

Better in than out?

**Economic performance inside and outside
the European monetary union**

Rapporto Europa 2015

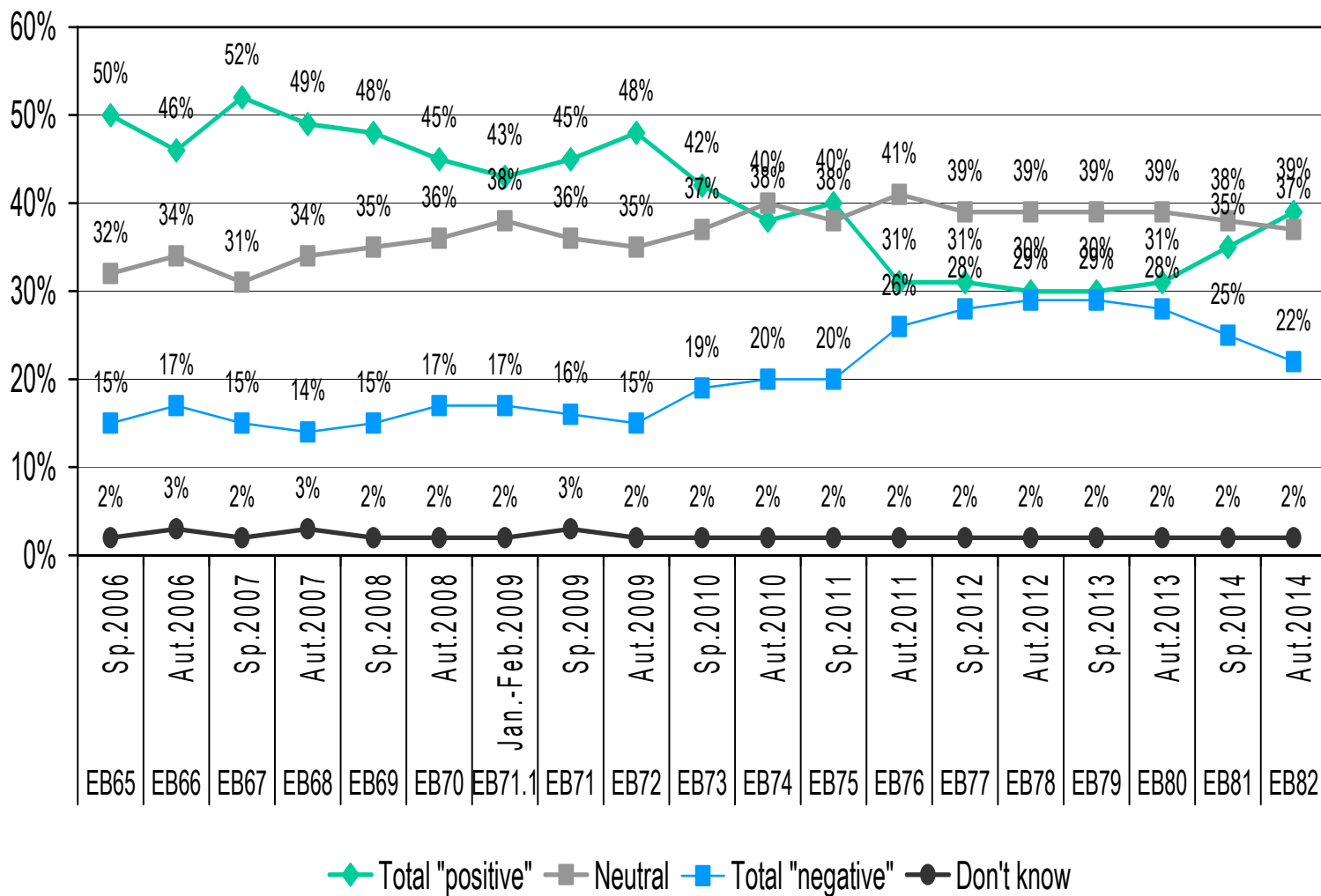
Roma, 9.7.2015

- I. The political threat
 - Why European monetary union?
- II. Europe's big recession
 - Economic growth inside and outside the Euro Area
 - Exchange rate flexibility
 - The impact of austerity
 - Output gaps
 - Components of aggregate demand
- III. Monetary Policy and Quantitative Easing
- IV. Fiscal Policy: austerity without end?
 - Debt dynamics
- V. Wage developments
 - Competitiveness
 - Decomposing the competitiveness effect

