



Divided we stand ?

The way forward in EMU's hybrid structure

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Where we stand

- An uneven and fragile recovery
- At the brink of a double-dip recession
- With the traditional tools of macro-stabilisation largely exhausted.

Action so far

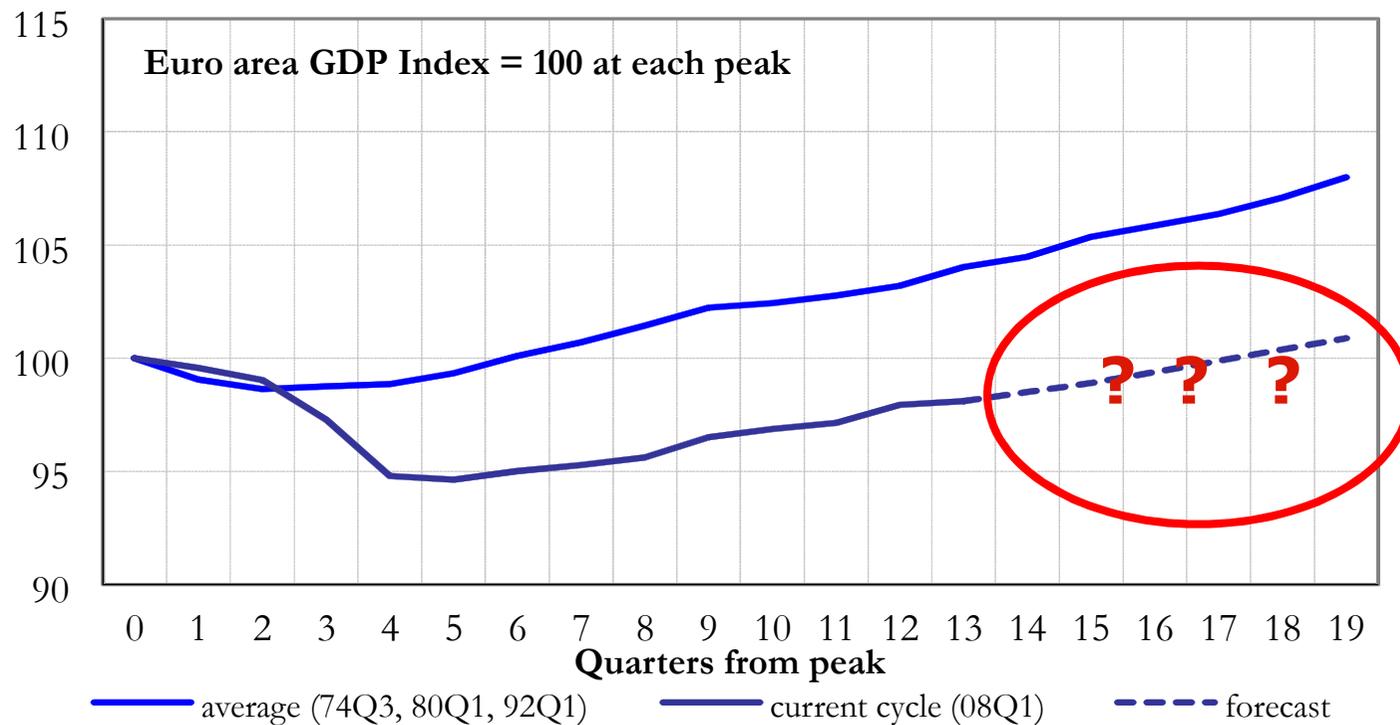
- No shortage of initiatives: fire-fighting and medium-term exit strategy
- Macro-financial stability: regulatory design & sovereign firewalls
- Macro-fiscal stability: The “six-pack” and the fiscal compact

