



# Completing EMU: what remains to be done?

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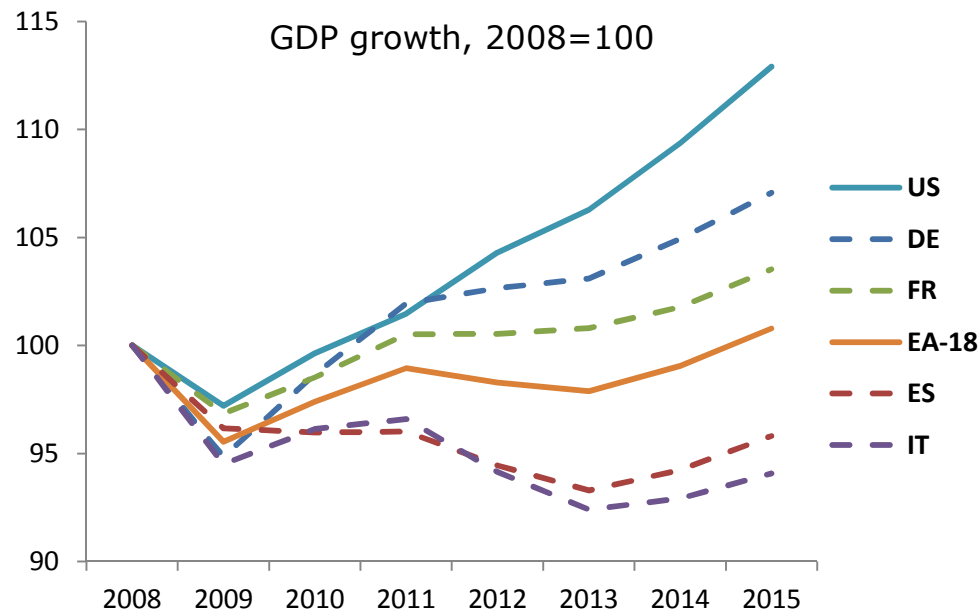


# Outline

- A slow recovery
- EMU architecture: gaps exposed by the crisis
- Stabilisation thanks to a strong policy response
- Policy challenges ahead: 3 post-crisis inconsistent trinities...
- ... and an EMU-friendly consistent one
- Overcoming policy conflicts

# The recovery needs to become more robust

- Signs of a turnaround in the euro area, including in vulnerable economies
- An internal rebalancing is underway – much of the correction is structural
- But growth is still weak due, notably, to EA specific factors:
  - Deleveraging and balance sheet repair slower than in the US
  - Financial fragmentation



Source: European Commission

# What explains the faster recovery in the US?

1. More expansionary macroeconomic policies
2. Quicker fixing of the banking system
3. More flexible economy

# The recovery needs to become more robust

## Commission Spring 2014 Forecast

	GDP growth		Inflation		Public Deficit (-)		Unemployment	
	2014	2015	2014	2015	2014	2015	2014	2015
Germany	1.8	2.0	1.1	1.4	0.0	-0.1	5.1	5.1
Ireland	1.7	3.0	0.6	1.1	-4.8	-4.2	11.4	10.2
Greece	0.6	2.9	-0.8	0.3	-1.6	-1.0	26.0	24.0
Spain	1.1	2.1	0.1	0.8	-5.6	-6.1	25.5	24.0
France	1.0	1.5	1.0	1.1	-3.9	-3.4	10.4	10.2
Italy	0.6	1.2	0.7	1.2	-2.6	-2.2	12.8	12.5
Portugal	1.2	1.5	0.4	1.1	-4.0	-2.5	15.4	14.8
Euro area	1.2	1.7	0.8	1.2	-2.5	-2.3	11.8	11.4
US	2.8	3.2	1.7	1.9	-5.4	-4.7	6.4	5.9

Source: European Commission

## Completing the architecture of the EMU: gaps exposed by the crisis

- ***Excessive risk-accumulation*** in quiet/good times in both the public and private sectors
  - Failing market discipline
  - Insufficient monitoring and enforcement tools

➡ Need to improve **risk prevention**

- ***Risks of financial instability*** within the single currency :
  - Contagion between fragile sovereigns
  - Feedback loops between weak sovereign and financial sectors
  - Financial fragmentation across the euro area, even threatening the integrity of the euro area

➡ Need to improve **crisis resolution**



# Stabilisation thanks to a strong policy response

What has been done so far?

