

# **The European Economy**

## **in the Medium Term**

Report prepared for the AIECE spring meeting in Berlin

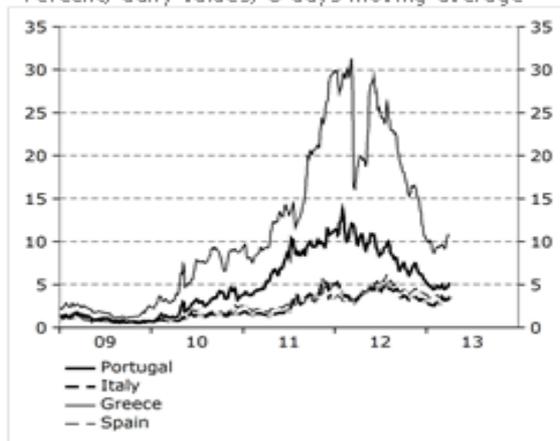
2 – 3 May 2013

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NIER, Stockholm

**FIN233 Diagram 1 Selected  
Government Bond Interest Rates,  
Difference over German bonds**

Percent, daily values, 5-days moving average

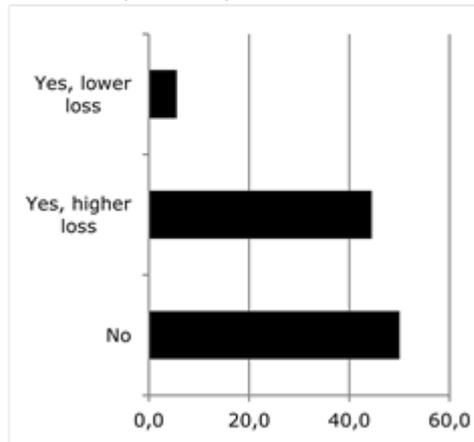


Note: 10-year maturity.

- A further increase of the assessed permanent output loss caused by the financial and debt crisis
- Rather gloomy outlook for global productivity growth in the medium term

Figure 1 Have you changed your view on what permanent loss of output has been induced by the financial and debt crisis? **03**

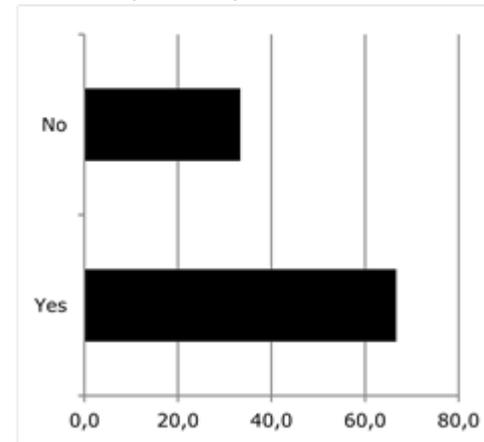
Share of respondents, percent



Source: AIECE community.

Figure 1 Do you agree that global productivity growth will be considerably lower ahead compared to the last couple of decades? **07**

Share of respondents, percent

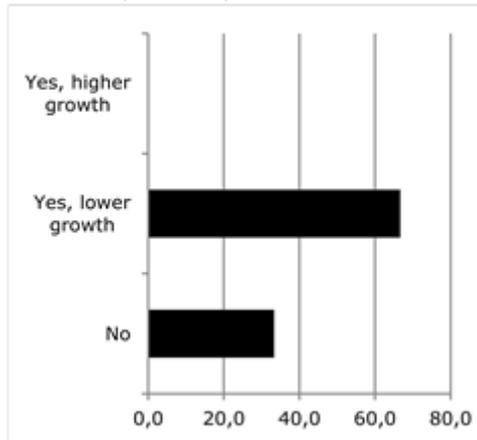


Source: AIECE community.

- More pessimistic view on medium term growth
- Trend GDP growth (unweighted) 2013-2017 halved compared to 2003-2007

**Figure 1 Have you changed your view of 2013–2015 growth since spring 2011?**

Share of respondents, percent



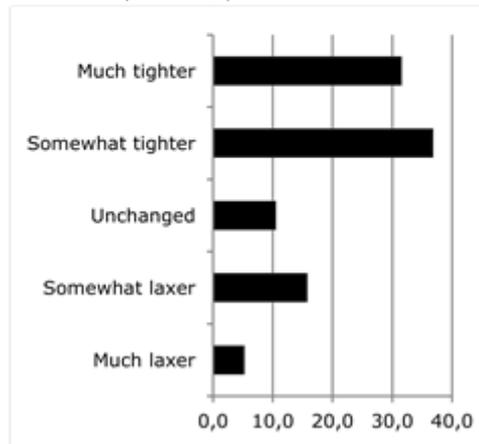
Source: AIECE community.

