MEF Dipartimento del Tesoro

Revitalising Europe's Economy: Towards Growth

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On the way to recovery

- **Structural reforms** are ongoing.
- **ECB** commitment to address adverse shocks is in place.
- The **European Stability Mechanism** was established.
- **Banking Union** in the process of being implemented.

- Have policies worked as the economy turns for the better?

The policy environment is still very challenging

- High **public deficit and debt**, both public and private.
- Still relatively sluggish **economic growth.**
- High **unemployment**, especially among the youth.
- Risk of de-anchoring inflation expectations.
- Need to absorb **macroeconomic imbalances**.
- Increased **poverty** and reversal of progress towards **social inclusion** processes, with potential **political risks**.

Addressing challenges collectively: what’s the best recipe?

- EU Member States are engaged in **fiscal consolidation** and efforts to reduce **macroeconomic imbalances**, which inevitably have near-term negative effects on demand.
- **ECB’s monetary policy** is accommodative but less than those of other central banks. The **transmission mechanism of monetary policy** is still not working properly, with **financial fragmentation** across the Euro Area.
- During the crisis, policies focused on responding to short-term financial and fiscal challenges. There is now a strong need for **common structural policies to support long-term growth, employment and social cohesion.**

Europe 2020 Strategy: a model for growth?

- Adopted in 2010 to set out a new vision for Europe's economy.
- Replaced the **Lisbon Strategy** for growth and jobs (adopted in 2000, renewed in 2005 and still in place up to 2010).
- A growth model based on three mutually-reinforcing features:
  - **Smart**: targets on investment in education, research and innovation.
  - **Sustainable**: targets on the shift towards a low-carbon economy.
  - **Inclusive**: targets on job creation and poverty reduction.

Europe 2020 Strategy: an assessment

- In the March 2014 Communication "Taking Stock of Europe 2020", the EC notes the **"mixed progress"** in achieving the goals of Europe 2020.
- Protracted economic crisis has played a major role in hampering progress towards the Europe 2020 targets.
- Expected failure to reach the **employment, poverty and social exclusion** targets, falling resources dedicated to **research and innovation**.
- Only the **climate change and energy** targets likely to be reached given current efforts (partly because of lower economic activity).

The Europe 2020 Strategy: a critical view

- **Methods and approach** to structural reforms relatively unchanged since the Lisbon strategy.
- **Incentives** for Member States have in some cases weakened.
- **Governance and means** for achieving the objectives not sufficient.
- Not enough attention to **positive spillovers**.
- Important potential drivers of growth and employment – notably **deepening of the Single Market, greater integration of Financial Markets, and Greening Growth** – not incorporated in the Strategy.

Strengthening of the Single Market

- The EU **Single Market** is not included in the Europe 2020 targets, despite the significant benefits from deeper integration.
- Strengthening of the internal market, by making product markets and services more open and interconnected, would boost growth and facilitate greater integration of EU industries within global value chains.
- Based on their potential, particular attention should be given to:
  - **Single Digital Market.**
  - **Transport and energy networks.**
  - **Professional and other services.**

Finance for Growth

- Need to eliminate financial market fragmentation and create **favourable conditions for long-term investments**.
- Further progress is required to:
  - Assess the health and status of the **banking system**.
  - Restore **confidence** in the banking sector.
  - Increase efforts for the further development and integration of **non-bank finance**, including long-term institutional investment and direct capital market financing.
  - Ensure availability of **credit to firms**, especially SMEs.

Greening growth

- **Green growth** is a tool to foster economic growth while preventing environmental degradation, biodiversity loss and unsustainable use of natural resources.
- **Environment as an opportunity** not just a regulatory constraint.
- A green growth strategy can boost:
  - Business opportunities and green jobs.
  - Productivity gains and competitiveness of enterprises.
  - Innovation in new, high-value-added markets.
  - Certainty in availability of industrial inputs and resources.

A new paradigm for the EU

- The pre-crisis paradigm was **unsustainable** economically, socially and environmentally.
- For Europe, complete recovery **must not be not a return to pre-crisis normality**.
- Recovery must foster new sources of growth and competitiveness, based on knowledge-intensive activities, high productivity and environmental sustainability.
- Positive solutions in Europe require **further integration: politics must take the lead.**