- Improved crisis management (ESM / EFSF)
- Better surveillance tools:
  - Stronger enforcement instruments
  - Extended surveillance beyond fiscal dimension
  - Enhanced coordination
- Monetary policy (OMT, LTRO)
- Front-loaded fiscal consolidation
- Banking Union launched
- Structural reforms in a number of Member States



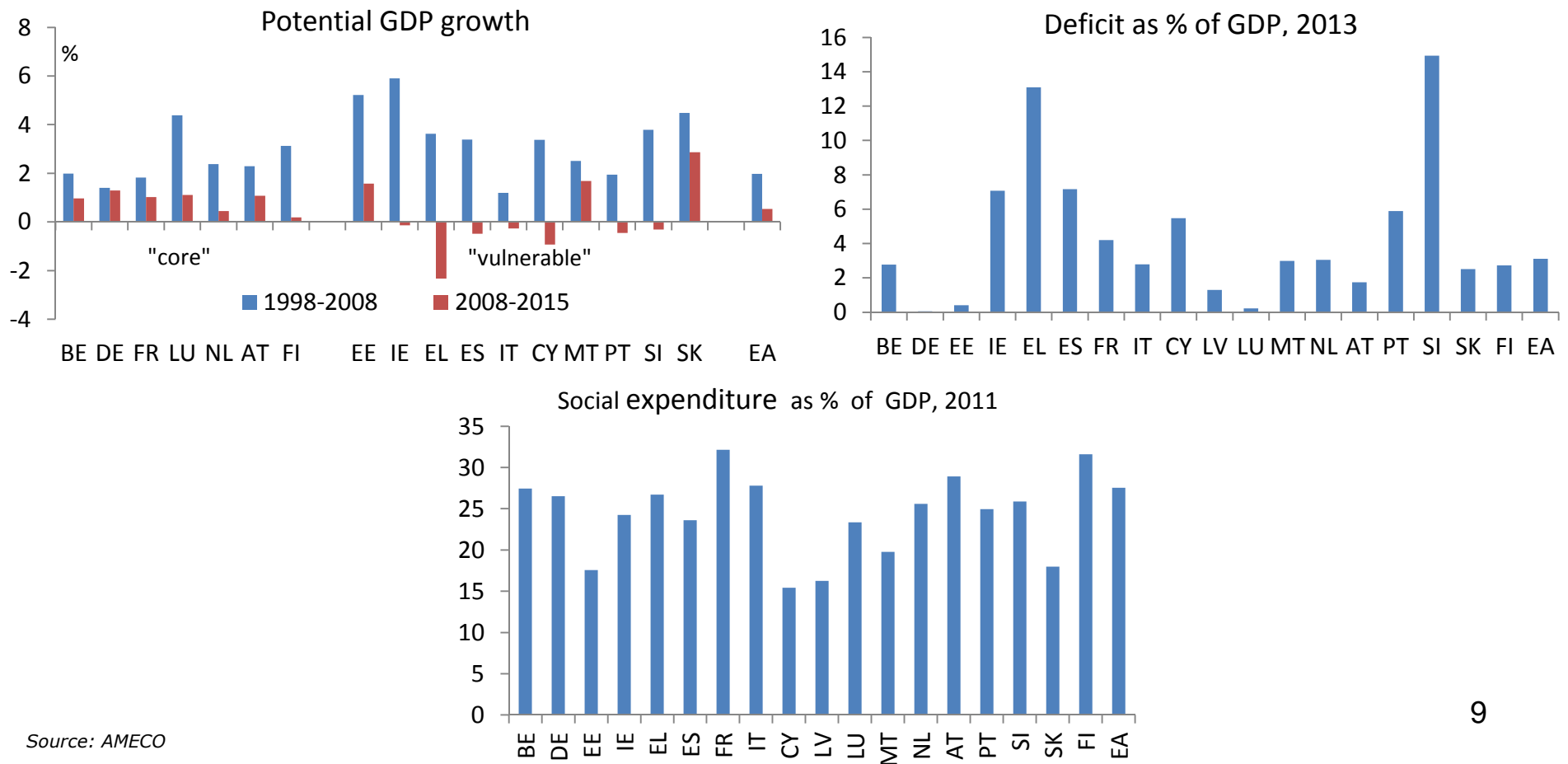
## Policy challenges ahead

3 post-crisis inconsistent trinitities:

- Political and social viability
- Adjustment objectives in the euro area
- Restoring financial integration and stability