Conclusion

Annex

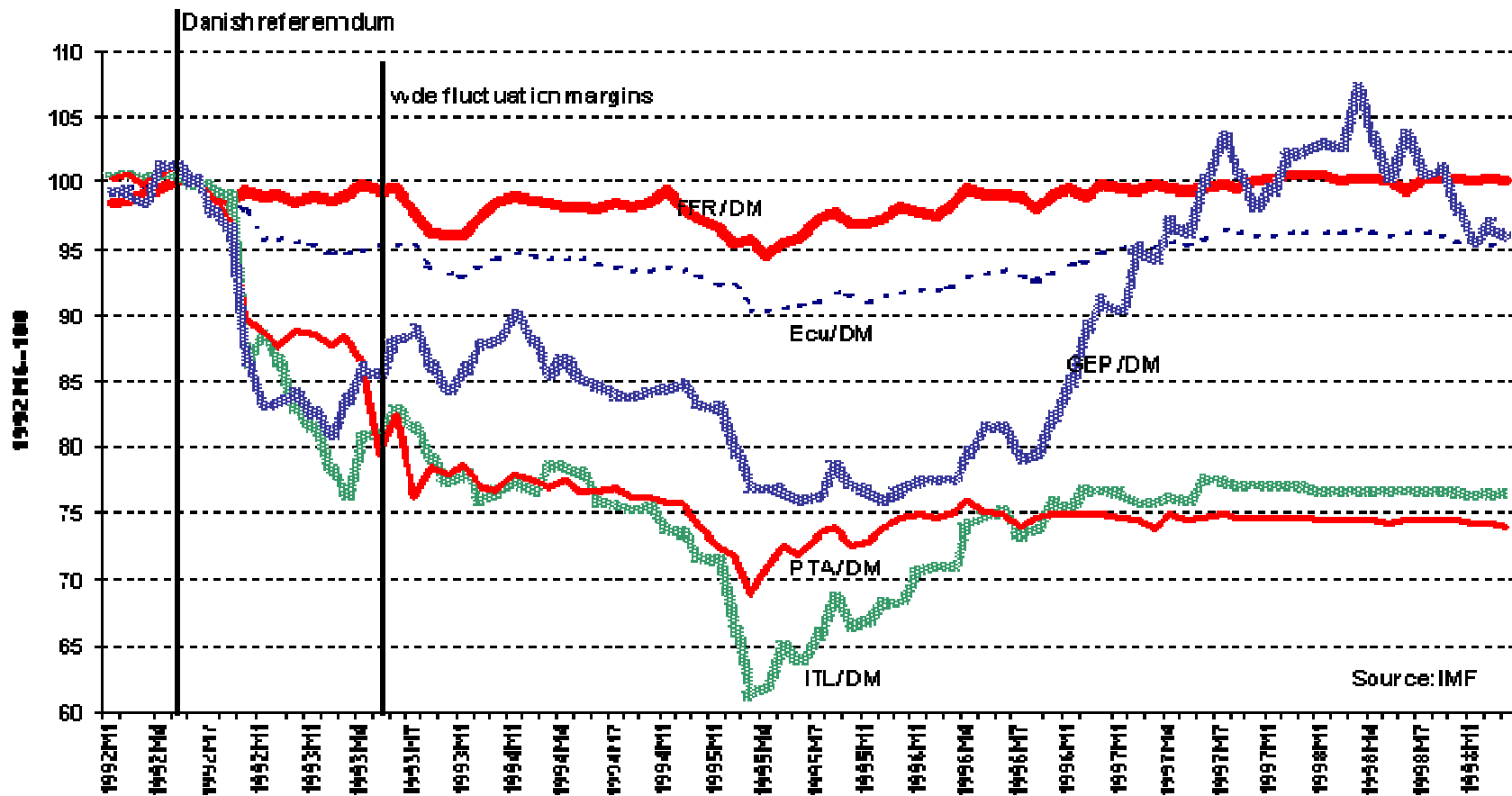
I. The political threat



Why European monetary union?

- Padoa Schioppa's inconsistent quartett
- Robert Mundell's optimum currency area

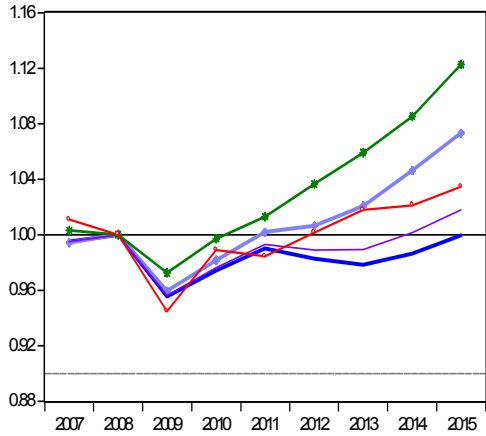
Figure 3. ERM Exchange rates in crisis



Source: IMF

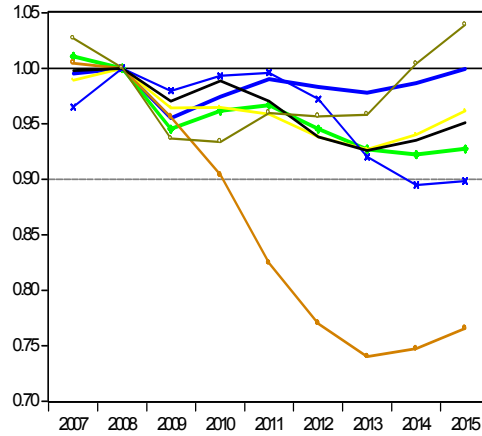
II. Europe's big recession

Major Economies



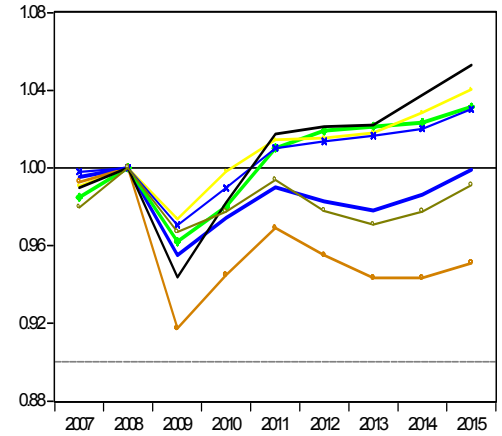
— Euroarea (18 countries) — Non-Euro 18 — European Union (28 countries)
— United States — Japan

Oisic Countries



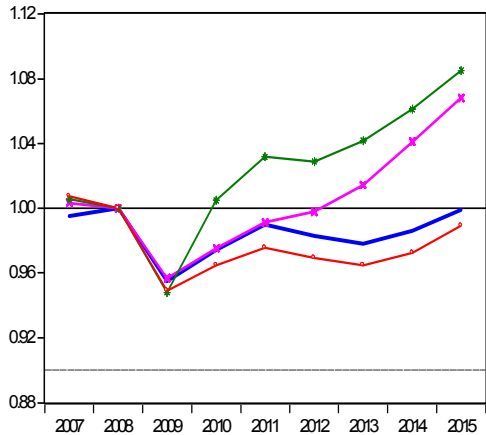
— Euroarea (18 countries) — Italy — Spain
— Greece — Cyprus — Portugal
— Ireland

Northern Europe inside Euro Area



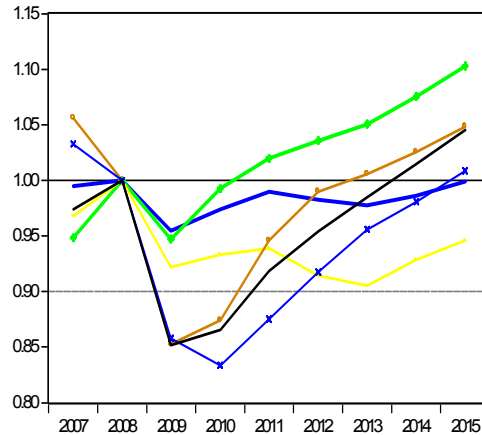
— Euro/Area (18 countries) — Austria — Belgium
— Finland — France — Germany
— Netherlands

Opt out Countries



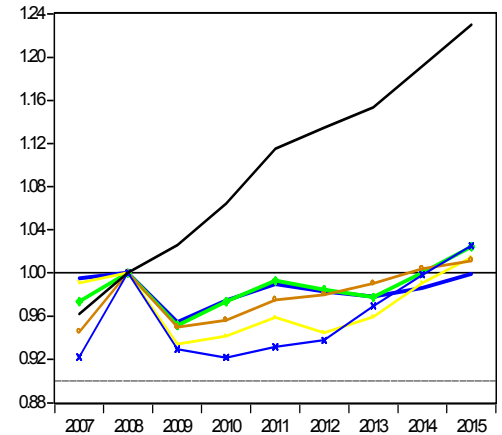
— Euroarea (18 countries) — United Kingdom — Sweden
— Denmark