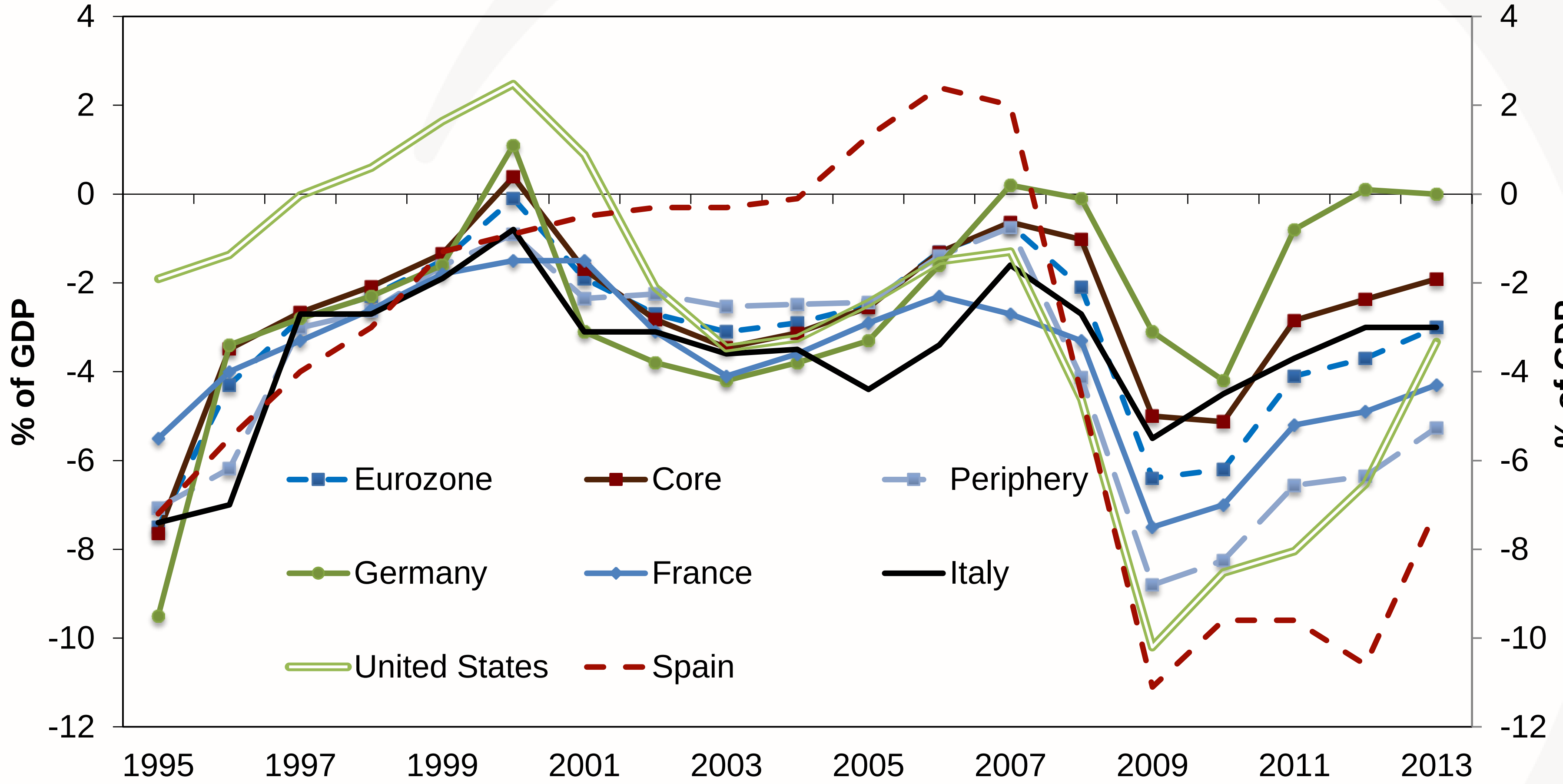
Integration comes together with some imbalances

- **Macroeconomic imbalances** were at the root of the crisis in Europe … but not all imbalances are bad!
- Strengthening the Single Market leads to **economic specialisation, resource efficiency and proper allocation**, which in turn leads to some imbalances in C/A that should be offset by a much more **integrated financial sector**.
- Contained current account imbalances **should be accepted** if they are consistent with the smooth allocation of capital within the Euro Area.

A different policy mix?

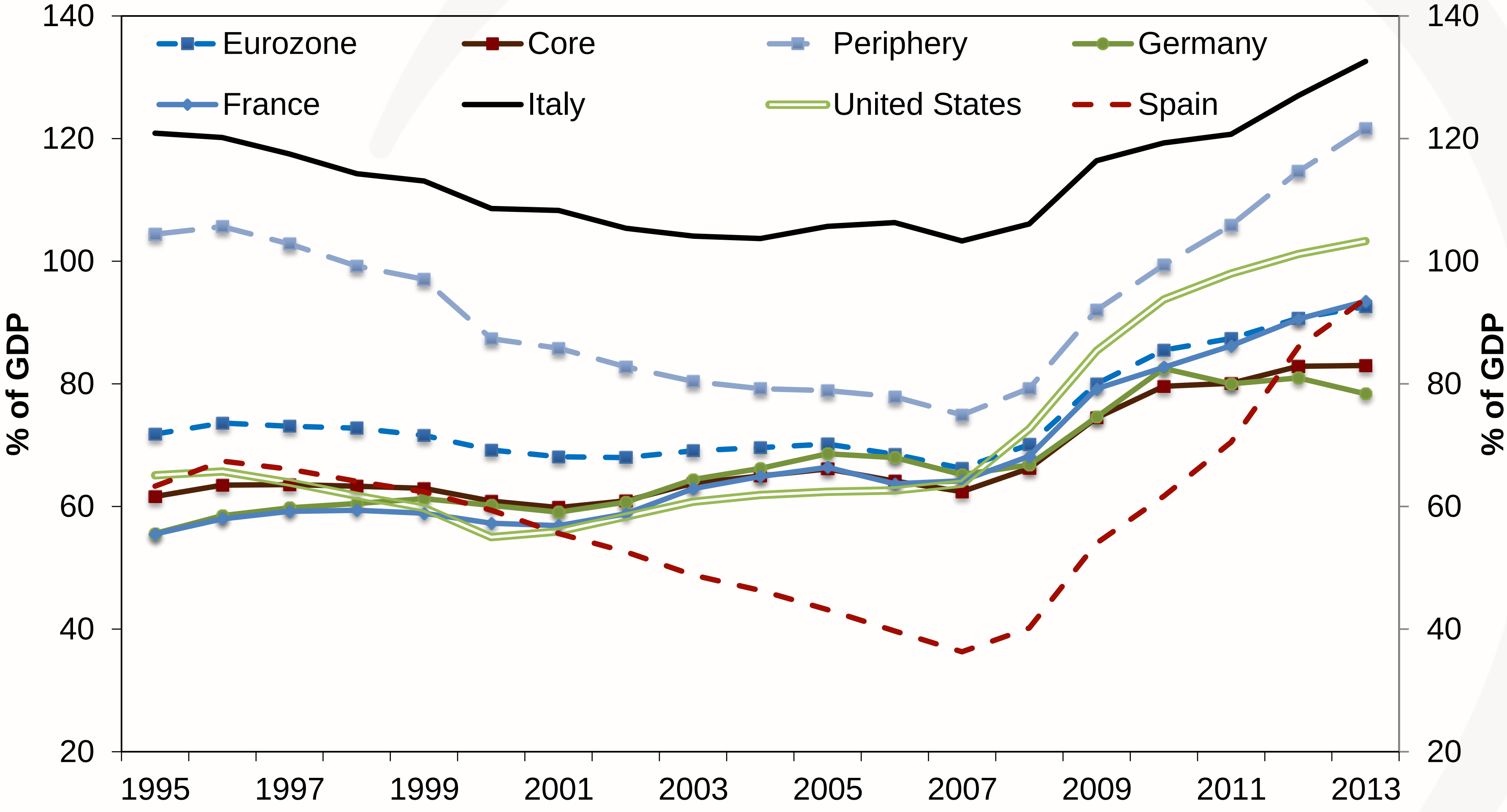
- Private and public sector **deleveraging** must continue; tight **fiscal policy** and insufficiently accommodative **monetary policy/financial fragmentation** leads to:
  - Weakness in **consumer spending.**
  - Insufficient recovery in **investment activity.**
  - Uncomfortably high **unemployment.**
  - **Continuing disinflation** (and risks of deflation).
  - Rising Euro Area **C/A surpluses.**
  - Strengthening of the **euro exchange rate.**
  - More problematic **debt dynamics.**