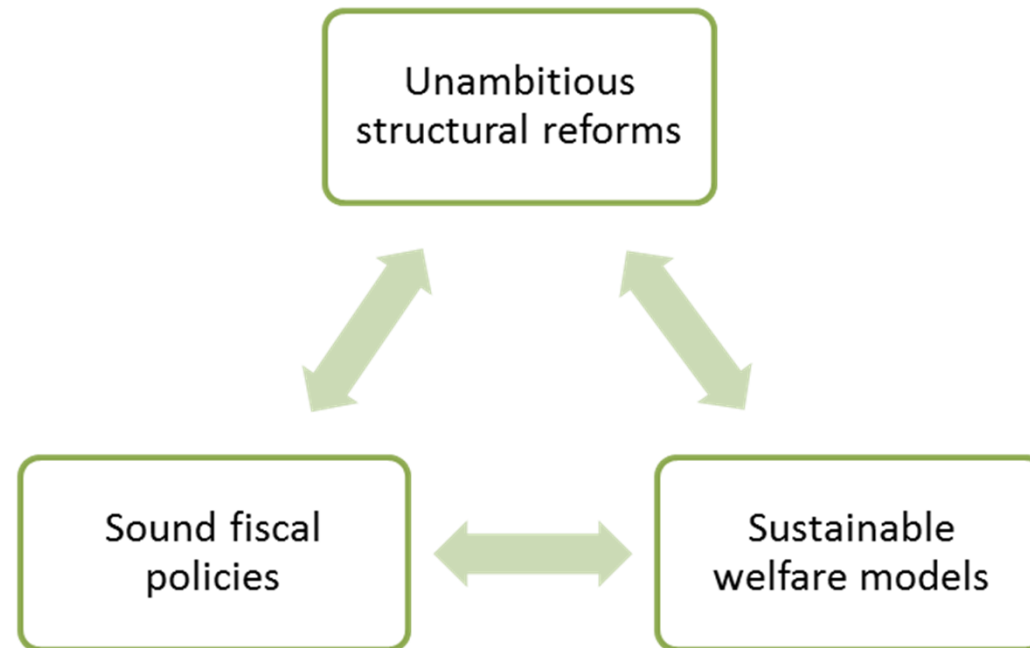


# (A) Higher growth needed to ensure fiscal discipline and sustainable social models

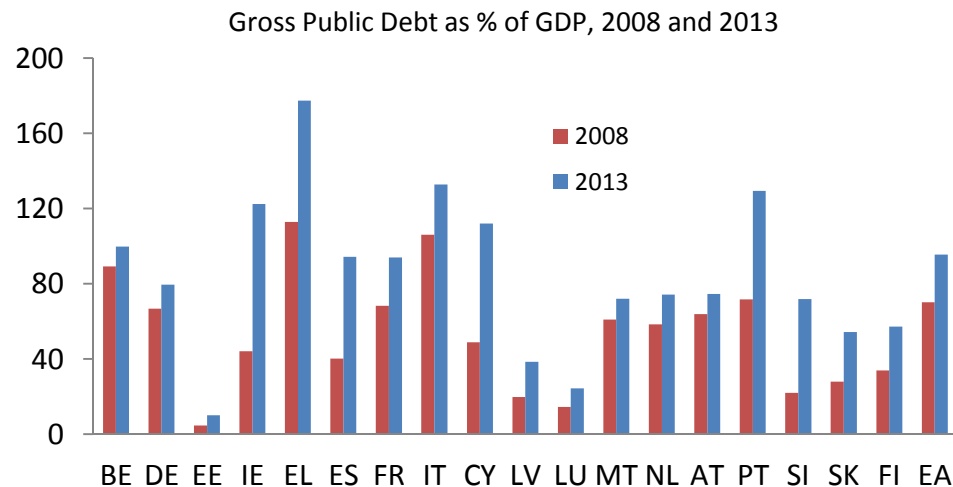
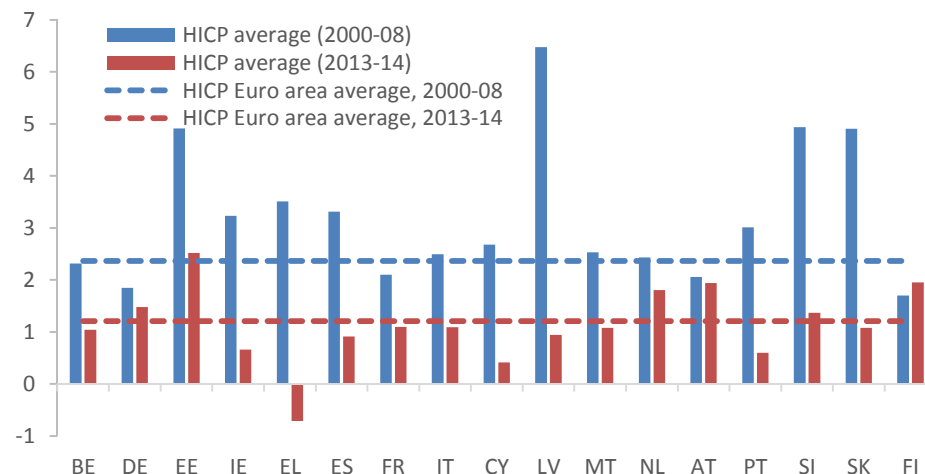
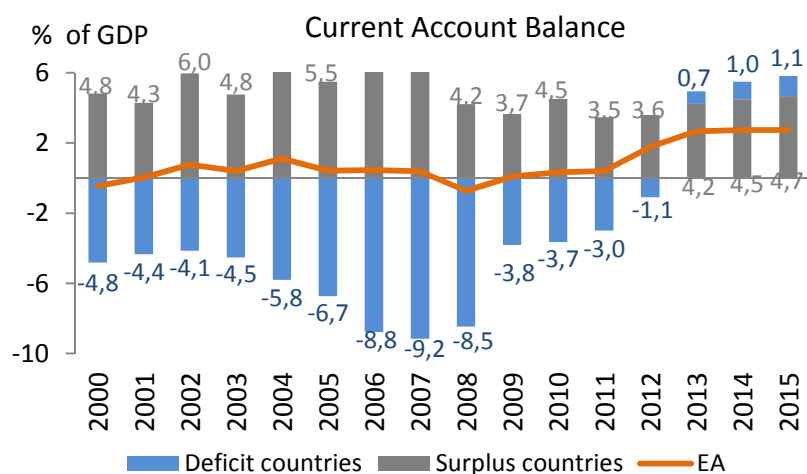


