

Macroeconomic Policy and the Euro Area after the Crisis

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The Financial Crisis and the Global Recession

- Crisis unveiled serious weaknesses in the global financial and economic system
- Need for coordinated policy response
- Open world trading and financial system must be preserved
- New global economic governance (G-20)

The Crisis and the Euro Area

- Euro area has responded in coordinated and relatively effective manner
- Severe recession in 2009
- Unemployment set to continue to rise
- Inflation fell
- Severe worsening of public finances

Figure 1
Growth Before and After the Crisis

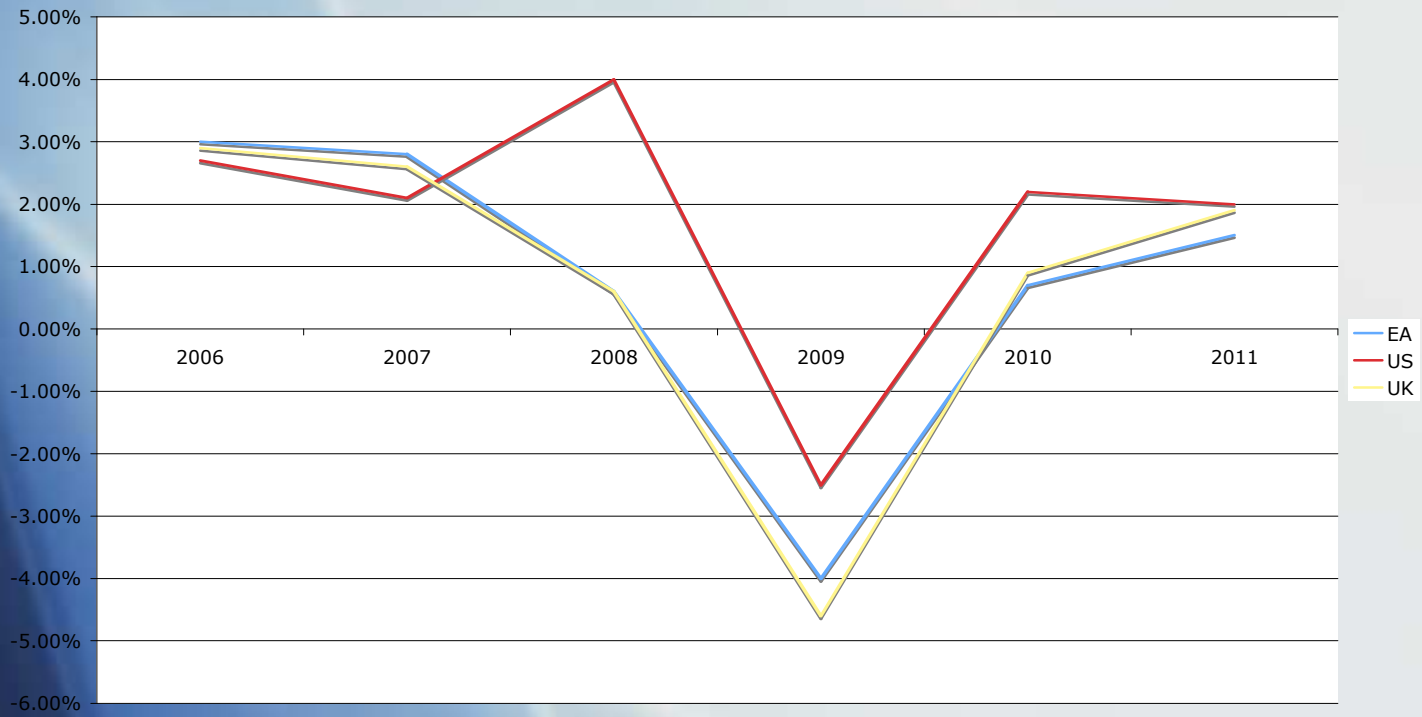


Figure 2
Unemployment Before and After the Crisis

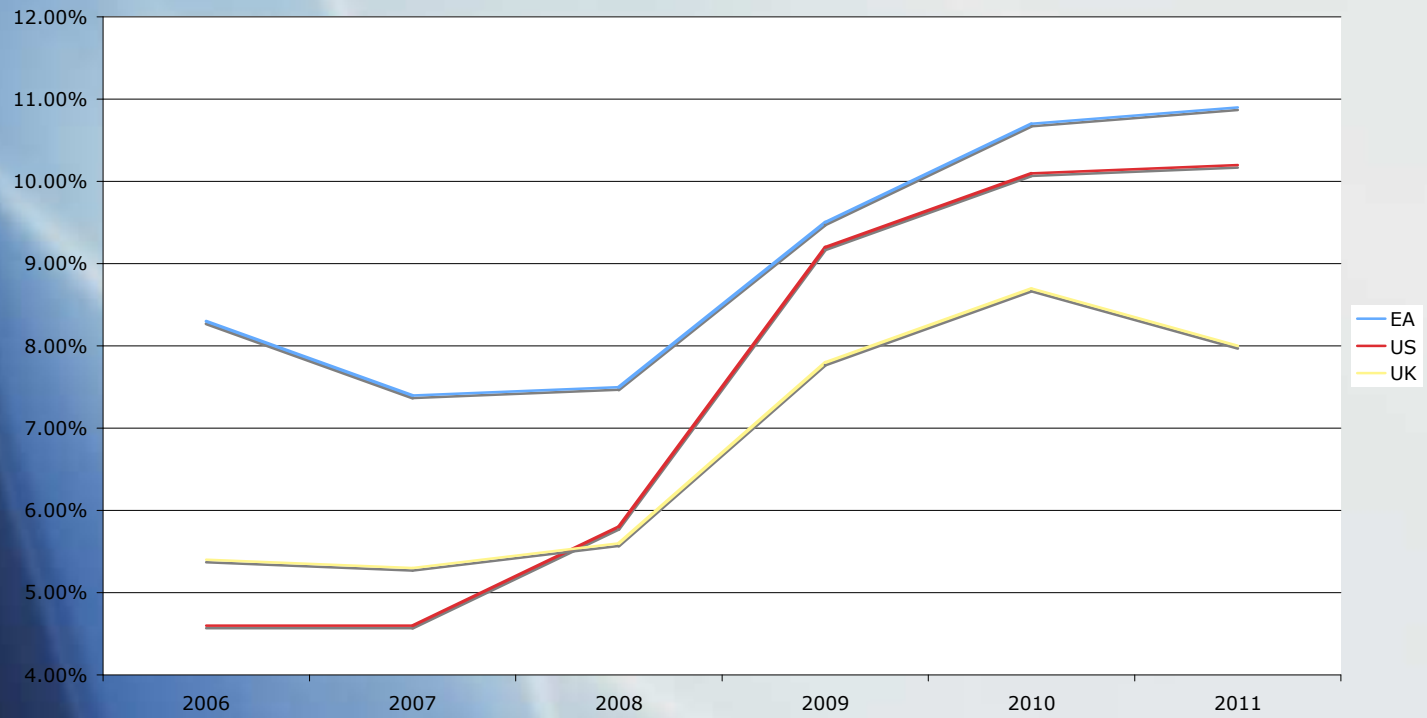


Figure 3
Inflation Before and After the Crisis

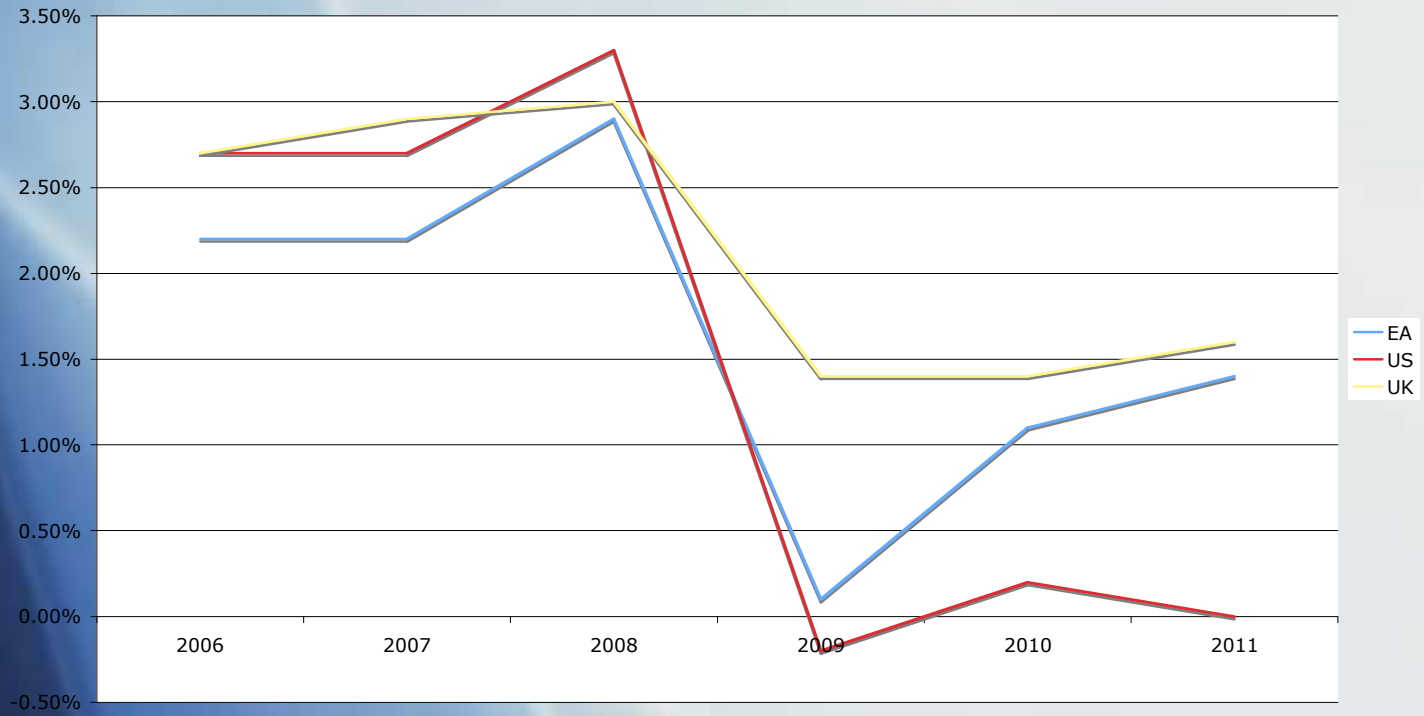
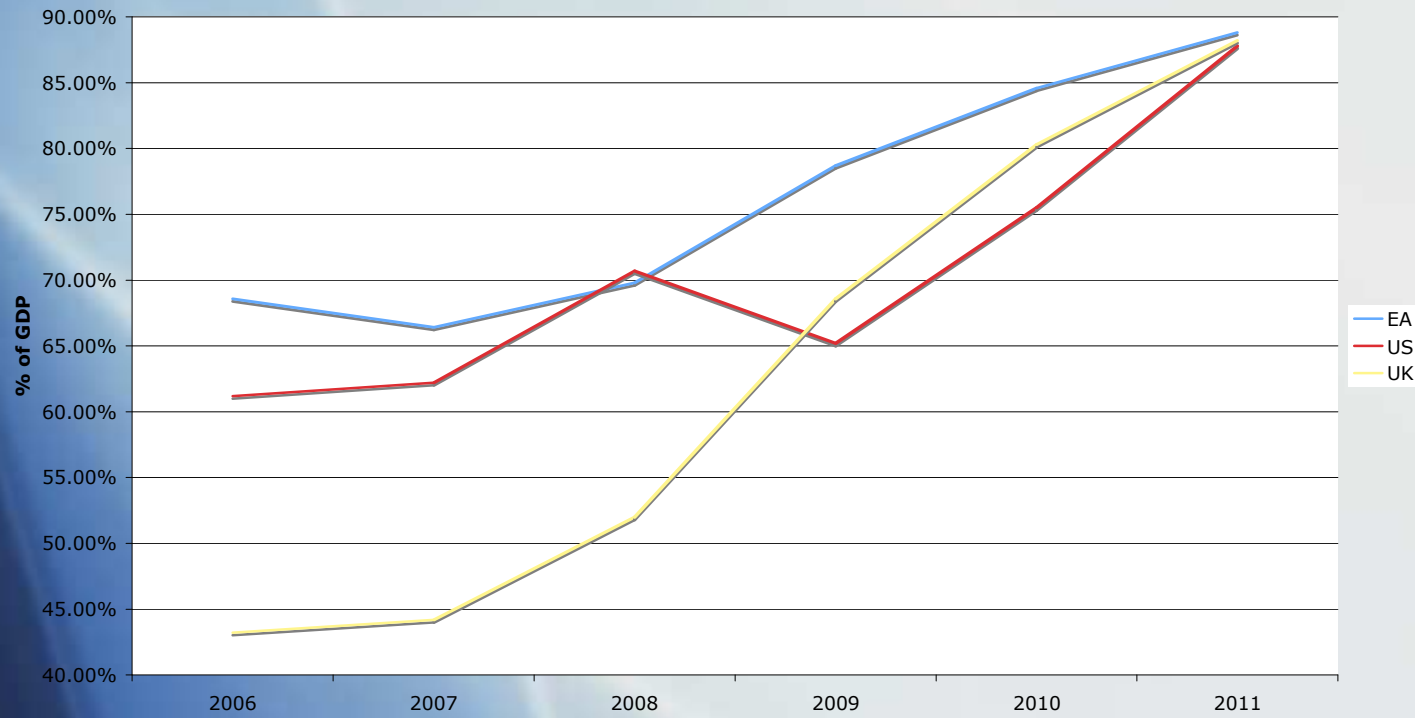


