



INTERNATIONAL MONETARY FUND

EURO AREA: PROSPECTS AND POLICIES

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June 2018

Growth in advanced economies is strong

Real GDP Growth Projections (April 2018 World Economic Outlook)

(percentage change from a year earlier)



	World	U.S.	U.K.	Japan	Euro Area	DEU	FRA	ITA	ESP
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2018	3.9	2.5	1.6	1.2	2.4	2.5	2.1	1.5	2.8
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<i>Revision from October 2017</i>	<i>0.3</i>	<i>0.2</i>	<i>0.1</i>	<i>0.5</i>	<i>0.5</i>	<i>0.7</i>	<i>0.3</i>	<i>0.4</i>	<i>0.3</i>
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2019	3.9	2.2	1.5	0.9	2.0	2.0	2.0	1.1	2.2
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<i>Revision from October 2017</i>	<i>0.2</i>	<i>0.3</i>	<i>0.1</i>	<i>0.1</i>	<i>0.3</i>	<i>0.5</i>	<i>0.1</i>	<i>0.2</i>	<i>0.2</i>
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Growth in Emerging and Developing Markets is fragile

Real GDP Growth Projections (April 2018 World Economic Outlook)

(percentage change from a year earlier)



World EMDCs China India Russia Brazil South Africa Argentina Turkey

2018 3.9 4.9 6.6 7.4 1.7 2.3 1.5 2.0 4.4

Revision from October 2017

0.3 **0.0** **-0.1** 0.0 0.1 0.8 0.4 **-0.5** 0.9

2019 3.9 5.1 6.4 7.8 1.5 2.5 1.7 3.2 4.0

Revision from October 2017

0.2 **-0.1** **-0.1** 0.0 0.0 0.5 0.1 0.5 0.5

Downside risks to the outlook have increased

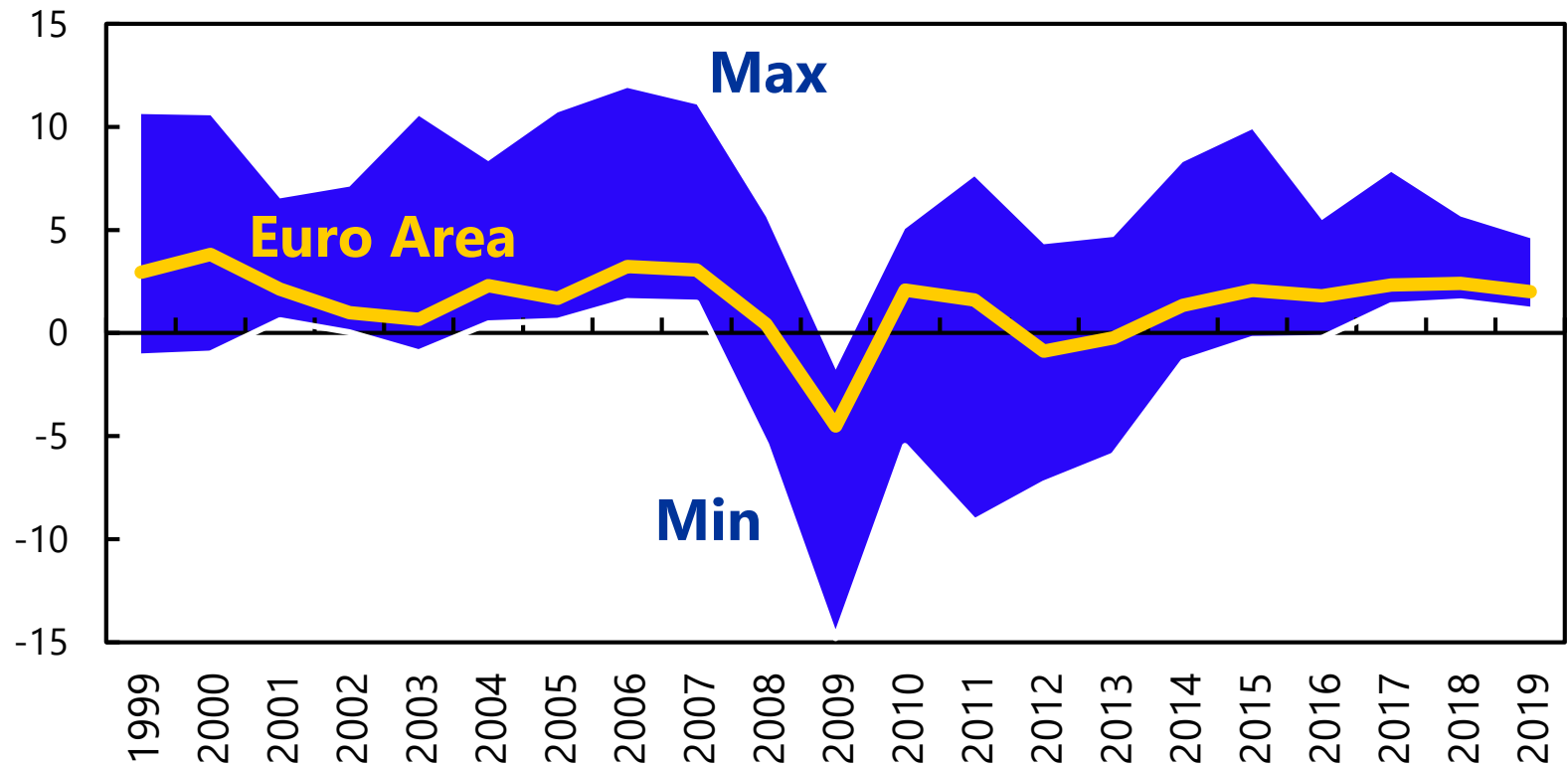
Risks beyond the next several quarters clearly lean to the downside.

- Possible sharp tightening of financial conditions
- Growing trade tensions and risks of a shift toward protectionist policies
- Geopolitical strains

Euro Area

The recovery is proceeding at a brisk pace and spans all euro area countries

Real GDP Growth (Percent, y/y)



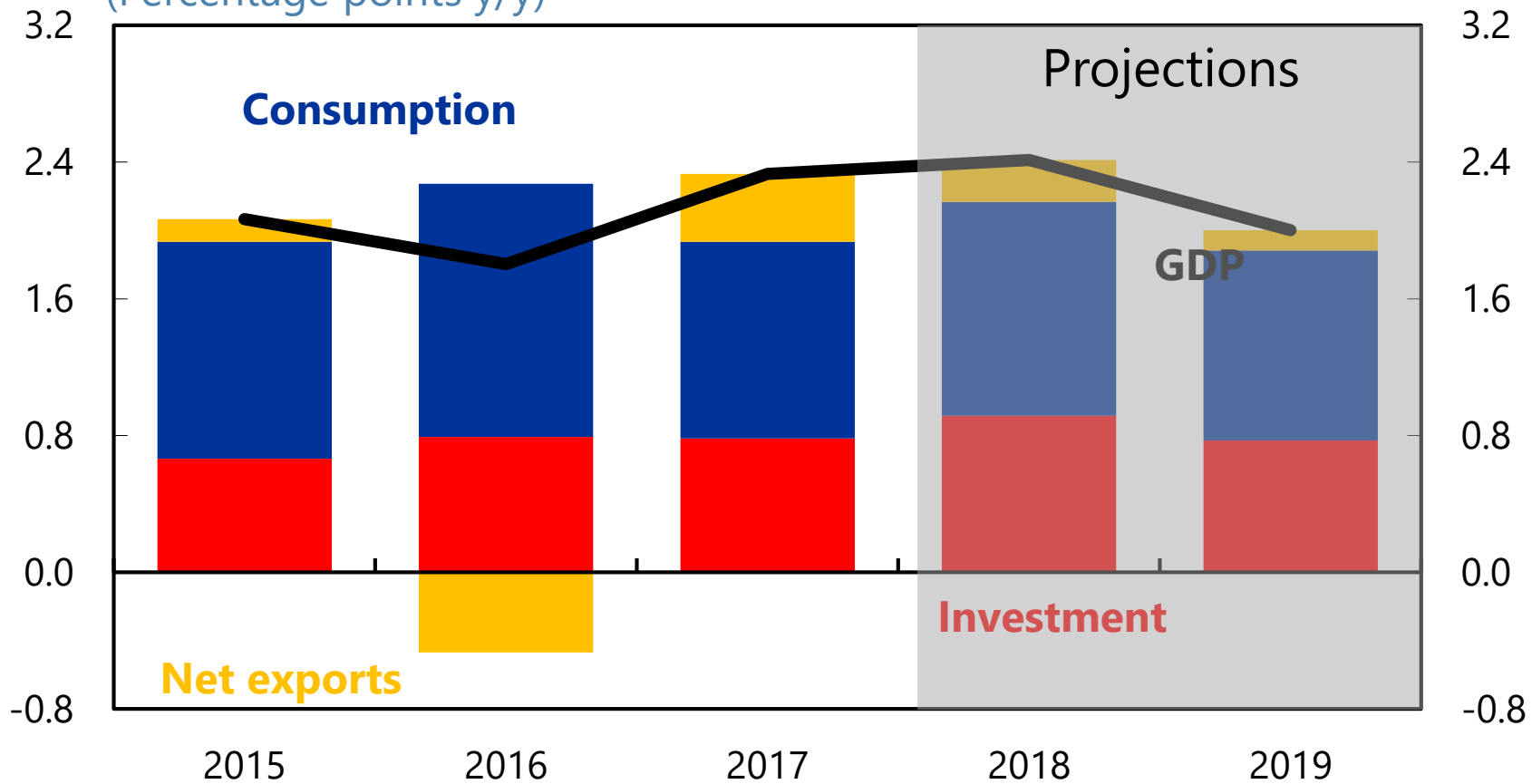
Source: WEO.