Source: AMECO

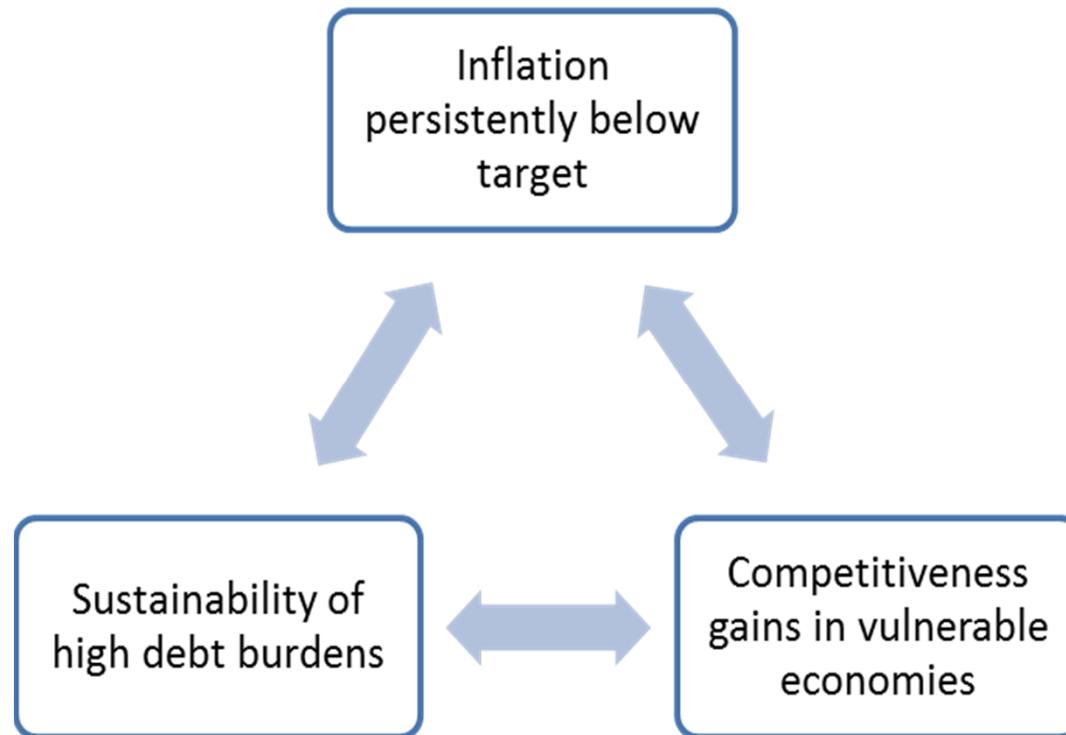
## First inconsistent trinity - Political and social viability