The way forward – unfinished business

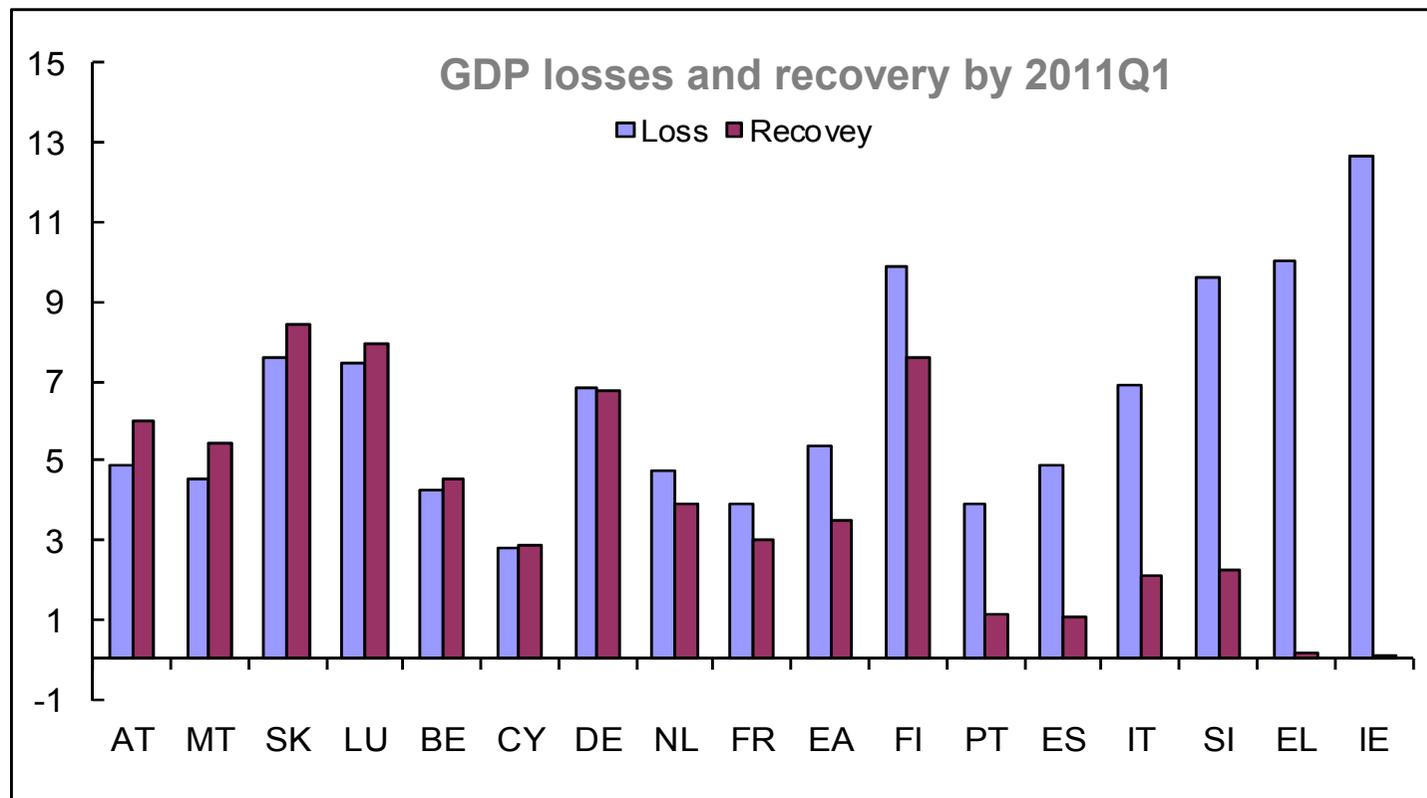
- Breaking the vicious feed-back loop
 - Anchoring the financial system, building a banking union
 - From the fiscal compact to fiscal union
- ❖ **Resounding Europe’s prosperity triangle: growth-stability-equity**



