The euro crisis: an update

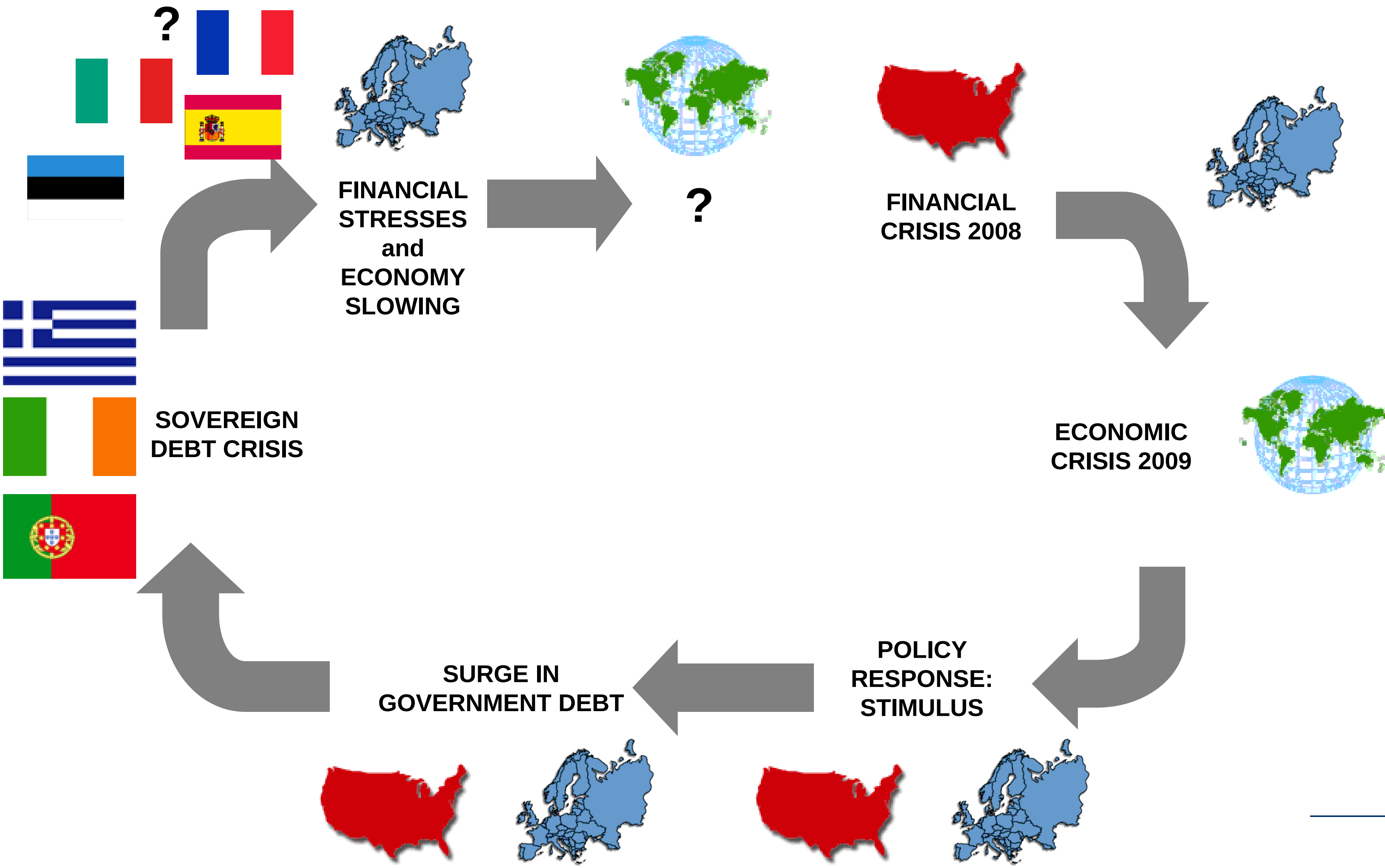
Euro Challenge 2013

Delegation of the European Union to the United States
www.euro-challenge.org

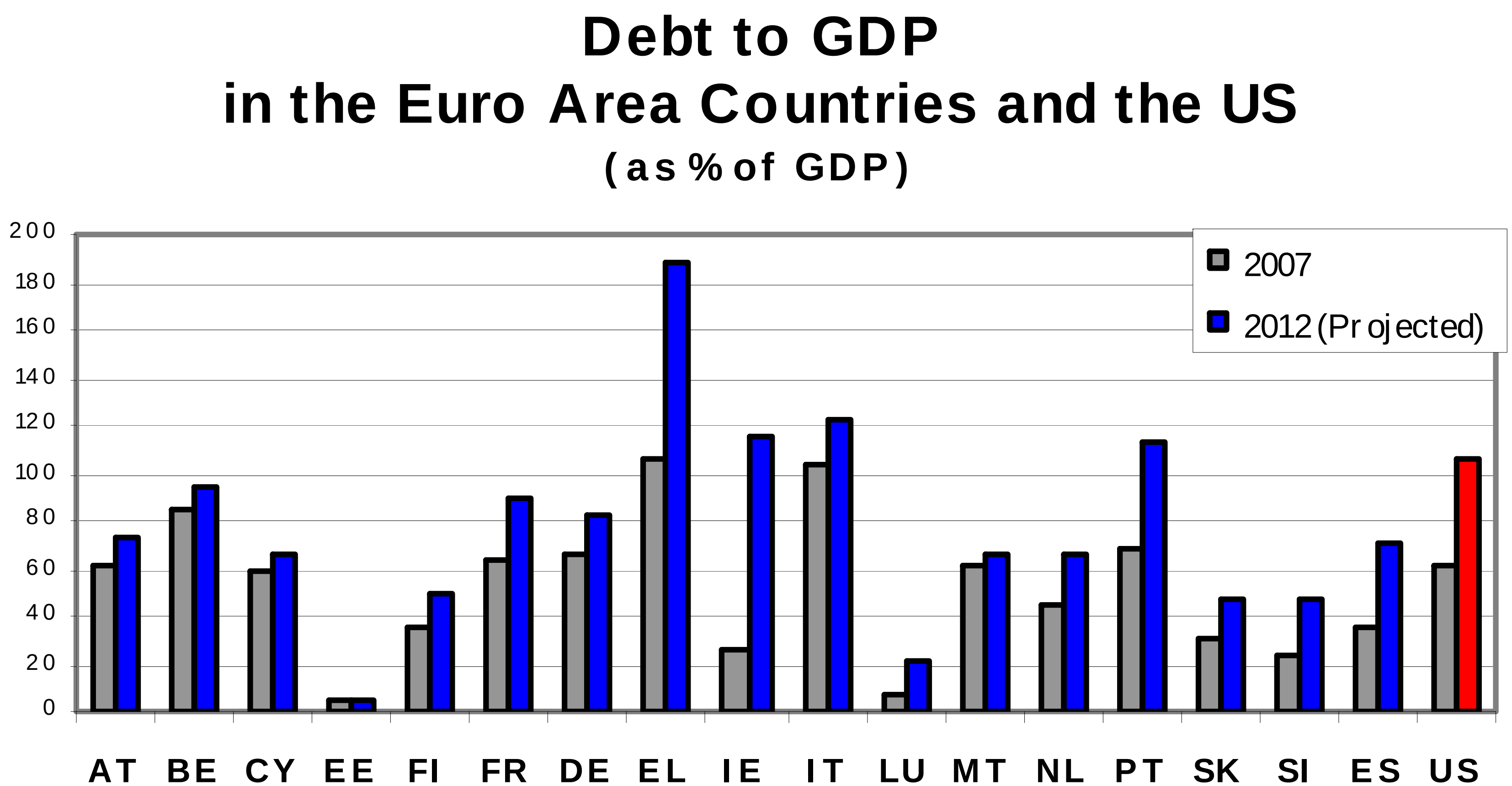
What this presentation will cover

- Background: origins of the crisis
- Update on the economic situation in the euro area
- “Rebalancing” the euro area economy
- Europe’s policy responses: “EMU 2.0”

The never-ending crisis?