Additional fiscal consolidation is unavoidable



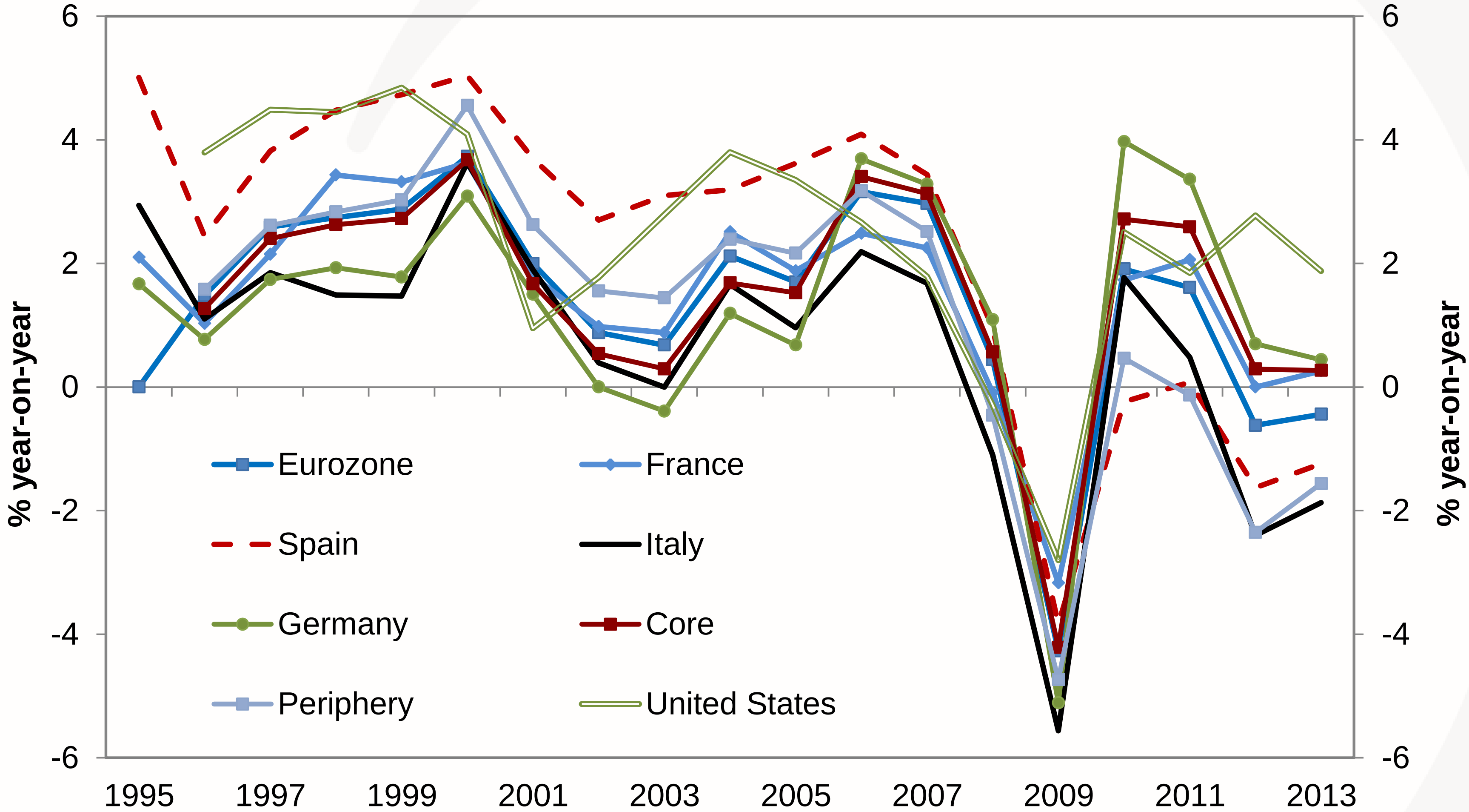
Note: Deficit data for Greece, included in Periphery, are not available for the period 1995-1999.
Source: Eurostat, US Department of the Treasury, Bureau of Economic Analysis

Public debt deleveraging has yet to start



Source: Eurostat, US Department of the Treasury, Bureau of Economic Analysis

Is GDP going back to its pre-crisis potential?