A subdued recovery following financial crises

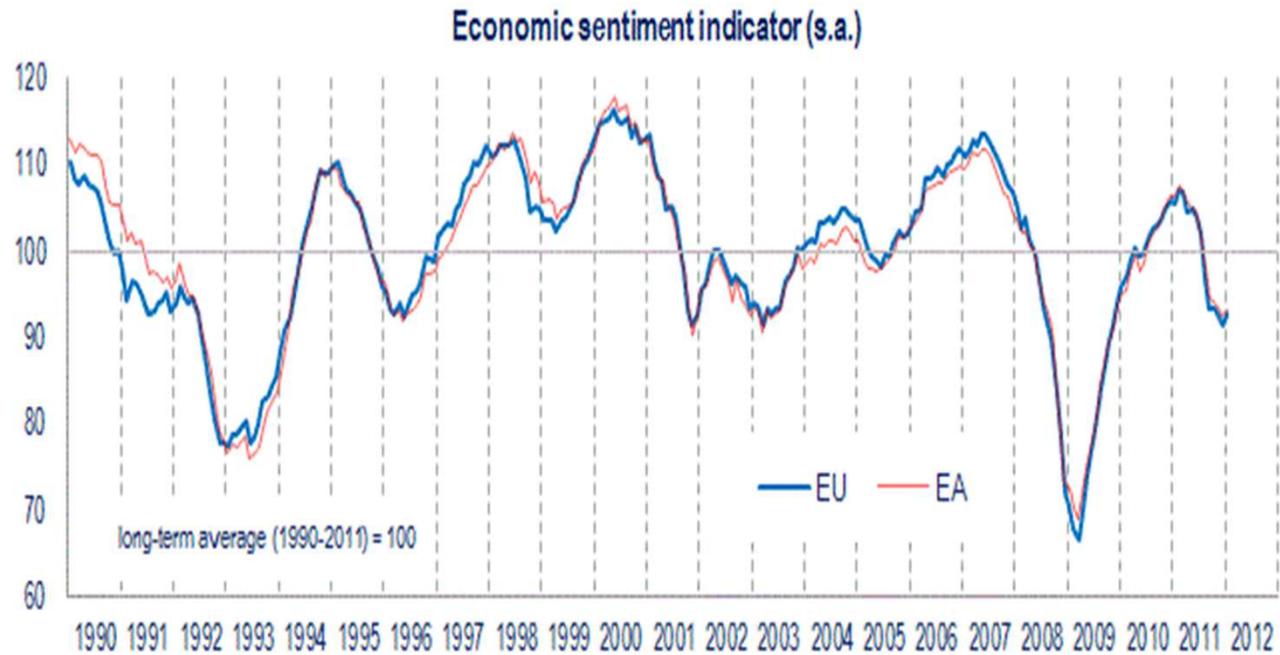


A fairly uneven recovery across countries



* MS are ordered according to the difference between losses and recovery

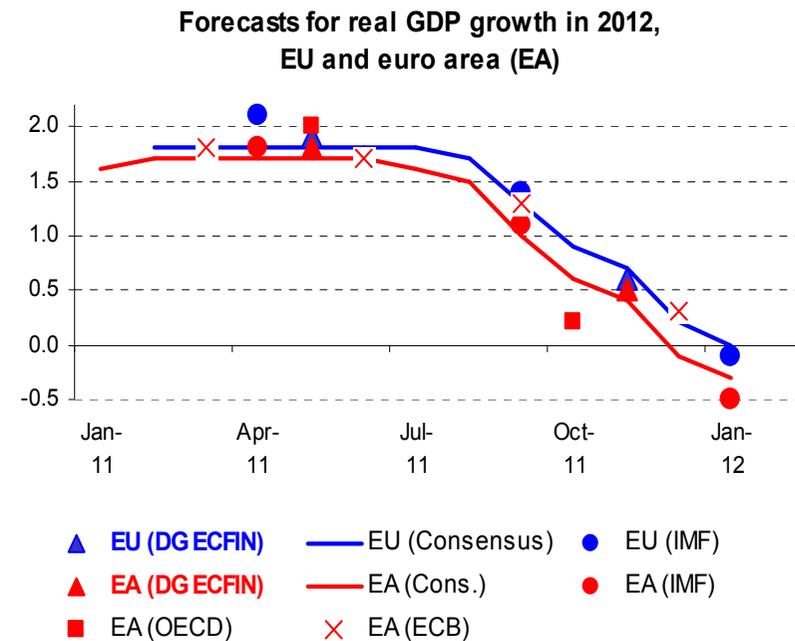
On the brink again



source: European Commission services

Forecasts getting more pessimistic

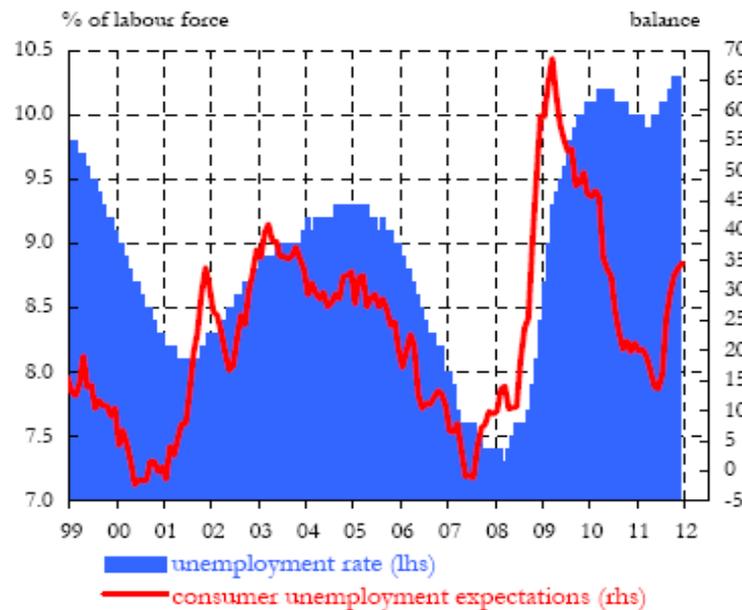
Real GDP growth (%) selected forecasts			
EU	2011	2012	2013
ECFIN (Nov. 10)	1.6	0.6	1.5
Consensus (Jan. 9)	1.6	0.0	.
IMF (Jan.24)	1.6	-0.1	1.2
Euro area	2011	2012	2013
ECFIN (Nov.11)	1.5	0.5	1.3
OECD (Nov. 28)	1.6	0.2	1.4
ECB (Dec. 8)	1.6	0.3	1.3
Consensus (Jan. 9)	1.6	-0.3	1.0
IMF (Jan.24)	1.6	-0.5	0.8



Situation

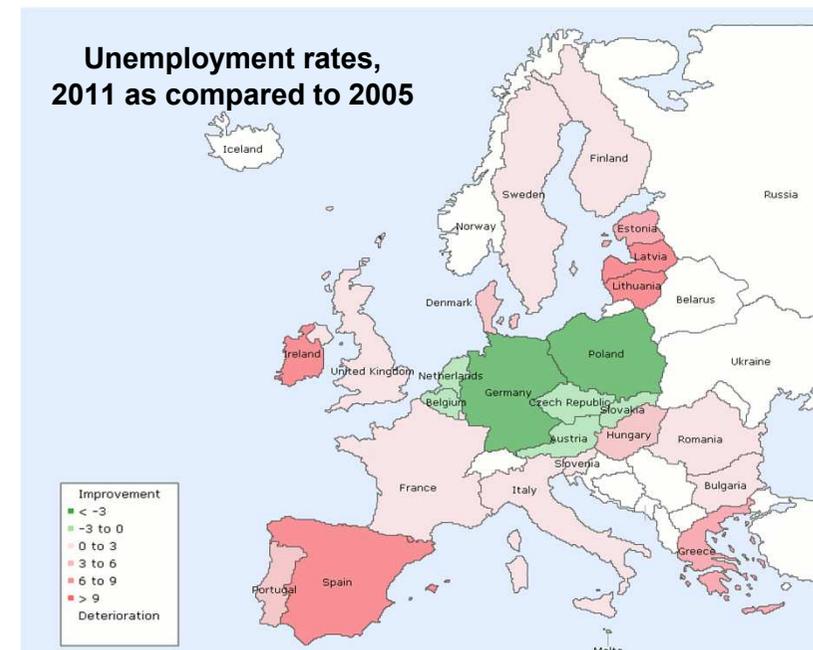
Resilience during downturn led to only **moderate improvements**. But now unemployment again creeping up. Substantial cross-country differences

Unemployment rate and unemployment expectations



Outlook

Employment growth comes to standstill, turns slightly negative. **No substantial improvements** over forecast horizon.



