

Quarterly Report on the Euro Area (QREA)

Vol.13, No. 4 (2014)

The focus section reviews the issue of cross-border spillovers, with an emphasis on the euro area. Close linkages in the euro area imply that macroeconomic policies can have significant spillovers. In particular, spillovers from fiscal policy shocks can be sizeable and model simulations show that increasing investment in euro area countries with fiscal space could have significant positive spillovers. Structural reforms are generally found to generate positive but rather small spillovers, although their simultaneous implementation across the euro area can lead to larger output gains. Financial spillovers were large during the crisis. An analysis of the bilateral spillover effects of sovereign credit risk shows considerable heterogeneity in the size of financial spillovers and asymmetry in the bilateral linkages between Member States.

The first special topic presents DG ECFIN's medium-term growth projections and assesses the risks of secular stagnation. It argues that the euro area is facing a decline in potential growth, mostly due to weak productivity and ageing. The negative growth effect of this medium-term supply trend, which started before the great recession, has been aggravated by downside demand pressures due to the correction of macroeconomic imbalances accumulated in pre-crisis years. The correction process is slow but ongoing and should be facilitated by measures taken to repair the financial sector. The recently announced Investment Plan for Europe and a renewed commitment to structural reforms are also essential to counter risks of secular stagnation in the euro area.

The second special topic assesses the progress made in terms of external rebalancing in the countries that accumulated large current account deficits prior to the crisis. It finds that, in a number of countries, the process of rebalancing is not finished yet as high stocks of external debt still need to be addressed. Risks to the rebalancing process relate to lower-than-projected inflation and growth.