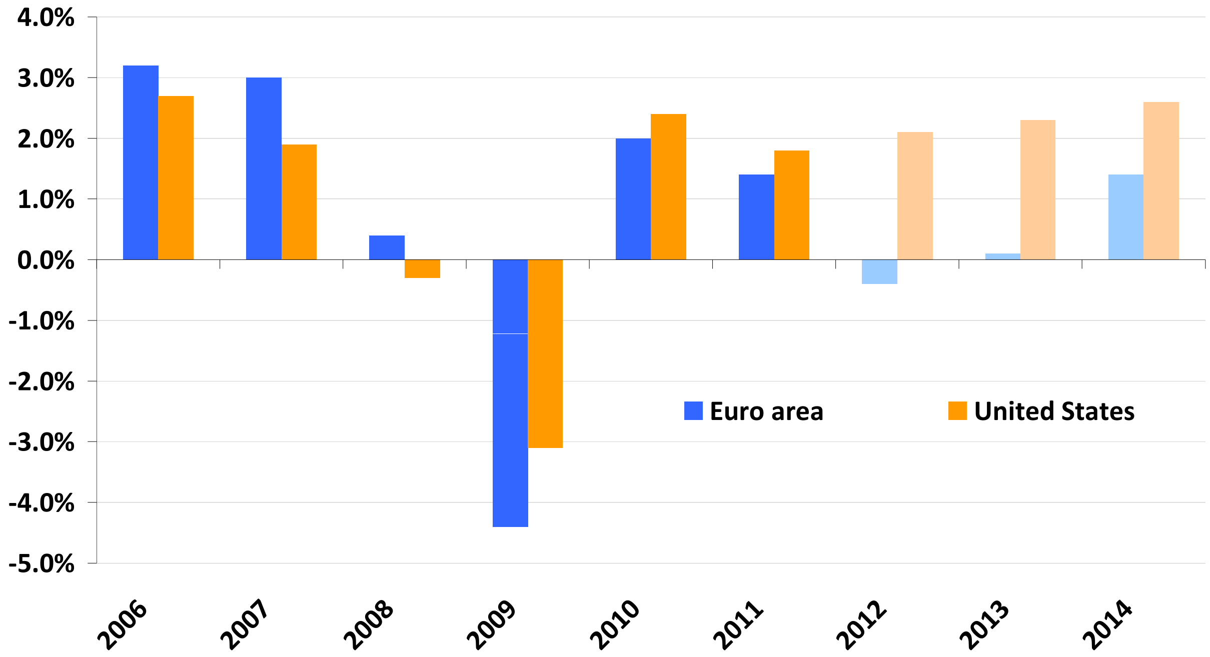
Government (sovereign) debt levels ballooned



Source: European Commission, Spring 2012

Mild recession in the euro area

Euro Area & US GDP with Forecasts



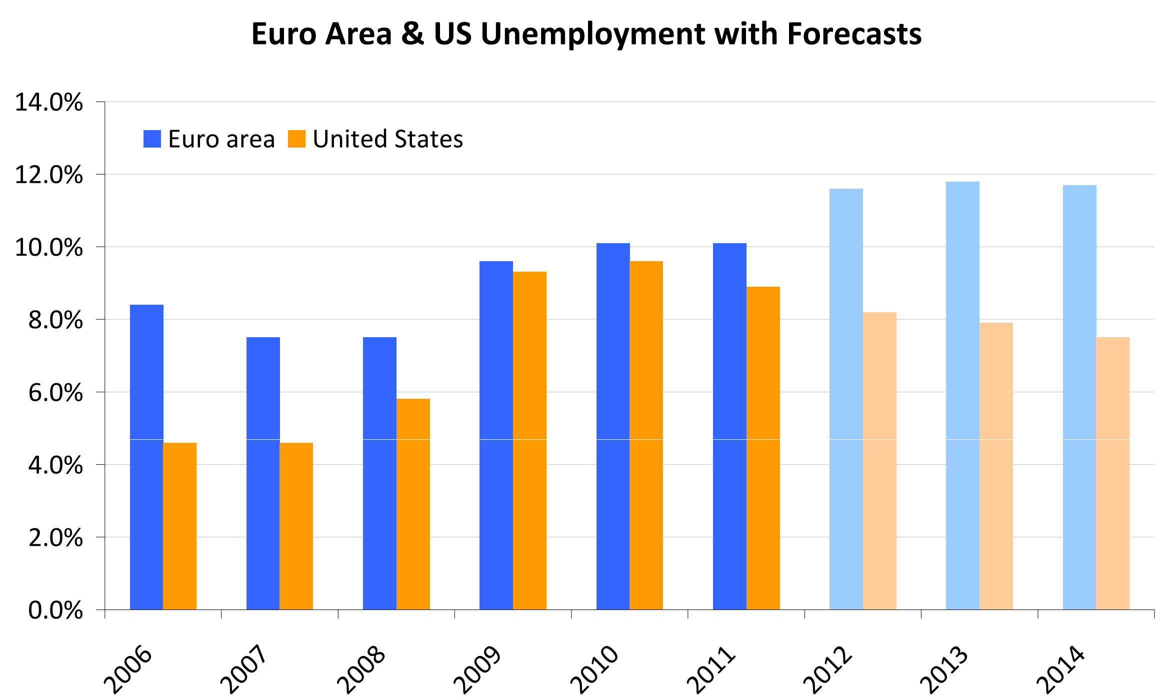
Source: European Economic Forecast - Autumn 2012