Note: Ireland 2015 excluded.

Growth is also increasingly broad based

Contributions to Growth

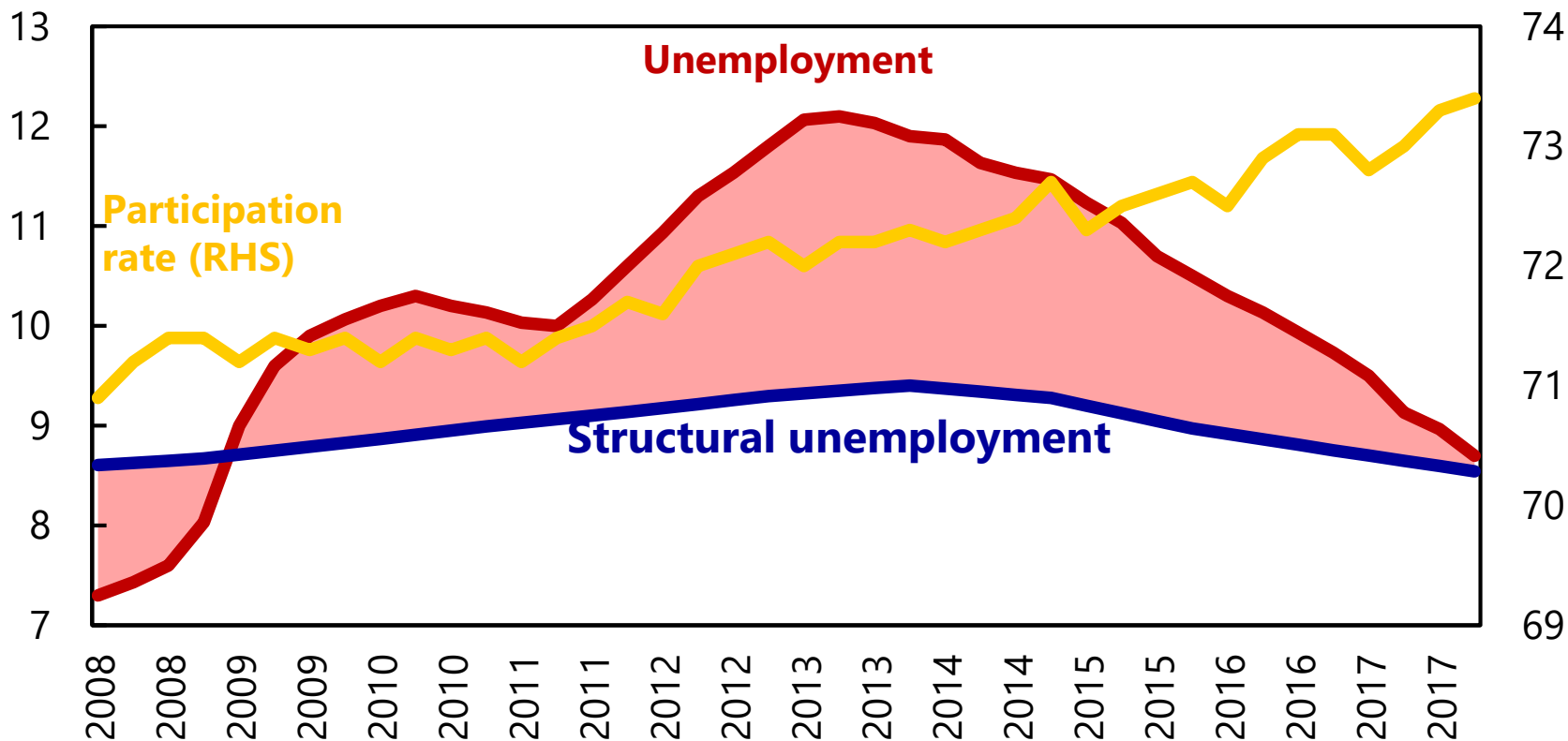
(Percentage points y/y)



Sources: Eurostat; Haver Analytics; WEO; and IMF staff calculations.

Unemployment is falling, participation is rising

Unemployment and Participation (Percent)