Source: Eurostat, BEA

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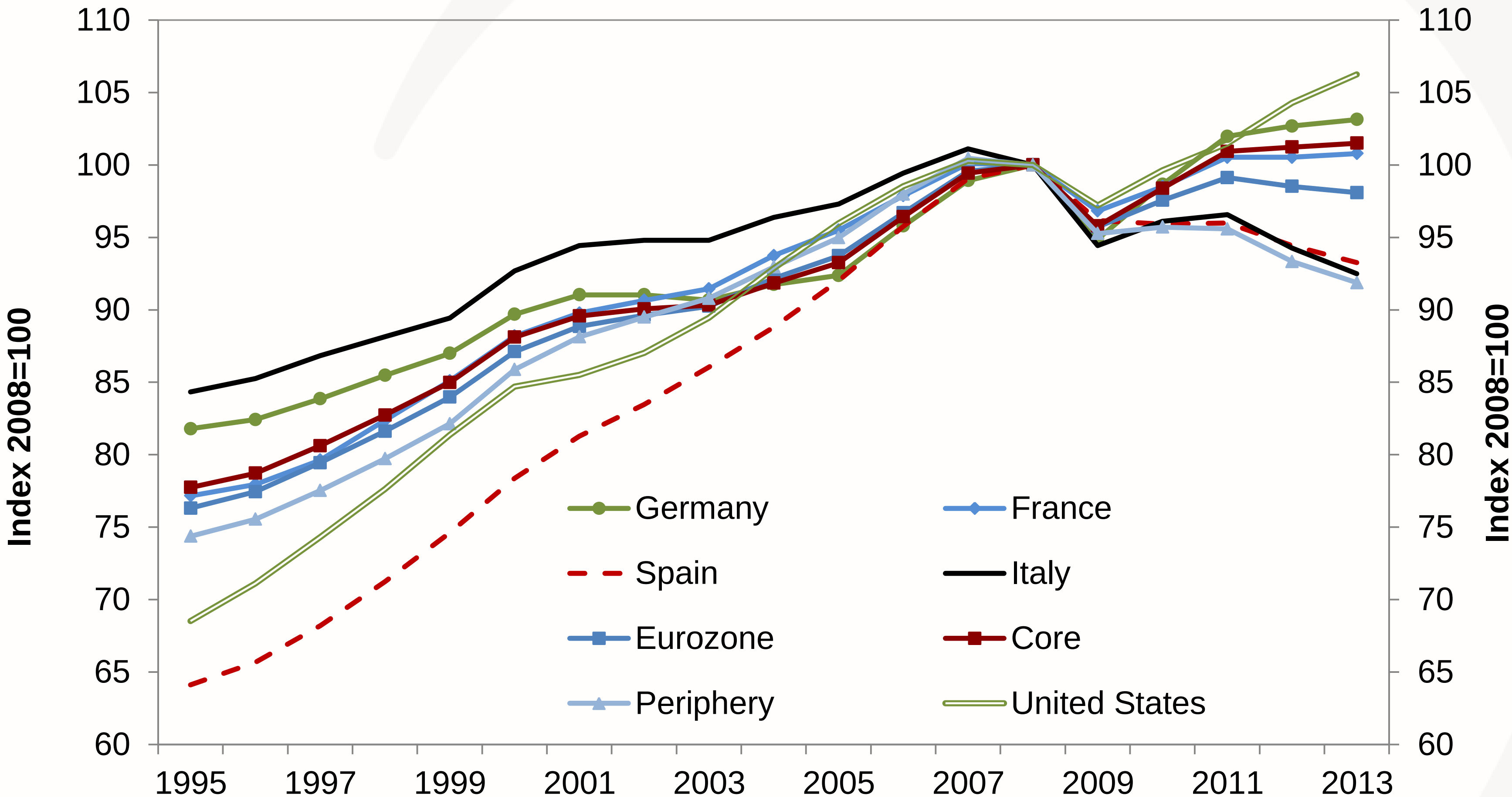
Are GDP level losses going to be recovered?



