EUROZONE: STRENGTHENING RESILIENCE IN COMPLEX TIMES

Jeffrey Franks
Director, IMF Europe Office

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1. ECONOMIC OUTLOOK
2. SHORT TERM RISKS
3. MEDIUM TERM CHALLENGES
4. POLICY RECOMMENDATIONS
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Economic outlook

Disappointing 2018 Q3 and Q4

GDP growth
Quarter over quarter, percentage change

Sources: IMF IFS, Haver analytics, IMF staff calculations.
Slowing trade and industrial production

World trade and industrial production

Three-month moving average; annualized percent change

Sources: Haver analytics, CPB, IMF staff calculations.
Market indicators show a softer momentum

**Composite PMIs**
>50 = expansion, sa

**Manufacturing PMIs**
>50 = expansion, sa

**Manufacturing PMIs export orders**
>50 = expansion, sa

Sources: Haver analytics, Markit, IMF staff calculations.
## Advanced economies

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>Advanced Economies</th>
<th>U.S.</th>
<th>U.K.</th>
<th>Japan</th>
<th>Euro Area</th>
<th>Germany</th>
<th>France</th>
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**Revision from Oct. 2018**

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### Emerging economies

<table>
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<th>Emerging Market and Developing Economies</th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>Russia</th>
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<th>Low Income Developing Countries</th>
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Risks to the outlook are tilted to the downside

Immediate risks include:

- An escalation of trade tensions
- Sharper slowdown in China
- A no deal Brexit
- Renew market uncertainties
- Political discontents (e.g. Gilets Jaunes)
G20 Advanced Economies
Real GDP in trade tensions scenarios

Risks

Slowing demand in China under the impact of trade sanctions

China GDP growth
Quarterly, y/y percent change, sa

Sources: China NBS, IMF staff estimates.
A no-deal Brexit would be costly

**Long-Term Impact of Brexit: WTO scenario**
(Decline in the level of output compared to a non-Brexit scenario; In percent)

- GBR
- IRL
- NLD
- DK
- BEL
- CZE
- SWE
- HUN
- DEU
- POL
- AUT
- GRC
- PRT
- SVK
- SVN
- FRA
- ESP
- ITA
- FIN

**Short term risks**
- Widespread disruptions of production
- Decline in confidence
- Financial volatility and asset prices decline

Source: IMF staff estimates.
Market confidence: Italian spreads remain elevated

10-Year Government Bond Yield Spread
(Versus Bunds, basis points)

Sources: Bloomberg Finance L.P.
Risks

Financial markets have weakened

**Equity markets**

Index, 2015-01=100

- Euro STOXX 50
- S&P 500
- UK FTSE 100

Sources: Haver analytics, Markit, IMF staff calculations.
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Euro area recovery has been slower

Real GDP
(2008=100)

Sources: IMF WEO, IMF staff estimates.
Productivity gaps is widening relative to the U.S. ...

**Total factor productivity**

(2000 = 100)

Sources: European Commission, AMECO.
Challenges

... and within the euro area

Total factor productivity
(2000 = 100)

Sources: European Commission, AMECO.
Unemployment rates are now closer to their pre-crisis level but remain elevated.

Unemployment rate  
(Percent)

Sources: Eurostat.
Little consolidation is planned in 2019...

### 2019 Budgets
(Change in primary structural balance, percent of potential GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>IMF Projection</th>
<th>IMF Recommendation</th>
<th>SGP Requirement 1/</th>
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<td>Spain 2/</td>
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<td>France 3/</td>
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Sources: WEO and country authorities.

1/ SGP requirement on the structural balance is adjusted for the change of interest expenses to translate it into the primary structural balance.
2/ The IMF projection assumes the extension of the 2018 budget and already legislated measures.
3/ This corresponds to the average for 2019-20. The IMF projection is based on legislated and identified measures only.
Challenges

... in an environment of high debt

Gross public debt
Percent of GDP

Sources: IMF WEO, IMF staff estimates.
The health of banks is improving but risks remain.

Non-Performing Loans
(Percent of gross loans)

Return on Equity
(Percent)

Note: Cyprus and Greece excluded.
Source: ECB.

Note: The ROEs are average of 100 largest banks.
Sources: Bloomberg Finance L.P., Fitch; and IMF staff calculations.
Strong bank-sovereign links leave no room for complacency

Bank Holdings of Domestic Sovereign Bonds
(Percent of bank assets)

Source: ECB.
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Policy priorities

Multilateral cooperation is needed!

Trade

→ Deescalate tensions
→ Address sources of dissatisfaction with the rules based trading system
→ Limit disruptions related to Brexit

More cooperation

→ Financial regulatory reform
→ International taxation to avoid tax evasion
→ Building a financial safety net
→ Mitigating and adapting to climate change
Policy priorities

Structural reforms to boost productivity

→ **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)
Sound fiscal policies and shock insurance

- National fiscal policies towards reduction of imbalances
- Simplified, enforceable EU fiscal rules
- Support macroeconomic stabilization through a Central Fiscal Capacity
More robust and integrated financial sector

- Complete the Banking Union (operationalize the SRF backstop; EDIS)
- Continue to repair balance sheets (reduce NPLs)
- Build a European Capital Markets Union
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