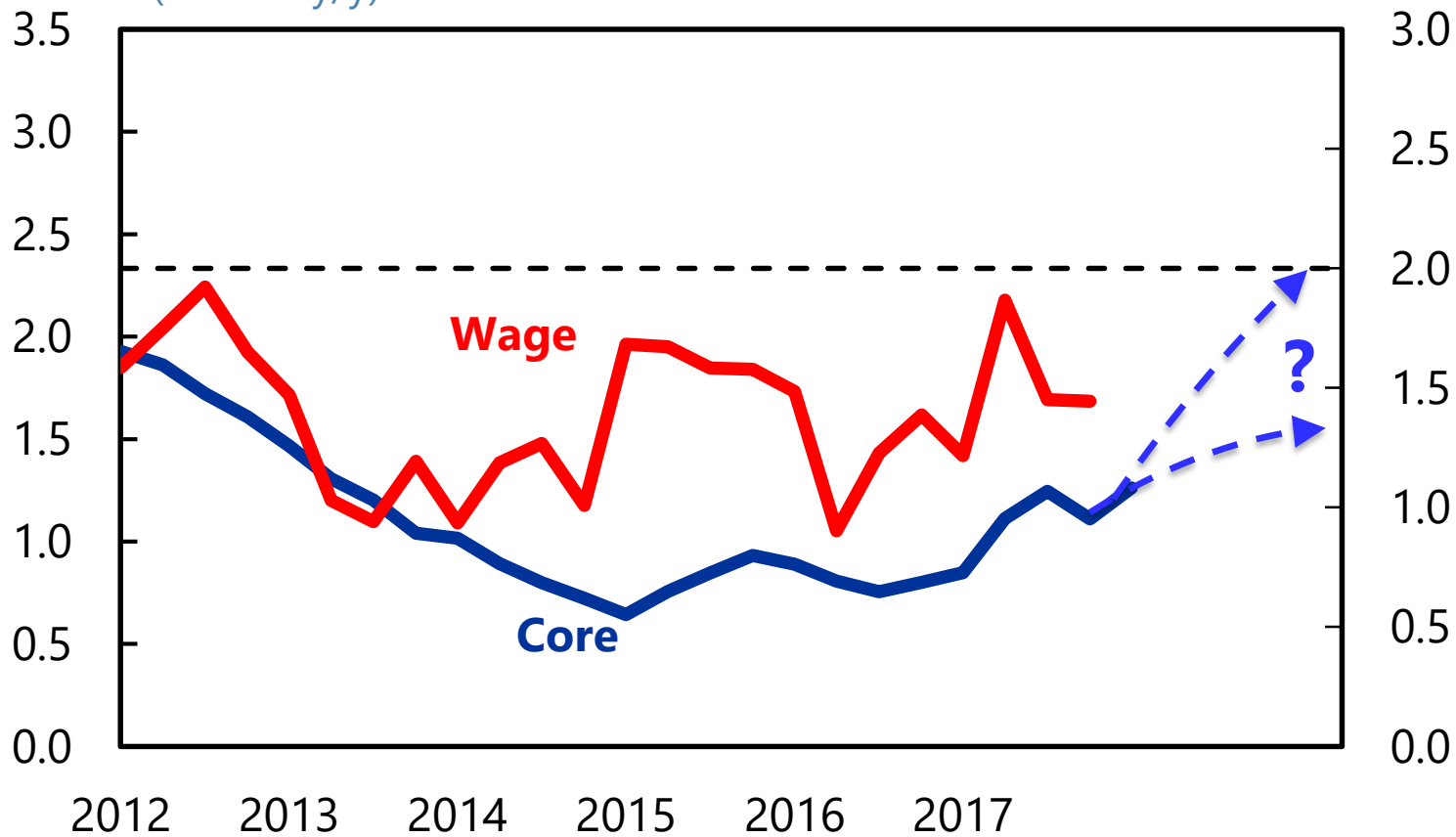


Sources: Eurostat; Haver Analytics; WEO; and IMF staff calculations.

Core inflation and wage growth up, but still low

Inflation and Wage Growth

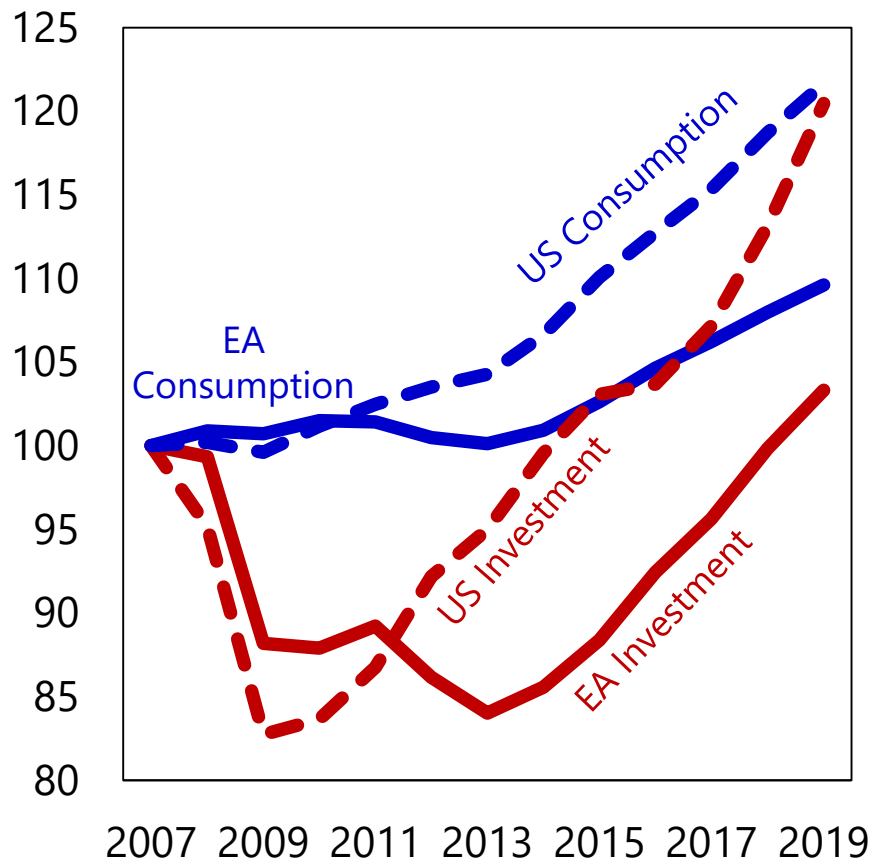
(Percent y/y)



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

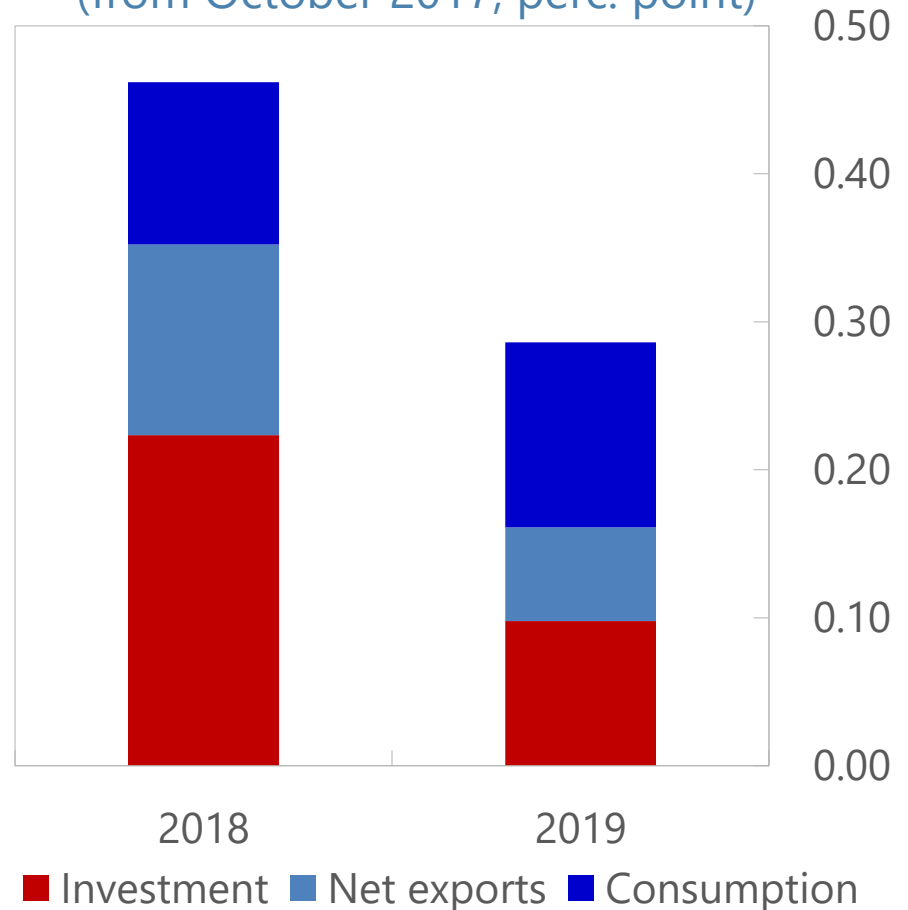
Recent investment trends are encouraging

Real Growth Components (Index; 2007=100)