Source: Eurostat, BEA

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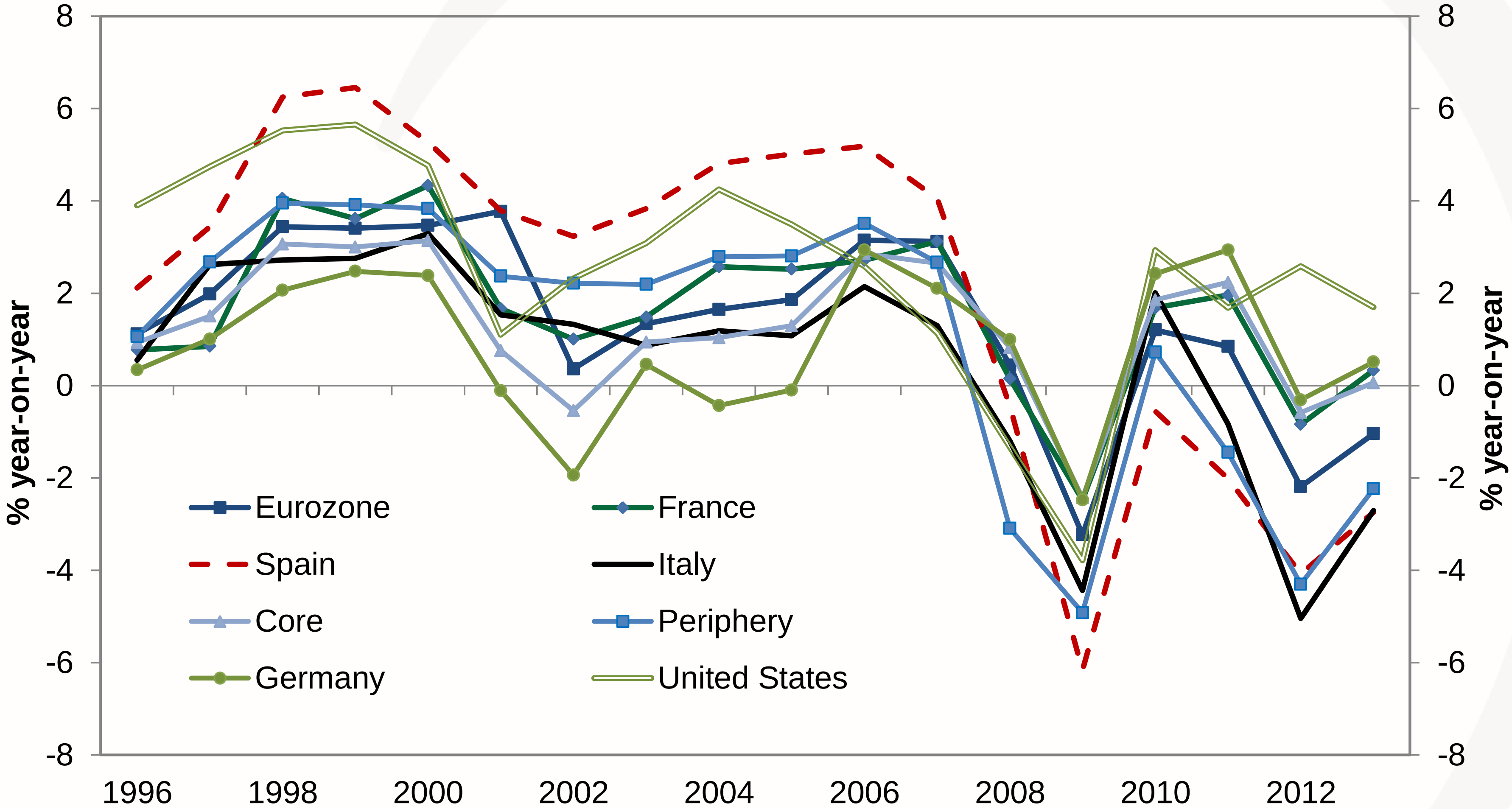
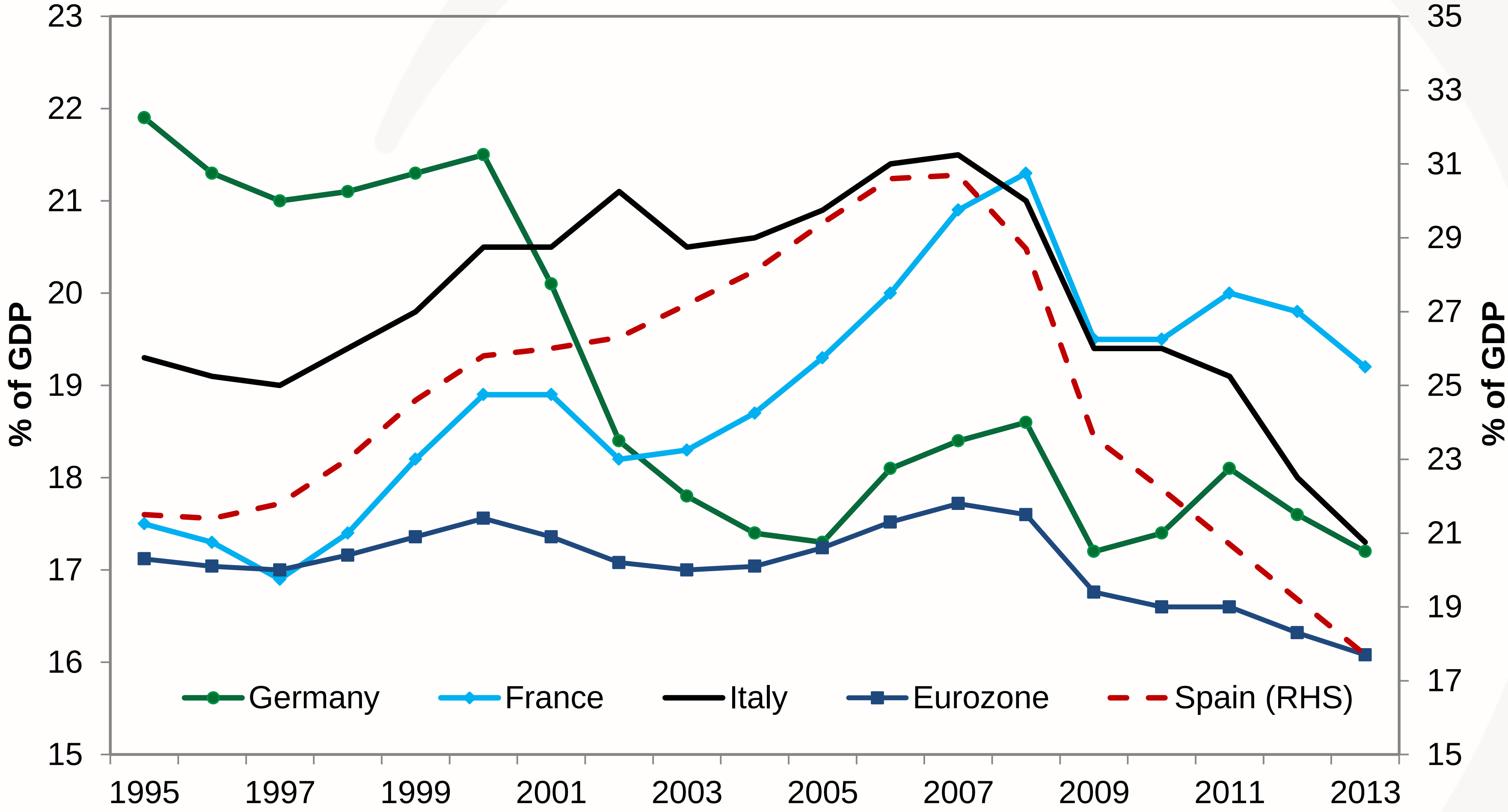
Domestic demand improving slowly even in core EA countries