Situation

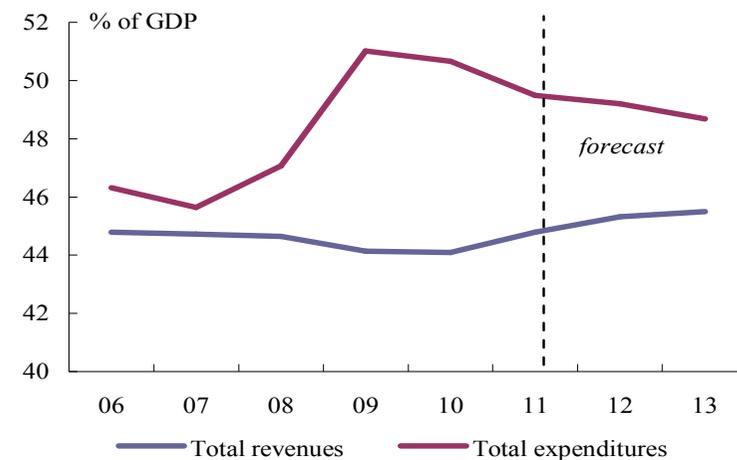
Fiscal consolidation measures taken that **lower net lending**. Gross **debt still increasing**. Substantial cross-country differences in fiscal developments.

(Real annual % change unless otherwise stated)	EU27			
	2010	2011	2012	2013
GDP	2.0	1.6	0.6	1.5
Consumption	1.0	0.4	0.4	1.1
Total investment	-0.3	1.9	0.8	3.0
Employment	-0.6	0.4	0.1	0.4
Unemployment rate (% I.	9.7	9.7	9.8	9.6
Inflation	2.1	3.0	2.0	1.8
Govt balance (% GDP)	-6.6	-4.7	-3.9	-3.2
Govt gross debt (% GDP)	80.3	82.5	84.9	84.9