New Member States within the Euro Area



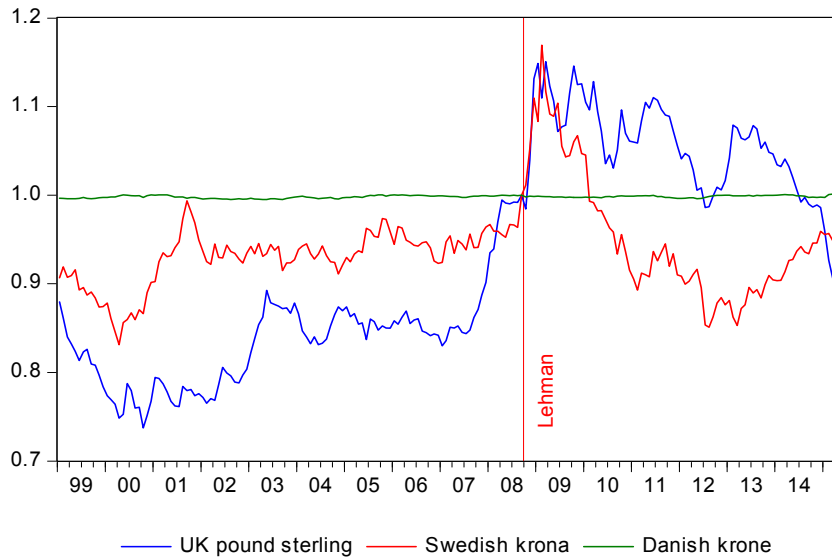
— Euroarea (18 countries) — Slovakia — Slovenia
— Estonia — Latvia — Lithuania

New Member States outside the Euro Area



— Euroarea (18) — Czech Republic — Hungary
— Bulgaria — Romania — Poland

Exchange Rate Index for Opt-out Countries



Exchange Rate Index for New Member States

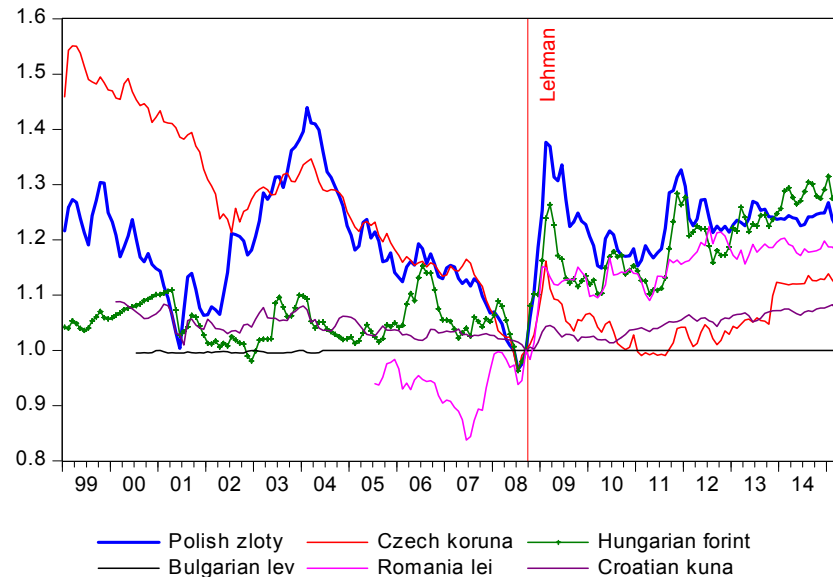


Figure 7. Output gaps and potential output

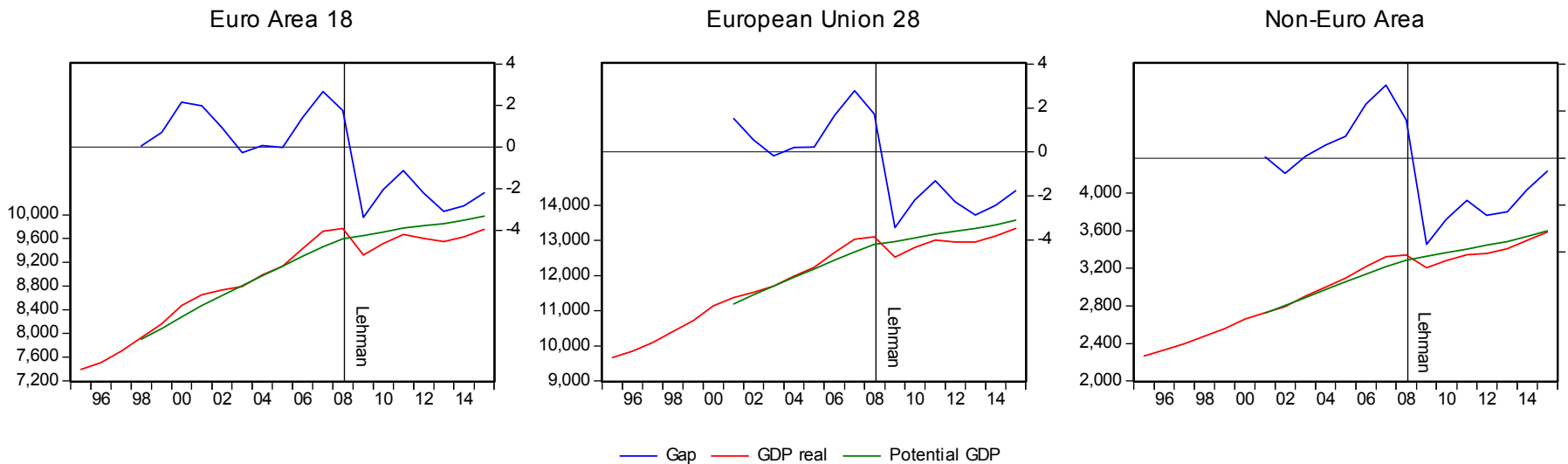
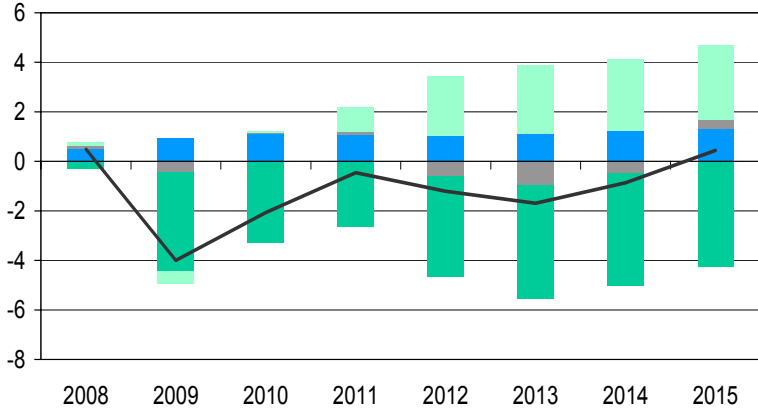
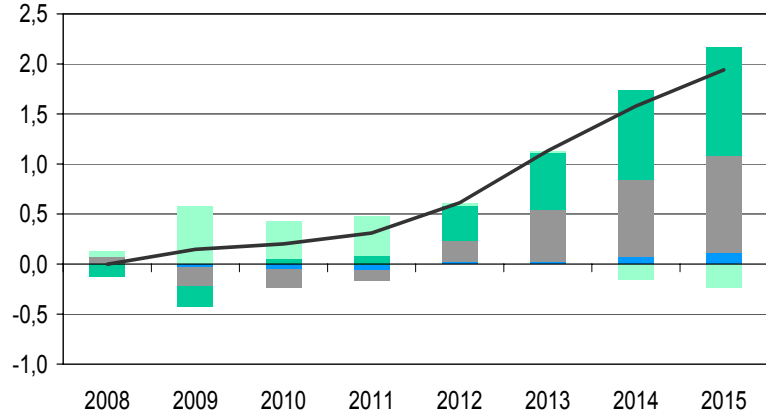