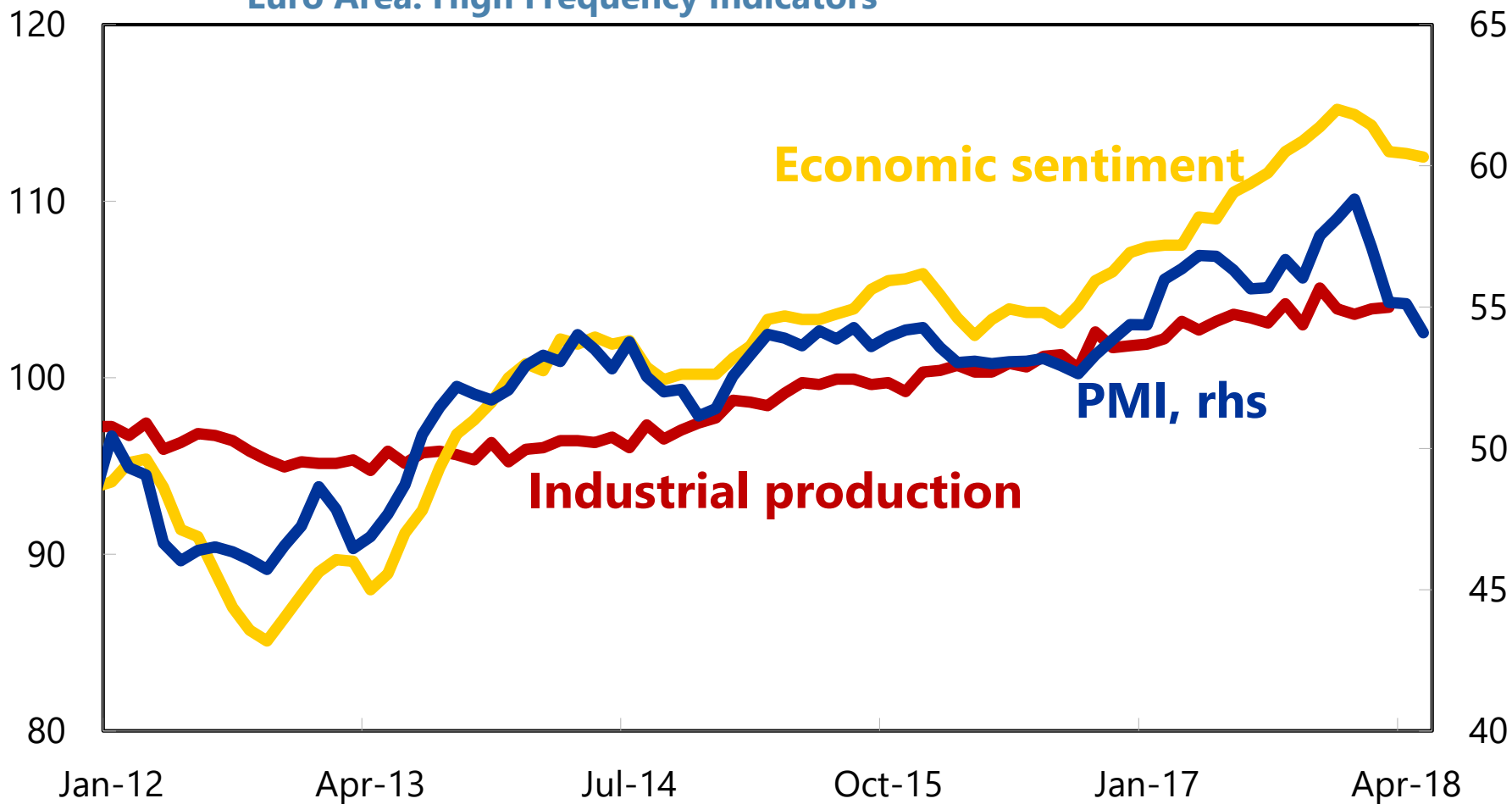
Source: IMF, World Economic Outlook.

April 2018 Upward revision of growth projections (from October 2017; perc. point)



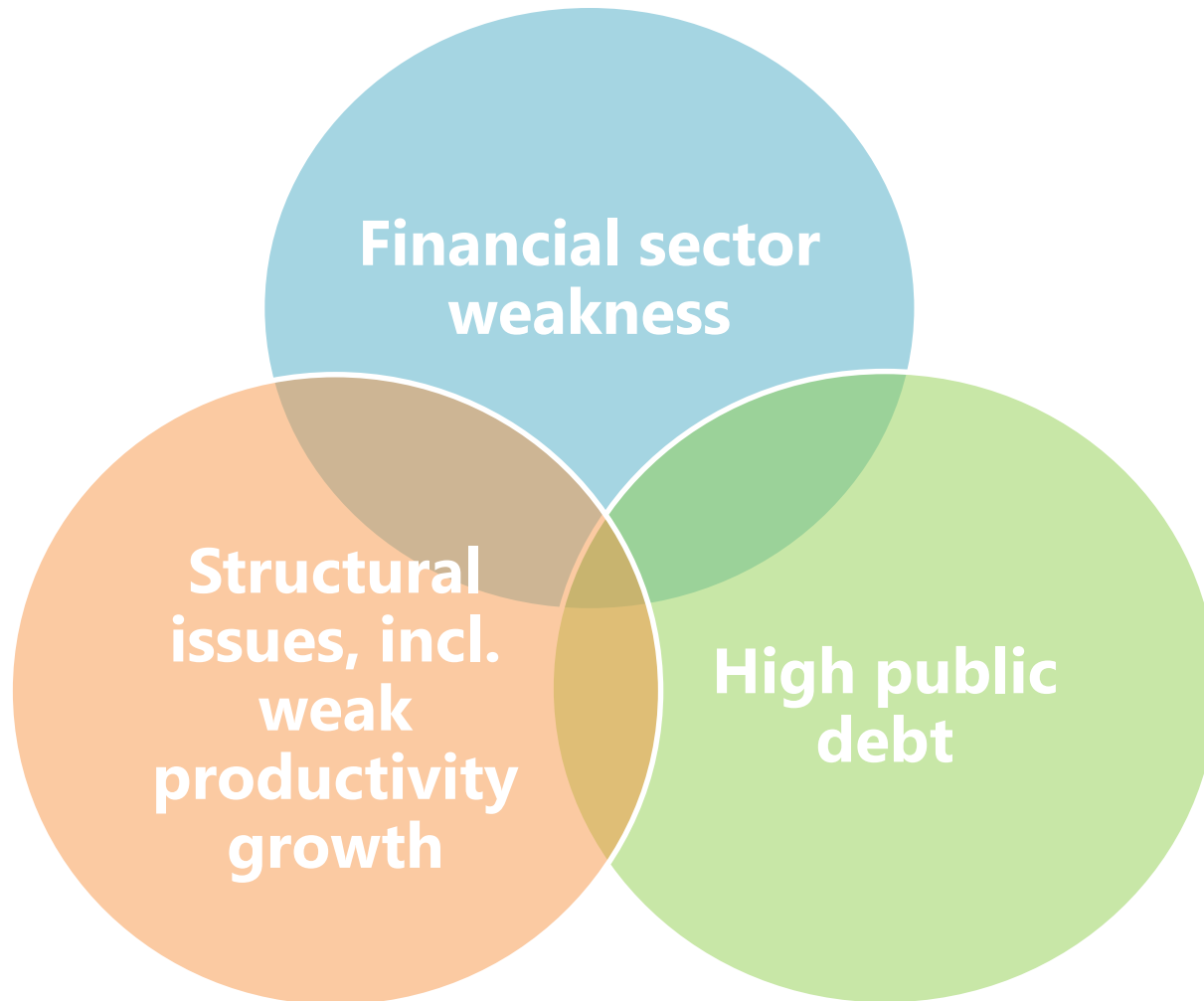
However, recent high-frequency indicators may suggest a weakening

Euro Area: High Frequency Indicators



Sources: Eurostat; and Haver Analytics.

