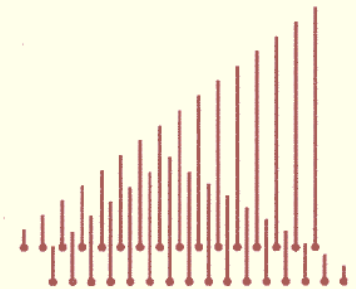


niesr

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# AIECE General Report: key risks and uncertainties

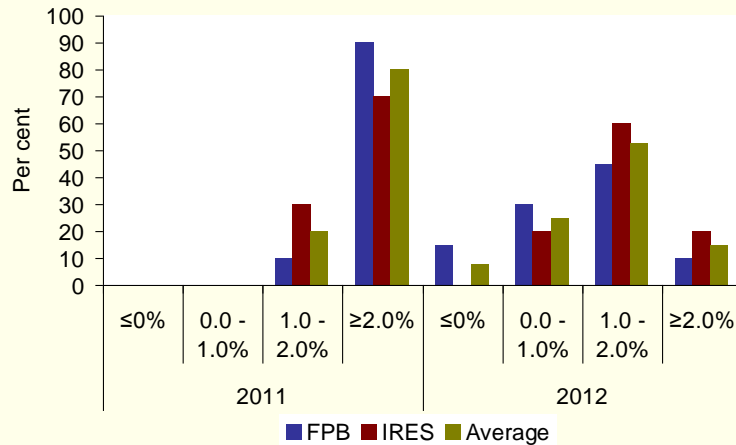
November 2011



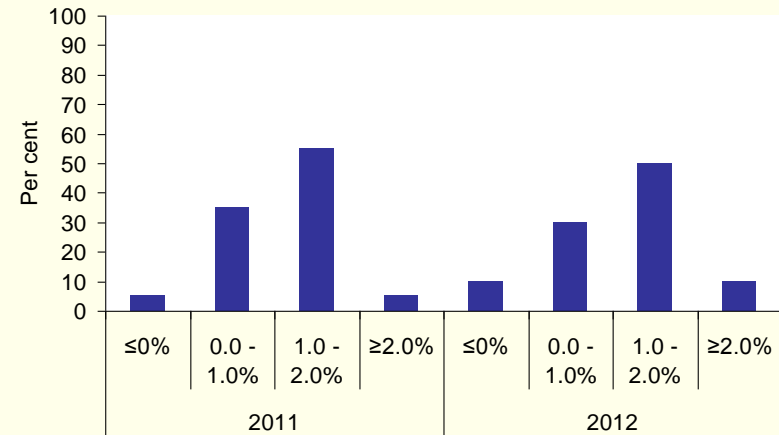
National Institute  
of Economic and  
Social Research

# Probability distributions (1)

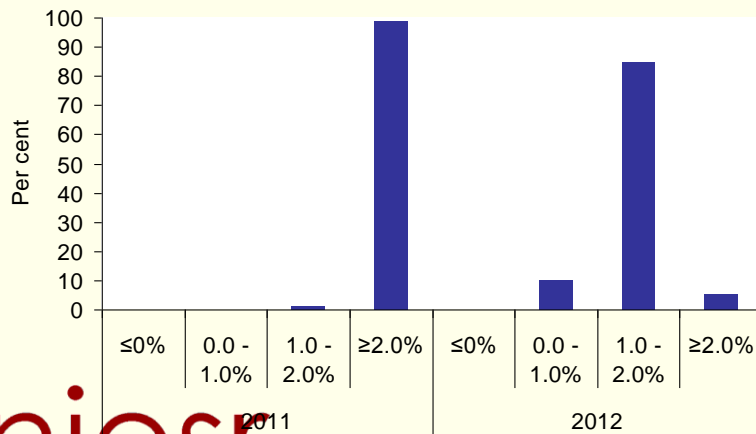
Belgium: GDP growth



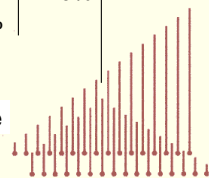
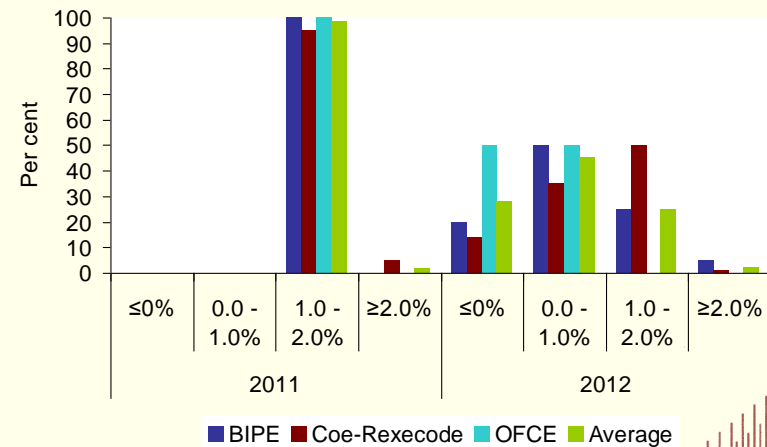
Denmark: GDP growth



Finland: GDP growth

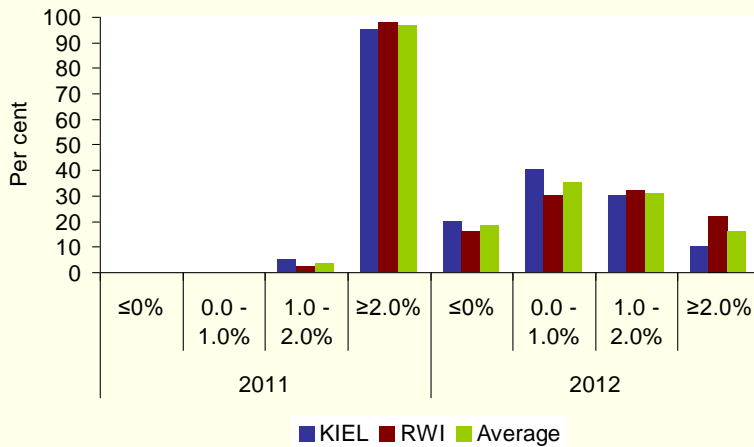


France: GDP growth

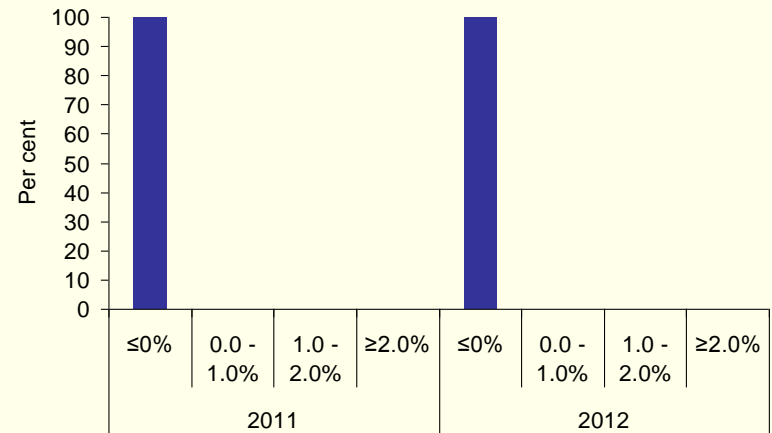


# Probability distributions (2)

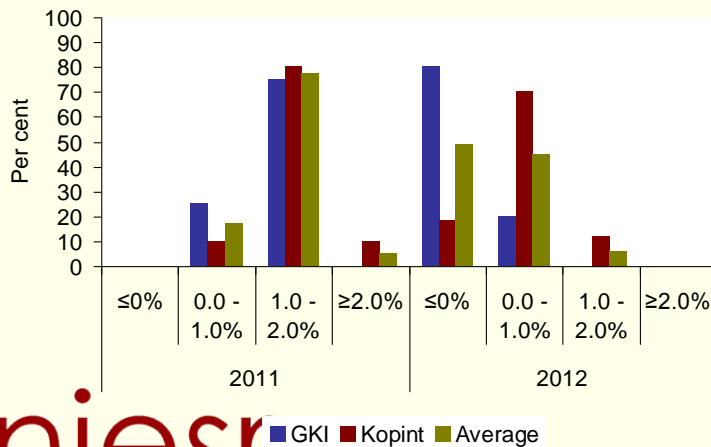
Germany: GDP growth



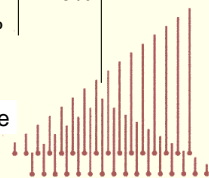
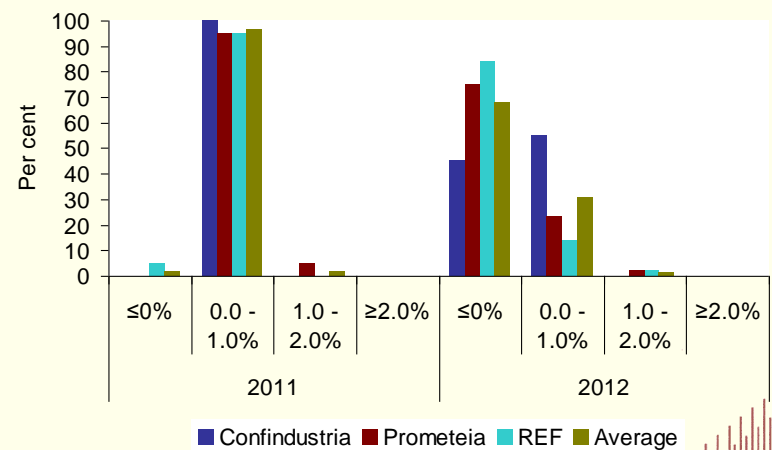
Greece: GDP growth