Figure 8. Cumulative effect of growth components since 2008

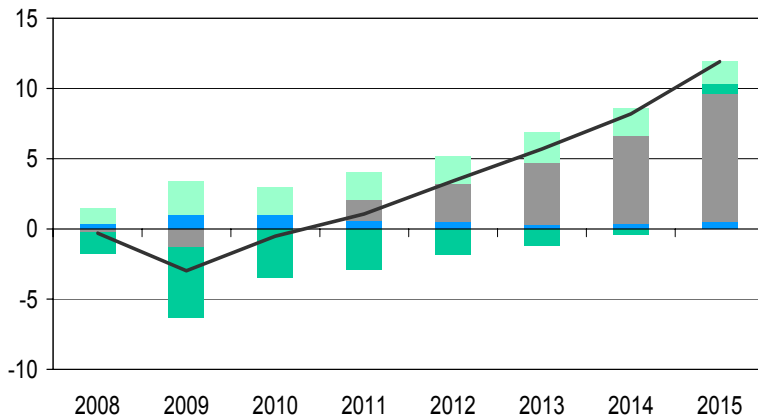
Euro Area 18



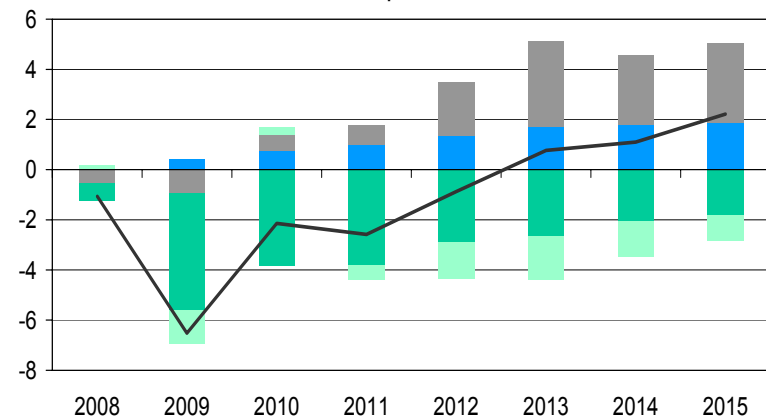
Non-Euro Area



United States



Japan

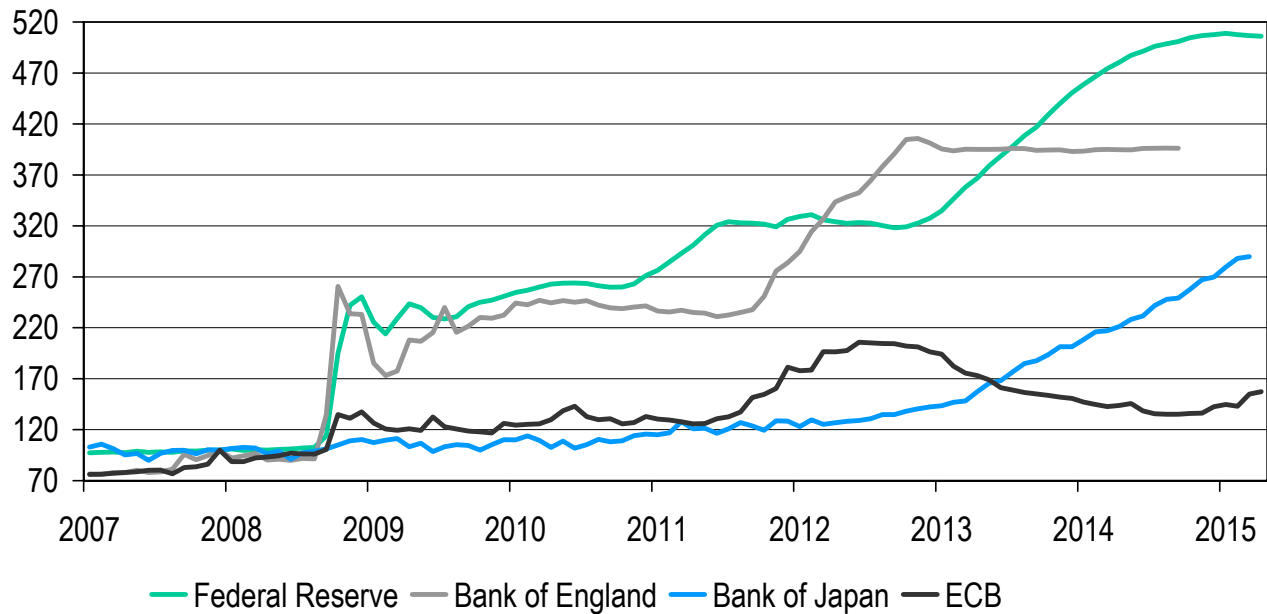


Public consumption Private consumption Gross investment Net export GDP growth

Public consumption Private consumption Gross investment Net export GDP growth 11

III. Monetary Policy and Quantitative Easing

Figure 9. Total Assets of Central Banks (index December 2007=100)