## (B) Asymmetric adjustment makes rebalancing more painful when inflation is low



## Second inconsistent trinity - Adjustment objectives in the euro area

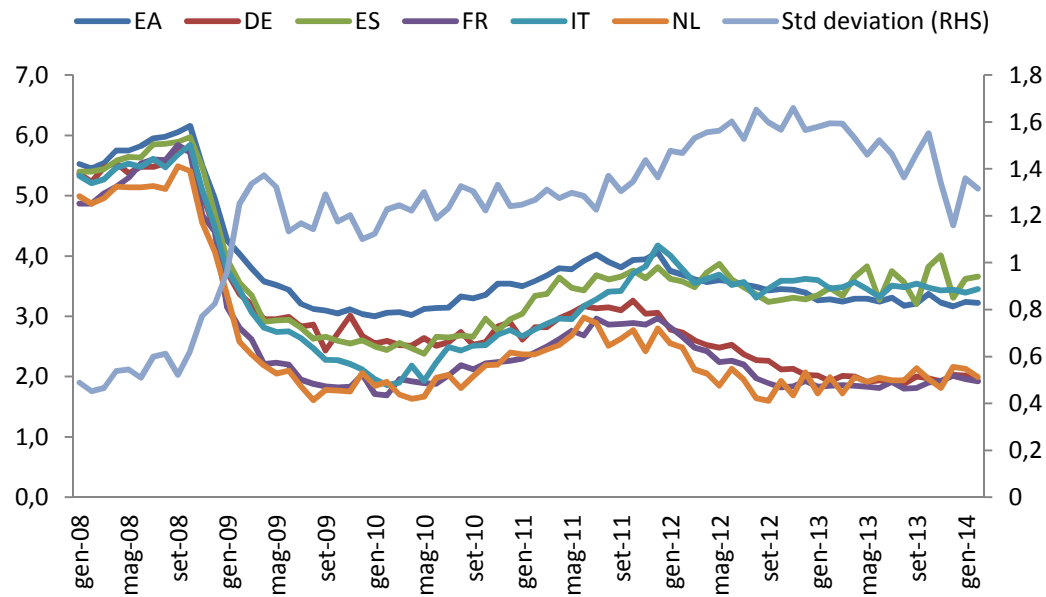


## (C) Financial stability threatened by limited national fiscal space

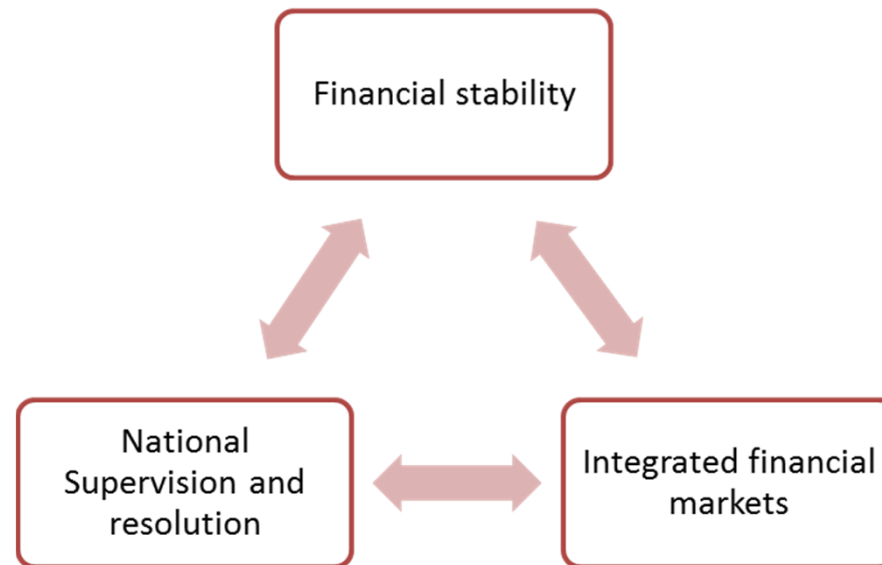