Economic challenges loom over the medium term

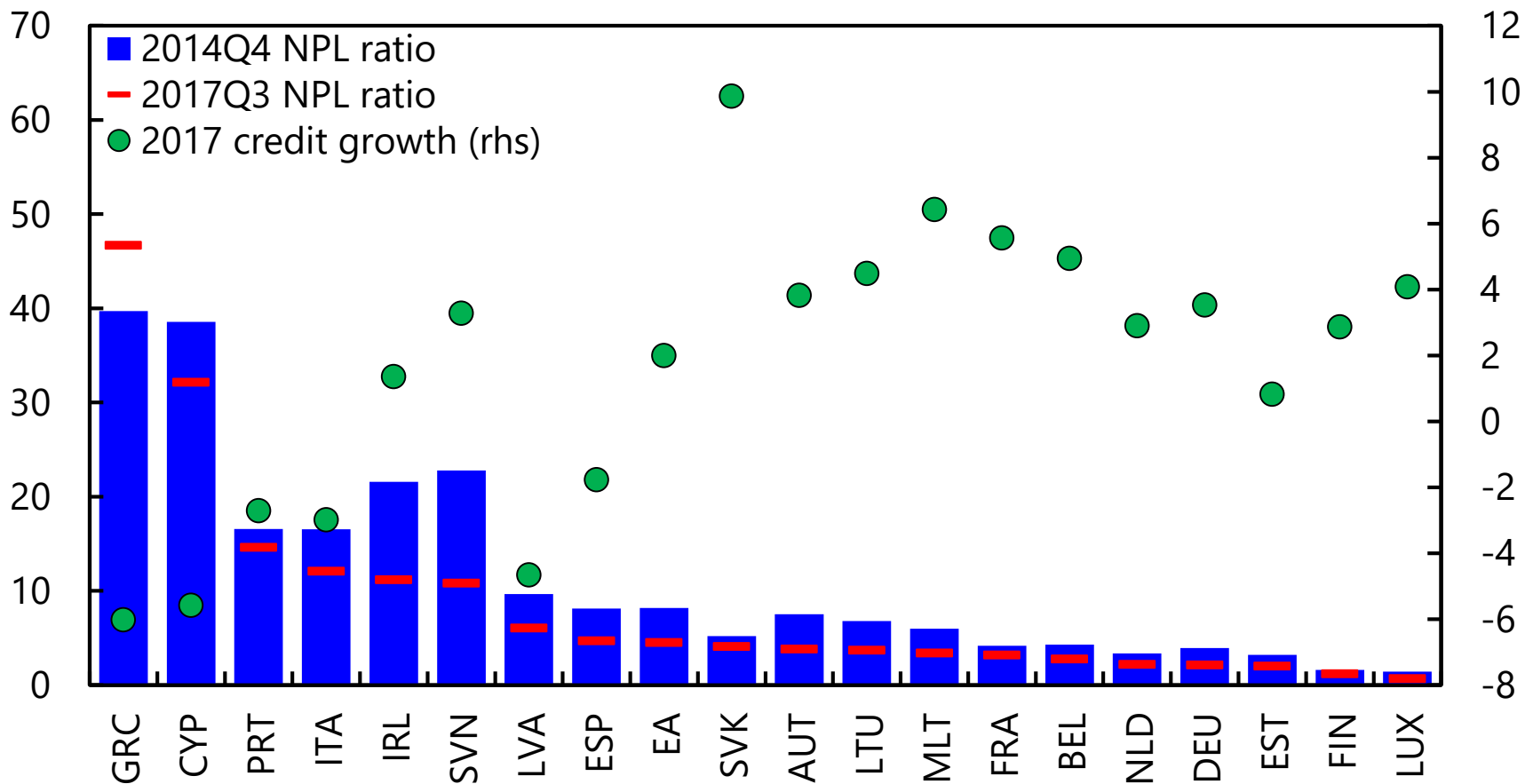


NPLs are coming down, credit is growing. Further effort needed

NPL Ratio and Credit Growth

(Percent of gross loans)

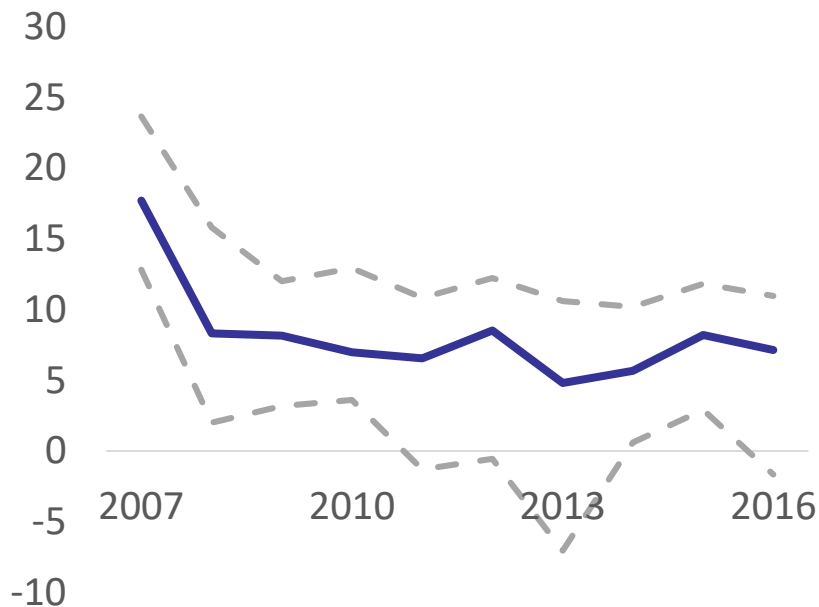
(Percent y/y)



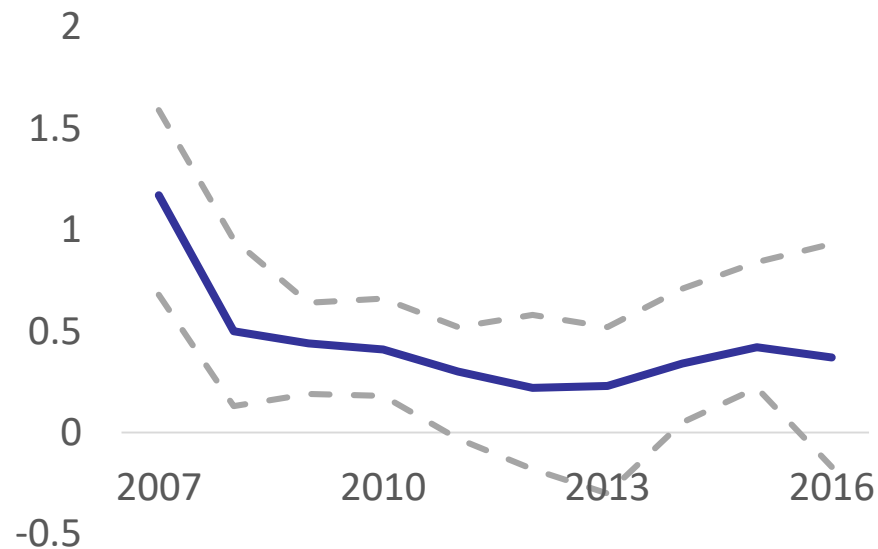
Source: ECB, Consolidated Banking Database.

Bank profitability is weak, and partly reflects overbanking

Return on Equity
(in percent)



Return on Assets
(in percent)



