Lessons from the euro crisis

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6th BBVA Seminar for Public Sector Investors and Issuers
Valencia, 23 March 2017
The European economy after the crisis

1. **A comprehensive crisis response brought the euro area back to**
   - equitable growth
   - more balanced macro-economic position
   - safer banks

2. **Overcoming legacies takes persistent efforts – more work needed**
   - Unemployment
   - Investment and productivity
   - Financial legacy assets

3. **Making the euro area more robust – better risk-sharing**

4. **Why populists are wrong about the euro area**
1. Europe’s comprehensive response to the crisis

- Budget consolidation and structural reform in euro area countries
- Accommodative monetary policy, including unconventional measures
- Closer economic policy coordination in the currency union
- Strengthening the banking system
- Firewalls against the crisis: EFSF and ESM
1. Growth in Europe: back to normal

Note: Figure for Ireland in 2015: 26.3%
Source: EC European Economic Forecast – Winter 2017
1. Growth in Europe is moving in line with the U.S. again

Per capita growth in US and EU is very similar

Average GDP growth per capita, 1999-2008
- Euro area: 1.6%
- US: 1.6%

Source: EC European Economic Forecast – Winter 2017
…but income equality in Europe is much greater than in the U.S.

Ratio of highest 10% earners vs lowest 10% earners in US and European countries

Note: Gross earnings of full-time dependent employees
Source: OECD
1. Fiscal deficits are shrinking

**Government balance in programme countries (% of GDP)**

Note: Government balance for Ireland in 2010: -32.4%
Source: European Commission Economic Forecast – Winter 2017
1. Competitiveness is improving

Thanks to the convergence in competitiveness, external imbalances in the periphery have disappeared.

Source: EC European Economic Forecast – Winter 2017
1. Employment in Europe better than recognized

- Unlike in previous crises, participation and employment rate did not fall in Europe

Cumulative percentage point change since 2000
Age group: 16-64
Source: EC European Economic Forecast – Winter 2017
2. Youth unemployment still unacceptably high

- Unemployment rate still above pre-crisis levels
- High youth unemployment particularly concerning

Source: Eurostat
2. The investment gap after the crisis

- Investment critical for both recovery and long-term growth
- Both public and private investment stay below pre-crisis levels

Euro area: public and private investment
(% GDP, cum. p.p. change since 2000)

Spending on R&D (% GDP)

Source: EC European Economic Forecast – Winter 2017
2. Europe: Non-Performing Loans are stalling at a high level…

Source: Standard & Poor’s (SNL Financial), banks’ annual reports, ESM calculations
3. How to make the euro more robust

- No full Fiscal Union needed

- No full Political Union needed

- Complete Banking Union
  - European Deposit Insurance
  - Backstop for the SRF

- Capital Markets Union
  - To facilitate private sector efforts for financial integration
  - More capital flows, more risk sharing
  - Address taxation, insolvency and company law issues

- Fiscal Union
  - Limited fiscal capacity for the euro area
Risk sharing is underdeveloped in the EU and euro area

- Economic risk sharing in the euro area is lagging behind the US

Percentage of shock smoothed by different channels

- Credit market
- Capital market
- Fiscal

Source: Bruegel and IMF
4. Why populists are wrong about the euro area

Myth #1: Euro area is underperforming
- Euro area is doing better than generally recognised – per-capita growth close to the US, more equal income distribution, overcoming imbalances and making banks safer

Myth #2: Euro area too rigid to respond to policy challenges
- Remarkable achievements over the crisis: SGP reform, banking union, country programmes all agreed jointly around one table – historically unprecedented success

Myth #3: Euro area is flawed and source of the crisis
- Diversity in income is not an issue. Imbalances due to policy mistakes caused the crisis, not the euro. But imbalances were successfully addressed within monetary union.

Myth #4: Euro area countries can do better when exiting
- Leaving the euro area would only make people poorer, not richer if the fundamental problems of a country are not resolved
5. How do Europeans see the EU?

<table>
<thead>
<tr>
<th>EU as a place of stability</th>
<th>Support for the EU four freedoms</th>
<th>Support for the euro</th>
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<tbody>
<tr>
<td><strong>Total ‘Agree’</strong></td>
<td><strong>For</strong></td>
<td><strong>For (euro area)</strong></td>
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<tr>
<td><strong>Total ‘Disagree’</strong></td>
<td><strong>Against</strong></td>
<td><strong>Against (euro area)</strong></td>
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<td>66%</td>
<td>81%</td>
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Source: Eurobarometer, October and November 2016, EU28
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