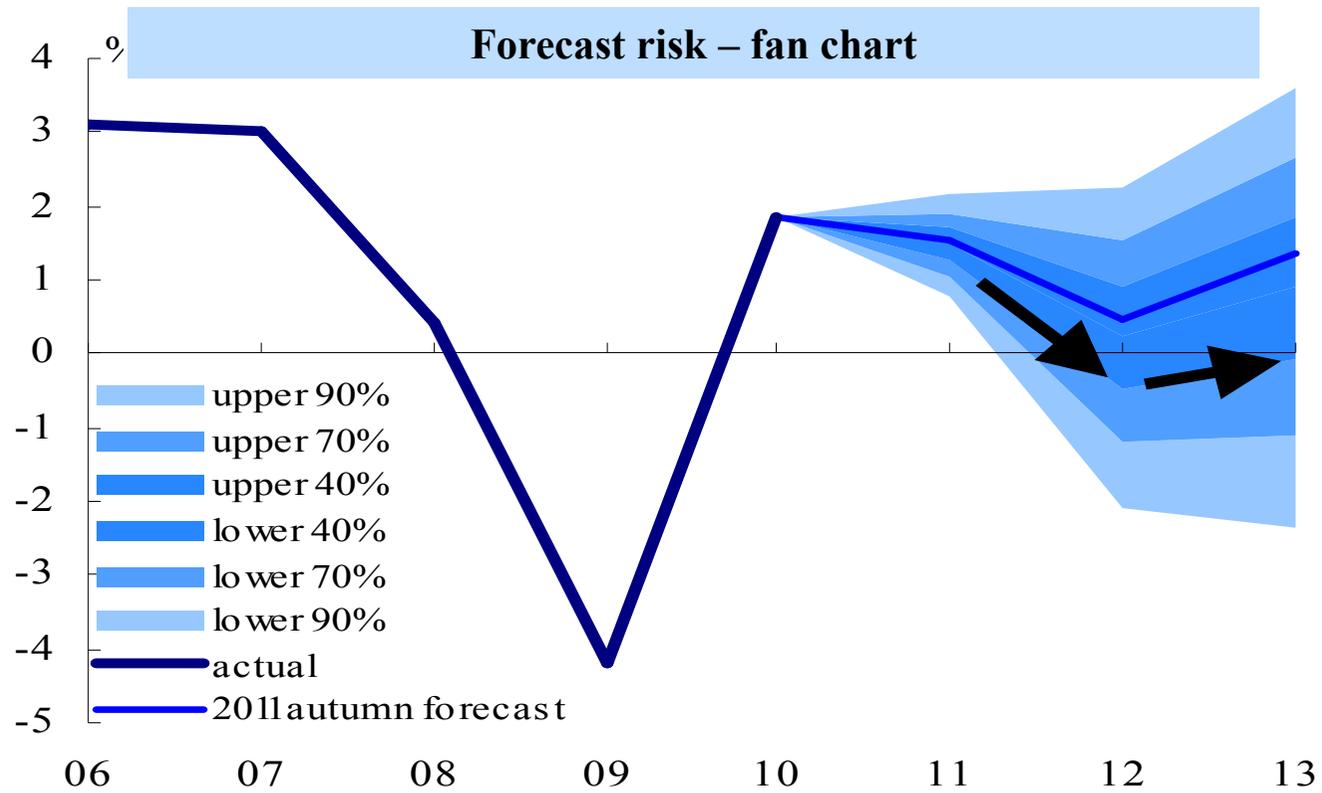
Outlook

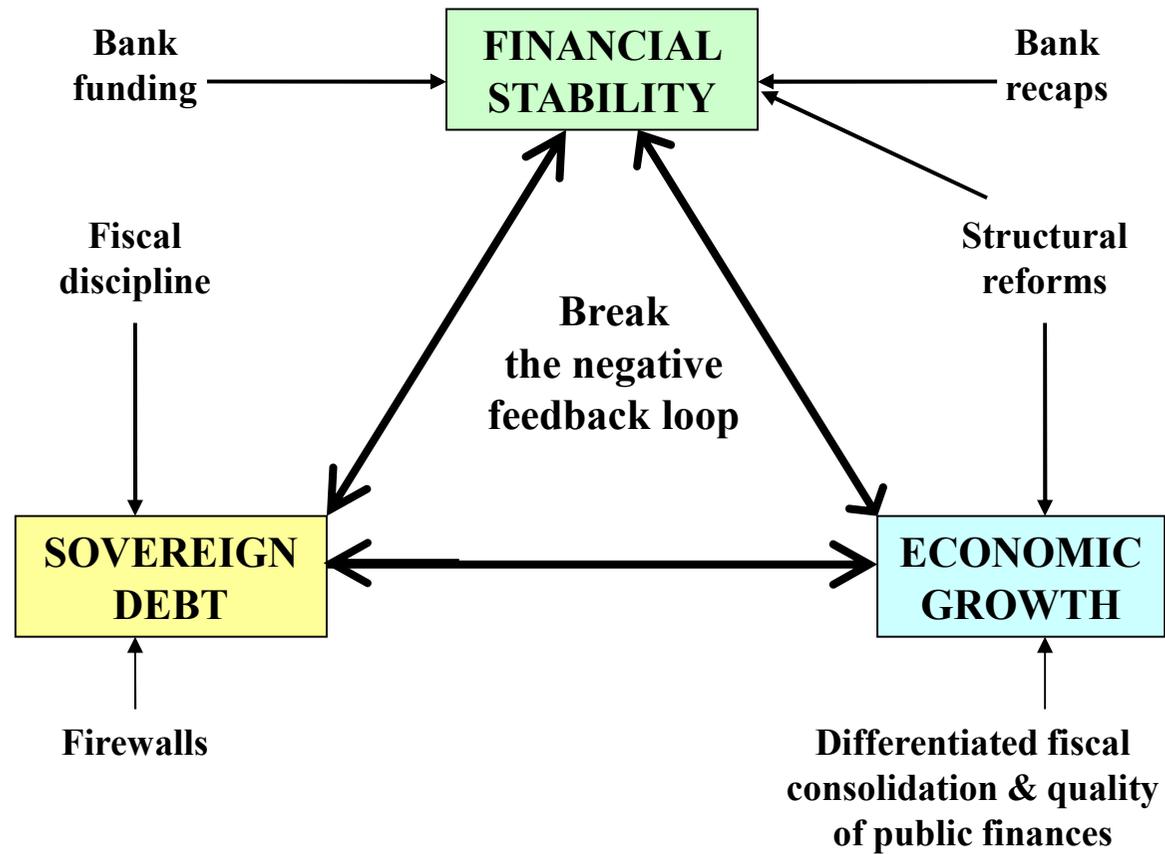
Fiscal consolidation continues and **lowers net lending further**. Gross government **debt stabilises** over the forecast horizon.

General government revenues and expenditure, EU



Euro area growth outlook:







Europe's response to the crisis

No lack of measures, programmes and initiatives

- **European Recovery Plan 2008**
- **European semester**
- **Annual Growth Survey**
- **Euro Plus Pact**
- **Europe 2020**
- **Financial sector regulation and supervision**
- **'The 6-pack' for a stronger Economic Governance**
 - **Reinforcing Excessive Deficit Procedure and the SGP**
 - **Introducing Macroeconomic Imbalances Procedure**
 - **The Alert Mechanism Report (12 countries on the Watch List)**





Europe's response to the crisis

- **Balance of payments facility 2008-**
- **European Financial Stability Facility, May 2010**
- **European Financial Stabilisation Mechanism, May 2010**
- **ECB – Liquidity support, Securities Market Programme**
- **European Stability Mechanism (ESM)**
 - **Now advanced from 2013 to 2012**
 - **Bilateral contributions to the IMF**
- **Two new proposals for Regulations by the Commission**
- **Commission Green Paper on Stability bonds (Nov 2011)**
- **New intergovernmental agreement (Dec 2011)**
 - **Reinforced EMU architecture**
 - **Fiscal compact**
- **Growth summit (Jan 2012)**
 - **Youth initiative**
 - **SME financing**