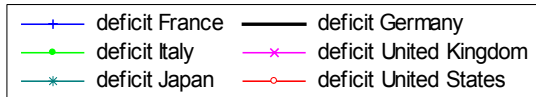
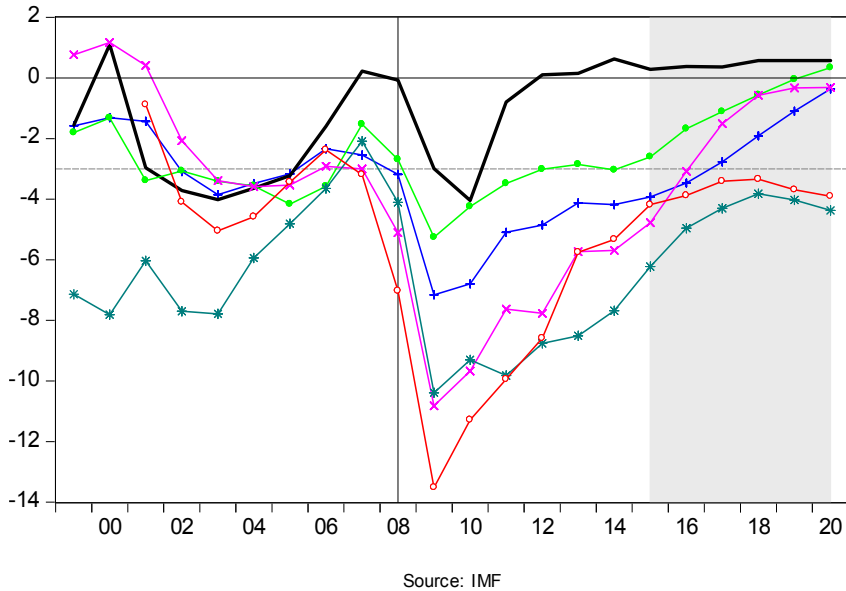


Source: Datastream.

IV. Fiscal Policy: austerity without end?

Figure 11. Budget positions

Budget Balance General Government



Structural Budget Balance

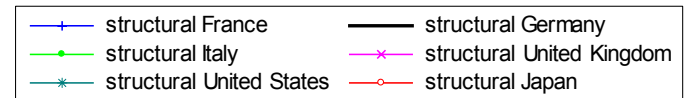
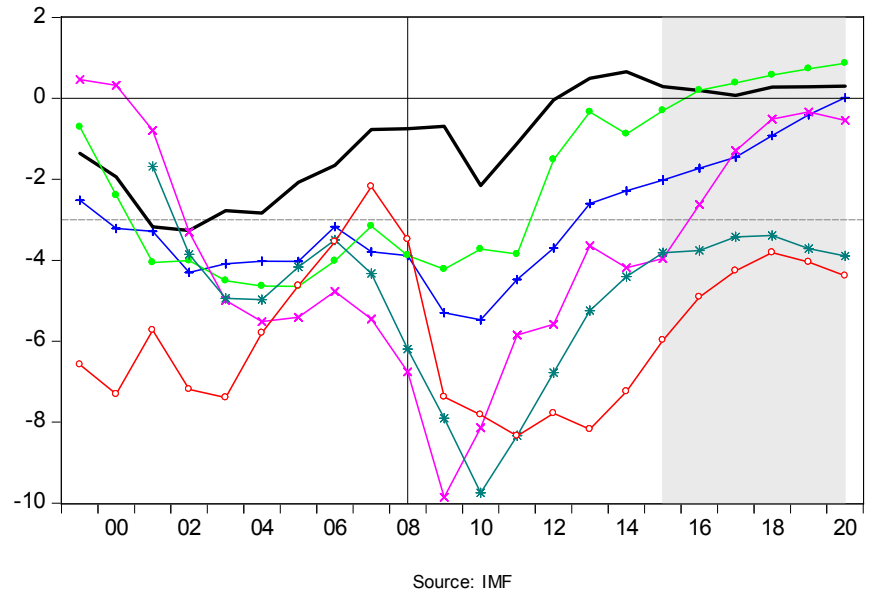
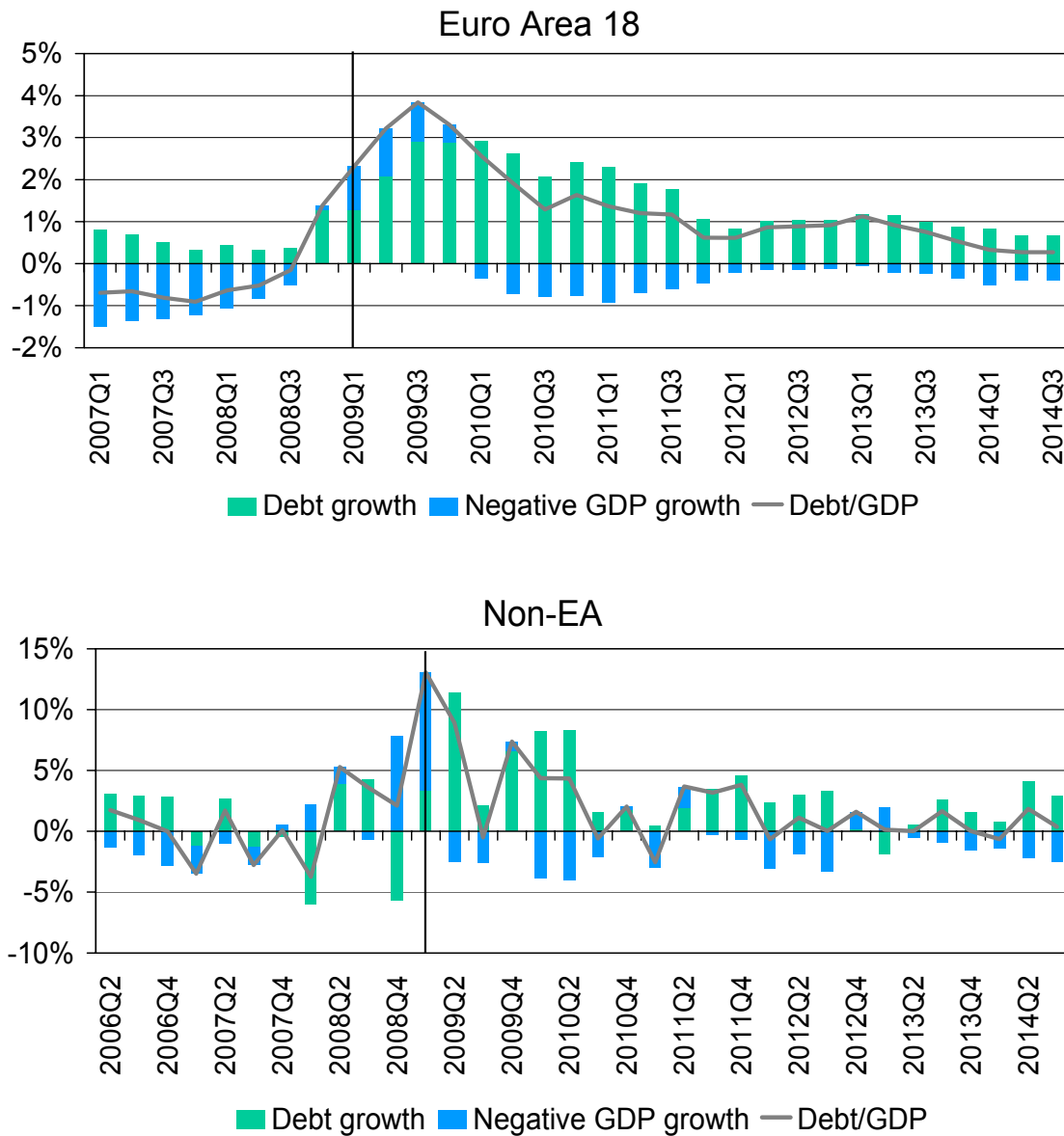


