The Outlook for Europe and the Commission's Recommendations

Meeting of BusinessEurope's Advisory and Support Group

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The economic outlook and the Commission's recommendations

Is the sun shining over Europe? (Forecast)
Next question: What should be done?

"The time to repair the roof is when the sun is shining."
President Kennedy
State of the Union Address 1962

"We must complete the European House now that the sun is shining and whilst it still is."
President Juncker
State of the Union Address 2017
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"Continued economic growth in a changing policy context"

(Autumn 2017 Forecast)

Key messages

• Accelerating growth in Europe with all Member States participating.
• Robust employment growth ahead and lower unemployment.
• The recovery still has a way to go.
• The outlook for inflation remains subdued amid sluggish wage growth.
• Deficit and debt ratios continue declining.
• Risks to the outlook are broadly balanced.
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A rather subdued recovery until recently

Euro area GDP recovered slower than in the past...

...mainly due to weak private consumption...

Note: Recoveries according to decisions by the CEPR Business Cycle Dating Committee (data sources: AWM database and Eurostat).
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**Investment is finally reviving**

... but investment has recovered relatively strong...  ... from low levels of the investment-to-GDP ratio.

*Note: Recoveries according to decisions by the CEPR Business Cycle Dating Committee (data sources: AWM database and Eurostat).*
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Recovery is broadening but not fully complete yet

- Investment gap
- Erosion of potential growth
- Persistently low inflation
- Low "indigenous" growth
- "Excessive" external dependence
- Labour market slack
- Low "indigenous" growth
- Accelerator trap
- External surplus
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"Missing inflation" in the euro area

Inflation has remained subdued given labour market improvements...

...reflecting persisting slack and structural features...

Graph I.28: Wages and inflation, euro area

Graph I.49: Unemployment and labour market slack, euro area
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Supportive factors: the external environment

A synchronised global upswing,...

...a continued rebound in global trade,...
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Supportive factors: financing conditions

Favourable financing conditions in the euro area

...due to accommodative monetary policy.

Sources: ECB, Bloomberg, own calculations.
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Supportive factors: a broadly neutral fiscal stance

Graph I.63: Budgetary developments, euro area

- General government balance (% of GDP)
- Structural balance (% of potential GDP)

Forecast
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Exchange rates and Brexit

A moderate euro appreciation weighs only marginally on GDP

Brexit: A purely technical assumption

Given the ongoing negotiation on the terms of the UK withdrawal from the EU, projections for 2019 are based on a purely technical assumption of status quo in terms of trading relations between the EU27 and the UK. This is for forecasting purposes only and has no bearing on the talks underway in the context of the Article 50 process.

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<td>United Kingdom</td>
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<td>EU28</td>
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The recovery is forecast to continue

Real GDP set to continue growing at about 2%...

...with domestic demand contributing strongly.

*Figures next to horizontal bars are annual growth rates.*
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Labour market conditions to improve further

Euro area employment growth expected to moderate...

...while the unemployment rate falls to pre-crisis levels.
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**Inflation set to increase modestly**

HICP inflation expected to remain below 2% by 2019...

...still also affected by base effects from past oil prices
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Public finances set to continue improving

Lower interest expenditures support decline of deficits...

...and keep public debt ratios on declining path.
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**Broadly balanced risks**

External downside risks are substantial...

**External risks**
- Elevated geopolitical tensions
- Tighter global financial conditions
- Shifting US trade policies
- Disorderly adjustment in China
- Oil price increase stronger than assumed
- The synchronous rebound

**Domestic risks**
- Faster steepening of the yield curve
- A stronger euro
- Outcome of Brexit negotiations
- Improving sentiment
- More dynamic investment
- Further progress on completion of EMU

...but overall risks to growth are broadly balanced.

Graph: Fan chart, euro area GDP
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Conclusion: The sun will be shining for a while! (Forecast)

Next question: What should be done?