Macroeconomic imbalances procedure

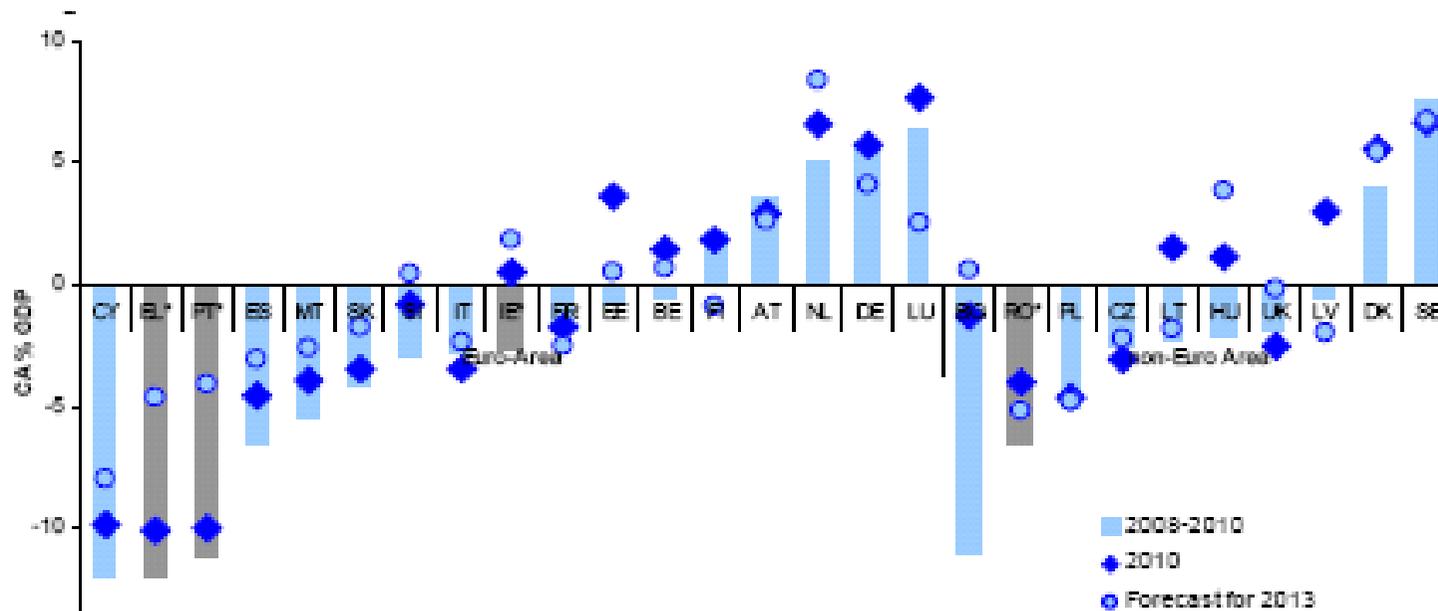
- New monitoring framework for imbalances
- Preventive dimension: annual review process, alert mechanism (scoreboard of indicators with thresholds and expert analysis), in-depth country analysis where warranted.
- Corrective dimension: excessive imbalance procedure in case of severe imbalance, Council recommendation with deadline for taking action, Member State presents corrective action plan





European
Commission

Current account balances as % of GDP



Note: Forecast figures are corrected for the level differences between Balance of Payments and National Accounts (Rest of the World) data; programme countries are in grey and marked with an asterisk.

Source: European Commission.





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Commission

Table 1. Scoreboard indicators and indicative thresholds (*)

	External imbalances and competitiveness					Internal imbalances				
Indicator	3 year average of current account balance as a % of GDP	Net International Investment Position as a % of GDP	% change (3 years) of Real Effective Exchange Rate, HICP deflators relative to 35 industrial countries (a)	% change (5 years) in export market shares	% change (3 years) in nominal unit labour cost (b)	y-o-y % change in deflated house prices (c)	private sector credit flow as % of GDP (d), (e)	private sector debt as % of GDP (d), (e)	general government debt as % of GDP (f)	3 year average of unemployment rate
Data source	Balance of Payments statistics EUROSTAT.	Balance of Payments Statistics, EUROSTAT.	DG ECFIN indicator data base on Price and Cost competitiveness.	Balance of Payments statistics, EUROSTAT.	EUROSTAT	Harmonised house price index by EUROSTAT, completed with ECB, OECD and BIS data.	EUROSTAT for annual data and QSA, ECB for quarterly data.	EUROSTAT for annual data and QSA, ECB for quarterly data.	EUROSTAT (EDP – treaty definition).	EUROSTAT
Indicative thresholds	+6/-4%	-35% Lower quartile	+/-5% for EA +/-11% nonEA Lower and Upper Quartiles of EA - /+ s.d. of EA	-6% Lower quartile	+9% EA +12% non-EA Upper Quartile EA3 p.p	+6% Upper quartile	+15% Upper Quartile	160% Upper Quartile	+60%	+10%
Period for calculating thresholds	1970-2007	First available year (mid-1990s)-2007	1995-2007	1995-2007	1995-2007		1995-2007	1994-2007		1994-2007
Some additional indicators to be used in economic reading	Net lending/borrowing vis-à-vis ROW (Capital Account + Current Account balances as % of GDP)	Net External Debt as % GDP	REER vis-à-vis rest of the euro area	Export market shares based on volumes of goods; Labour productivity; Trend ITP growth	Nominal ULCs (changes over 1, 5, 10 years); Effective ULC relative to rest of euro-area Other measures of productivity	Real house price (changes over 3 years); Nominal house price (changes over 1 and 3 years) Residential construction	Indicator on change in financial liabilities of the non-consolidated financial sector and the debt over equity ratio	Private sector debt based on consolidated data		