Figure 13. Drivers of public debt



Public debt is sustainable
when the policy adjustment (change in
primary surplus)
exceeds the growth-adjusted interest rate:

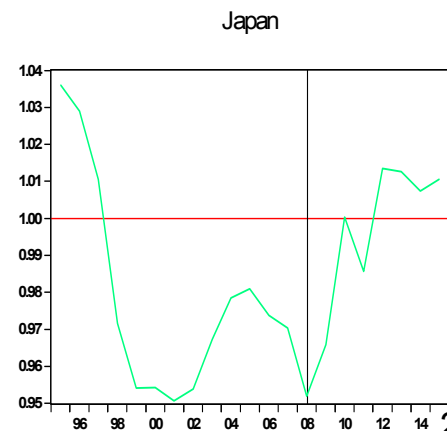
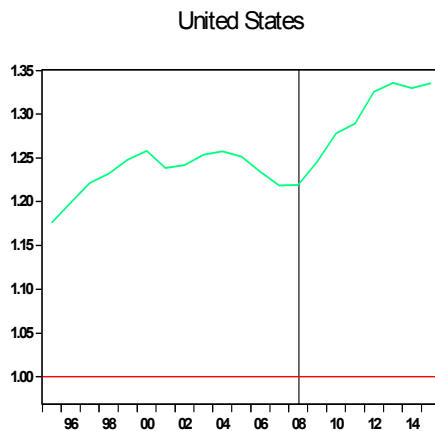
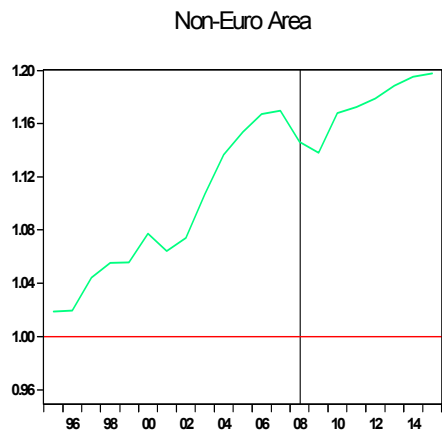
$$\Delta s > (i - g)$$

Table 4. Fiscal Policy Stance and Debt Sustainability

	2015	2011-15	2010-15		
	Primary surplus		growth adjusted interest rate		
	level	Sum of change	(y-r)	Difference	
European Union	0.81				
European Union (15)	0.90	2.70	0.97	1.72	sustainable
Euro area	1.59	3.10	0.95	2.14	sustainable
Euro area (12)	1.63	3.09	1.61	1.48	sustainable
Belgium	0.50	0.77	0.86	-0.09	not sustainable
Germany	2.58	2.16	-0.22	2.38	sustainable
Estonia	-0.28	-0.73	-4.61	3.88	sustainable
Ireland	-0.02	5.85	0.79	5.06	sustainable
Greece	2.80	6.79	6.97	-0.18	not sustainable
Spain	0.74	5.80	3.77	2.04	sustainable
France	-0.21	3.24	1.02	2.22	sustainable
Italy	3.63	2.63	3.52	-0.90	not sustainable
Cyprus	3.28	6.32	5.27	1.05	sustainable
Latvia	-0.70	-0.40	-2.77	2.37	sustainable
Lithuania	-0.47	1.07	-1.49	2.56	sustainable
Luxembourg	0.94	0.19	-2.24	2.43	sustainable
Malta	0.57	1.64	-0.10	1.74	sustainable
Netherlands	1.05	3.06	1.46	1.60	sustainable
Austria	1.58	1.65	0.57	1.08	sustainable
Portugal	3.36	8.04	4.18	3.86	sustainable
Slovenia	0.75	3.74	3.63	0.11	sustainable
Slovakia	-0.24	5.61	0.76	4.85	sustainable
Finland	-0.53	-0.76	0.48	-1.25	not sustainable
Bulgaria	-1.67	0.09	1.70	-1.61	not sustainable
Czech Republic	-0.42	2.35	2.93	-0.58	not sustainable
Denmark	0.93	-0.28	2.03	-2.31	not sustainable
Croatia (1)	-0.49	3.46	6.26	-2.79	not sustainable
Hungary	1.09	0.25	4.42	-4.17	not sustainable
Poland	-0.72	5.11	1.54	3.57	sustainable
Romania	0.31	4.67	0.72	3.95	sustainable
Sweden	-0.25	-2.08	-0.66	-1.42	not sustainable
United Kingdom	-1.77	2.83	-2.18	5.02	sustainable