Source: Eurostat,Oxford Economics

Investments for growth: the challenge to reverse current trends



Source: Eurostat

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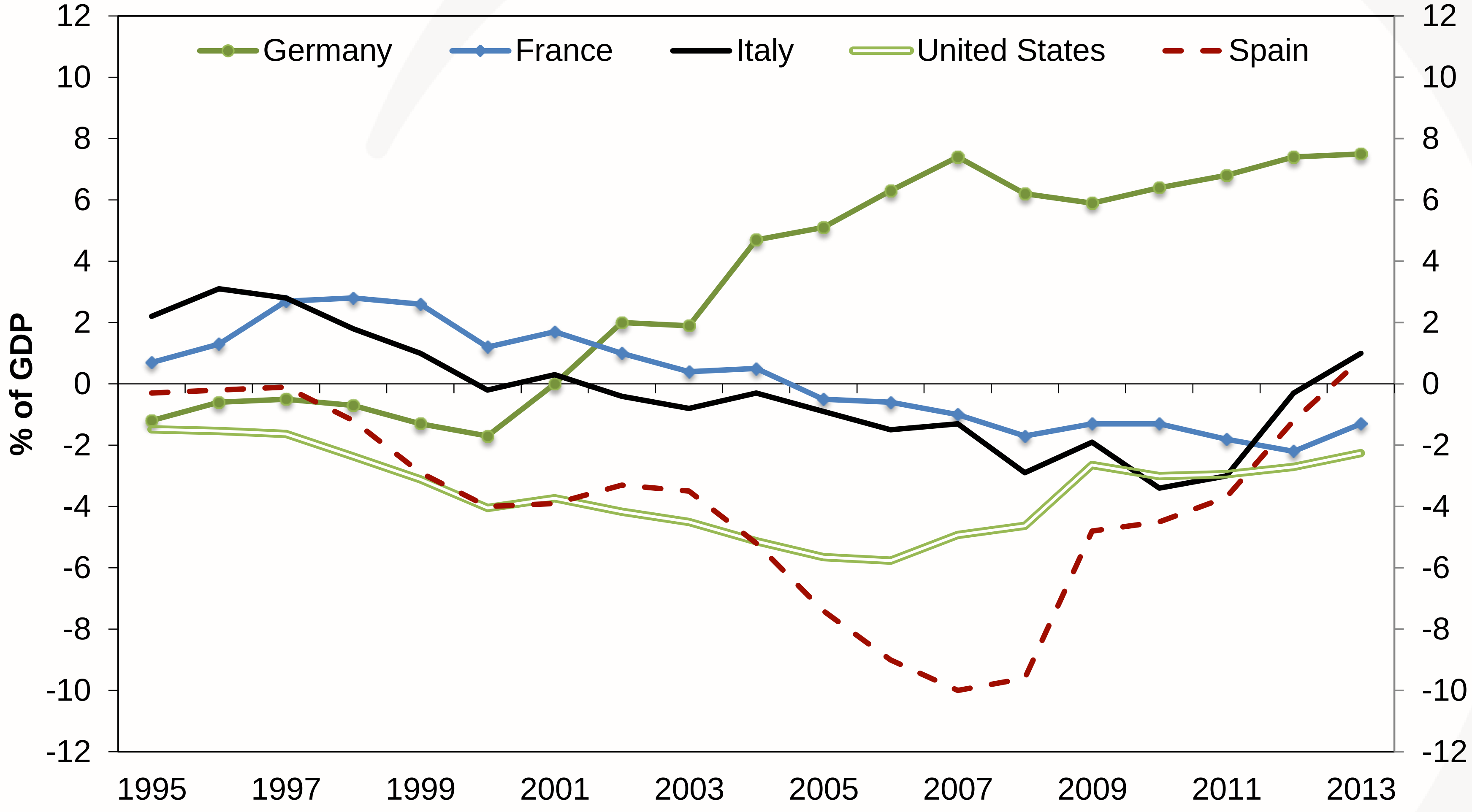
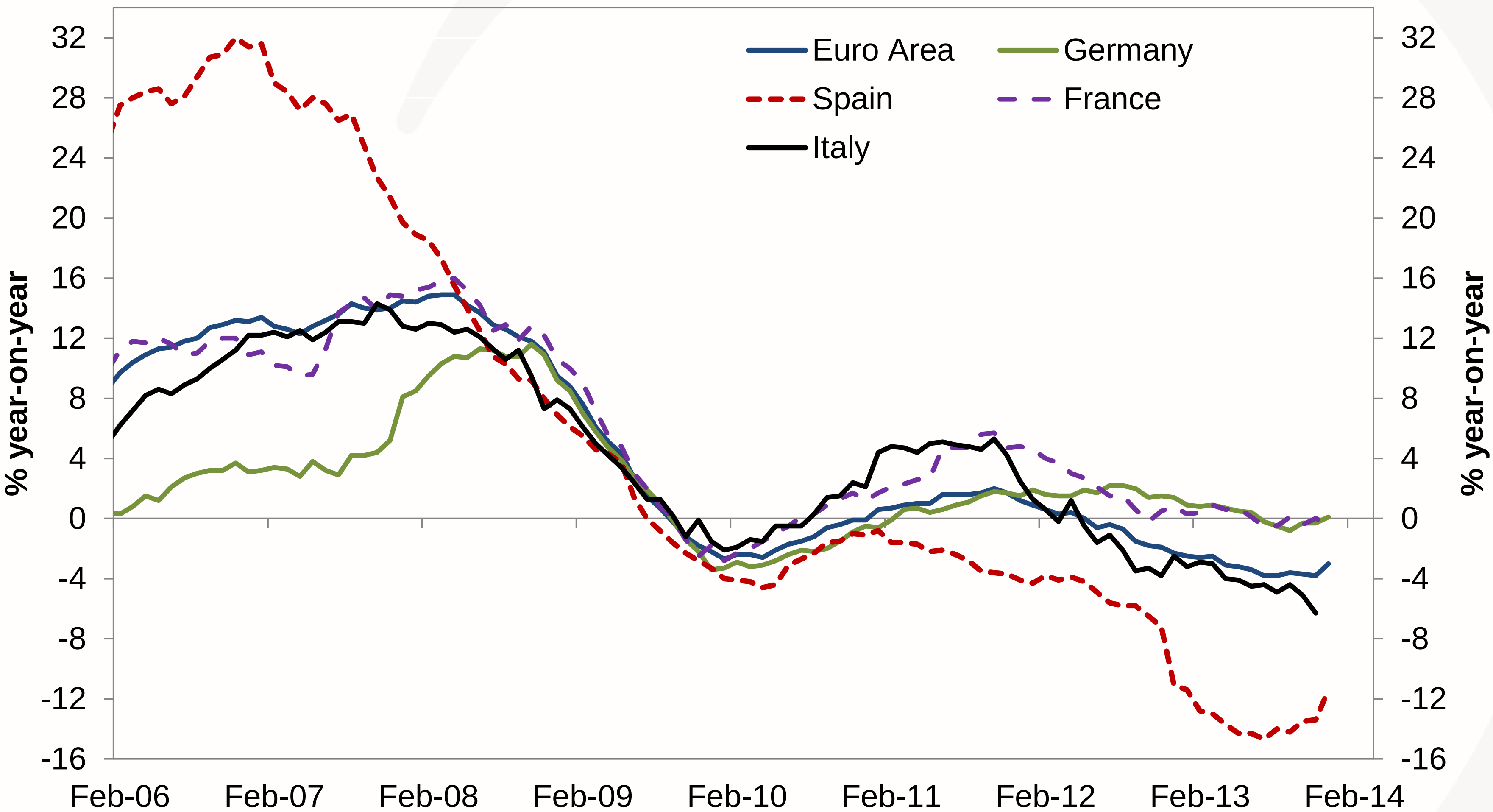
Policy mix leading to C/A surpluses