Hungary: GDP growth

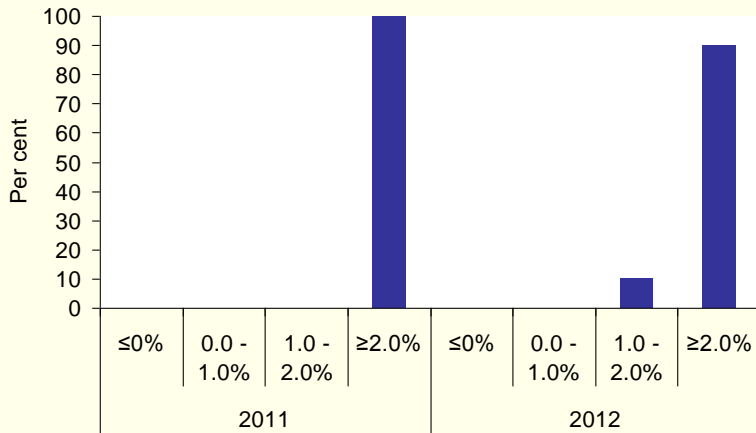


Italy: GDP growth

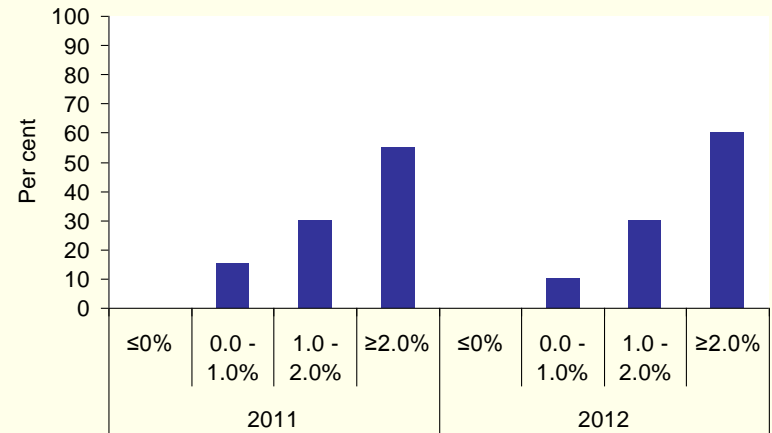


# Probability distributions (3)

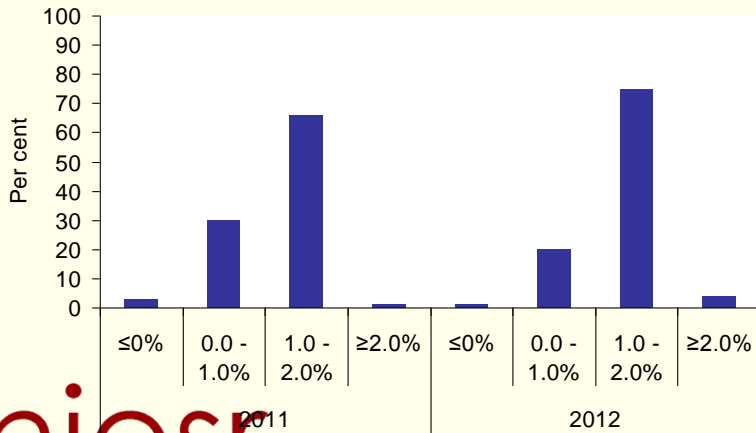
Poland: GDP growth



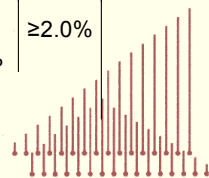
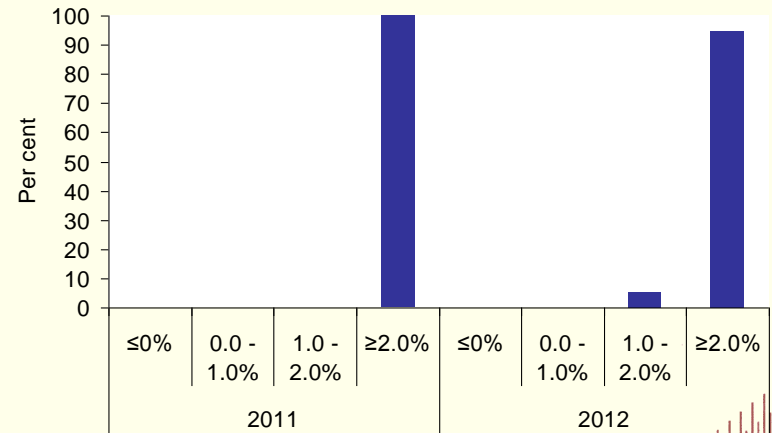
Serbia: GDP growth