Fixing the financial sector requires:

- Breaking the "deadly embrace" between sovereigns and banks
- Reverting financial fragmentation
- Repairing banks' balance sheet and restoring credit to SMEs

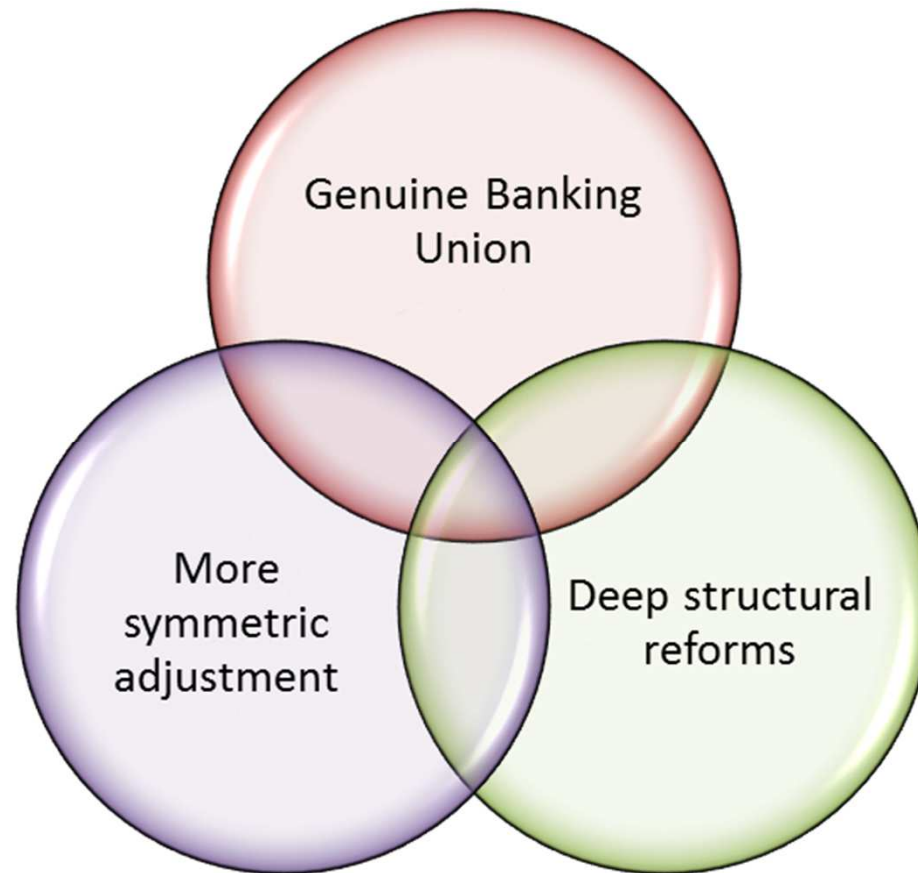
Interest rates on loans to non-financial corporations



