The EMU at 20: current status and the way forward

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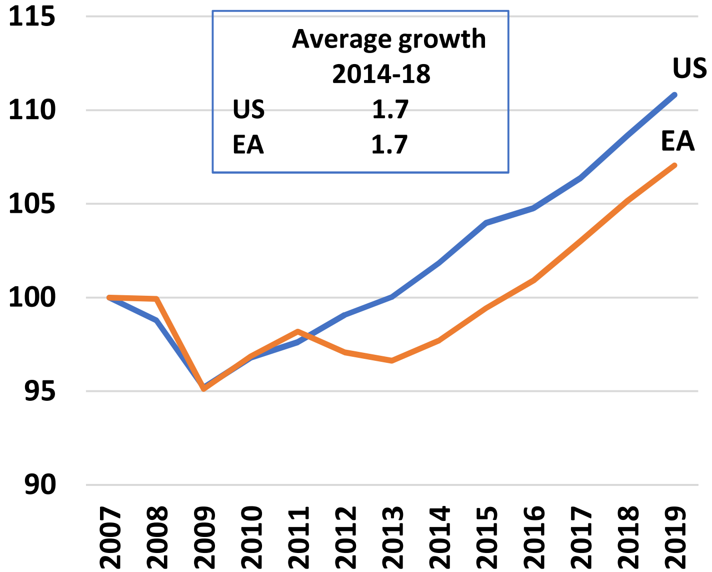
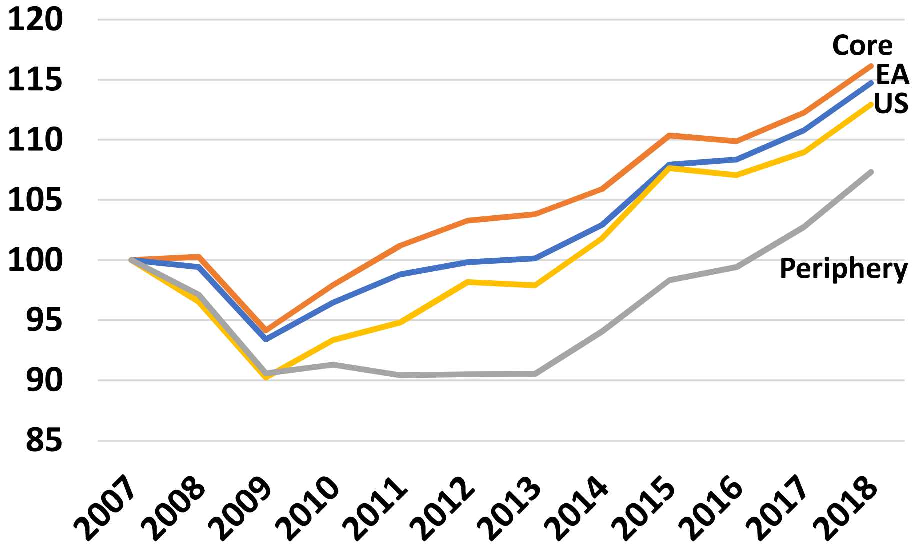
Performance: growth and convergence

Growth of the real GDP per head of population (2010 prices; 2007=100)