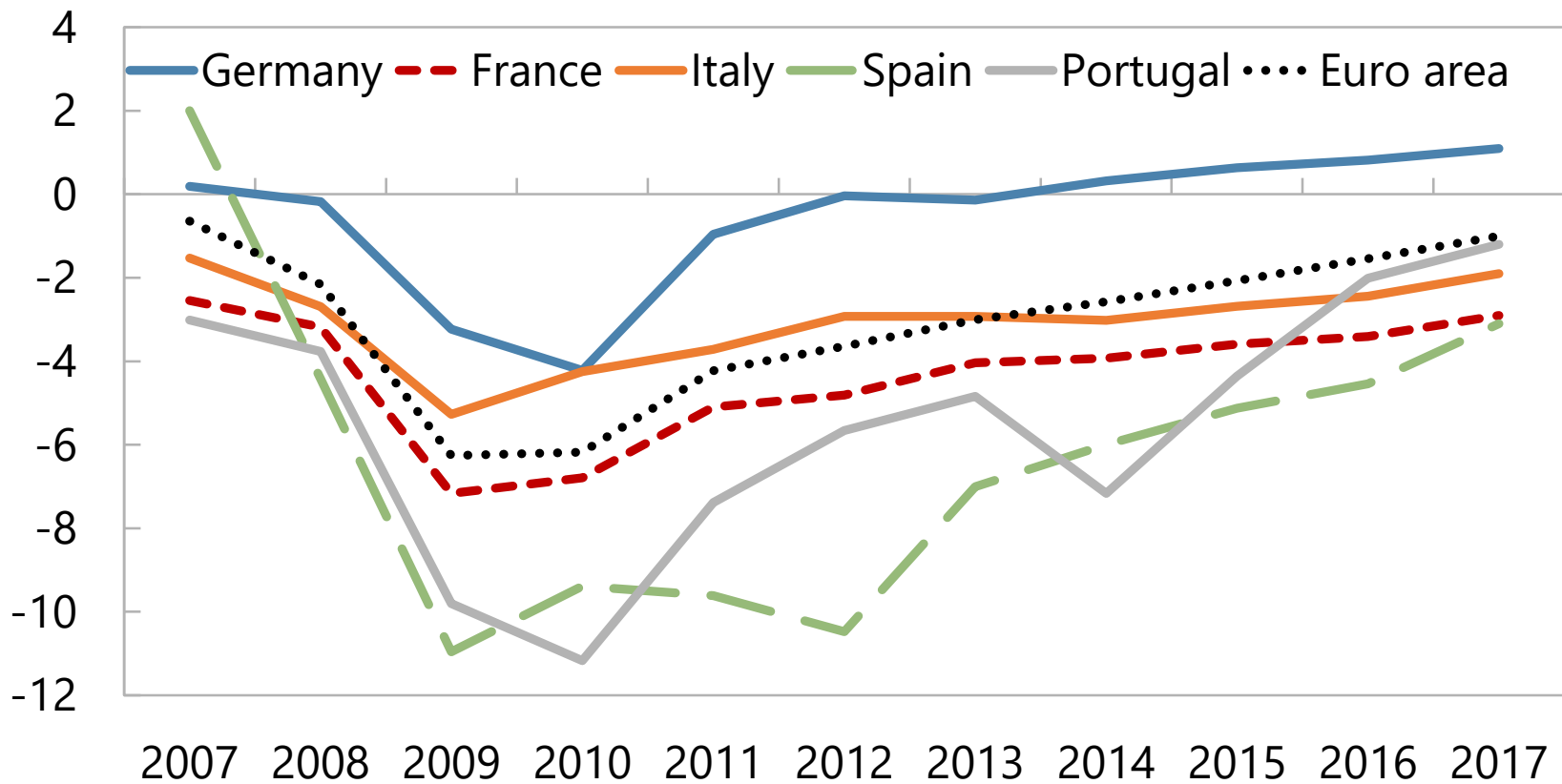
Source: FitchData; IMF staff calculations.

Note: Based on a balanced sample of 45 SSM banks, comprising 56 percent of sample assets.

Government balances have improved thanks to the cyclical upswing

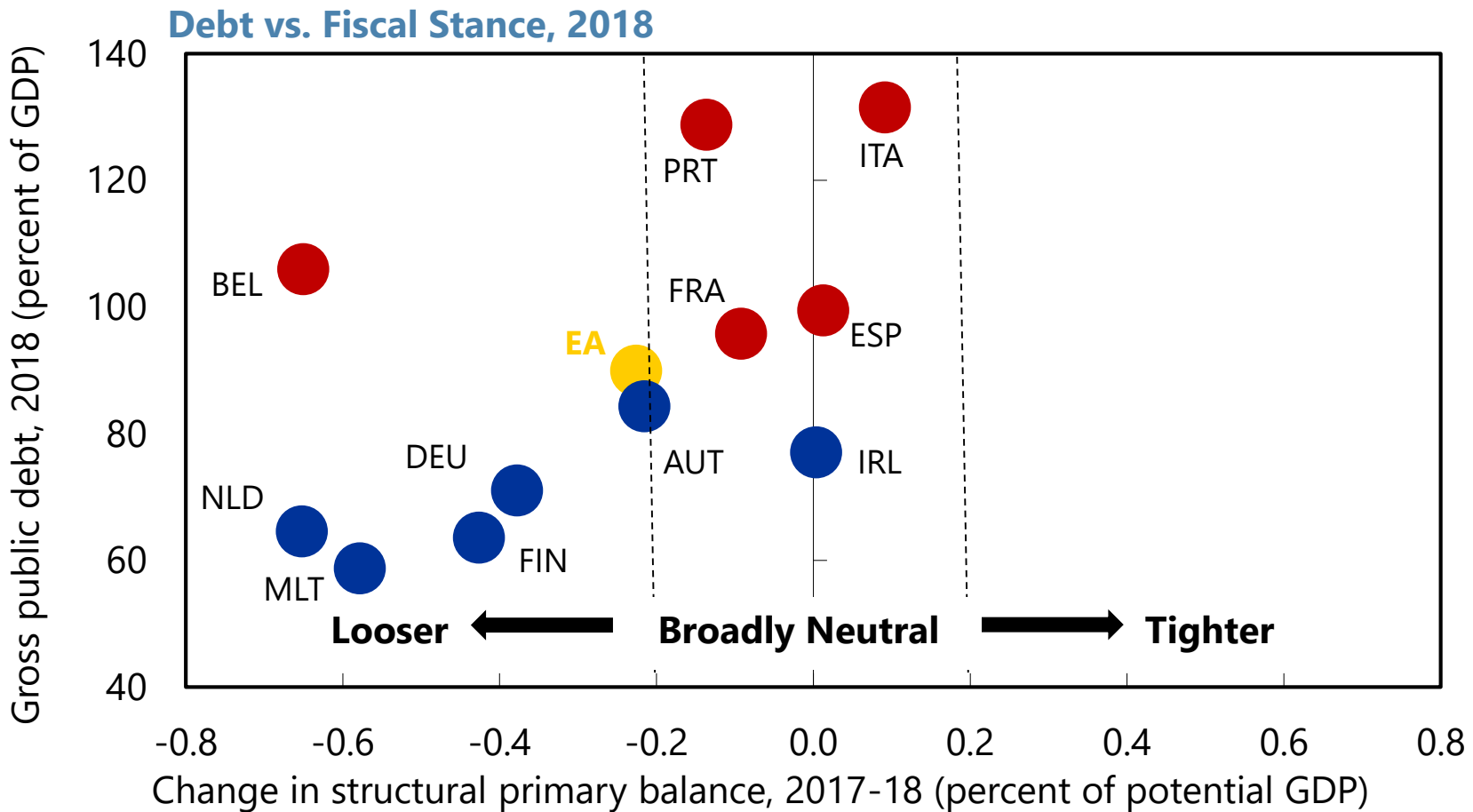
General Government Net Lending and Borrowing

(In percent of GDP)



Source: IMF, World Economic Outlook, October 2017, and final 2017 outturns.