## Third inconsistent trinity - Restoring financial integration and stability



## A consistent trinity



## Overcoming the policy conflicts

Resolving the inconsistent trinitities through EMU-friendly solutions requires:

- Stepping-up the pace of structural reforms to boost growth and allow a more symmetric adjustment
- A Banking Union and bank balance sheet repair to address the dysfunctional financial sector
- A growth-friendly, differentiated fiscal consolidation to boost demand in surplus countries and put debt on a downward trajectory in vulnerable countries

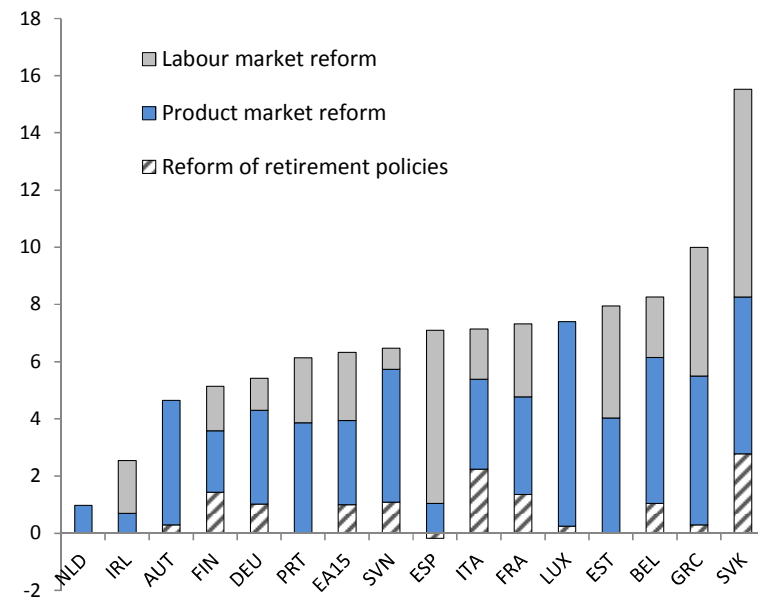


# Structural reforms

- Structural reforms needed to boost growth and facilitate rebalancing
- Important measures have been taken by vulnerable countries to reform labour markets, but employment will take time to recover. More is needed to improve the functioning and flexibility of product markets
- Less progress has been made in core countries; product market reforms needed to improve competition and strengthen domestic demand