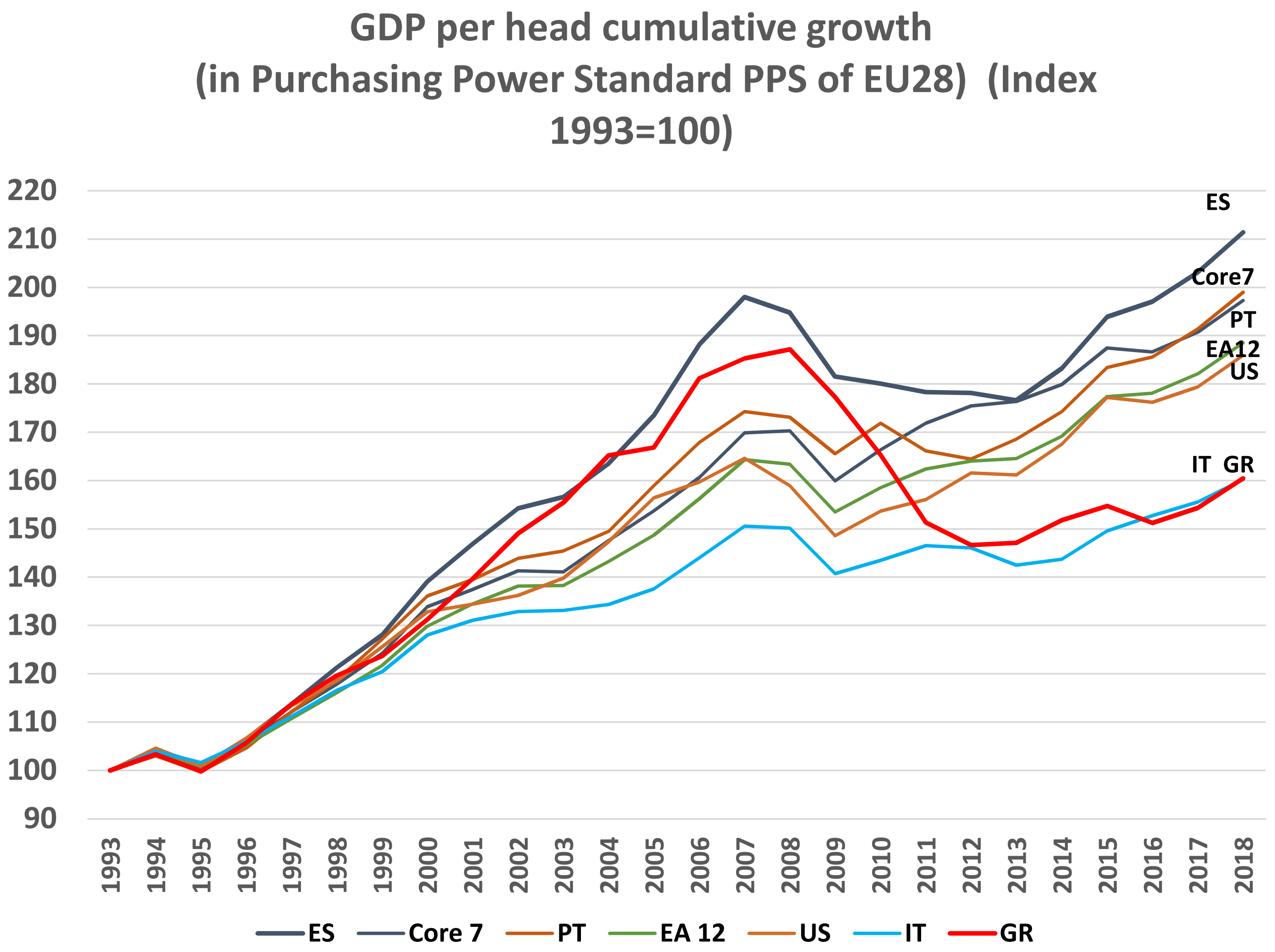


Cumulative growth of GDP per head in PPS of EU 28 (indice 2007=100)