Slovenia: GDP growth

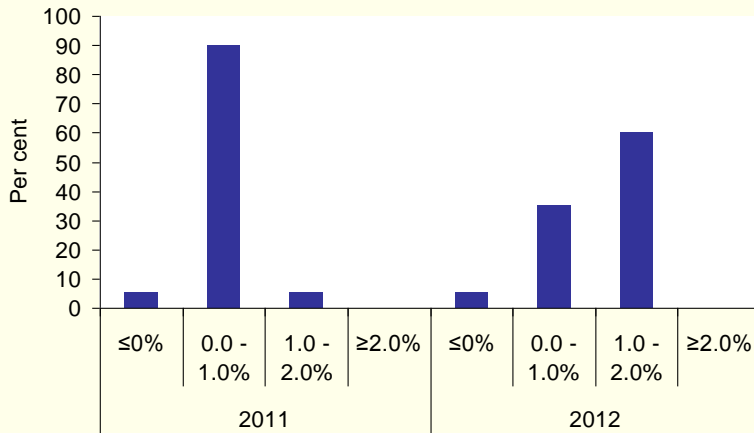


Slovakia: GDP growth

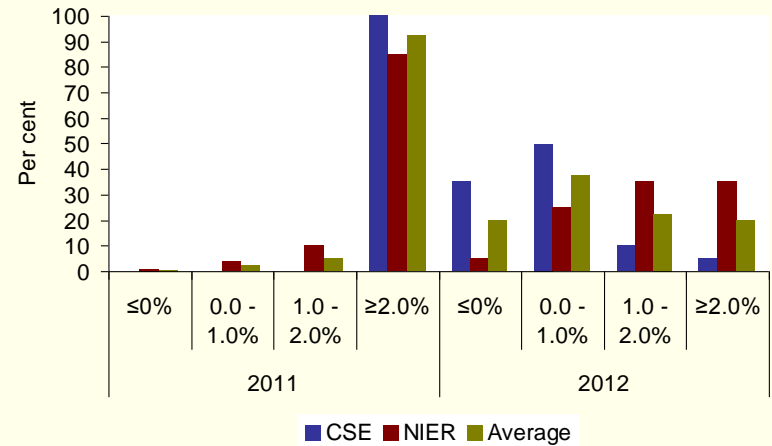


# Probability distributions (4)

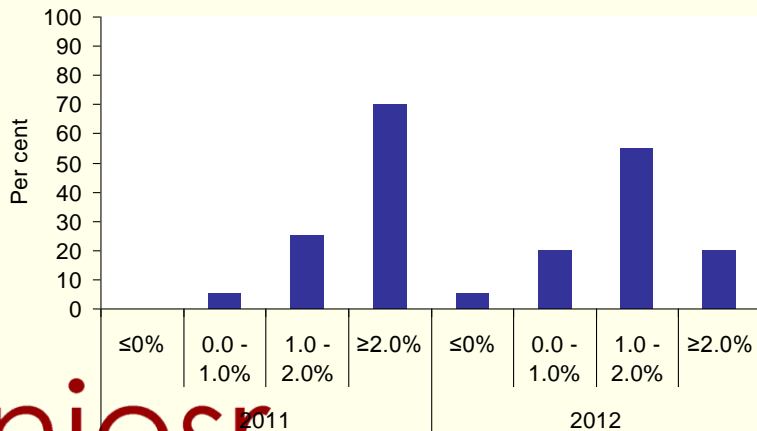
Spain: GDP growth



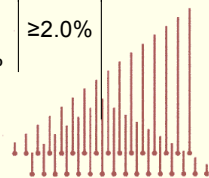
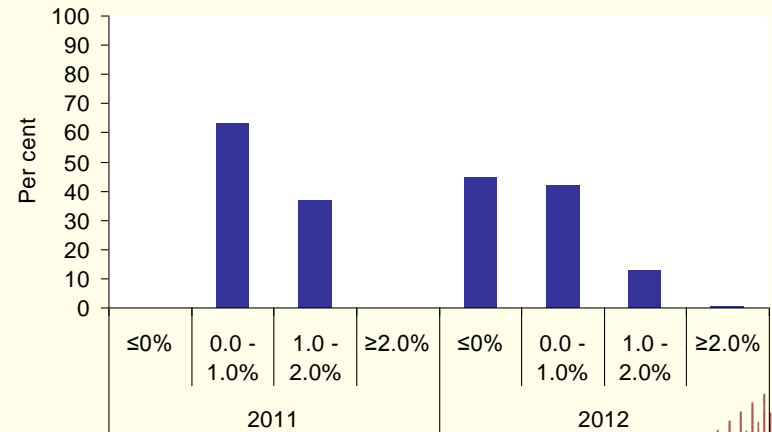
Sweden: GDP growth



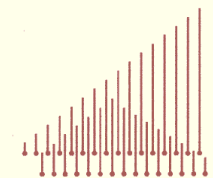
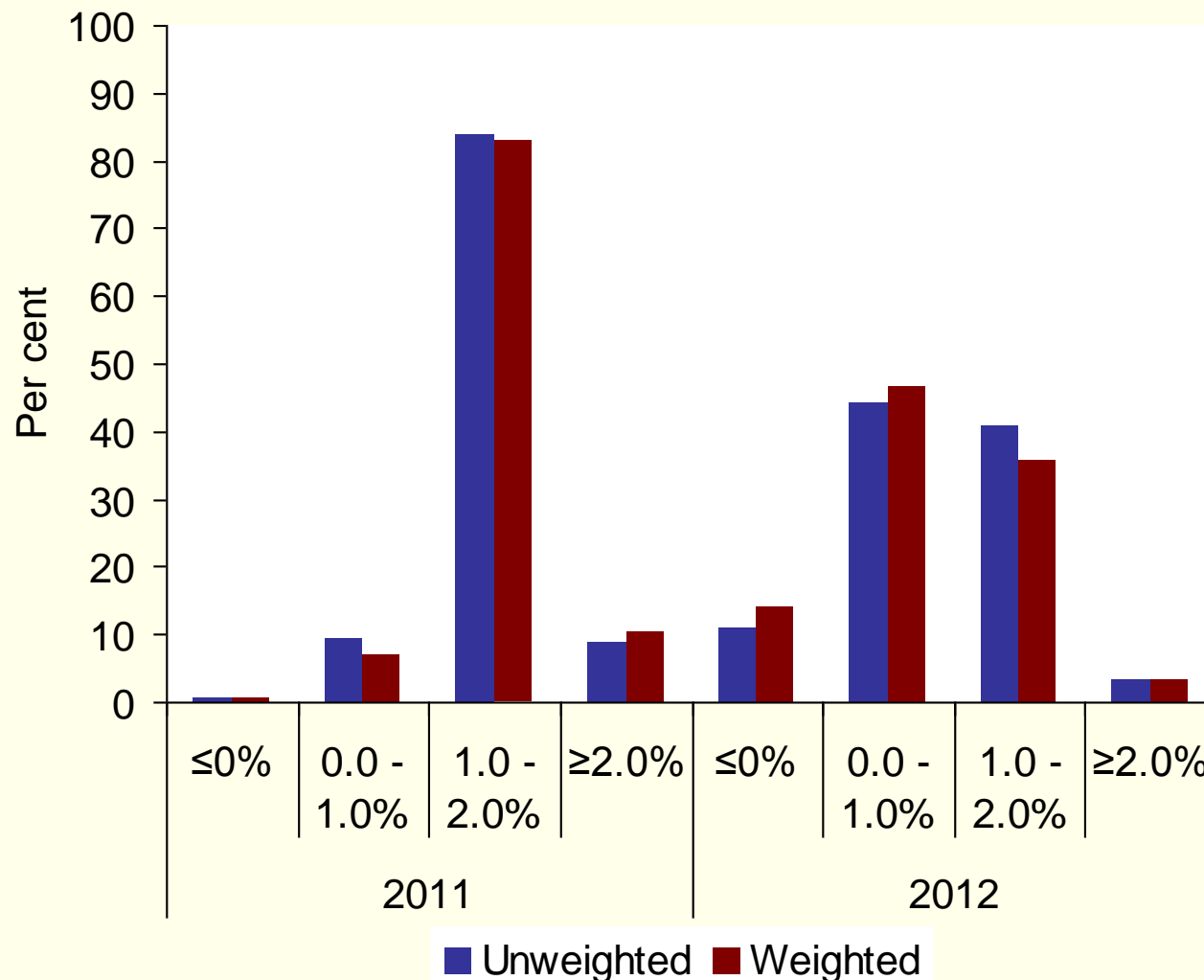
Switzerland: GDP growth



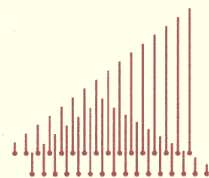
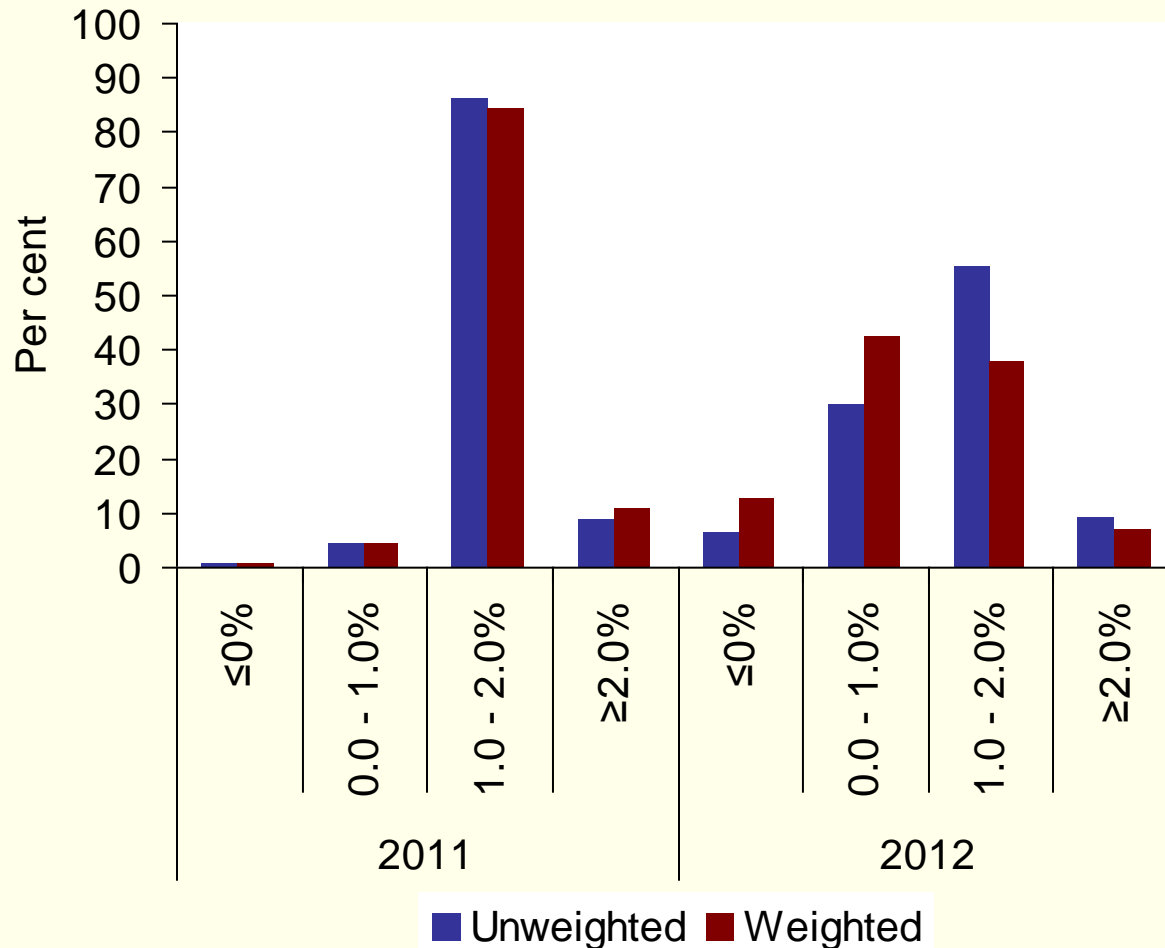
UK: GDP growth