Figure 4
General Government Balance Before and After the Crisis



Figure 5
Government Debt Before and After the Crisis



The Stability and Growth Pact

- Fiscal deficits below 3% of GDP at all times
- Fiscal balance in the medium term
- Public debt tending towards 60% of GDP or lower
- Rules for corrective action

The Crisis and the Greek Economy

- Greece has been in the spotlight since the end of 2009
- The main problem seems to be a confidence crisis on the part of investors in Greek bonds, concerning the ability of Greece to keep servicing its sovereign debt
- This is reflected in an almost continuous widening of spreads of Greek bonds since October 2009.

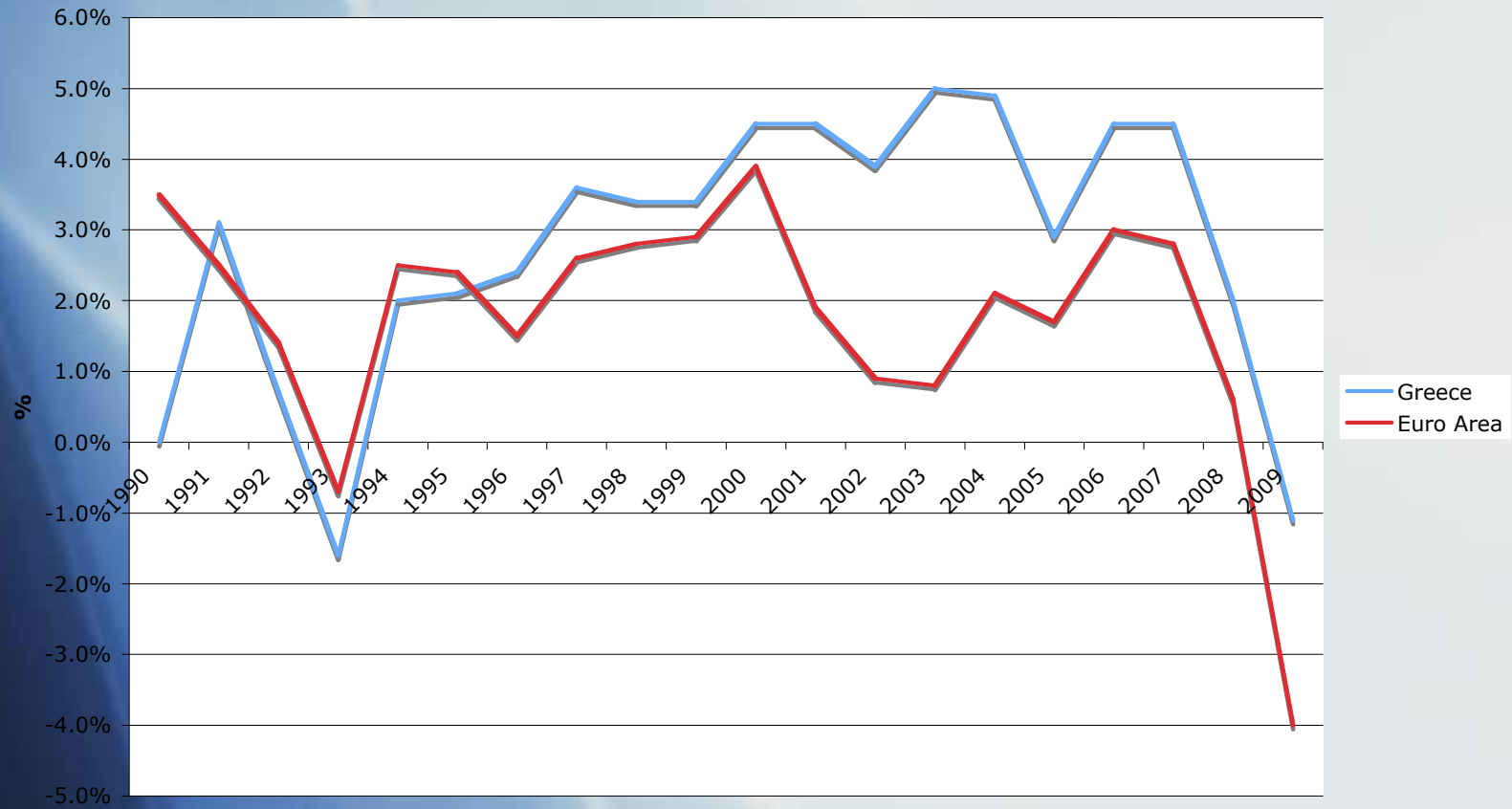
Three reasons for the Confidence Crisis

- High level of public debt relative to the rest of the euro area
- Severe deterioration of the fiscal position, especially during 2009
- Delayed and inadequate response to the deterioration of public finances by the new government