- Tighter credit conditions lies ahead in most member countries

**Figure 1 How will bank credit conditions for non-financial firms and households be over the next 5 years compared to the decade before 2009?**

Q4

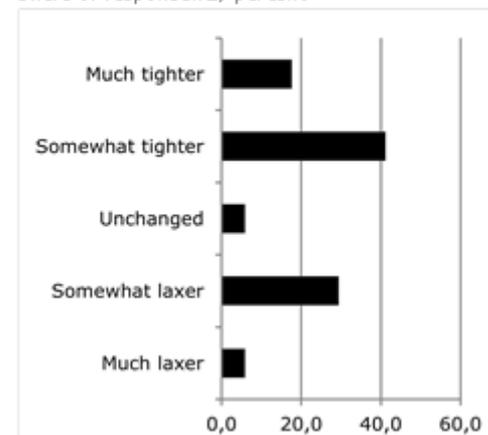
Share of respondents, percent



**Figure 1 How will borrowing costs for non-financial firms be over the next 5 years compared to conditions during the decade before 2009?**

Q5

Share of respondents, percent



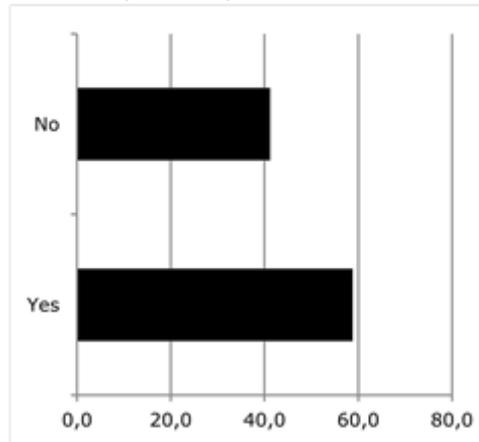
Source: AIECE community.

# Re-balancing and growth

- AIECE split on global re-balancing and its growth effects
- A minority (40%) expect significant global re-balancing with lower growth

Figure 1 Do you expect significant continued re-balancing globally during the next few years? **Q9**

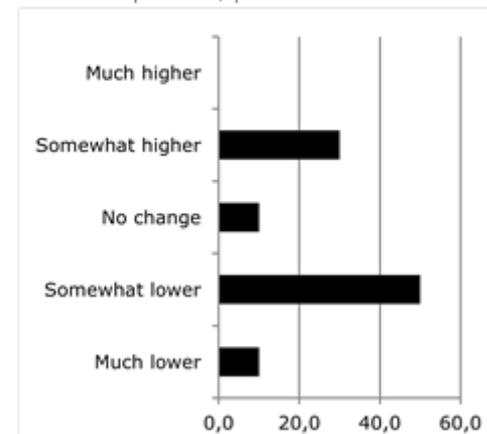
Share of respondents, percent



Source: AIECE community.

Figure 1 Compared to a "no re-balancing scenario", what change in global GDP growth over the next few years is consistent...? **Q10**

Share of respondents, percent



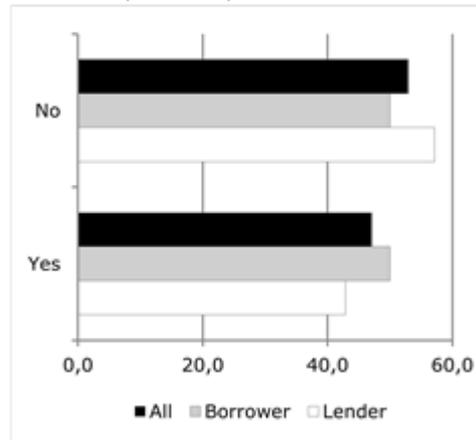
Source: AIECE community.