Source: EU Ameco Database

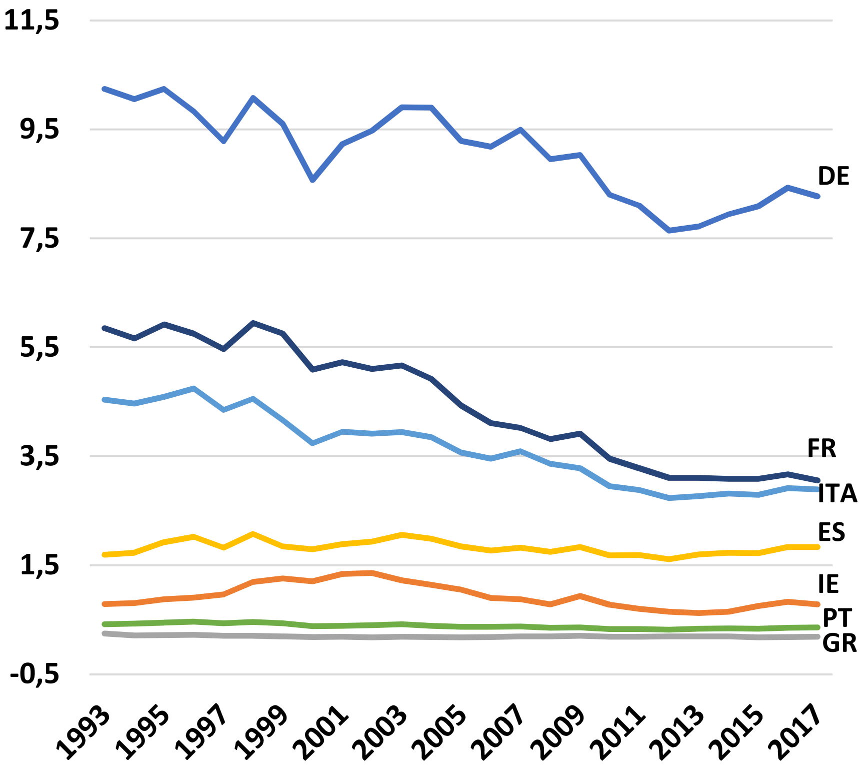
Performance: growth and convergence



Source: EU Ameco Database

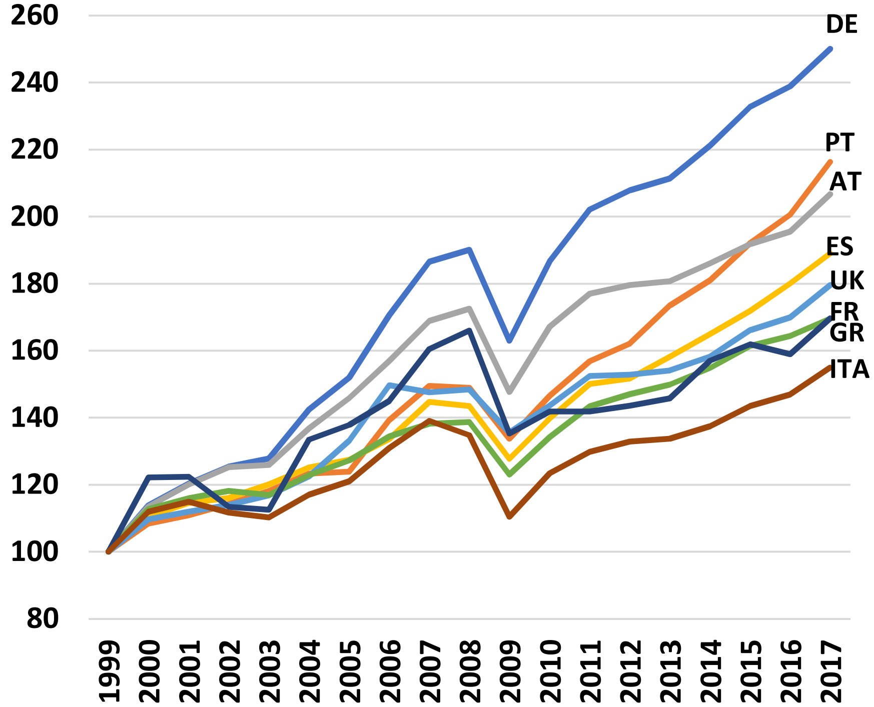
The Competitiveness narrative: Exchange rate and export performance

Export shares in world exports (1993-2017)



Source : Eurostat AMECO Database

Growth of real Exports of goods and services (1999=100)



Source : Eurostat AMECO Database. At 2010 prices

Regressors of export markets shares growth as indicator of competitiveness

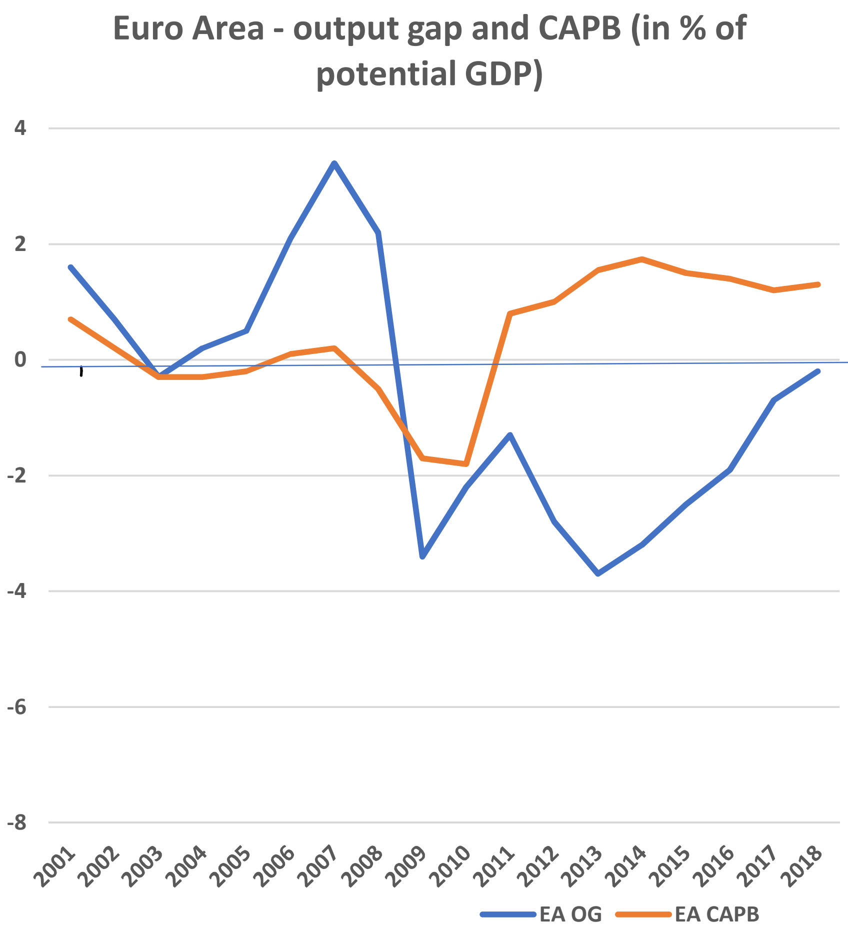
Bayesian Model Averaging approach to explain export market shares of 25 EU countries, estimating combinations of 42 regressors and 5 diferente types of model. This Table shows part of the averaging of the Country Fixed Effects Model.

