EURO AREA:
PROSPECTS AND POLICIES

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Director, IMF Europe Office

June 2018
Growth in advanced economies is strong

**Real GDP Growth Projections (April 2018 World Economic Outlook)**
*(percentage change from a year earlier)*

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>U.S.</th>
<th>U.K.</th>
<th>Japan</th>
<th>Euro Area</th>
<th>DEU</th>
<th>FRA</th>
<th>ITA</th>
<th>ESP</th>
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<tr>
<td>2018</td>
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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)

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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)

Unemployment
Participation rate (RHS)
Structural unemployment

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)

Source: IMF, World Economic Outlook.
However, recent high-frequency indicators may suggest a weakening...
Economic challenges loom over the medium term

- Financial sector weakness
- Structural issues, incl. weak productivity growth
- High public debt

Core inflation and wage growth edging up, but still too low
NPLs are coming down, credit is growing. Further effort needed.

NPL Ratio and Credit Growth
(Percent of gross loans)

Source: ECB, Consolidated Banking Database.
Bank profitability is weak, and partly reflects overbanking

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

Debt vs. Fiscal Stance, 2018

- Gross public debt, 2018 (percent of GDP)
- Change in structural primary balance, 2017-18 (percent of potential GDP)

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


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)
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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