# Probability distribution for EA17 GDP growth

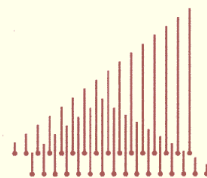
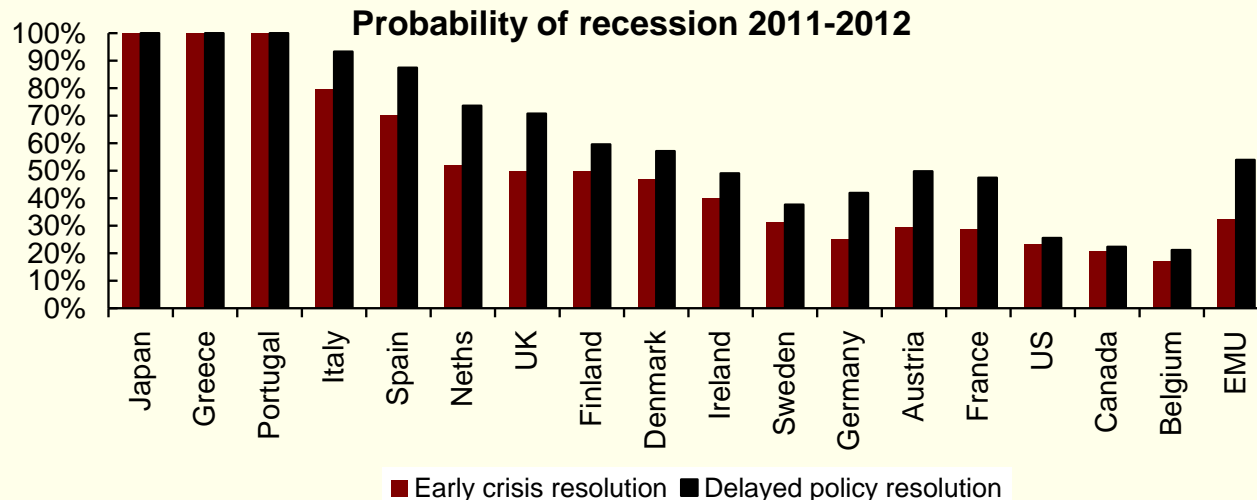


# Probability distribution for EU GDP growth



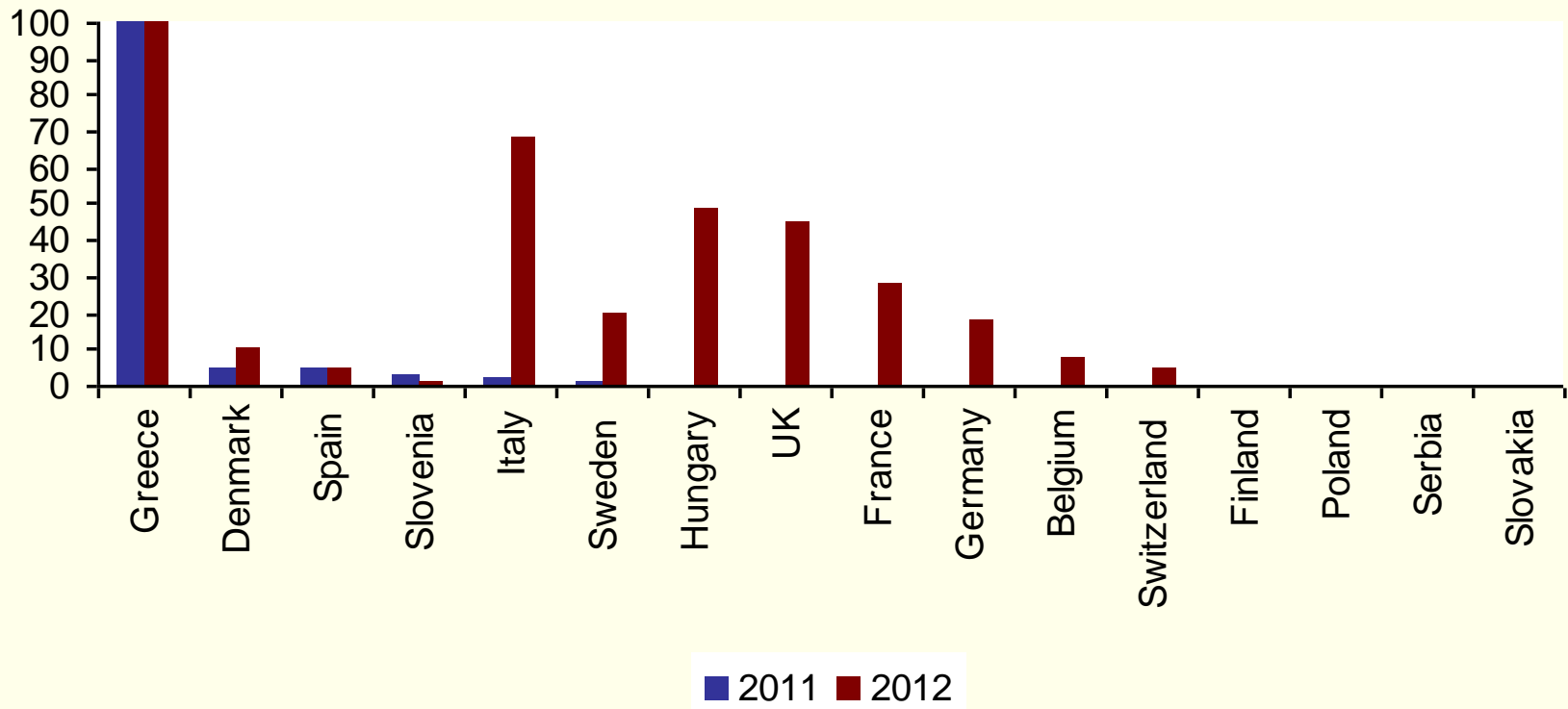
# Probability of recession in 2011-12

- Probability of a technical recession
- Based on NIESR's October 2011 forecast
  - Assumed early resolution of the crisis
  - The October 26 summit did not provide this

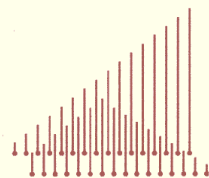




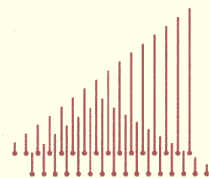
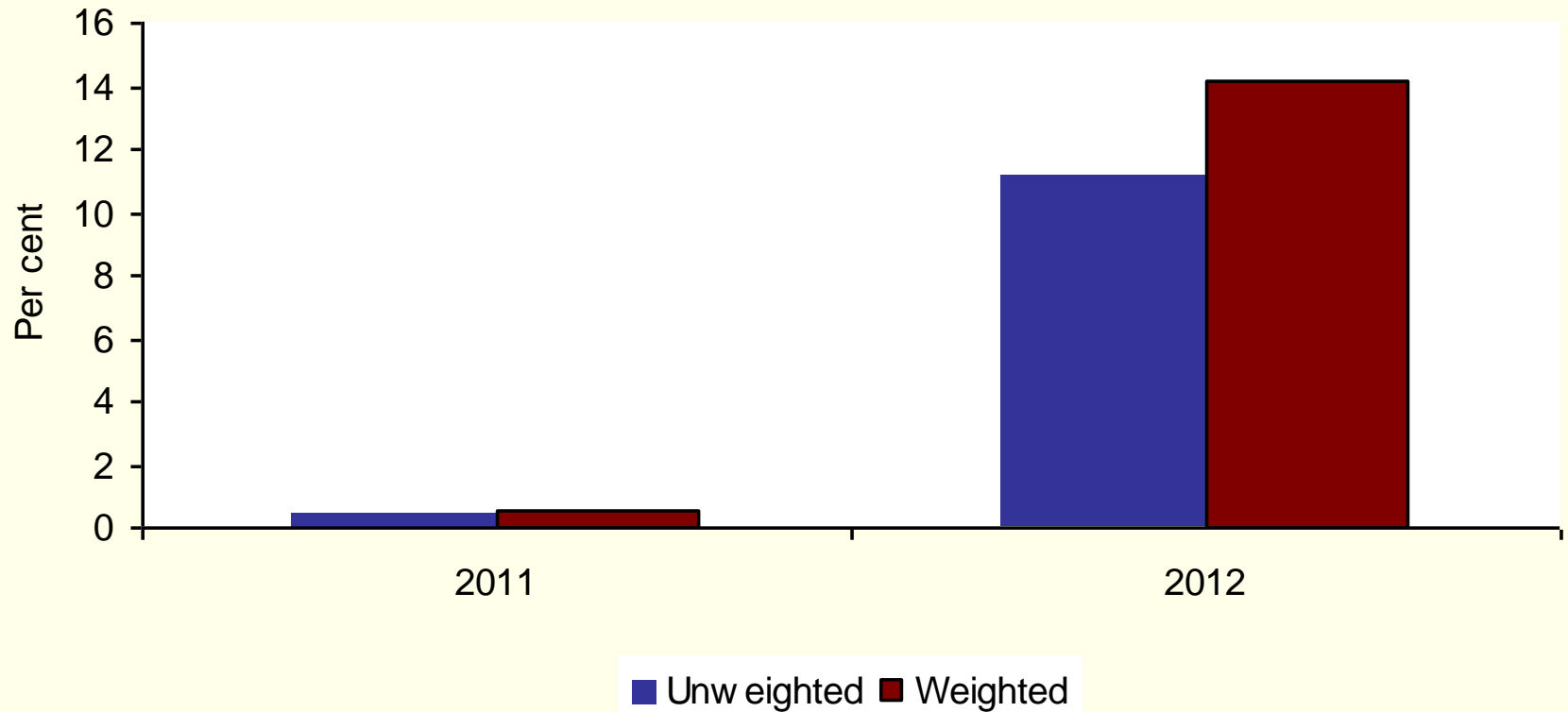
# Individual country probabilities: output falling, annual basis



