Markets have been stabilizing and there are some signs of growth, but the recovery is still weak and fragile.

Why is this happening? There are downdrafts from fragmentation, balance sheet weakness, fiscal drag and policy uncertainty; structural rigidities are amplifying the hit to jobs.

What should be done? Euro area and national level policies need to tackle each of the factors listed above.
UPDATE ON EUROPE

What’s happening in financial markets?

CDS Spreads
(Basis points weighted by debt)

Sovereign

Emerging Europe

Periphery (excl. Greece)

Core

Jan-10  Jan-11  Jan-12  Jan-13  Oct-13

0  100  200  300  400  500  600  700
UPDATE ON EUROPE

What’s happening in financial markets?

Sovereign Bond CDS Spreads
(Basis points weighted by assets)

Bank

Periphery (excl. Greece)
Core

Jan-10 Jan-11 Jan-12 Jan-13 Oct-13
UPDATE ON EUROPE

What’s happening in financial markets?

10-year Sovereign Yields
(Percent)

Pre-OMT (July 2012)
Pre-US Fed (May 2013)

US pass through
DEU & FRA: 0.6
ITA & ESP: 1.0

DEU  FRA  IRL  ITA  ESP
UPDATE ON EUROPE
What’s happening in the real economy?

WEO Growth Projections and Revisions
(Percent; cumulative 2013-14)

January -Latest

EA
DEU
FRA
ITA
ESP
PRT
IRL
What’s happening in the real economy?

Euro Area: PMI and Real GDP Growth

PMI (SA, composite; 50+ = expansion) Q3 = July and August flash data avg.

Real GDP growth (qoq)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>PMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010Q1</td>
<td>54.5</td>
<td>56.7</td>
</tr>
<tr>
<td>2011Q4</td>
<td>49.8</td>
<td>51.3</td>
</tr>
<tr>
<td>2013Q3</td>
<td>58.5</td>
<td>55.2</td>
</tr>
</tbody>
</table>
UPDATE ON EUROPE

What’s happening in the real economy?

Euro Area HICP Inflation
(Percent, with constant tax rate)
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What’s happening in the real economy?

Total Unemployment Rate

2007-Latest

AUT DEU LUX NLD MLT FIN BEL SVN FRA ITA EA IRL CYP SVK PRT ESP GRC

0 5 10 15

Total Unemployment Rate - Latest
UPDATE ON EUROPE

What’s happening in the real economy?

Youth Unemployment Rate

2007-Latest
UPDATE ON EUROPE What’s happening in the real economy?

Unemployment and Political Strife

Change in ICRG political risk rating (adjusted)

Unemployment rate

2007

CYP SVN EST ITA GRC
BEL FRA SVK PRT
ESP MLT NLD LUX FIN DEU
UPDATE ON EUROPE

What’s happening in the real economy?

Unemployment and Political Strife

Change in ICRG political risk rating (adjusted)

Unemployment rate

2012

Countries: DEU, AUT, FRA, ITA, SVN, PRT, ESP, GRC, LUX, FIN, NLD, SVK, IRL, BEL
Has the economy of your country been made stronger or weaker by the economic integration in Europe?

(Balance of responses)
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What’s happening in the real economy?

Avg. Correlation of Europe Uncertainty and Growth, 2007-13

Stressed Economies

Core
UPDATE ON EUROPE

Why is it happening?
UPDATE ON EUROPE

Why is it happening?

Change in Cross-border Financial Linkages

pre-crisis
Change in Cross-border Financial Linkages

post-crisis
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Why is it happening?

Fragmentation and Interest Rates, 2010-Latest

Interest rates on new loans to NFCs (percent)

Average bank CDS spreads (bps)

DEU
ESP
ITA
FRA
UPDATE ON EUROPE

Why is it happening?

SME Lending Rate and Output Gap, 2012

SME lending rate vs. Output Gap for various European countries. The graph shows a negative correlation between SME lending rates and output gap, indicating that countries with larger output gaps tend to have higher SME lending rates. Countries are represented by their national flags, and the data points are plotted accordingly.
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Why is it happening?

SMEs Access to Finance and Employment

Proportion of SMEs where access to finance is most pressing problem vs. Percent share SME in employment (2010)

Countries: DEU (Germany), FRA (France), ITA (Italy), PRT (Portugal), ESP (Spain), FIN (Finland), AUT (Austria), BEL (Belgium)

Legend:
- DEU (Germany)
- FRA (France)
- ITA (Italy)
- PRT (Portugal)
- ESP (Spain)
- FIN (Finland)
- AUT (Austria)
- BEL (Belgium)

EA (Europe)
UPDATE ON EUROPE

Why is it happening?

Growth and Balance Sheet Stress

(Private sector)

Cumulative GDP growth since 2008

Private Sector Balance sheet stress, 2007
UPDATE ON EUROPE

Why is it happening?

Over-indebtedness and Long-term Growth
(Debt above threshold)

1 over-indebted sector
2 over-indebted sectors
3 over-indebted sectors

Impact on growth

Government

Corporate

Household
Household Deleveraging Episodes
(Change in household debt, percent of GDP)

Historical episode

Current episode

Boom
End

0  20  40  60  80

CAN  JPN  SWE  DEU  FIN  GBR  NOR  DNK  USA  NOR  PRT  GBR  SWE  ESP  AUS  GRC  NLD  DNK  CYP  IRL
Household Deleveraging Episodes
(Contribution to the change in debt-income ratio)
Corporate Deleveraging Episodes
(Change in corporate debt, percent of GDP)

Historical episode

Current episode

GBR  NOR  JPN  AUS  FIN  SWE  ITA  FRA  GBR  PRT  ESP  IRL

Boom
End
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What should be done?
UPDATE ON EUROPE

What should be done?

Loss recognition
Recapitalization
Recap Backstop

Repair
Balance
Sheets
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What should be done?

- Single Supervisory Mechanism
- Single Resolution Mechanism
- Backstop for resolution
- Fiscal integration
- Complete EMU Architecture

[Diagram showing conceptual blocks related to European Union governance and economic integration]
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What should be done?

Conventional ECB policy
Unconventional ECB policy
Gradual fiscal adjustment

Increase
Demand
Support
Europe’s Remaining Challenges

Dublin Economics Workshop
Limerick - October 19th 2013

Peter Breuer