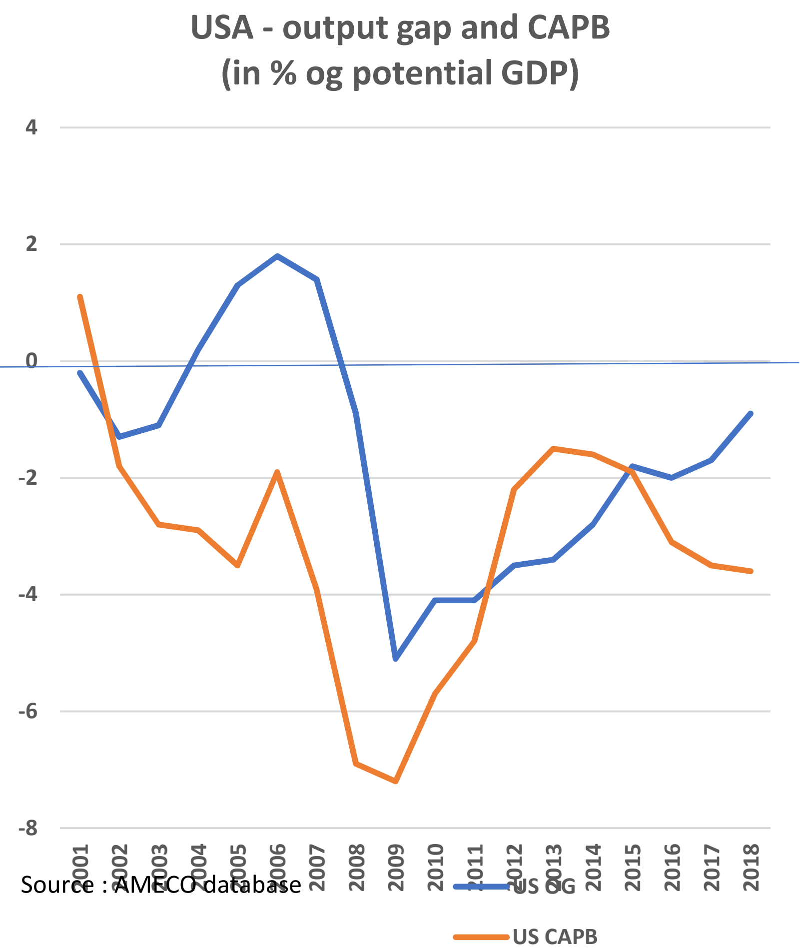
"… for both old and new EU Member States, competitive pressures from rapidly developing China strongly affected export performance since the early 2000s. In the case of old EU Member States, investment, quality of institutions and available liquidity to firms also appear to play a role for trade outcomes. For the new EU Member States, labour and total factor productivity are particularly important, and …by inward FDI".

Variables	PIP*	Mean	Mean/Standard deviation
Potential crowding out from China	**0.86**	**-0.42**	**-2.71**
New Member Countries overlap with China	**0.70**	**-0.31**	**-2.53**
Debt (total liabilities % GDP)	**0.51**	**-0.17**	**-2.09**
Investment (% of DGP)	0.44	0.28	1.59
Loan growth	0.34	0.14	1.64
…….			
Real Exchange rate (HICP-CPI)	0.23	-0.11	-1.19

Note: PIP * Posterior inclusion probability. Source: Osbat et al " What drives export market shares? An empirical analysis using Bayesian Model Averaging " ECB wp 2090, July 2017

Cyclically adjusted primary balance and output gaps in the Euro Area and the US (2001-2018)





Source: Ameco database August 2019

Shortcomings of initial monetary union design

Main design shortcomings:

- **1. Absence of any mechanism to respond to acute liquidity squeezes and " sudden stops" in the sovereign bond market, linked with the demotion of national public debts to debt with higher default risk.**
- **2. Absence of a crisis management mechanism foreseeing financial assistance to member countries with sustainable debt**
- **3. No inclusion of a macro stabilisation function to deal with asymmetric and symmetric significant recessionary shocks.**
- **4. Financial integration was not accompanied by any sort of European level micro and macro supervision of the financial system.**
- **5. Financial integration without considering a capital markets union to foster private risk sharing and growth**

Main reforms going forward

1. **Correction of the procyclical fiscal policy bias at the euro area level via the**
   1. **revision of the Stability and Growth Pact;**
   2. **creation of a European Stabilization capacity with temporary transfers linked to unemployment fluctuations;**
   3. **better coordination of national fiscal policies to build up a European fiscal stance;**
2. **Creation of a Capital Markets Union with the introduction of a European safe asset (important for several objectives)**
3. **Completion of Banking Union with EDIS, the financial backstop to the European Resolution Fund and the reduction of national prerogatives regarding banks´ capital and liquidity.**

4. Strengthening of macroprudential policy by enlarging the set of macroprudential instruments in the CRD/CRR, e.g. to include borrower-based measures, and streamlining of approval procedures.