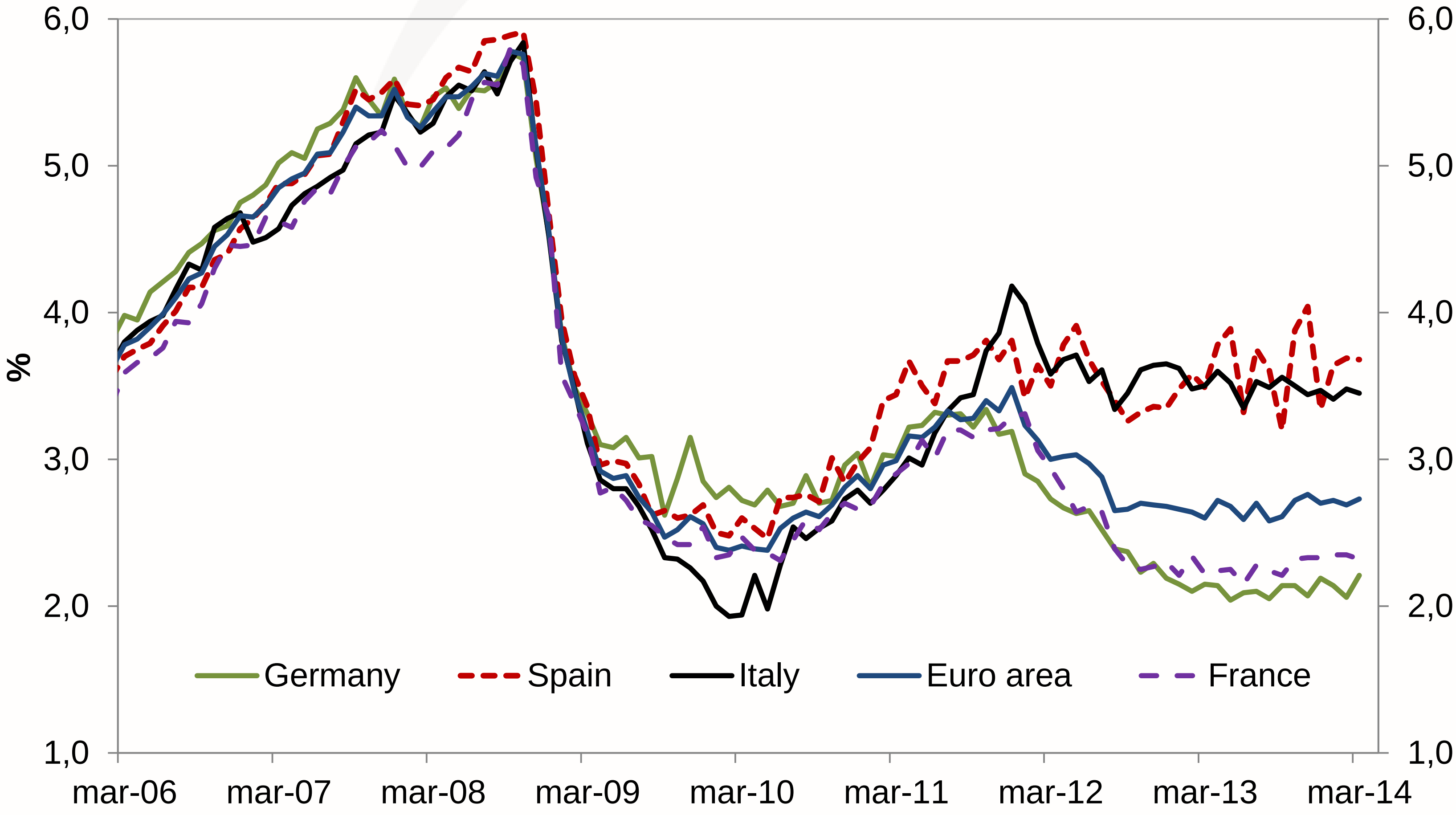
Source: Eurostat, ECB, IMF.