# Re-balancing in the euro zone

- Capital movement within the currency area but no income convergence
- Half of AIECE institutes detect savings imbalances
- The adjustment process has begun

Figure 1 Does a significant portion of 2012 current account surplus/deficit constitute an imbalance? **011**

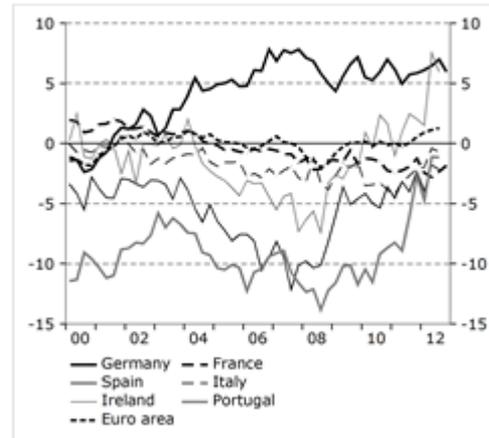
Share of respondents, percent



Source: AIECE community.

INT742 Diagram 1 Current Account in Selected Countries

Percent of GDP, seasonally adjusted quarterly values

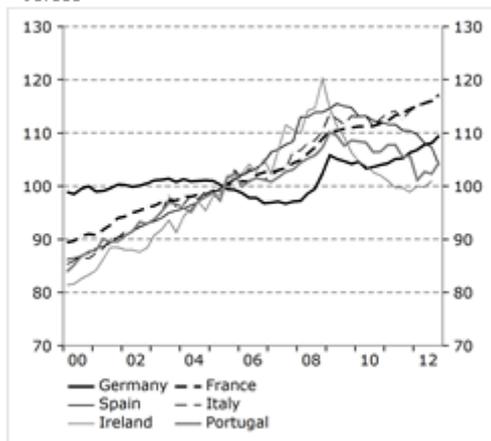


Source: OECD.

- Improving current account balances and cost adjustments in the periphery to a large part seem to be driven by high unemployment and low domestic demand
- How much adjustment so far is structural and how much is cyclical ?

**INT740 Diagram 1 Nominal Unit Labour Cost in Selected Countries**

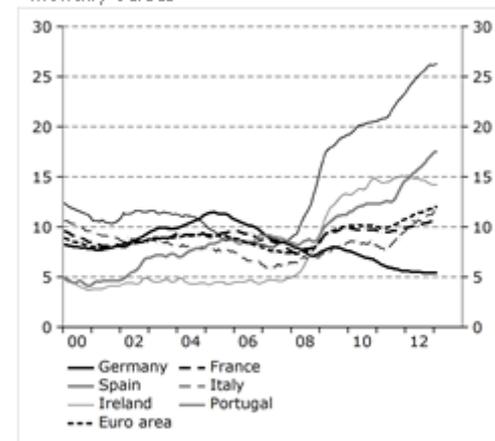
Index 2005= 100, seasonally adjusted quarterly values



Source: Eurostat.

**INT731 Diagram 1 Unemployment in Selected Countries**

Percent of labour force, seasonally adjusted monthly values

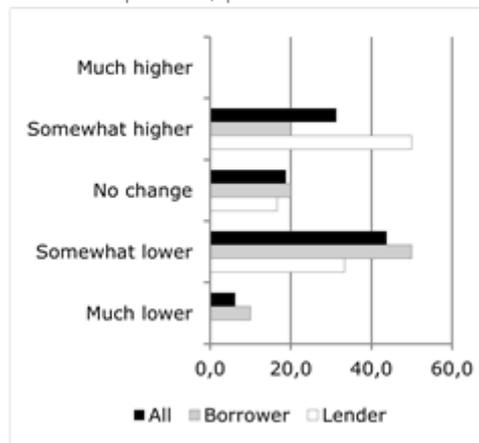


Source: Eurostat.

- On balance, AIECE answers consistent with continued re-balancing:
- Relatively lower wages and unit labour costs in borrower countries
- But no extravaganza in lender countries either ?

Figure 1 Compared to a "no re-balancing" scenario, what change in growth in hourly wages is consistent...? 012

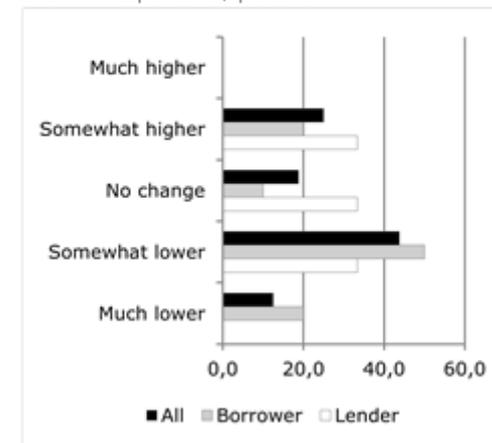
Share of respondents, percent



Source: AIECE community.