Correction of the procyclical policy bias at the euro area

1. The revision of the Stability Pact . The present rules became too complex and open to contradictory commands. As the European Fiscal Board wrote, The Pact has " overlapping fiscal requirements that occasionally offer conflicting signals: a structural adjustment and a target for debt reduction." and "policies are monitored using a multitude of indicators, which inevitably cause conflicting signals". With some adjustments, the proposals presented by the French CAE and by the European Fiscal Board , could be a good starting point for a negotiation. Both are built around an expenditure rule dependent on potential growth and a long term debt ratio target, while discarding the structural deficit approach.

2. The creation of a Stabilisation Fund along the lines of the recent IMF proposal to design it . What is necessary for periods of quite significant shocks in the form of a "rainy-day" fund with borrowing capacity that would provide transfers to be used in public spending with high multipliers. The IMF proposes an annual contribution of 0.35% of GDP to build-up the Fund. Transfers should not permanently benefit the same countries and, to avoid moral hazard, the use of the ESF should be conditional on past compliance by countries with the existent fiscal rules. Triggering the transfers should be automatically dependent on a threshold indicator based on the unemployment rate.

A European safe asset

1. A European safe asset is crucial to solve the question of the concentration of banks´ portfolios on domestic sovereign bonds, important for the stability and robustness of the European banking system

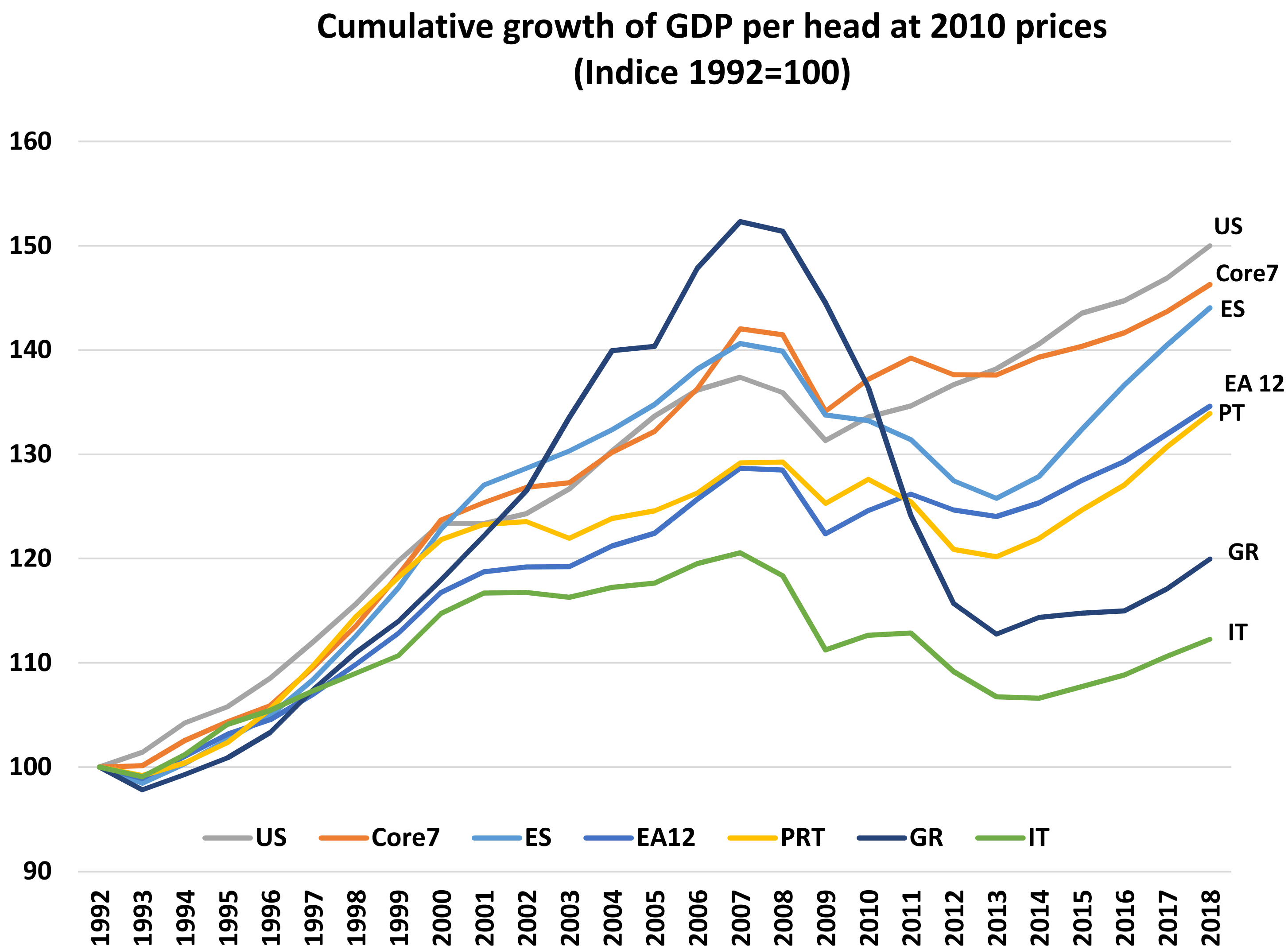
2. A European safe asset is crucial to reduce the scarcity of secure assets which reinforces the trend to lower yields and increases the temptation for the private sector to create pseudo-safe assets as it happened before the crisis, potentially endangering financial stability.