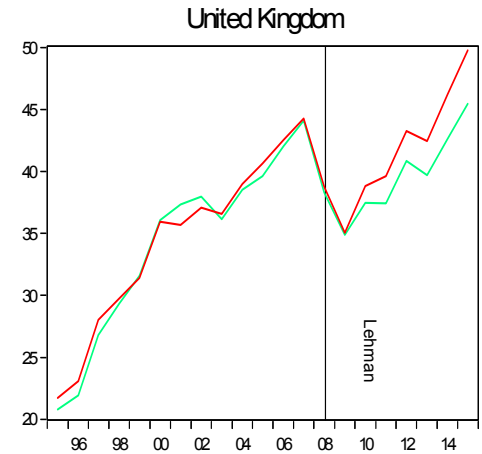
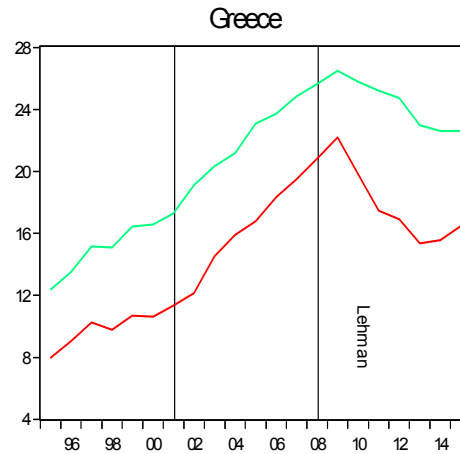
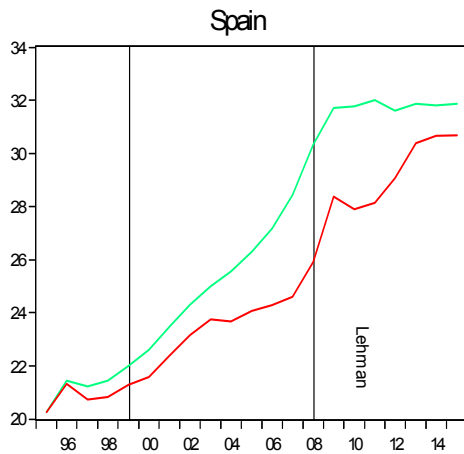
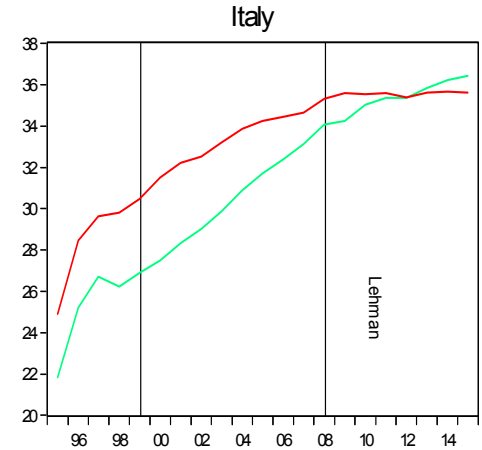
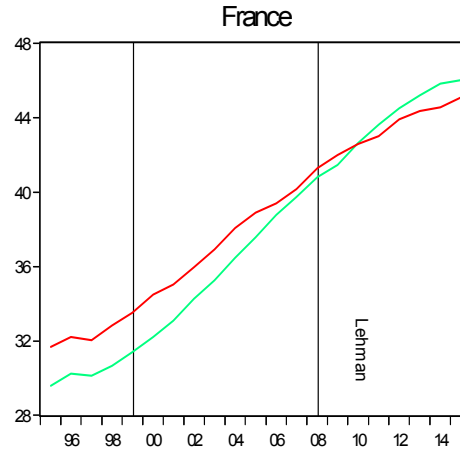
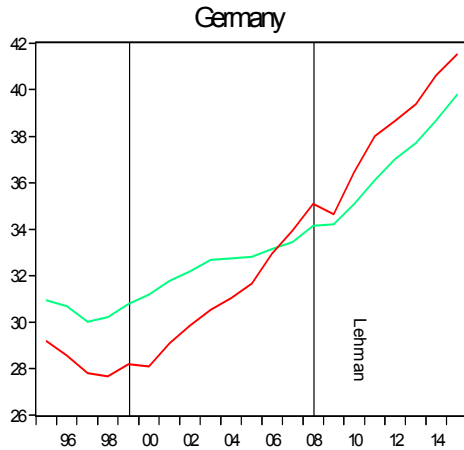
V. Wage developments

- Wage-led growth?
 - Increasing the wage share?
 - Implications for competitiveness
- A new measure of the CER-Competitiveness Index
 - Equilibrium wage derived from equality of return on capital

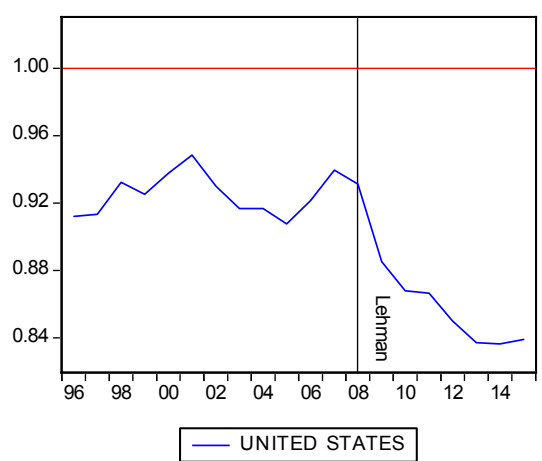
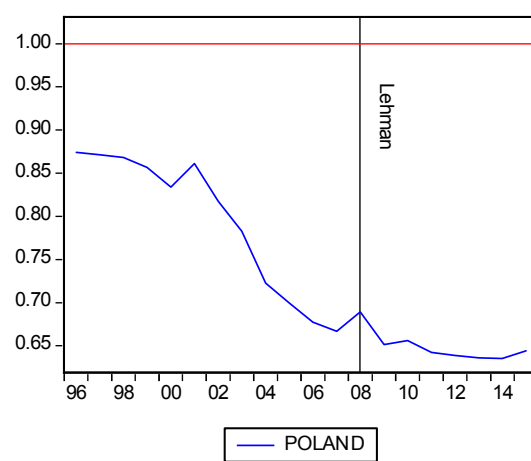
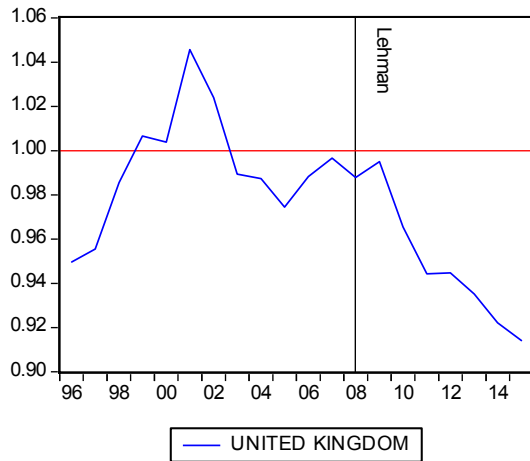
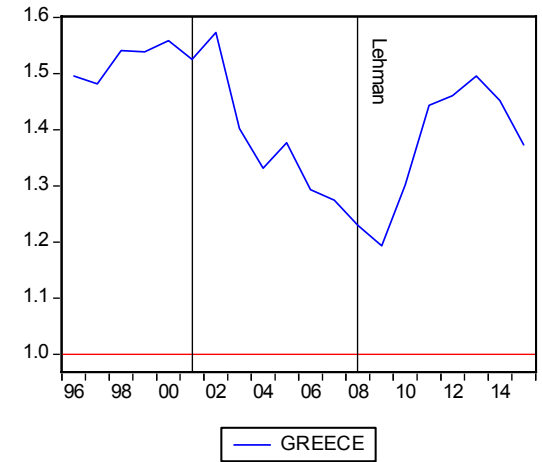
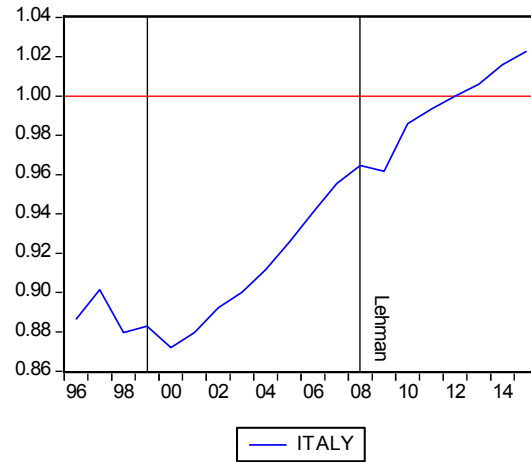
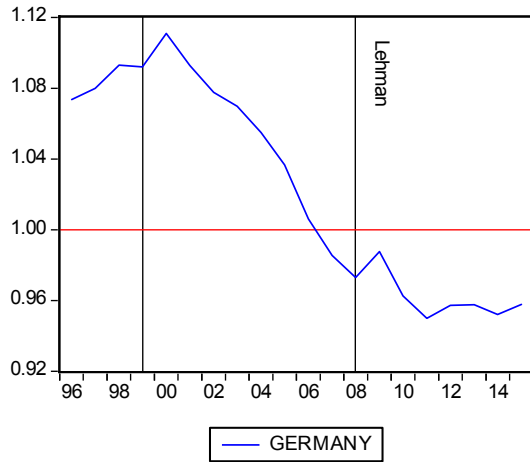