- The euro area economy is projected to experience a mild recession in 2012 and early 2013. Gradual recovery expected starting in 2nd half of 2013

- Several years of negative growth in countries hardest hit by the crisis (Greece, Portugal); but growth has slowed even in stronger countries like Germany and France

- A slowing global economy is not helping Europe overcome its crisis faster (and vice-versa).

Unemployment remains unacceptably high



Source: **European Economic Forecast - Autumn 2012**

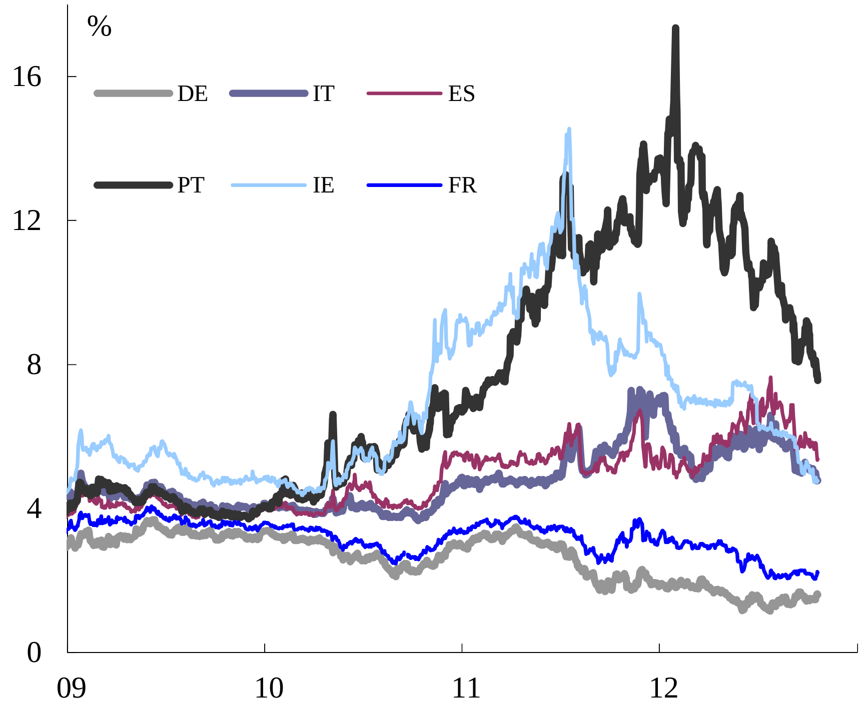
- **The unemployment rate is rising and currently stands at a high of 11.7% in the euro area**

- **There are huge differences between countries' unemployment rates, which range from a low of 4.3% in Austria to a high of 26.2% in Spain**

- **Meanwhile, inflation (2.2%) is above the ECB's preferred "close to but below 2%", but is expected to decline further due to slower growth and thus is not a threat**

Financial market tensions have eased…

Ten-year government-bond interest rates, selected euro-area Member States



- **Euro area countries have set up a permanent assistance fund and the European Central Bank has said it will buy bonds if necessary (like the US Fed is doing).**

- **These actions have brought down interest rates on government bonds of troubled euro area countries, further reducing the risk of default (not being able to pay back their debts)**

- **European stock markets have also stabilized.**

…but banks are not lending as they should

- An economy needs a functioning banking sector to support growth, through bank lending to consumers and businesses

- Banks have tightened their “credit standards” and are lending out less money. Less money in the economy means less economic growth.

- There was too much (private sector) borrowing before the crisis hit, but not enough now to support growth.