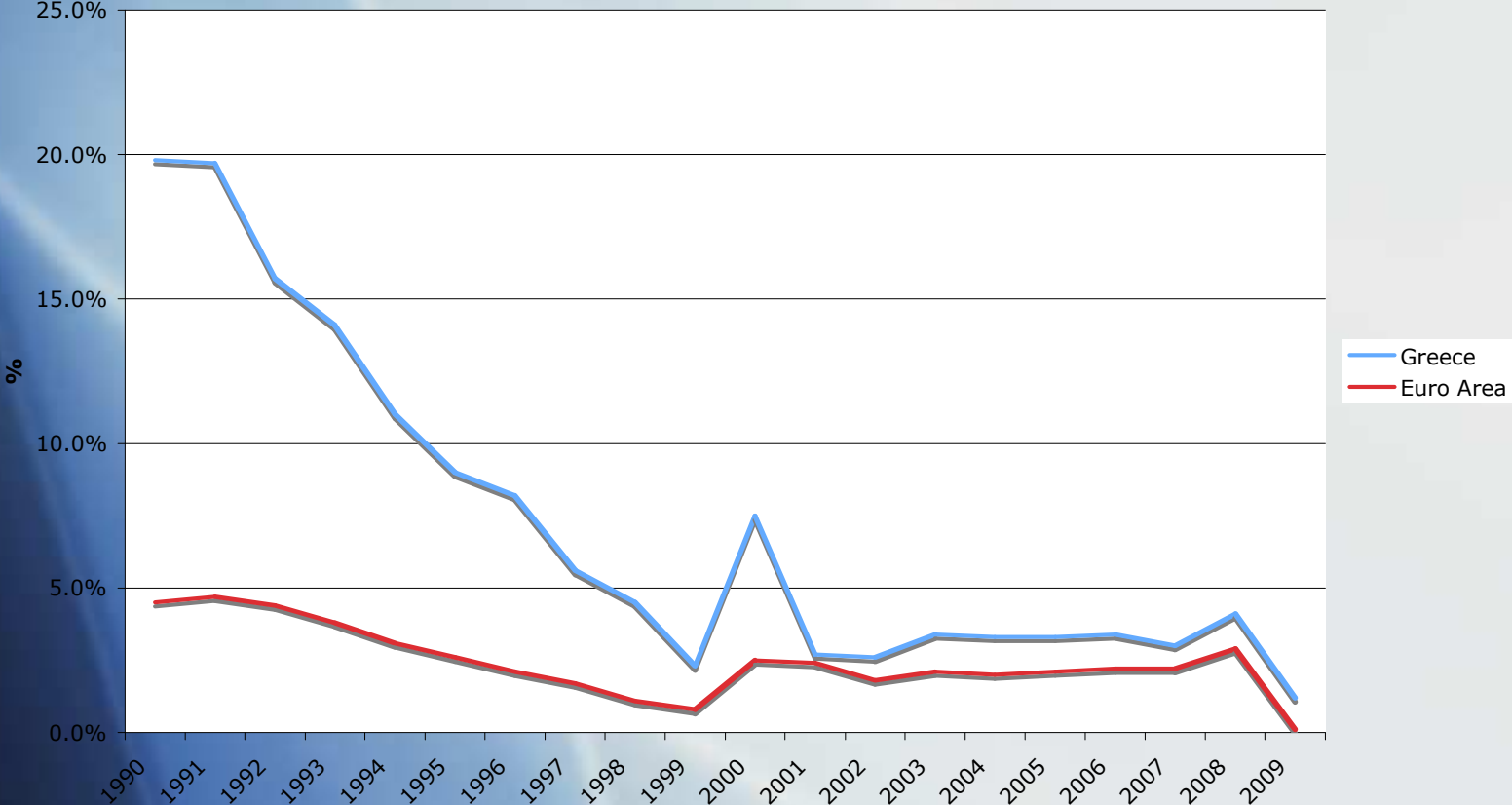
The Fundamentals of the Greek Economy

- The fundamentals of the Greek economy have improved significantly in the last twenty years, during the preparations for euro area entry, but especially *since* Greece's entry in the euro area.
- Public finances have remained a problem, but the recent deterioration is not markedly worse than what has happened in other euro area economies.
- The deterioration of the already high level of the debt to GDP ratio, which had remained roughly stable for about 15 years, is the most significant problem.
- International competitiveness has deteriorated