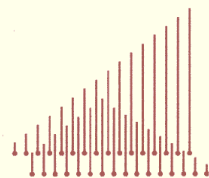
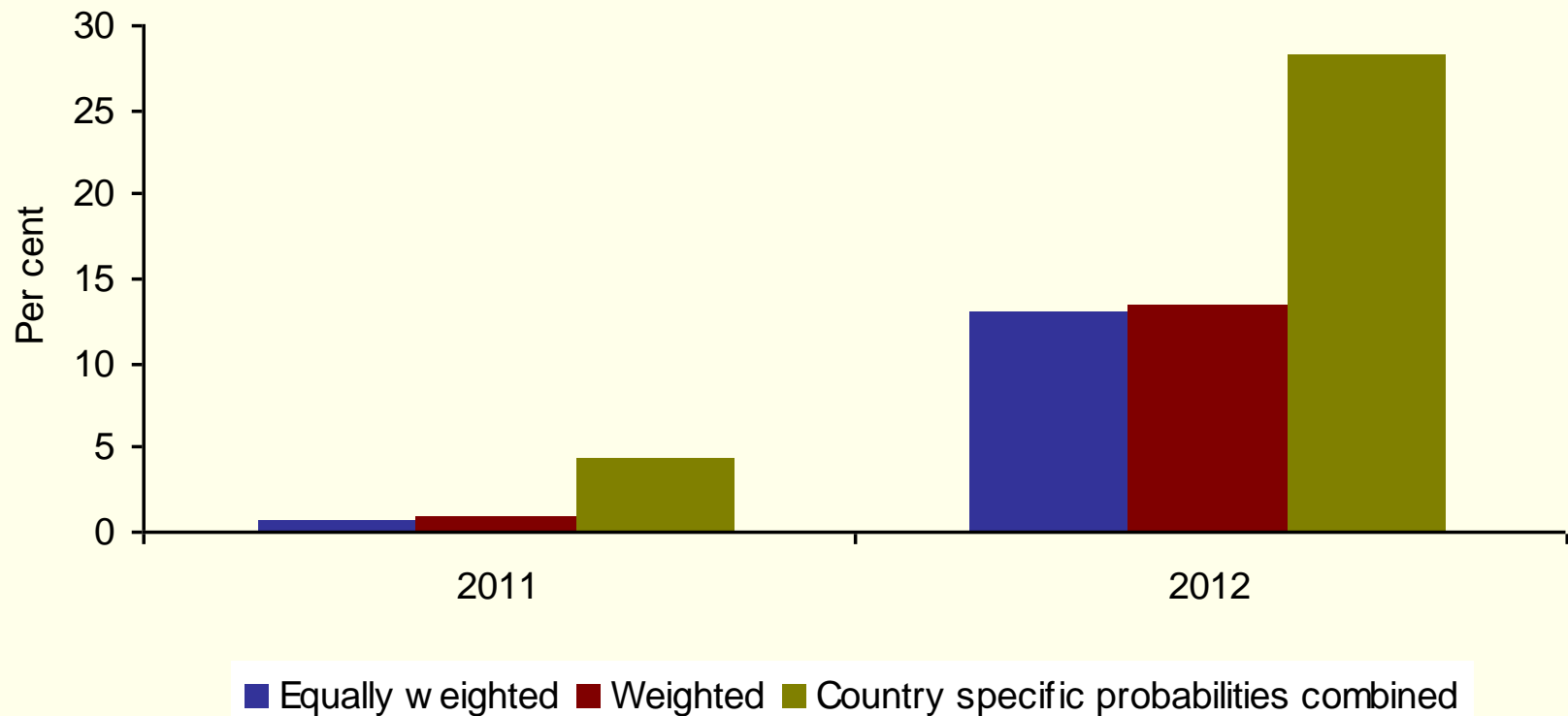
Source: 24 AIECE member institutes



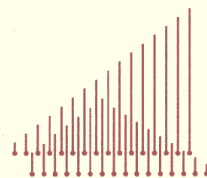
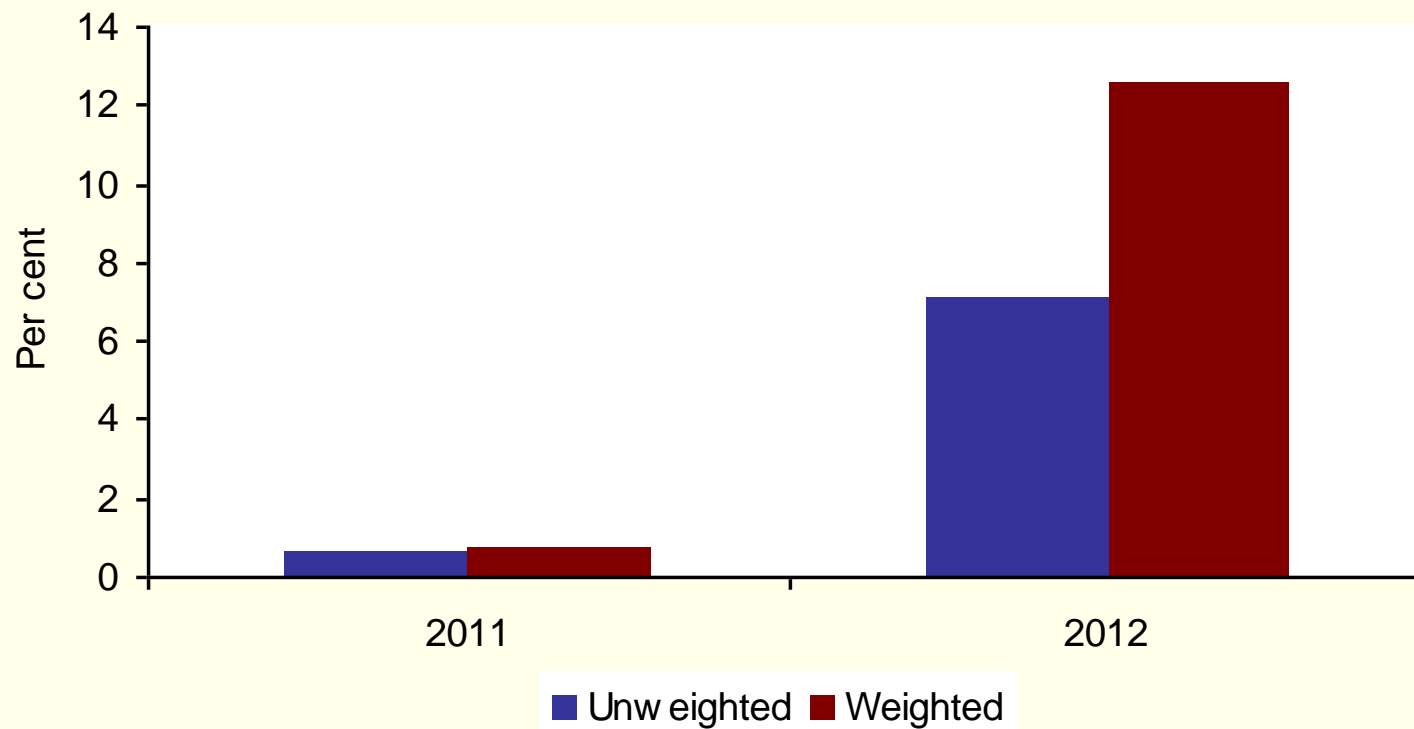
# Probability of EA17 output falling