Notes: (a) for EU trading partners HICP is used while for non-EU trading partners, the deflator is based on a CPI close to the HICP in methodology; (b) index providing ratio of nominal compensation per employee to real GDP per person employed; (c) changes in house prices relative to the consumption deflator of EUROSTAT; (d) private sector is defined as non-financial corporations; households and non-profit institutions serving households; (e) sum of Loans, and Securities other than shares; liabilities, non-consolidated; (f) the sustainability of public finances will not be assessed in the context of the MIP given that this issue is already covered by the SGP. However this indicator is part of the scoreboard because public indebtedness contributes to total indebtedness of the country and therefore to the overall vulnerability of the country. (*) It is envisaged to develop a wider indicator of the banking/financial sector by the end of 2012.

Preventive arm



Alert mechanism

Commission present report based on indicators (scoreboard) and economic reading identify Ms where potential risks exist

ECOFIN/Euro group discuss and adopt conclusions for the Commission to take account of.



In-depth review

Commission prepares in depth country studies, using much wider set of indicators and analytical tools, and takes account of

- other Council recommendations
- plans in SCP/ NRPs;
- warnings or recommendations from the ESRB.



No problem
Procedure stops.



Imbalance exists
Commission/Council recommendations under Article 121.2



Severe imbalance
Commission/Council recommendation on the existence of an « excessive imbalance » and corrective actions



What role for the scoreboard?

Only a **trigger** for launching in-depth studies
=> substantive basis of policy recommendations

Scoreboard is nonetheless important

- implicitly defines the scope of surveillance;
- a communication tool.

Scoreboard indicators not equivalent to EDP reference values for deficits and debt (more like 'structural indicators' in the Lisbon process strategy)

In-depth studies



European
Commission

**Identification
of
problematic
imbalances**

Sustainability of macro-trends

- Early warning
- Deviation from equilibrium (competitiveness, credit growth, housing prices)
- Other factors (GDP growth, demography, catching-up, global imbalances, saving and investment imbalances housing and other asset markets, shocks)
- Policy determinants (fiscal policy, financial regulation, labour and product market institutions)

Spillovers

- Trade linkages
- Financial linkages

Adjustment capacity

- Price and wage flexibility
- Labour and product markets
- Financial market intermediation
- Balance sheet adjustment