3. A European safe asset is crucial for a fully integrated European bond market which is essential to foster the international role of the euro

4. A European safe asset is crucial for monetary policy to benefit from a more representative European yield curve and more appropriate assets to purchase in open market operations that will be necessary even in normal times in the future.

Background Slides

Performance: growth and convergence



Source: EU Ameco Database

Decomposition of the increase in the REER/RULC v 35 industrial countries, from 1999 to 2009,

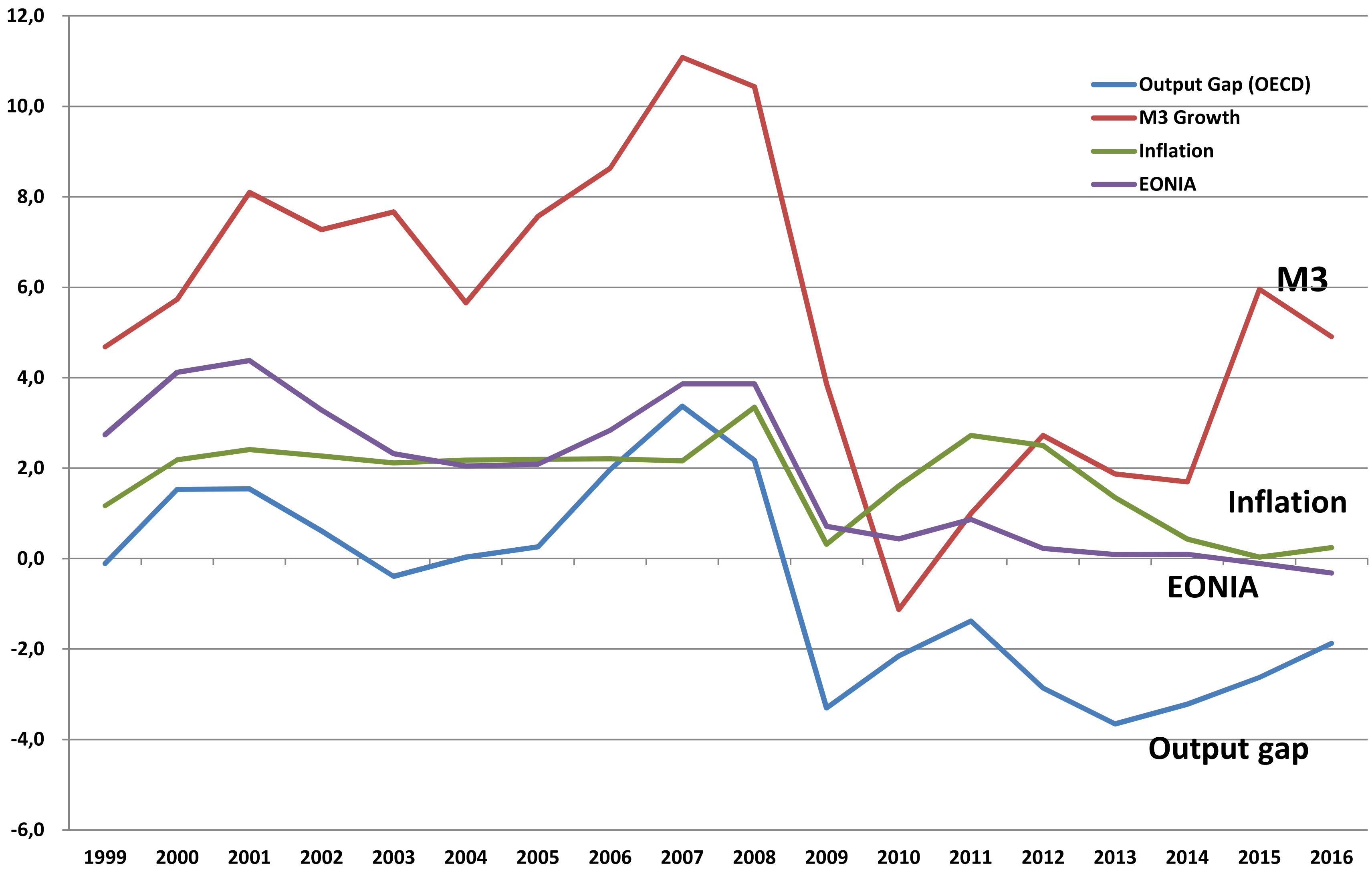
$$REER = \frac{E.U}{U^*} = \frac{\frac{U}{P}}{\frac{U^*}{P^*}}\frac{E.P}{P^*} = \frac{u}{u^*}.\mathrm{E}.\frac{P}{P^*}$$