# EA institutes not pessimistic enough about EA17?



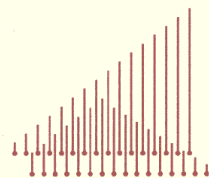
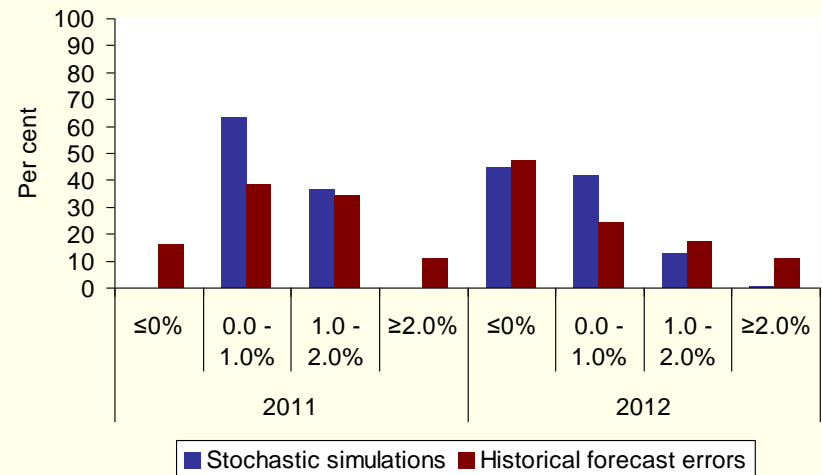
# Probability of EU output falling



# Derivation of distributions

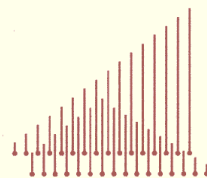
- NIESR uses two approaches to producing 'fan charts'
  - Stochastic simulations
  - Historical forecast errors
- Our forecasts are modal
  - 'Most likely outcome'
  - Normality is assumed
  - But empirical work (Wallis, 2004) supports this assumption
- What do other institutes do?

UK: GDP growth

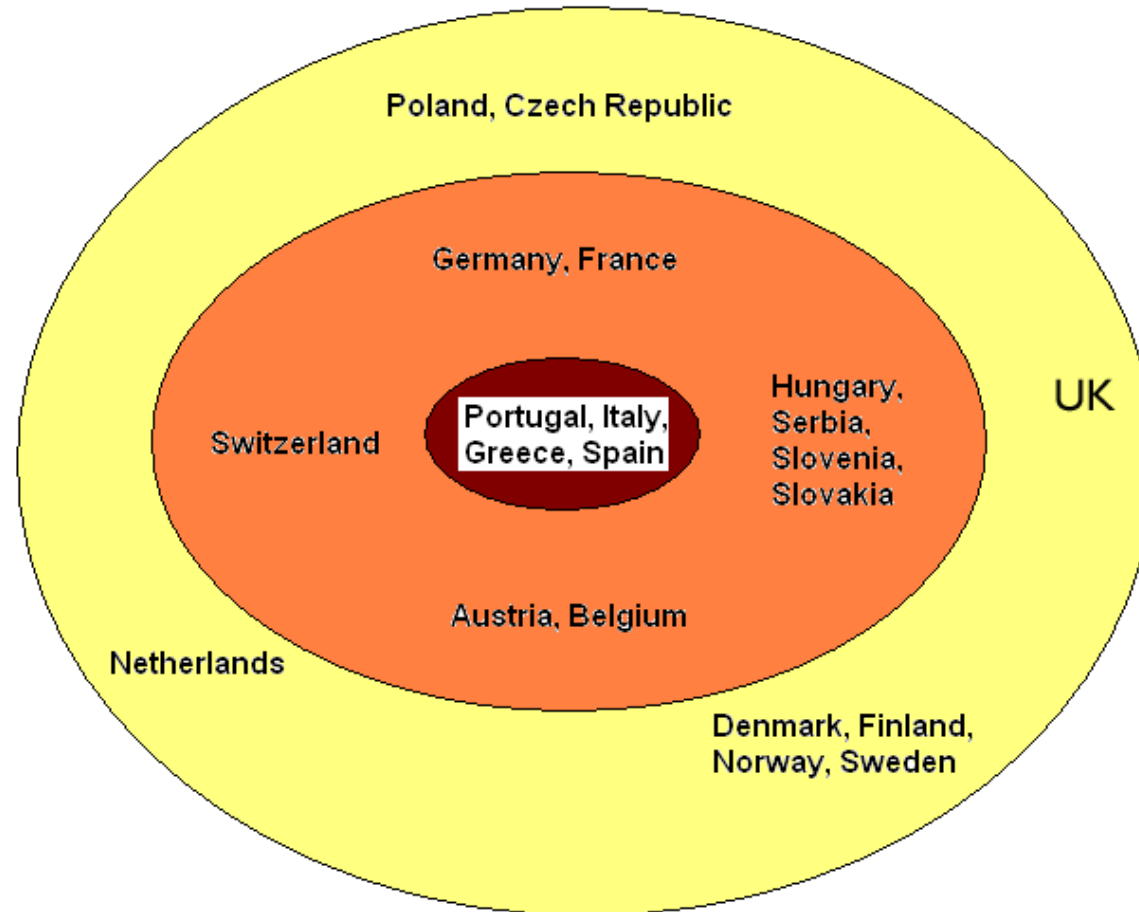


# Questions for members

- How should we calculate the probability distributions around our forecasts?
- Would any AIECE member institutes change the probability of recession in their country for next year?
- Have any additional fiscal consolidation plans altered the probability of recession occurring, or even persisting in any AIECE member institutes?



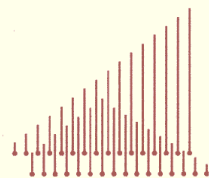
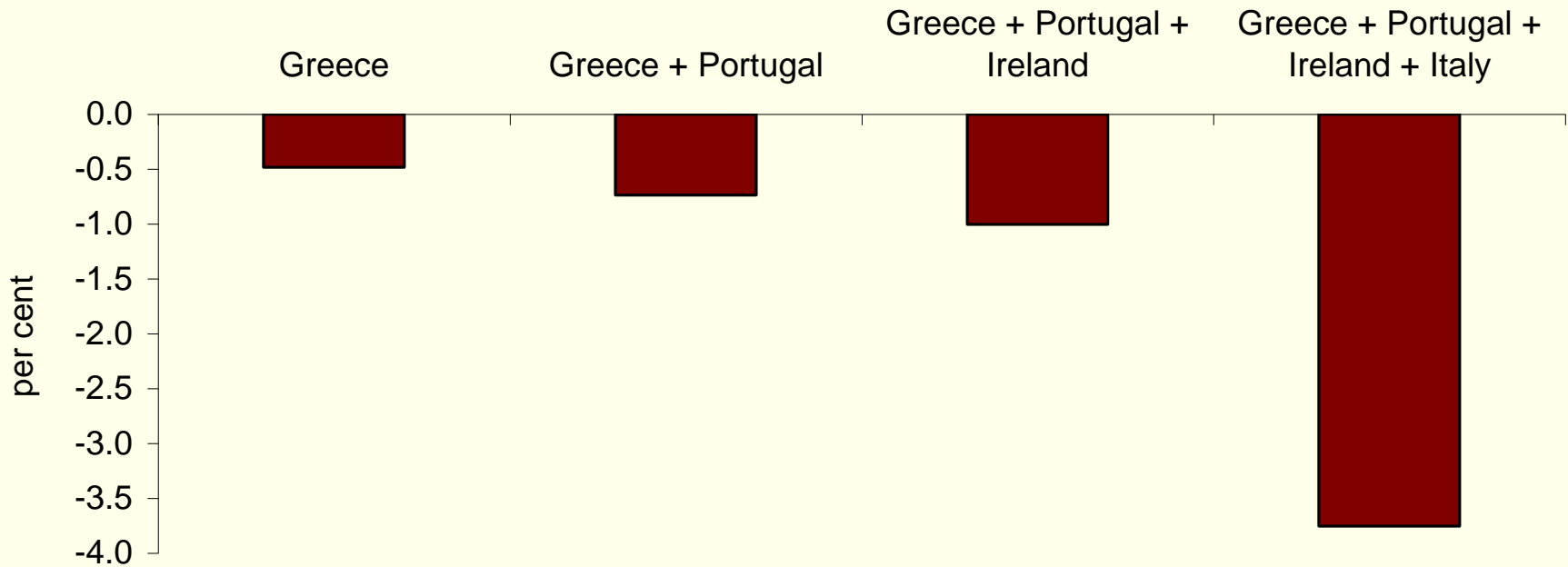
# Banking sector exposures to sovereign debt of the epicentre



# Default in Italy???

- Major banking crisis would be inevitable

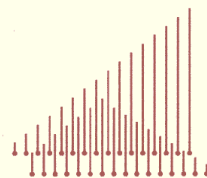
Loss to Euro Area bank assets of 50% default in....