Figure 1 Compared to a "no re-balancing" scenario, what change in unit labour cost growth is consistent...? 012

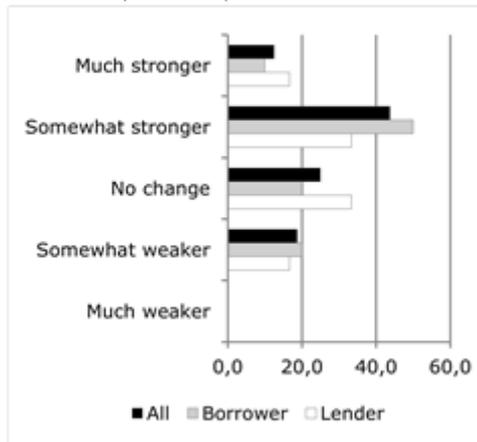
Share of respondents, percent



Source: AIECE community.

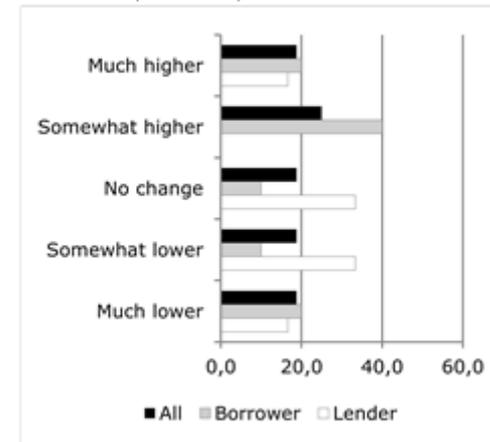
- Expected re-balancing associated with improved public finances
- Less than 40% of the institutes expect re-balancing to be associated with lower GDP growth

Figure 1 Compared to a "no re-balancing" scenario, what change in public finances is consistent...? 012  
Share of respondents, per cent



Source: AIECE community.

Figure 1 Compared to a "no re-balancing" scenario, what change in GDP growth is consistent...? 012  
Share of respondents, per cent



Source: AIECE community.

# Issues for discussion

IFW:

2 Ultra-expansionary monetary policies over a prolonged period of time in all major economic areas (US, EA, UK, Japan)

3 Is there still a consensus on monetary policy and the role of the ECB in the EA, if not, what are the perspectives for the stability and integrity of the currency union

4 Future of the EA in case of a lack of structural reforms in crisis countries.

Rexecode:

5 1, Is a re-industrialisation process occurring in the US and is there any room of manoeuvre to see such a process in EU ? What are its necessary conditions? 2, What will be the extent of labor migration between European countries ? And how does this process matter for European construction ?

# Issues for discussion

NIER:

6 Austerity...

7 How much of the re-balancing lately and in the near future that is due to cyclical forces is an important question. Unfortunately, the question in the questionnaire was not optimally put, which could explain why 100% of the institutes answered “both” to the question of cyclical and structural explanations, respectively (more alternatives should have been given). But maybe we could discuss the topic at the meeting.

8 It seems that SME:s face much tighter financing conditions than larger firms. In contrast to the latter, SME:s are more or less confined to bank borrowing. Given further bank deleveraging ahead, is there a risk that this will persist over the medium term?

9 Of those institutes that expect continued re-balancing of savings positions in the global economy 50% do not expect this to weigh on global growth, while the other 50% do expect negative effects. It would be interesting to hear each sides arguments. Are different answers a matter of difference in time perspectives?

# Issues for discussion

10 Related: Most institutes, not least from “borrower countries” do not expect negative growth effects from a continued re-balancing process in the coming years. In the long run, convergence implies higher growth in the periphery (at least in comparison to growth in the core). One could, however, fear that structural changes and related frictions will dampen growth in the short and medium term. Does the answer to the question on re-balancing and growth depend on the view of how long the re-structuring of the economy will take? Or that institutes take different time perspectives? Or is it plausible that re-balancing in the periphery will be associated with higher growth already in the short run?

11 On many accounts, Spain seems to have come quite a bit in its re-balancing process. For instance according to official statistics, unit labour costs have fallen since 2009. Are these numbers reliable?

# Issues for discussion

12 It seems that the view of AIECE is the German current account surplus will not change very much in the next few years. Judging also by the answers from other countries, this would imply that the EU/euro zone will have a substantial current account surplus visavis the rest of the world. Since many non-european countries also face stern demographic challenges ahead, how realistic is this? What parts of the world economy will accommodate euro zone/EU increased savings ?