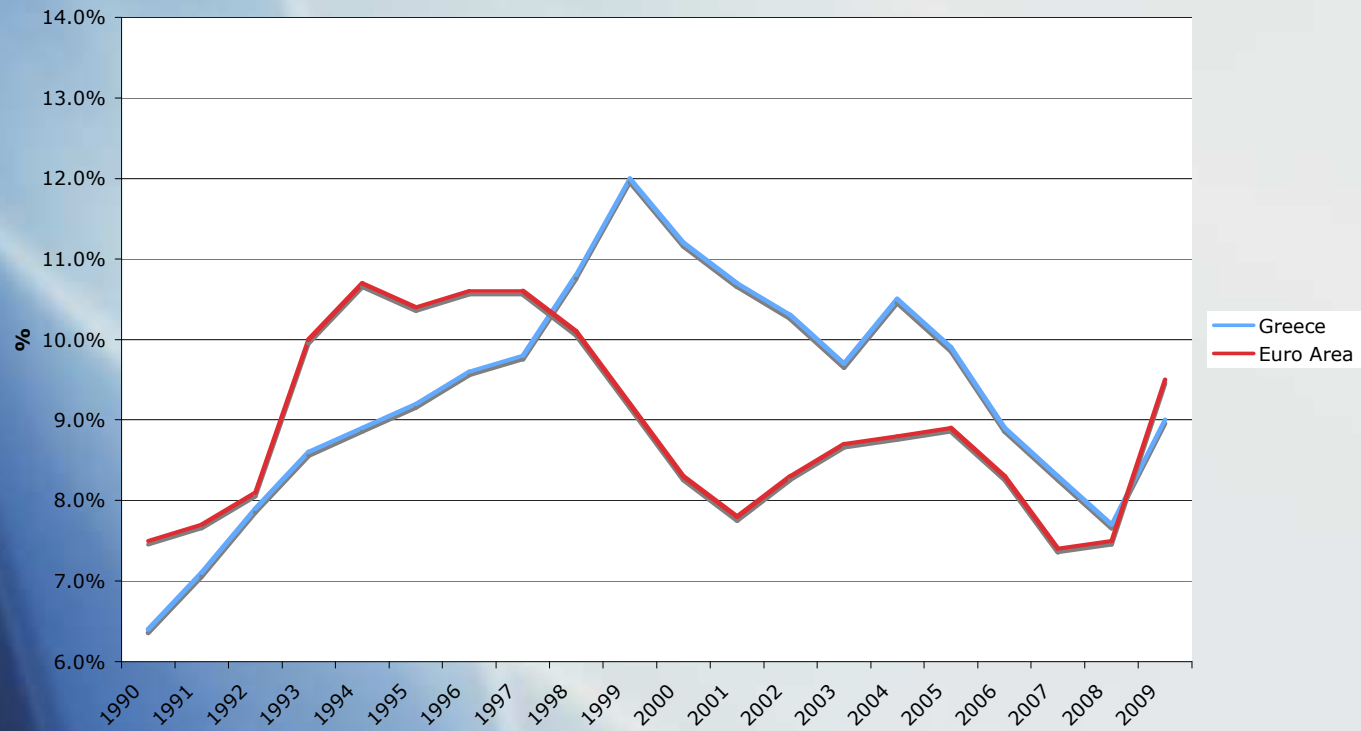
Growth Rate of GDP



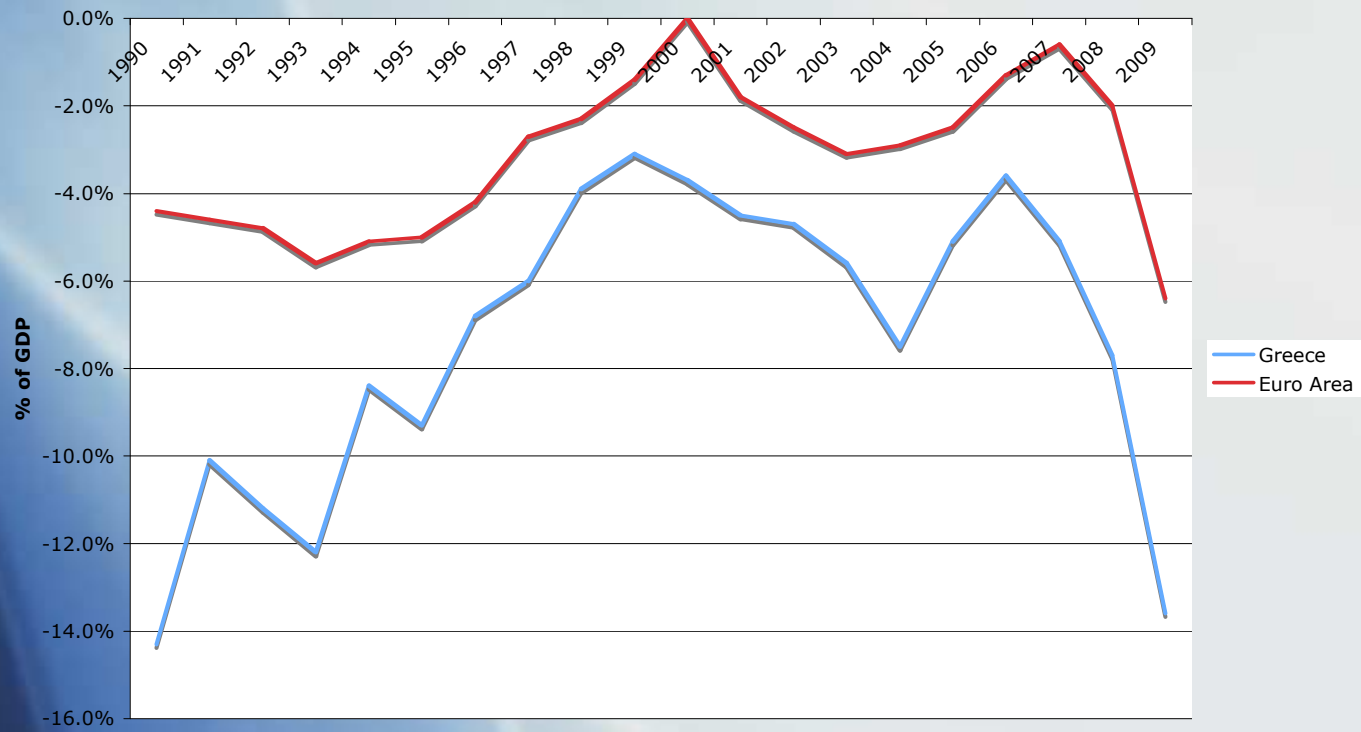
Inflation Rate



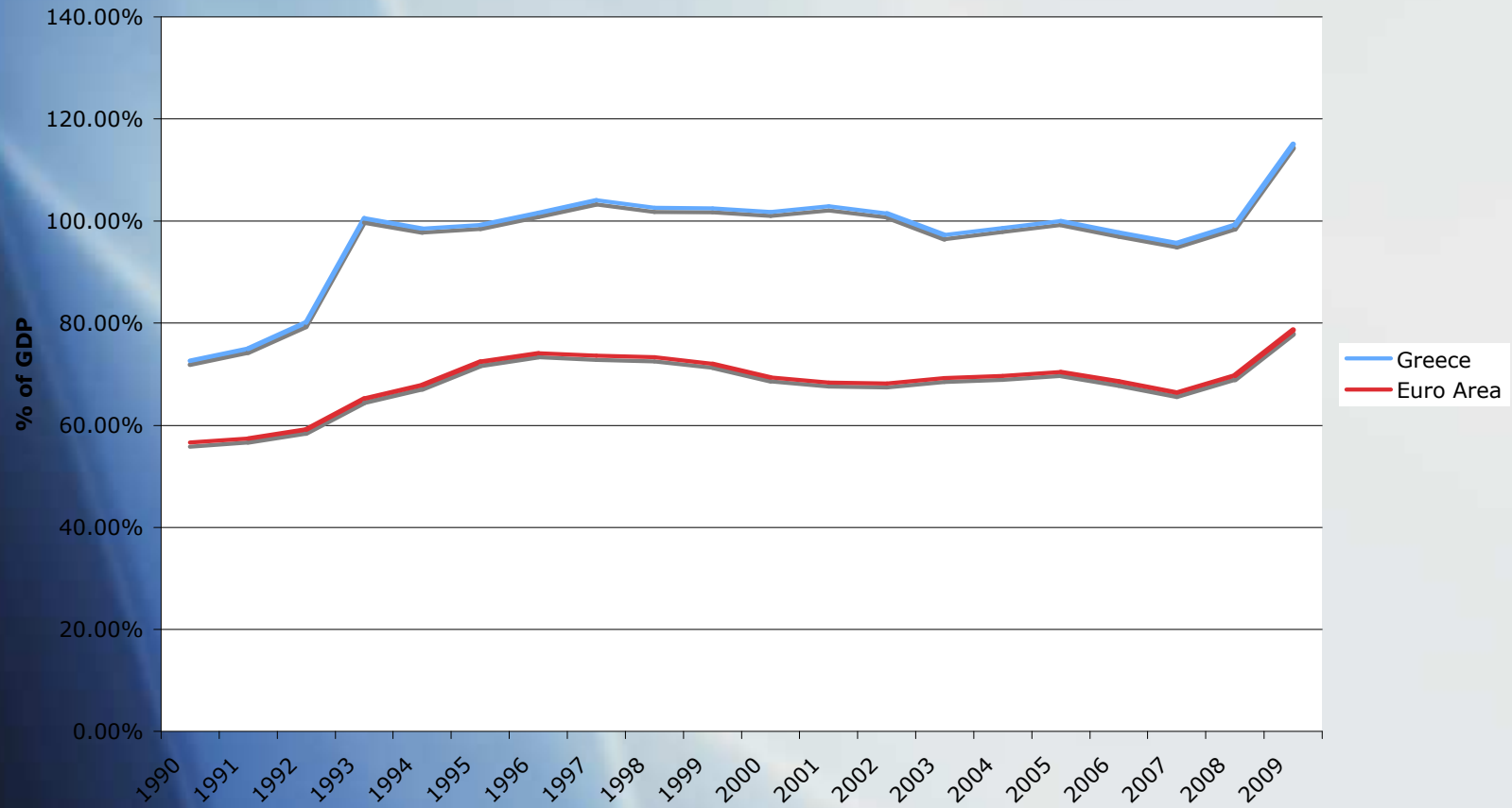
Unemployment Rate



General Government Balance



Government Debt



Challenges for Greece

- The deterioration in the fundamentals does not justify the severity of the confidence crisis.
- Greece has no other option but to address the confidence crisis through a program of drastic fiscal adjustment and structural reforms to improve competitiveness.
- The challenge for Greece is to aim for a fiscal position better than the euro area average
- The EU support mechanism must only be used in the short run, to give Greece some breathing space before its program is implemented fully and starts yielding results

Macro Policy for a Sustainable Recovery in the Euro Area

- Limited role for fiscal policy to play an active role in sustaining the recovery.
- Core economies must adopt a cautious approach to fiscal consolidation and take time so as not to stifle the recovery
- Peripheral economies must proceed with fiscal consolidation immediately to gain credibility
- The ECB must continue providing adequate liquidity
- Contingency mechanism for highly indebted euro-area economies

Microeconomic and Social Policy

- Important for the medium run to persist with the Lisbon agenda
- The European social model should function within the available budgetary limits