A process of “rebalancing” has started

“Periphery”

Countries that lived “beyond their means” need to reduce spending and raise revenues

Countries that lost competitiveness need to regain it, for instance by reducing costs so that they can sell more abroad (i.e., increase their exports)

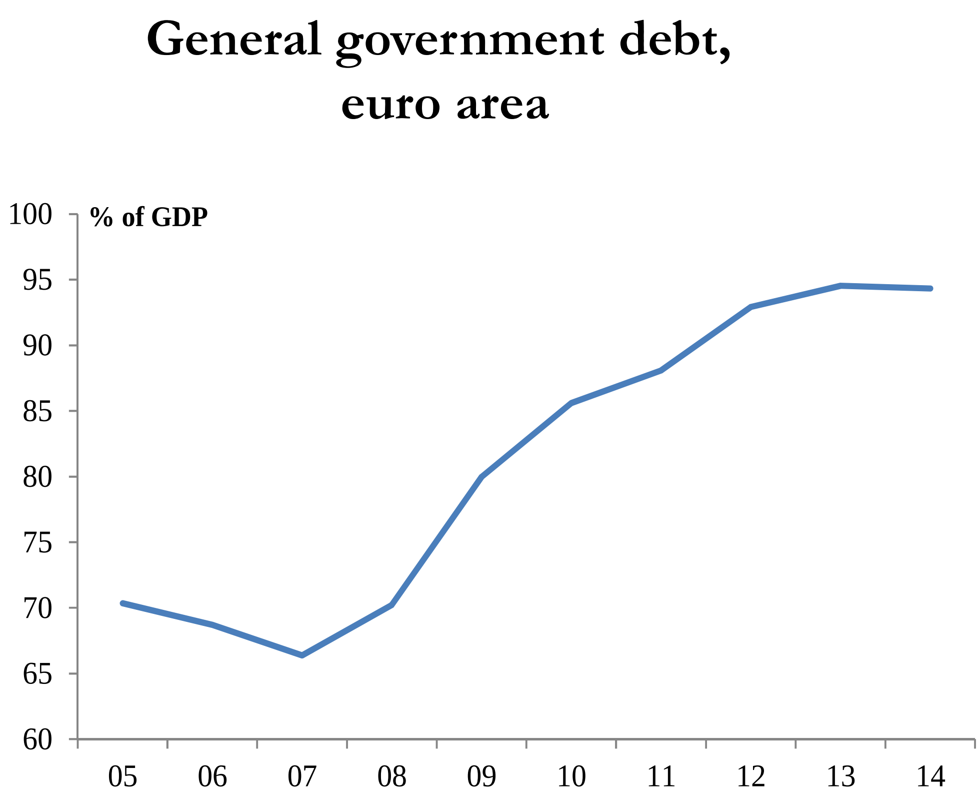
Some euro area countries fall between these two broad categories!

“Core”

Countries in better economic shape must sustain economic growth. But they also need to keep their budgets under control because of long-term costs (e.g., of pensions and health care in aging societies)

In the short run, “core” countries have room to spend more money at home and buy more goods from abroad (import more).

Public finances set to improve further



- Governments are gradually bringing their spending in line with revenues (working to balance budgets)

- Government debt is on a path to stabilize and eventually decline in the euro area

- Improvement in public finances will help restore investor and public confidence; however, it must be done in a way that does not choke off growth

Note: Debt is measured as a share of economic output (debt/GDP)
It is VERY difficult to reduce the numerator (debt)
if the denominator (GDP) is shrinking!

Europe’s response to the crisis

Strengthening the “E” in EMU

PROGRAMS

Financial assistance for countries in difficulty (but with conditions attached)

BANKS

Strengthen the banking system, including stronger supervision at the EU level

FIREWALL

A permanent mechanism (ESM) to stem the risk of contagion to other countries

RULES

Stronger, more effective fiscal rules and greater coordination of economic policies

GROWTH

Boost growth through “structural reforms” and completing the single market

More “union”, now and later on…

Political Union

Growth Union

Fiscal Union

Banking Union

The European Union is gradually solidifying

The case for the euro

Strong political commitment of leaders to defend the euro

Break-up or shrinking of the euro area would involve huge costs, make it harder for countries to borrow.

Governance of euro area is being strengthened, flaws fixed

Balanced emphasis on growth and fiscal adjustment

More sustainable public finances and economic reforms will help countries

"The euro is at the core of our European project."

Statement by Heads of State or Government of the euro area and EU institutions, Oct. 26th, 2011

Good luck in the Euro Challenge 2013!

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