- **Equilibrium wage depends on:**
 - A country's labour productivity (+)
 - Relative capital-output ratio (+)
 - Relative inflation (-)

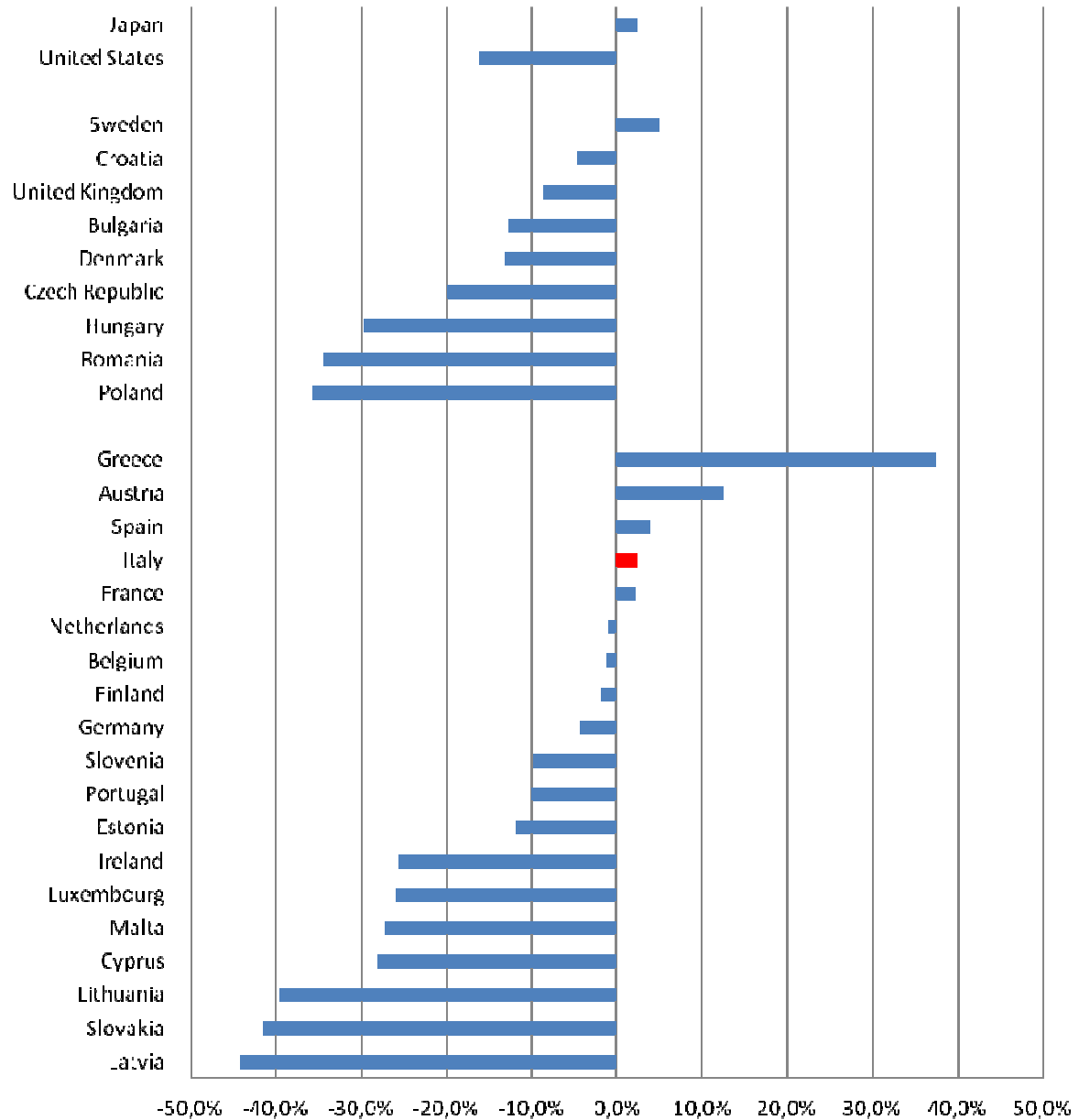
Equilibrium wage against actual wage



CER Competitive index



Wage Gap



Conclusion

- No systemic advantages for being outside the Euro Area and using the exchange rate as a policy tool.
- The difference between in and out countries is the conduct of stabilization policies.
 - The Euro Area has suffered from excessive restrictions on effective demand.
- Policy orientations must re-focus on macro-stability and balanced growth.

Conclusion

- The political question: how to change policy orientations
- Europe stands at a crossroad.
 - Either it will move forward towards more integration with centralized and democratically controlled decision making
 - or it will disappear.

Tertium non datur.