Does "repair" mean to rebuild old structures... ...or using state-of-the-art tools and knowledge?
Deepening EMU, a process to be completed by 2025

- **22 June 2015**: Five Presidents' Report on Completing Europe's Economic and Monetary Union
- **1 March 2017**: the White Paper on the Future of Europe
- **31 May 2017**: Reflection Paper on the Deepening of the Economic and Monetary Union
- **13 September 2017**: President Juncker's State of the Union Speech
- **11 October 2017**: Communication from the Commission on Completing the Banking Union
- **6 December 2017**: [EMU package of proposals](#) adopted by Commission
- **15 December 2017**: Euro Summit
- **2018 – 1H2019**: Decisions under the current EU legislature
- **2H2019**: New mandate for European institutions
- **By 2025**: Complete EMU
## EMU institutional changes since 2011

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<th>Fiscal</th>
<th>Stronger preventive arm SGP</th>
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<td>Introduction of an expenditure rule (6-P) and balanced budget rule (TSCG)</td>
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<td>Possibility of imposing sanctions (6-P)</td>
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<td>Surveillance of draft budgetary plans by Commission (2-P)</td>
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<td>Stronger corrective arm SGP</td>
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<td>Introduction of a numerical debt benchmark (6-P)</td>
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<td>Earlier and more gradual sanctions (6-P)</td>
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<td>More automaticity in decision-making via new voting scheme (TSCG)</td>
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<td>Enhanced surveillance for MS threatened with financial difficulties (2-P)</td>
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<td>National fiscal frameworks</td>
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<td>Mandatory minimum requirements at the national level (accounting &amp; statistics, forecasts, fiscal rules monitored by independent bodies, transparency)</td>
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<th>Macro</th>
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<td>Prevention and correction of macroeconomic imbalances via the introduction of the Macroeconomic Imbalance Procedure (MIP) (6-P)</td>
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<th>Crisis resolution mechanism</th>
<th>ESM, ECB OMT</th>
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<td>European Stability Mechanism (ESM)</td>
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<td>OMT programme by the European Central Bank (ECB)</td>
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<td>Macro-prudential: European Systemic Risk Board (ESRB)</td>
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<td>Micro-prudential: European Supervisory Authorities (ESAs) with EBA (for banks), ESMA (securities), EIOPA (insurance), national authorities etc.</td>
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<td>Single Supervisory Mechanism (SSM)</td>
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<td>Single Resolution Board (ERB) and Single Resolution Fund (SRB)</td>
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The case for completing the Economic and Monetary Union

A determined response to the crisis stabilised the situation, but challenges remain to be addressed

- Remaining sources of financial vulnerability, esp. given high public and private debt
  - Have the financial-sovereign doom loops been sufficiently severed?
- Low growth potential and persisting economic and social divergences
  - Can we create the right incentives for the necessary reforms (in good times)?
- Insufficient collective stabilisation tools
  - Does the EMU have the capacity to withstand the next large shock?
- Complex governance and democratic deficit
  - Can the decision-process be made more efficient and accountable?
Elements for a political synthesis *outlined in the Reflection Paper*

1. Financial Union
   - Complete Banking Union and Capital Markets Union

2. Economic and Fiscal Union
   - Economic and social convergence
   - Common fiscal stabilisation capacity

3. Institutions and Governance
   - Accountable institutions and effective governance
6th December "EMU package"

- Transformation of the ESM into a European Monetary Fund
- Creation of a dedicated euro area budget line in the EU budget
  - Stabilisation function
  - Structural reform assistance
  - Convergence instrument for euro pre-ins
  - Backstop for the Banking Union
- Integration of the substance of the TSCG into EU law
- European Minister of Economy and Finance
Elements for a political synthesis: the EMU package

1. Financial Union

- Complete Banking Union and Capital Markets Union

2. Economic and Fiscal Union

- Euro area budget line:
  - Backstop for the BU
  - Structural reform assistance
  - Convergence instrument for euro pre-ins
  - Stabilisation function

3. Institutions and Governance

- Transformation of the ESM into a European Monetary Fund
- Integration of the substance of the TSCG into EU law
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Communication on Banking Union (October 2017)