Where U and U* are national and foreign nominal ULCs;
u and u* real ULCs; E is the nominal Effective Exchange Rate;
P and P* are the national and foreign deflators

	REER = EU/U*	u/u*	E	P/P*
Greece	14.4	2.6	11.7	-0.1
Ireland	34.1	13.0	15.6	2.6
Italy	17.7	5.6	12.3	-0.8
Portugal	13.0	1.9	6.9	3.7
Spain	19.0	-2.7	10.3	10.9
Germany	-8.0	-2.5	11.4	-15.3

Source : C. Wyplocz (2013) " The Eurozone crisis and the competitiveness legend" in *Asia Economic Papers 12:3*

Monetary Policy in the Euro Area: targets and instruments

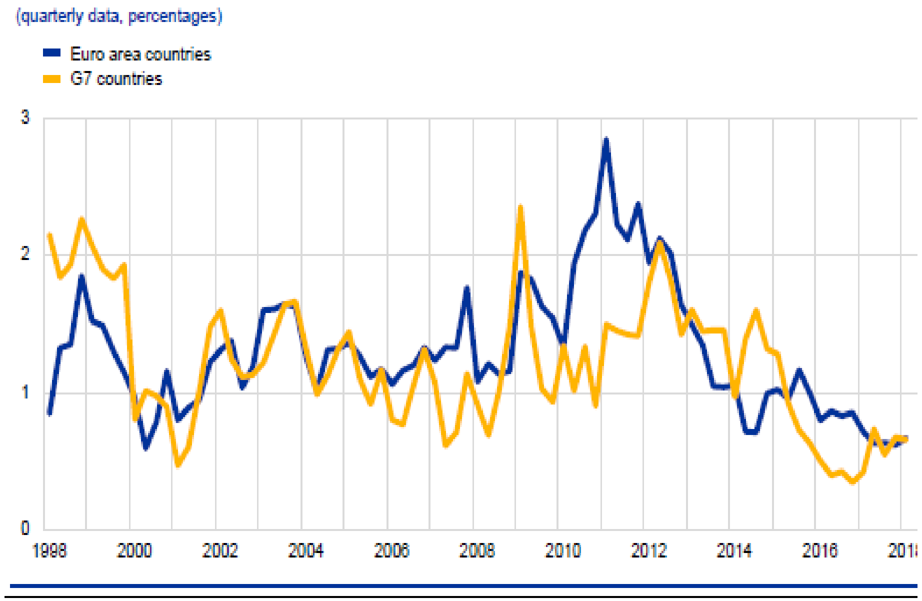


Source: OECD.
Note: Inflation is the growth rate on the same period of the previous year of the Consumer Price index (all items); ST interest rate is the short-term interest rates (per cent per annum); LT interest rate is the long term interest rate; Output gap is the Output Gap of the total economy; M3 growth is the Broad Money Index (M3)

1. Performance: crisis, adjustment and recente improvements

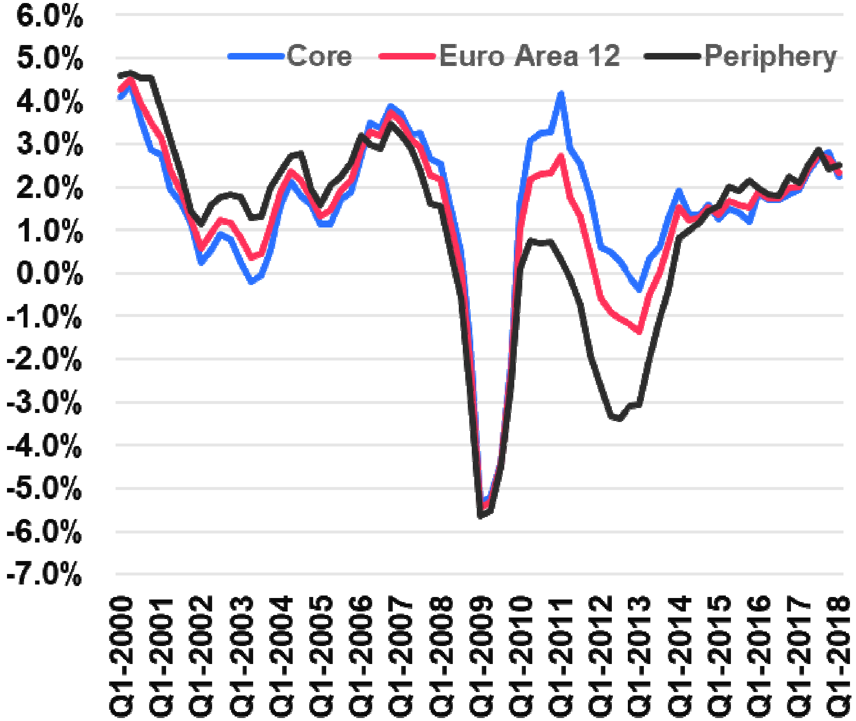
Recent performance: dispersion of real GDP growth and cyclical convergence