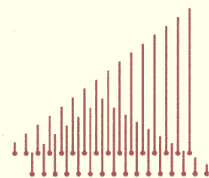
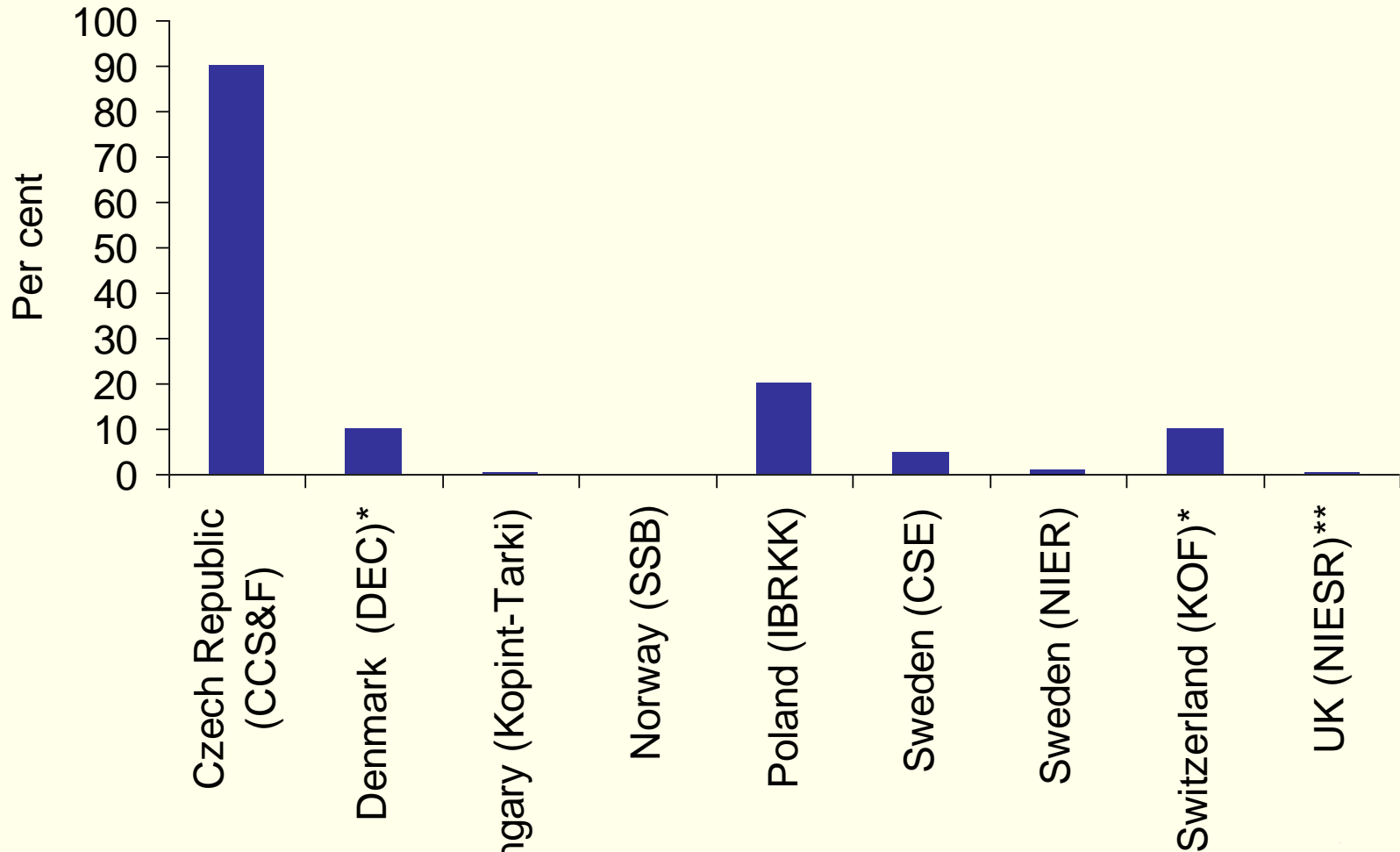


# Questions for members

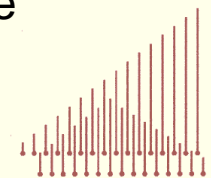
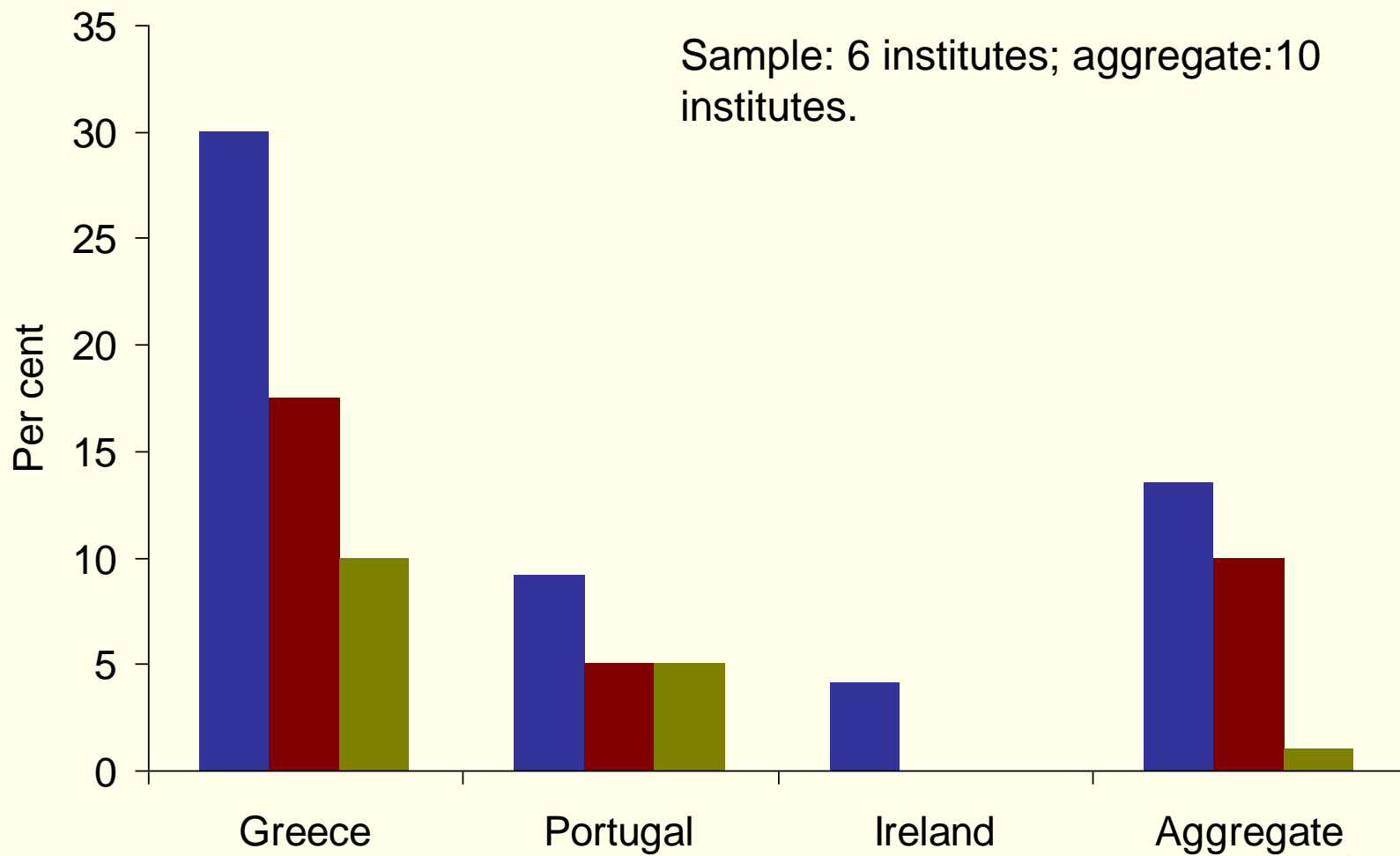
- Can European banks raise capital from the private sector in the current climate?
- Is there a risk that banks will meet the new capital requirements by shrinking their balance sheets rather than raising additional capital?
- Are banks reducing their exposure to the banks resident in countries at the centre of the storm?