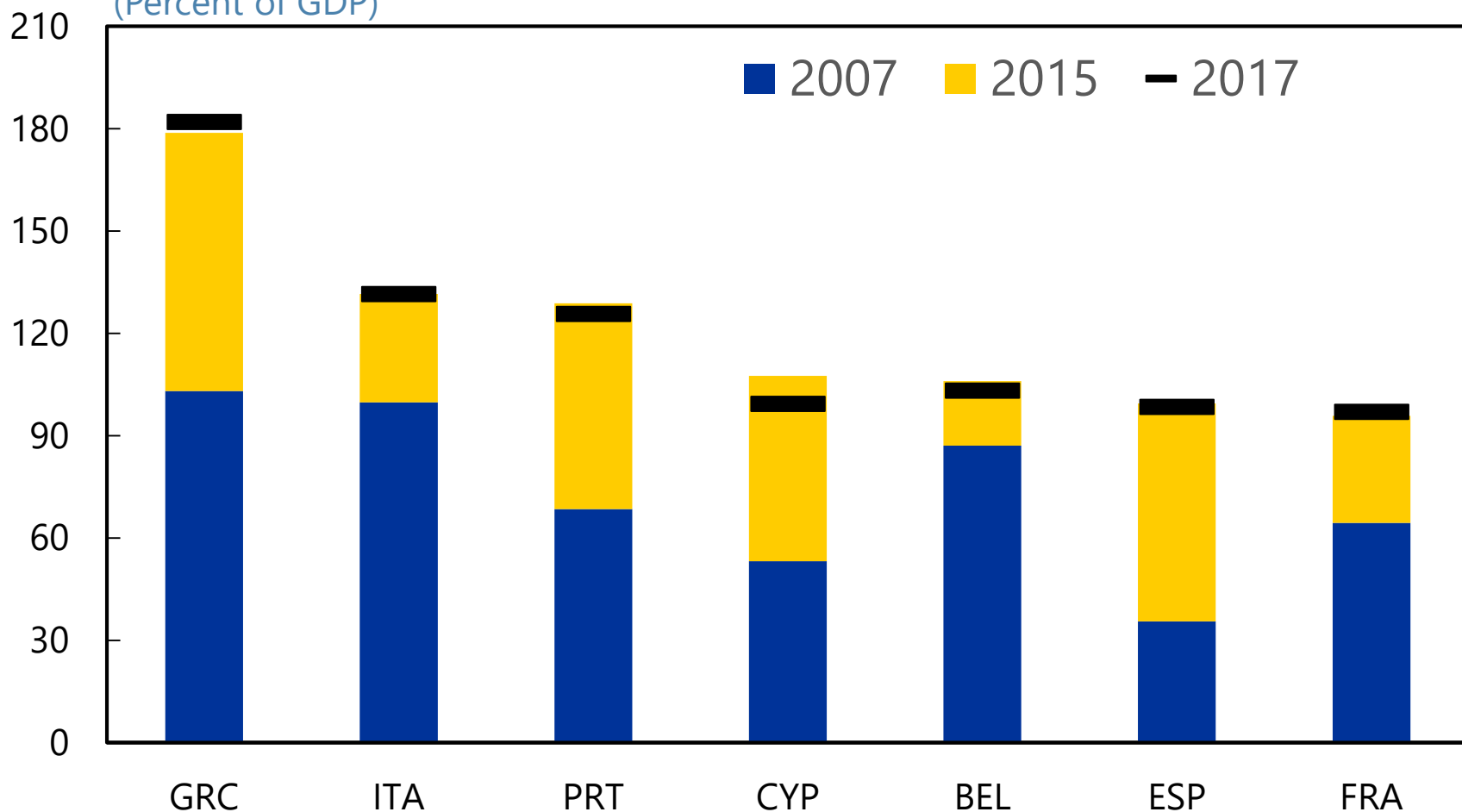
But high-debt country countries are still not consolidating enough



Source: IMF, WEO.

In return, the high debt load remains a key risk

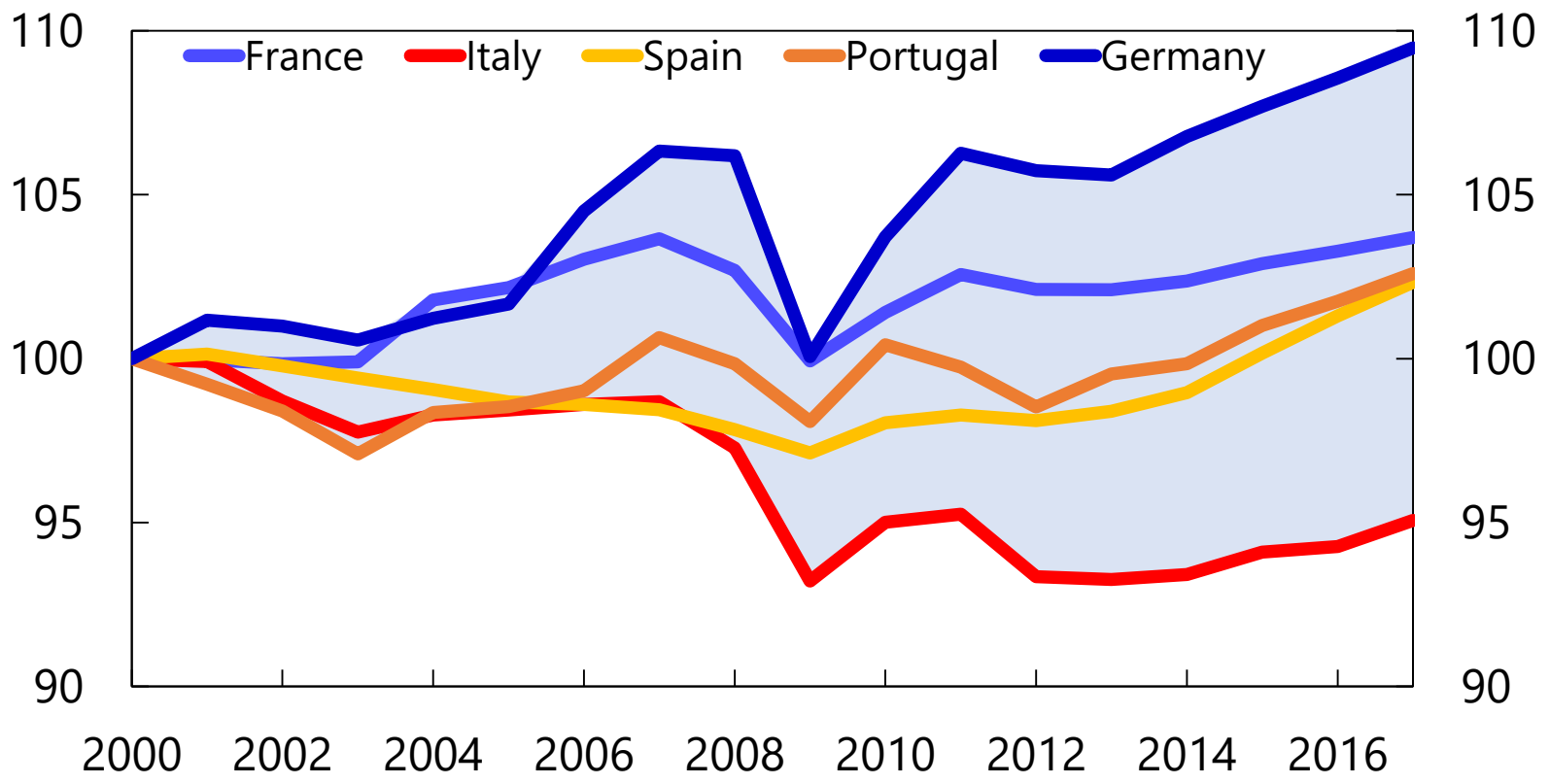
Gross Public Debt (Percent of GDP)



Source: IMF, World Economic Outlook.

Wide productivity gaps remain a threat to euro area cohesion

Total Factor Productivity
(2000=100)