Dispersion of Real GDP growth
(weighted standard deviation of yoy quartely growth)



Source: ECB Economic Bulletin, Issue 5 2018

Real GDP growth
(Annual rates of Quarterly data)

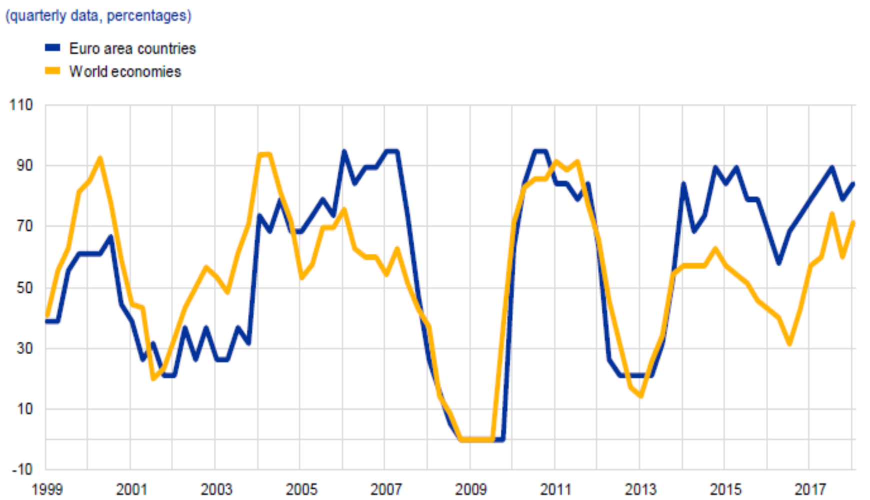


Source: OECD database. The data for Ireland were adjusted to deal with the excessive volatility in 2015 that does not reflect real economic activity

1. Performance: crisis, adjustment and recente improvements

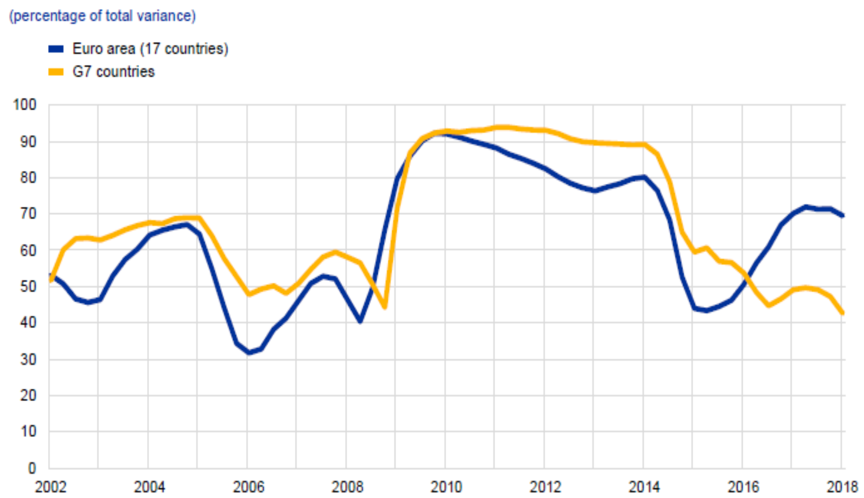
Recent Performance: Growth and cycle synchronisation improvements

Share of countries with current GDP growth exceeding the past 3-year average



Sources: OECD, Eurostat, Haver Analytics and ECB calculations.
Notes: The calculation is based on quarterly year-on-year real GDP growth rates. The euro area countries consist of the current 19 participating EU Member States (with data for Malta available as of 2001). The world economies consist of 34 countries and the euro area aggregate, accounting for more than 84% of global GDP in PPP. In particular, the group comprises the euro area, Argentina,

Relative contribution of the common factor to real GDP growth variance



Sources: OECD, Eurostat and ECB calculations.
Notes: The chart shows the share of the variation in real GDP growth that is explained by a common factor estimated over a five-year rolling window. The common factor is proxied by the first principal component of quarterly year-on-year GDP growth rates. The euro area group includes all euro area countries except Malta and Ireland owing to data availability. The latest observation is for the first quarter of 2018.

Source: ECB Economic Bulletin, Issue 5, August 2018