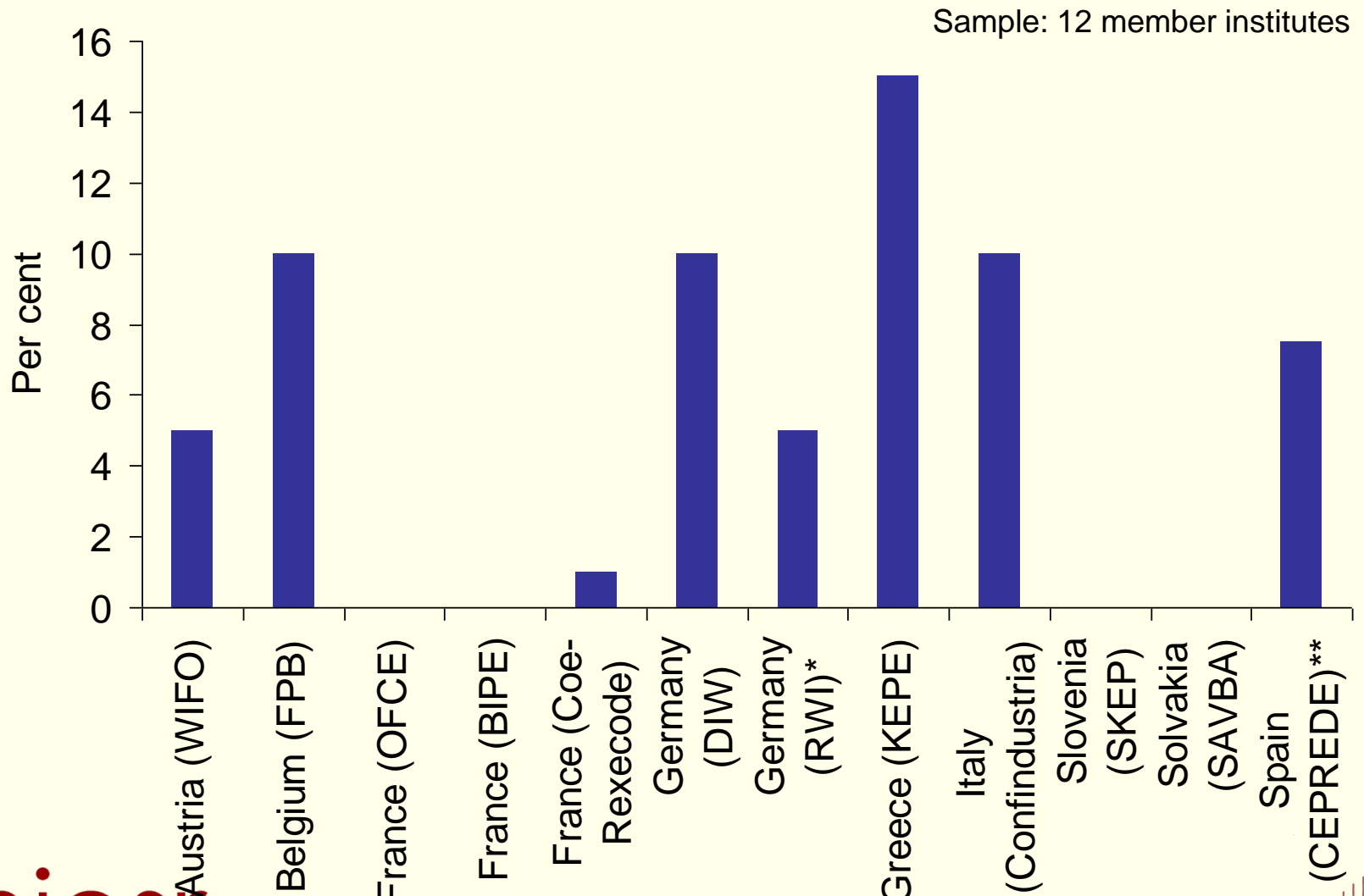
# The future of the euro: probabilities of countries joining the euro



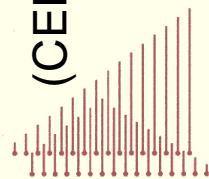
# Probability of EA exit, countries that have received bailout



# Probability of EA exit

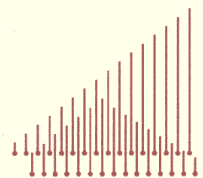


\* Less than 5%, \*\* 5-10%

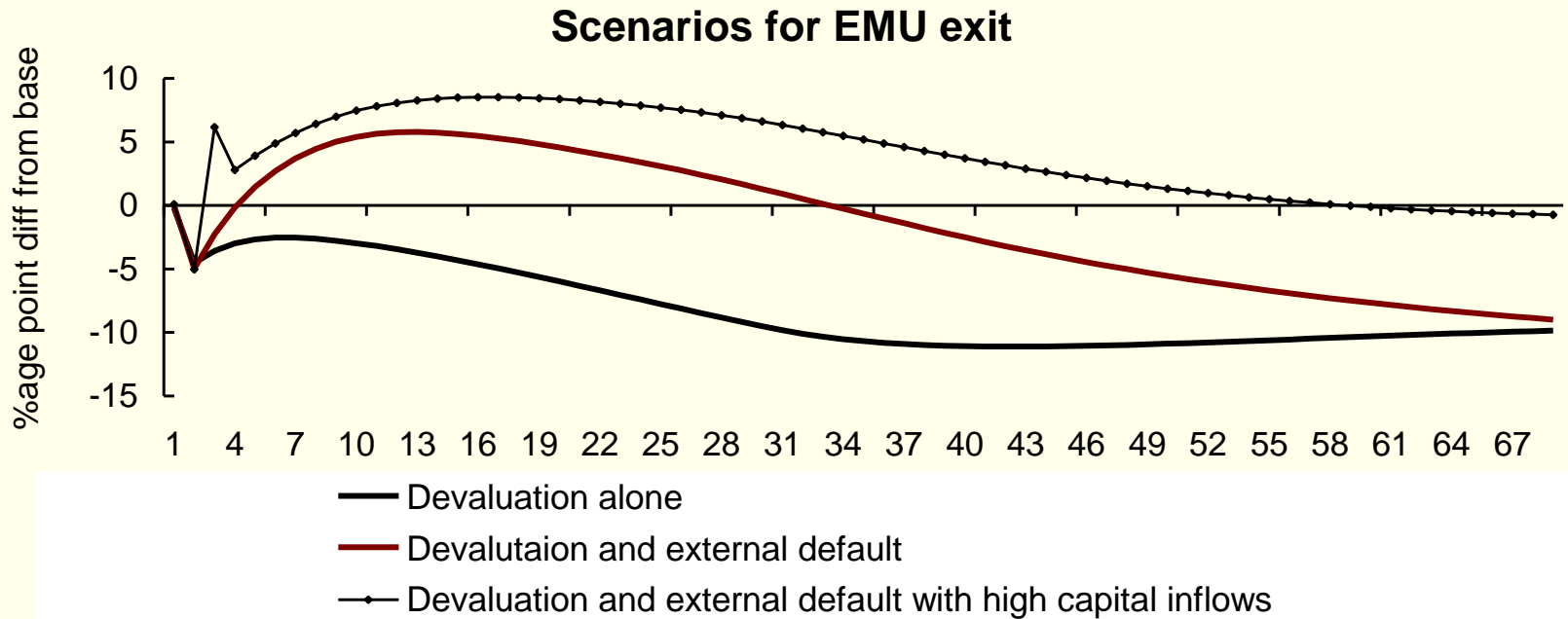


# EMU exit

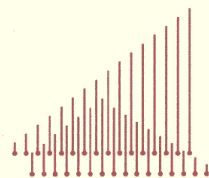
- Run on banks likely now that policy discussed openly
- Abstract from all political, legal, technical barriers
- Three scenarios
  - Exit and default through devaluation
  - Exit, devalue and default on all external debt
  - Exit, devalue, external default, lost domestic investment replaced by capital inflows
- In all scenarios bank lending freezes for 1 quarter
- No guarantee it will improve Greek outlook
- Risk it may worsen outlook



# EMU exit scenarios – impact on GDP

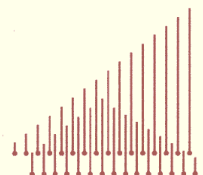


- **Additional risks:**
  - labour outflows
  - longer freeze on bank lending
  - exit from EU – trade tariffs?
  - social turmoil and civil unrest



# Questions for members

- What is the likelihood of the Euro Area breaking apart?
- Could a two-tier Euro Area form? How would this happen? Who would join the two clubs?
- There has been discussion of countries being forced out of the Euro Area. Given the lack of legislation to allow such an event, is this scenario even worth discussing?
- What would a break-up of the Euro Area look like? Do member institutes think a break-up in an orderly fashion is even possible?
- *Other risks*
- Is the crisis in the Euro Area distracting us from any other risks to the outlook?
- Are there any upside risks to the outlook for GDP growth?



# Questions for members (total)

- **Probabilities of recession**
- How should we calculate the probability distributions around our forecasts?
- Would any AIECE member institutes change the probability of recession in their country for next year?
- Have any additional fiscal consolidation plans altered the probability of recession occurring, or even persisting in any AIECE member institutes?
- **Banking system**
- Can European banks raise private sector capital in the current climate?
- Is there a risk that banks will meet the new capital requirements by shrinking their balance sheets rather than raising additional capital?
- **Prospects for EMU**
- What is the likelihood of the Euro Area breaking apart?
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