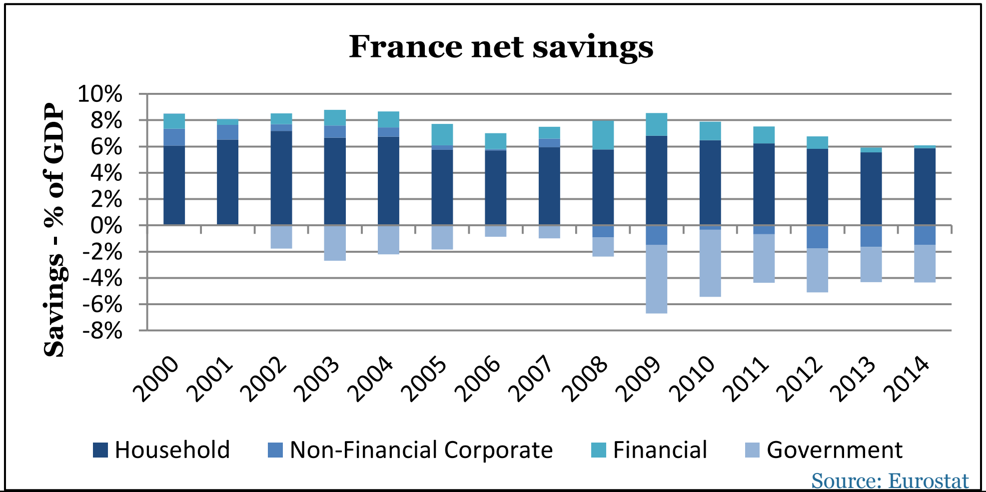
France - France – underperformance in employment and growth

- Consumption growth in France is almost stagnant (0.14% yoy average since 2012) stopped, but was not hit hard by crisis, so has fully rebounded (see above)

- Investment growth has also been stagnant (-0.18% yoy average since 2012)

- has led to government driving growth, leading to high government dissavings. Corporates have also become dissavers (see below)