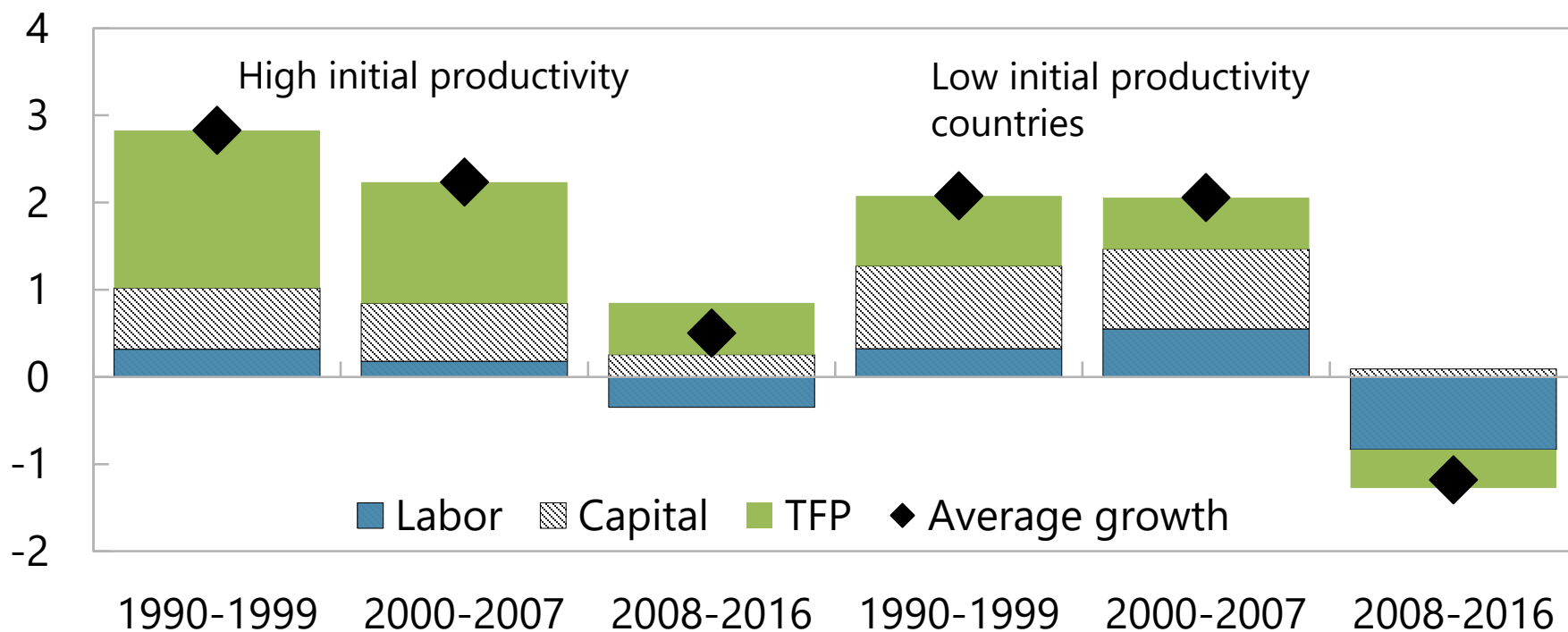


Sources: IMF, WEO; Eurostat; and IMF staff estimates.

Productivity growth in southern euro area countries slowed relative to others

Contributions to GDP Growth

Average annual real GDP per capita growth rates in percent, unweighted

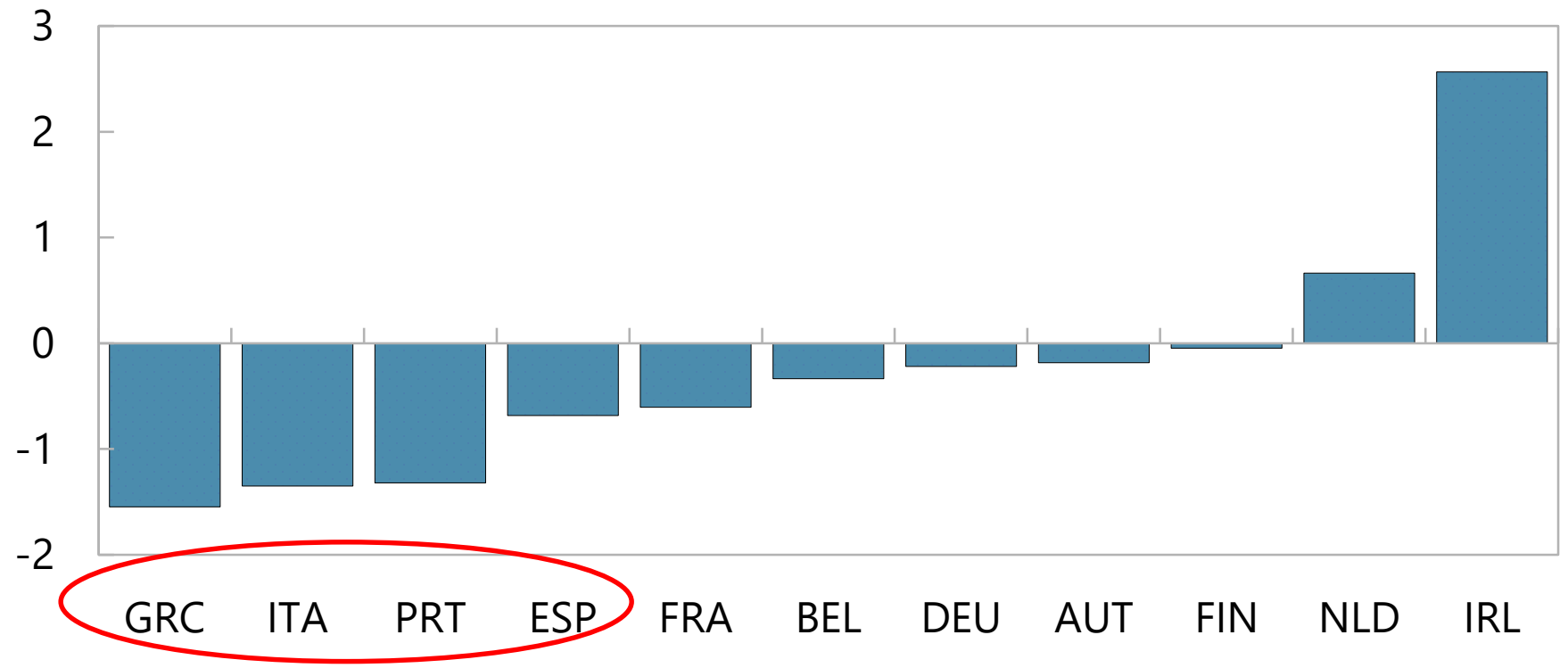


Note: Productivity groups defined on the basis of labor productivity. Countries with high initial productivity include Austria, Belgium, Finland, France, Germany, Ireland, and the Netherlands. Countries with **low initial productivity include Greece, Italy, Portugal and Spain**. No 1990s data available for Austria. Excludes Luxembourg. Sources: AMECO, Haver Analytics, and IMF staff calculations.

Which means that these countries fell short of growth expectations held at the beginning of EMU

Growth Performance v. Convergence Expectations, 1993-2015¹

Actual minus adjusted average annual growth in PPP GDP per capita, in percentage points



1/ Convergence expectations are defined as a country's hypothetical average annual PPP GDP per capita growth implied by its 1993 GDP level and its previous degree of convergence between 1960 and 1992. Excludes Luxembourg.

Source: WEO, and IMF staff calculations.

Policy recommendations

Robust and integrated financial sector

- → **Complete Banking Union** (SRF backstop; EDIS)
- → **Repair balance sheets** (reduce NPLs)
- → **Build a European Capital Markets Union**

Sound fiscal policies and shock insurance

- → **Growth-friendly national fiscal policies**
- → **Simplified, enforceable EU fiscal rules**
- → Support macroeconomic stabilization through a **Central Fiscal Capacity**

Structural reforms

- → **Country-specific structural reforms to enhance resilience and boost productivity growth** (product and labor markets; business environment)
- → **Strengthen EU reform governance** (benchmarking; fiscal incentives; coordination)

In conclusion:

Robust growth, but beware rising downside risks:

- Complacency and insufficient buffers
- Protectionism
- Political uncertainty and market volatility
- Asynchronous monetary policies and spillovers into EMs

Complacency at the national level is worrisome:

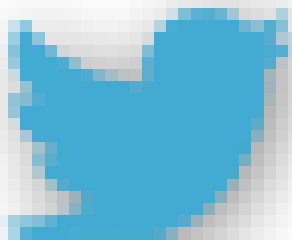
- Complacency on consolidation to **create fiscal space** in high-debt countries
- Complacency on structural reforms to **address persistent productivity gaps**

Lack of consensus on EMU architecture: Makes the EMU still insufficiently prepared for the next crisis

Yet, as the ECB's monetary normalization draws closer, the ***window afforded by supportive financial conditions will close. Countries should act now!***



Thank You!



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