**Difference in the level of GDP in 2025, (%)**



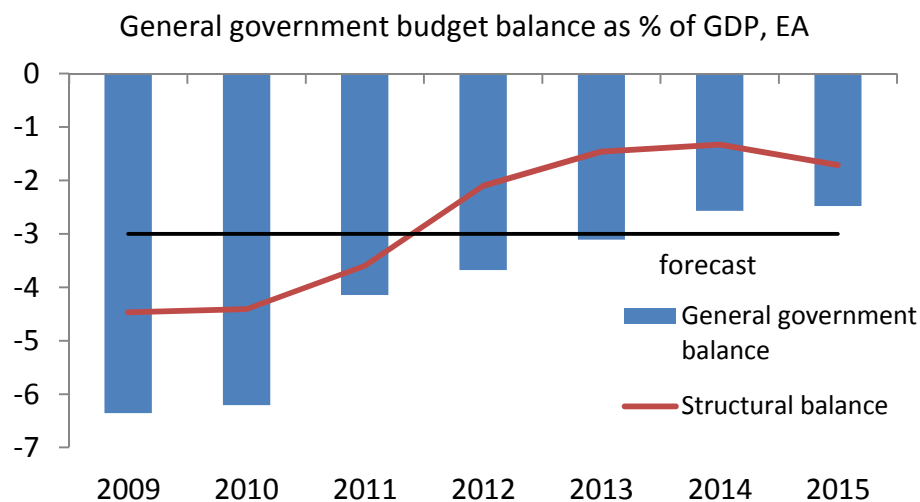


# A genuine Banking Union

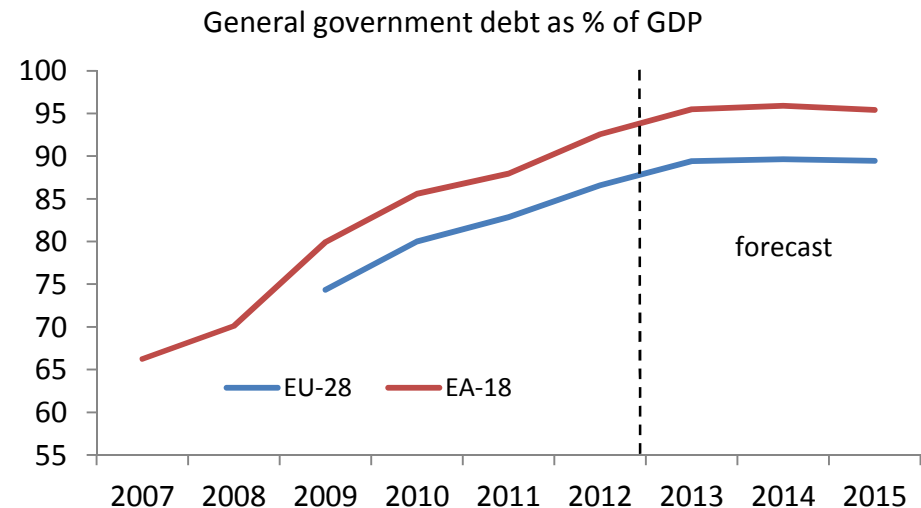
- A genuine Banking Union is necessary to:
  - Break the "deadly embrace" between sovereigns and banks
  - Strengthen overall financial stability, restore confidence and underpin the recovery
  - Consolidate the Single Market
  
- Considerable progress has been made:
  - Adoption of Single Supervisory Mechanism (SSM), Bank Recovery and Resolution Directive (BRRD) and Deposit Guarantee Scheme Directive (DGS)
  - Adoption of SRM in July, likely entry in force in September
  - Stress tests and asset quality reviews will be completed in Autumn 2014.

# Growth-friendly, differentiated fiscal consolidation

- Expenditure side: raise quality of public expenditure, prioritising productive investment
- Revenue side: make the tax system more fair and efficient
- Countries with more fiscal space should take measures to encourage domestic demand and make adjustment more symmetric



Source: AMECO



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# **The Macroeconomic Imbalances Procedure - 5 March Package Contains:**

## Communication (Results of in-depth reviews)

- 'Umbrella' for the whole package (integrated surveillance)
- Identifies excessive imbalances, imbalances and no imbalances

## IDRs (in-depth reviews) for 17 Member States

- BE, BG, DE, DK, IE, ES, FI, FR, HR, HU, IT, LU, MT, NL, SE, SI, UK.
- Third round of MIP

# Findings of the IDRs

## Excessive Imbalances

SI, HR, IT

opening of corrective arm will be decided in June after examination of NRPs and SGPs

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## Imbalances

BE, BG, DE, IE, ES, FR, HU,  
NL, FI, SE, UK

of which requiring decisive action:

IE, ES, FR, HU

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## No Imbalances

DK, MT, LU

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## Specific Monitoring

SI, HR, IT, ES, IE, FR

## **European Semester - 2 June Package will contain:**

- **Country-specific recommendations** on fiscal policy, structural reforms, banking system...
- **Commission legal steps under the Excessive Deficit Procedure** (reporting, stepping up, abrogation...)



**Thank you!**