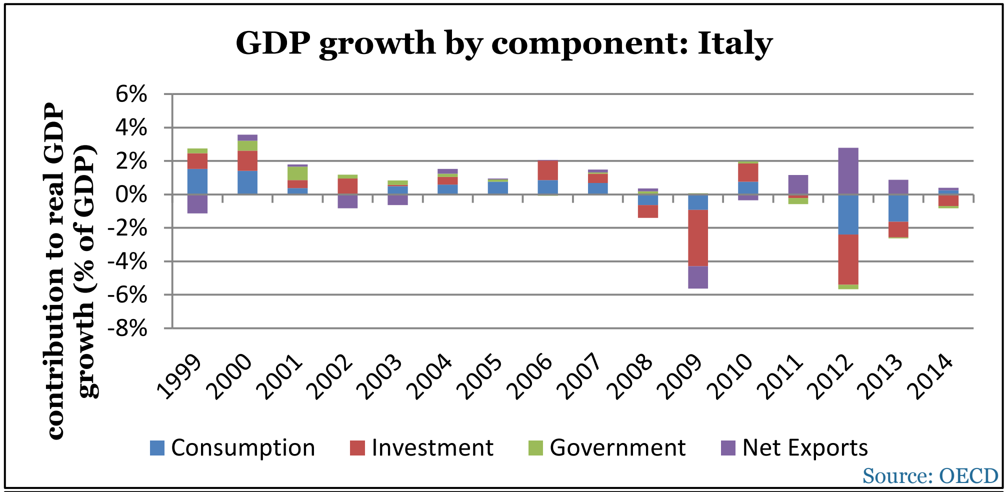


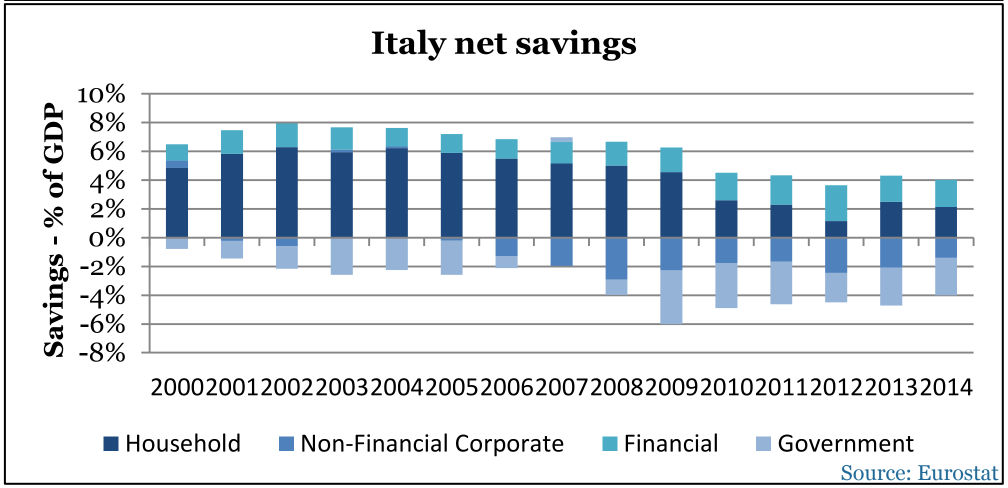


Italy - high structural barriers

- Italy has had low growth before the crisis, as well as high unemployment and inflexible labour markets, has led to significant falls in consumption in 2012 and 2013 (see above)

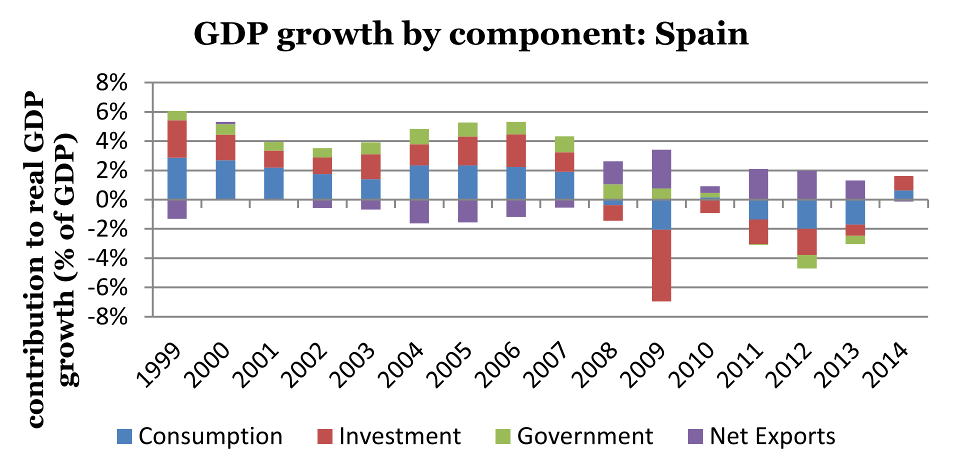
- Has led to household savings declining to roughly 2% per year from over 5% (see below)



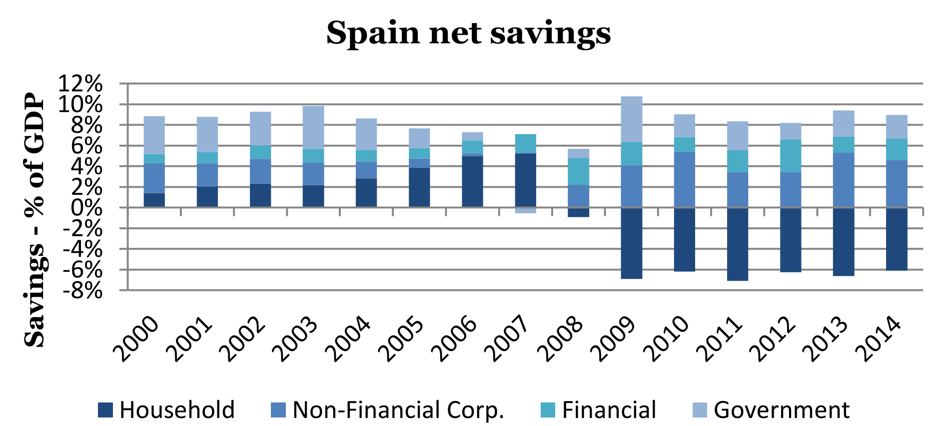


Spain - bouncing back, but permanently scarred?

- Spain grew quickly prior to the crisis through overleveraging, deleveraging has caused record high unemployment (26% high)
- Consumption has been strongly negative but rebounded in 2014.
- Savings for households have been negative to compensate for lack of employment, corporates and governments have saved



Source: OECD



Source: Eurostat

Conclusion

- UK's consumption driven growth model and flexible labour market have allowed it to bounce back from the crisis more quickly than the Eurozone
- Leveraging still remains a problem, although macroprudential regulation may address it
- EU countries have pursued a different growth model from the UK, which has 'stickier' labour markets
- Countries such as Germany and Spain which reformed those markets are growing faster
- Greatest drag on growth in the Eurozone is the lack of capital formation, rather than consumption