THE EURO AREA AT A CROSSROADS

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MONETARY UNION HAS IMPORTANT ACHIEVEMENTS …

• The ECB has become a highly competent institution
  • Monetary policy has been conducted with great skill

• The run-up to EMU, provided strong incentives for countries to reform:
  • There was significant structural reform.
  • Convergence and income growth
  • Fiscal responsibility improved in highly indebted countries

• Recently, banking union and the development of common supervision and regulation
... HOWEVER, SIGNIFICANT CHALLENGES FACE THE MONETARY UNION, WHICH – UNLESS ADDRESSED – COULD ENDANGER ITS LONG-TERM VIABILITY:

- Weak economic growth and convergence
- Inadequate fiscal policy
- Continued concerns about financial sector health
- Governance structures have not been adequate for the challenges faced

→ These issues are all interrelated
SLOW GROWTH AND INVESTMENT RECOVERY

Real GDP
(2008=100)

Real investment
(2008=100)

Source: Haver Analytics and IMF staff calculations.
LONG-TERM SLIPPAGE IN PRODUCTIVITY GROWTH

Slowdown in Total Factor Productivity Growth
(GDP-weighted, average annual growth, in percent)

Sources: AMECO. Periphery: Greece, Ireland, Italy, Portugal and Spain. Core: Austria, Belgium, Finland, France, Germany and the Netherlands.
REAL INCOME CONVERGENCE HAS STALLED

σ-Convergence Across EA Countries, 1960-2015
Coefficient of variation, PPP GDP per capita

Sources: WEO database and IMF staff calculations.
1/ Excludes Luxembourg.
2/ Includes Ireland from 1970 and the Netherlands from 1980 onwards.
3/ Includes Lithuania from 1995 onwards.
FISCAL POLICY HAS NOT BEEN ADEQUATE

Constraint
- MTO
- Adjustment path toward MTO
- Expenditure benchmark
- 3 percent deficit
- 60 percent debt
- 1/20th debt reduction criterion
- Annual nominal balance targets under EDP
- Annual fiscal effort under EDP
- Fiscal compact (national structural balance rule)

Fiscal aggregate
- Nominal fiscal balance (level)
- Net expenditure growth
- Structural fiscal balance (level)
- Structural fiscal balance (change)
- Public debt (level)
- Public debt (change)

Non-compliance with 3 percent of GDP deficit ceiling
(percent of years, 1999-2013)
PERSISTENT BANKING PROBLEMS LIMIT CREDIT GROWTH

Nonperforming Loans and Write-offs

Bank Credit to Non-Financial Corporations
Annual Growth Rates


Note: */ as of end-Sept. 2015 for the United States and
THE STRUCTURAL DIMENSION IS ALSO LAGGING

Country Compliance with Country Specific Recommendations (CSRs)
(Index, full compliance = 4)

Source: European Commission, and IMF staff calculations.
Note: The EC assesses progress on CSR on the scale: none (0), limited (1), some (2), substantial (3), full (4).
1/ IRL and PRT data are for 2014 since these countries fell outside the Macro Imbalance Procedure framework in 2013.
COLLECTIVE, COMPREHENSIVE ACTION NEEDED TO BOLSTER GROWTH AND STRENGTHEN THE UNION

- Strengthen fiscal framework while expanding centralized fiscal support
- Accelerate balance sheet repair and complete the banking union
- Create better incentives for growth-friendly structural reforms

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BOOSTING PRODUCTIVITY AND GROWTH

• Undertake productivity-enhancing structural reforms
  • **Union level**: Digital single-market, capital markets union, concentrate spending on growth-boosting activities. Provide greater incentives for countries to reform.
  • **Country level**: undertake greater reforms in product, services, and labor markets. Reorient spending toward growth-boosting activities

• Juncker plan and similar initiatives

• Banking reforms will help

• Capital Markets Union
MORE ROBUST RULES AND GREATER CENTRALIZED FISCAL SUPPORT

• Compliance with fiscal rules has been weak

• Simplify and strengthen the framework:
  • Debt-to-GDP could be the ultimate fiscal anchor and expenditure growth the single operational target
  • More automatic enforcement

• Centralized fiscal support desirable:
  • “Rainy day fund”, unemployment insurance, etc.
  • Central fiscal support could be contingent on compliance with country-specific recommendations
REPAIR BALANCE SHEETS AND COMPLETE BANKING UNION

• **SSM: Comprehensive assessment revealed high NPLs**
  • Apply strict supervisory monitoring of banks’ NPL reduction targets
  • Impose additional bank-specific capital requirements as needed

• **SRM not yet complete:**
  • SRF needs a common fiscal backstop
  • EU-wide deposit guarantee scheme

• **Capital Markets Union can diversify funding sources and facilitate cross-border private-sector risk-sharing**
  • SME securitization
  • Insolvency frameworks
IMPROVE EMU GOVERNANCE

• “Carrots and Sticks”

• Structural reform incentives

• Banking sector architecture

• Fiscal: Simplification, enforcement and incentives
Thank You!

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