Contraction in credit growth: no signs of stabilisation



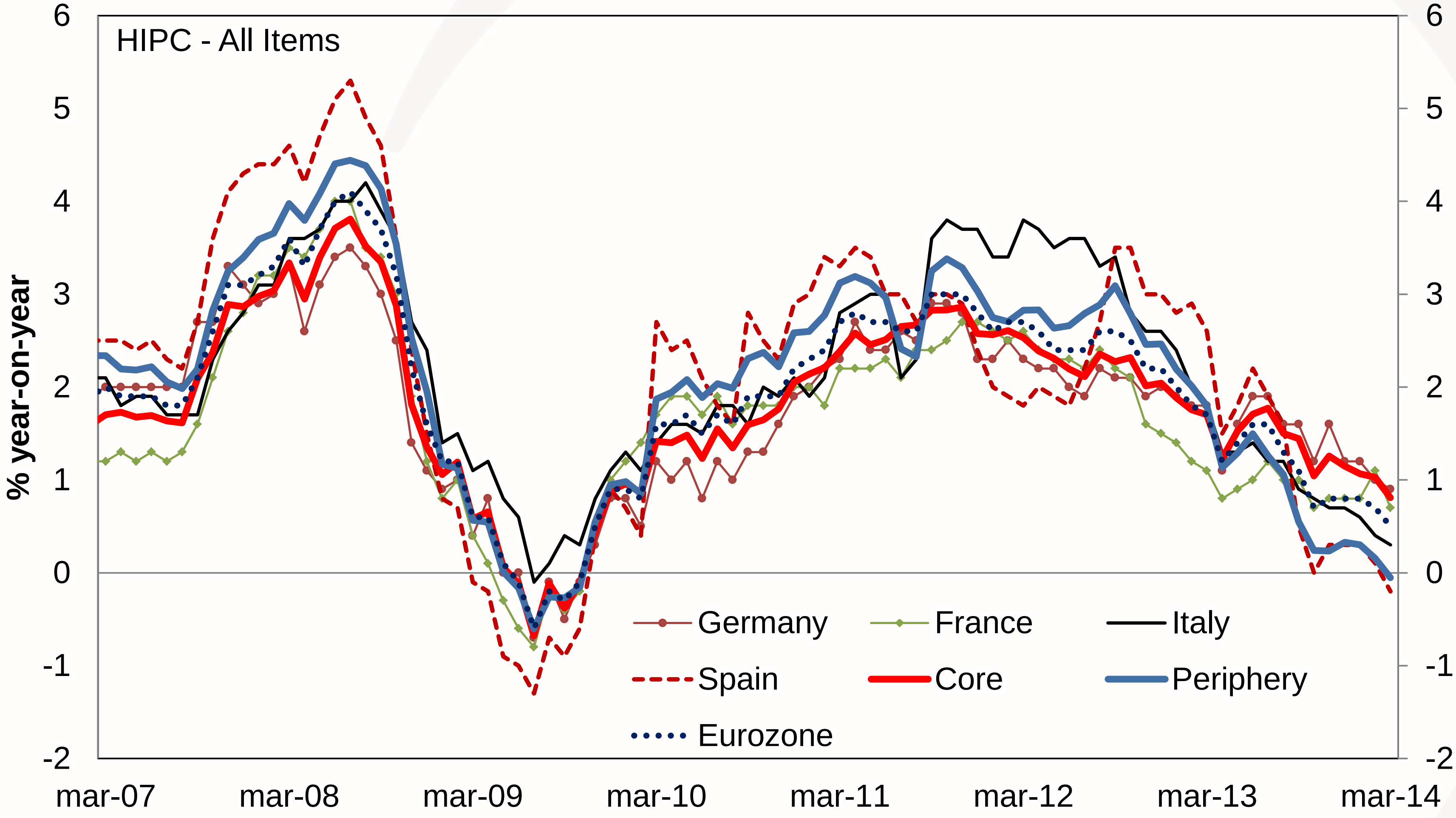
Source: ECB

Cost of credit: the gap among EA countries remains wide



Source: ECB

Disinflation continues (with non-negligible risk of deflation)



Source: ECB

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Bottom line: a new policy approach

- Continuing **fiscal consolidation**, where possible at a pace consistent with decent growth in domestic demand.
- Strengthening integration in **financial and credit markets**, deepening of the **Single Market** and speeding-up **labour and product market reforms** to support growth and employment.
- Addressing **macroeconomic imbalances** with a view to advancing further economic integration.
- Reviewing the **policy mix** to maintain anchored **inflation** expectations and balanced **external accounts**.
- **Politics must take the lead both at national and EU level.**