**Policy
Response**

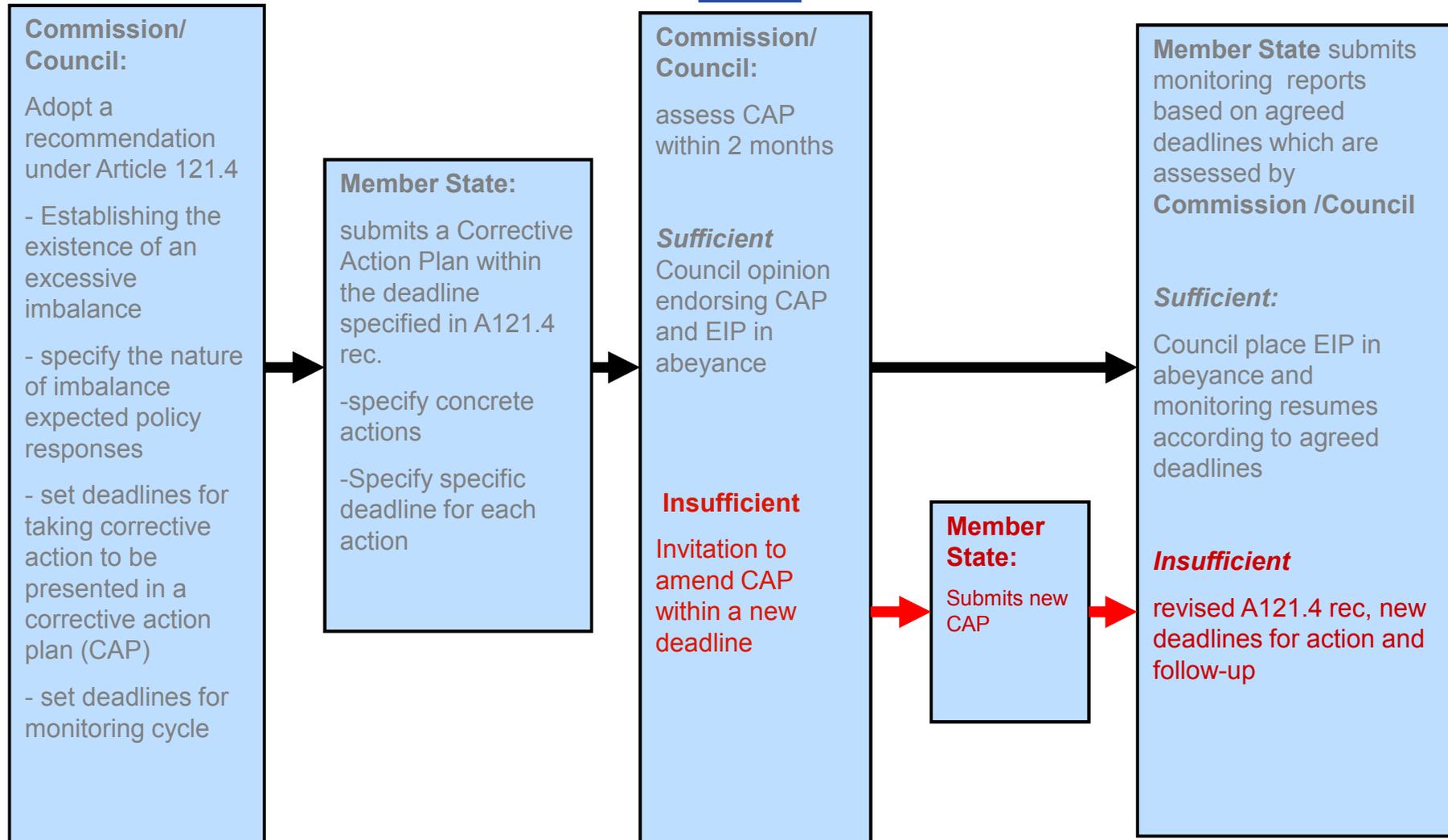
Policy options

- Wage bargaining system
- Financial market regulation
- Fiscal policy
- Growth and structural reforms

Corrective arm



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Ongoing action



Greece

1. Finalise negotiations 2nd programme, PSI
3. Few upsides, many downsides

Other programme countries & vulnerable Member States

4. IRL more or less on track
5. IT, SP – critical re-financing needs upcoming
6. PT, HU - others in the waiting – launch of MIP

Banking sector

7. Re-capitalisation – but at a high risk
8. Liquidity support from the ECB

Sovereign firewall

9. EFSF leveraging, ESM advancement
10. Bilateral contributions to the IMF

Fiscal compact

11. Intergovernmental agreement
12. Debt brake in constitution or equivalent





Anchoring the financial system

- Creating a credible “risk-free” reference asset
 - Stability bonds – joint and several guarantee by Member States
 - Or backed up by a central tax-raising capacity
- ESM: A European Monetary Fund or a Debt Management Agency
- Towards a banking union (deposit insurance, resolution schemes etc.)

Fiscal compact

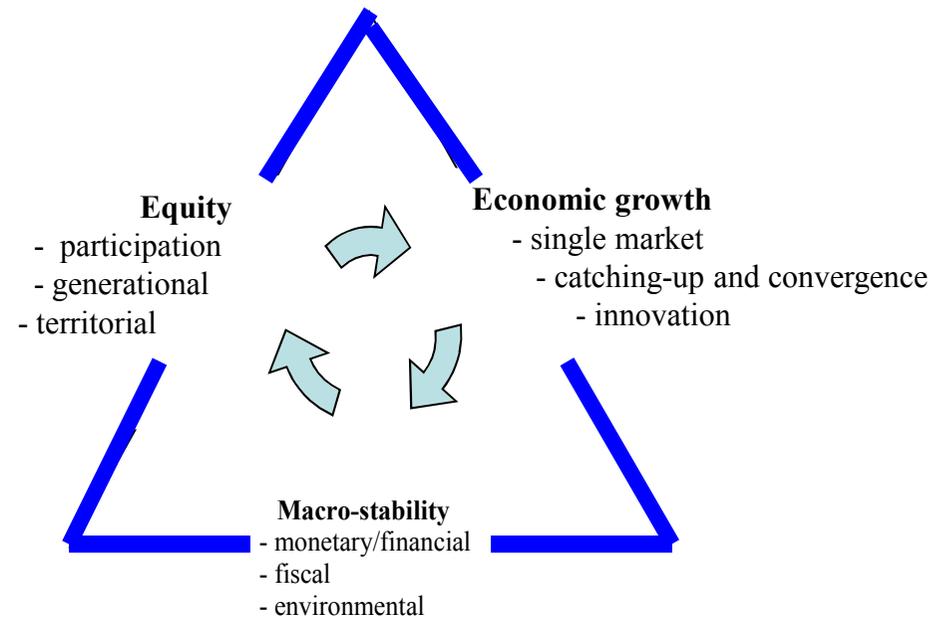
- From a fiscal compact to a (minimalist?) fiscal union
- EU budget, own resources, transfer funds
- A fiscal compact (and a single market) without a social compact?

Governance issues and democratic representativeness

- The inevitable transfer of „national sovereign rights“
- Intergovernmental vs. Community institutions
- The European electorate and the role of the Parliament



Europe's prosperity triangle





***Thank you very
much for your
attention***

