DEEPENING OF THE ECONOMIC AND MONETARY UNION – Taking stock of the Euro@20

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European Commission – DG Economic and Financial Affairs

A deepening EMU – where will it leave Sweden and Denmark?
Stockholm, 5 February 2019
Content

1. Coming of age: has the euro delivered on its objectives?
2. EMU@20=EMU@10+10
3. Reforms during the crisis but job still not completed
4. Euro ins, pre-ins and outs: charting the future together
The euro

- EU Member States using the euro
- EU Member States not using the euro
- Non-EU States

From 11 to 19 euro area Member States
GDP growth per capita broadly at par with the US

GDP per capita growth (%)

GDP per capita (in pps, US=100)

Source: Ameco
Credibility of the Central Bank

Inflation target versus actual inflation in EA-19*

In %

Dispersion** of HICP inflation

Notes:
* The EA-19 aggregate does not reflect the changing composition according to entry date in EA
** Dispersion measured as an unweighted standard deviation. 2018/19 projected values according to Autumn 2018 forecast. EA changing composition: according to entry date in EA

Source: Ameco
Not all Member States improved sufficiently public finance sustainability

Government debt/GDP (%)

10-year government bond yields (%)

Lehman Brothers default (sept-08)

Start of EA Sovereign debt crisis (Oct-09)

QE announcement (Jan-15)

« What ever it takes » (Jul-12)

Data source: AMECO
Real convergence mostly driven by 'new' euro area Member States

GDP per capita (in PPS) before and after the start of the financial crisis

Note: Countries which were in 1999 (left chart) and in 2008 (right chart) not members of the euro area are highlighted in red. The black regression line is based on the full sample of countries, the blue one excludes the 'new' euro area Member States, which are highlighted in red.

Source: Eurostat.
Imbalances and resource allocation

Increasing imbalances

Cumulative growth rate of non-tradable/tradable value added

Source: Commission calculations based on AMECO and Eurostat
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Origin of the EA crisis: my preferred reading

- A "sudden stop" crisis following capital misallocation in pre-crisis years
- A banking crisis triggered a feedback loop: bank solvency concerns $\rightarrow$ higher bond yields and debt service $\rightarrow$ default worries $\rightarrow$ deeper recession
- The euro-area crisis was not a fiscal crisis (apart from Greece), but lack of fiscal space hindered the policy response during the crisis
- Heterogeneity in the euro area much larger than assumed before the crisis: different growth models and agglomeration effects
- Structural divergences during the first 10 years of EMU led to divergent social and political preferences $\rightarrow$ "ultima ratio" mode
Upon sudden stops, short-term flows were replaced by central bank lending

Central bank lending to EA credit institutions

* start in 2002, ** start in 2004
Source: Eurostat
ECB intervention: rates and balance sheet

Source: Macrobond, ECB
Fiscal policy tends to be pro-cyclical

Fiscal stance over the economic cycle, EA 2011-2018e

- Pro-cyclical loosening
- Counter-cyclical restriction
- Pro-cyclical restriction
- Counter-cyclical loosening

Output Gap (% of GDP)

Change in Structural Balance (pps. of GDP)

Source: Commission calculations based on autumn 2018 Commission forecast
Programs: the euro-area crisis was not a fiscal crisis (apart from Greece)

Five financial assistance programmes

Ireland: €85bn, exit in 2013

Portugal: €78bn, exit in 2014

Spain: financial sector support; €40bn, exit in 2014

Greece: 1st €110bn in 2010, 2nd €172.6bn in 2012 and €86bn in 2015 €, exit in 2018

Cyprus: €10bn, exit in 2016
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EMU reform during the crisis: an overview

Sound fiscal policy
- More effective prevention of gross policy errors
  - Focus on structural balances
  - Expenditure benchmark
- Better enforcement of SGP rules
  - Sanctions
  - Two Pack: ex ante submission of draft budgets, closer monitoring
  - National layer: Directive on fiscal frameworks, Fiscal Compact

Focus on debt developments
- Debt reduction benchmark

Crisis resolution instruments
- EFSM/EFSF: temporary
- ESM: permanent
- ECB: OMT

Balanced growth
- Prevention and correction of macro imbalances
  - Procedure and sanctions
- Structural reform strategy (Europe 2020)
- Growth Compact
  (EIB, Structural funds, Projects bonds)
The job is not completed

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

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

3. Institutions and Governance
   - Accountable institutions and effective governance
Policy integration in the financial sector is progressing

- Economic objectives
  - Private risk sharing
  - Reallocation of excess savings via equity

- EU initiative
  - Banking Union
  - Capital Market Union

- Instruments
  - Delivered: SSM, SRM
  - Pending: EDIS, SRF backstop
  - Delivered: Action plan 17 proposals
  - Pending: 14 still ongoing
Impact of a central stabilisation capacity in bad times

Fiscal stance over the economic cycle, EA 2011-2018

Pro-cyclical restriction

Counter-cyclical restriction

Change in Structural Balance (pps. of GDP)

Output Gap (% of GDP)

Broadly neutral fiscal stance

Counter-cyclical loosening

Pro-cyclical loosening

Source: Commission calculations based on autumn 2018 Commission forecast
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The Euro and the Single market

The Euro created to tackle the “inconsistent quartet”

The Single Market: a priority area for Denmark and Sweden
### Single market perspective versus euro area perspective

<table>
<thead>
<tr>
<th></th>
<th>Single Market</th>
<th>Euro Area</th>
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<tbody>
<tr>
<td>Banking Union</td>
<td>Protect deposits, boost pan-European banking sector, promote most efficient lending conditions</td>
<td>Break the sovereign-bank doom loop, foster private risk sharing</td>
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<tr>
<td>Capital Market Union</td>
<td>Financing, investment, saving</td>
<td>Recycling of excess saving via equity</td>
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<tr>
<td>Stabilisation fund for</td>
<td></td>
<td>Supplementing national stabilisers in case of large shocks</td>
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<tr>
<td>the euro area</td>
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<td>Productivity boards,</td>
<td>Can improve the functioning of the Single market</td>
<td>Increase economic resilience to reduce agglomeration effects</td>
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<td>Support reform</td>
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<td>programme (including</td>
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<td>Reform Delivery Tool)</td>
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Eurogroup

- Role set out in Protocol No 14 to the Lisbon Treaty (entered into force on 1 December 2009)
- **Who:** EU-19 + relevant institutions (COM, ECB, …)
- President: elected for 2.5 years by EU-19
- Frequency: usually once a month, one day before Ecofin
- Work programme: set every 6 months
- Topics pertaining to the euro area: economic situation and outlook, budgetary policies, macroeconomic situation, structural reforms, EMU architecture, financial stability, euro area enlargement

Eurogroup plus

- **EU Member States** + relevant institutions (COM, ECB, …)
- Architecture of EMU (**BU, ESM, fiscal capacity**)
Thank you!
Background slides
Structural reform uptake at national level

Source: OECD (PMR)