

# Macroeconomic Policy and the Euro Area after the Crisis

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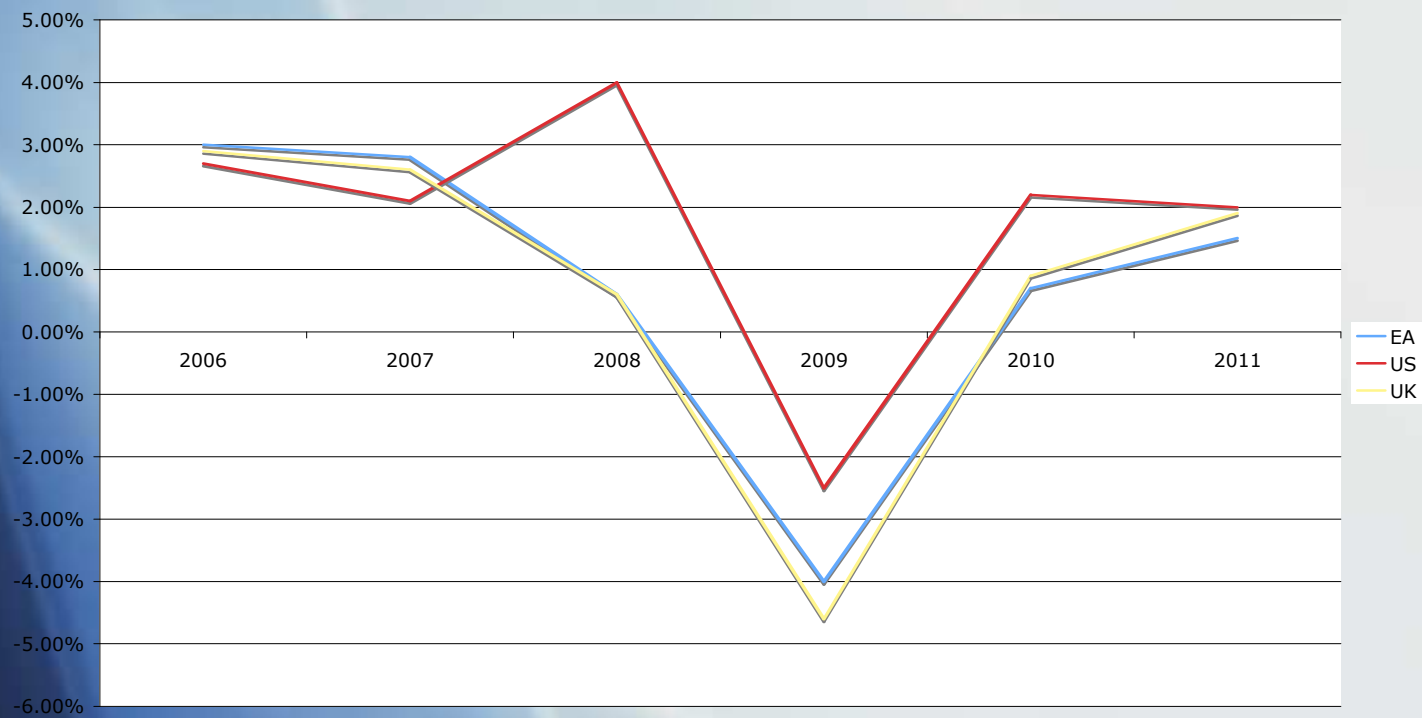
# The Financial Crisis and the Global Recession

- 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)

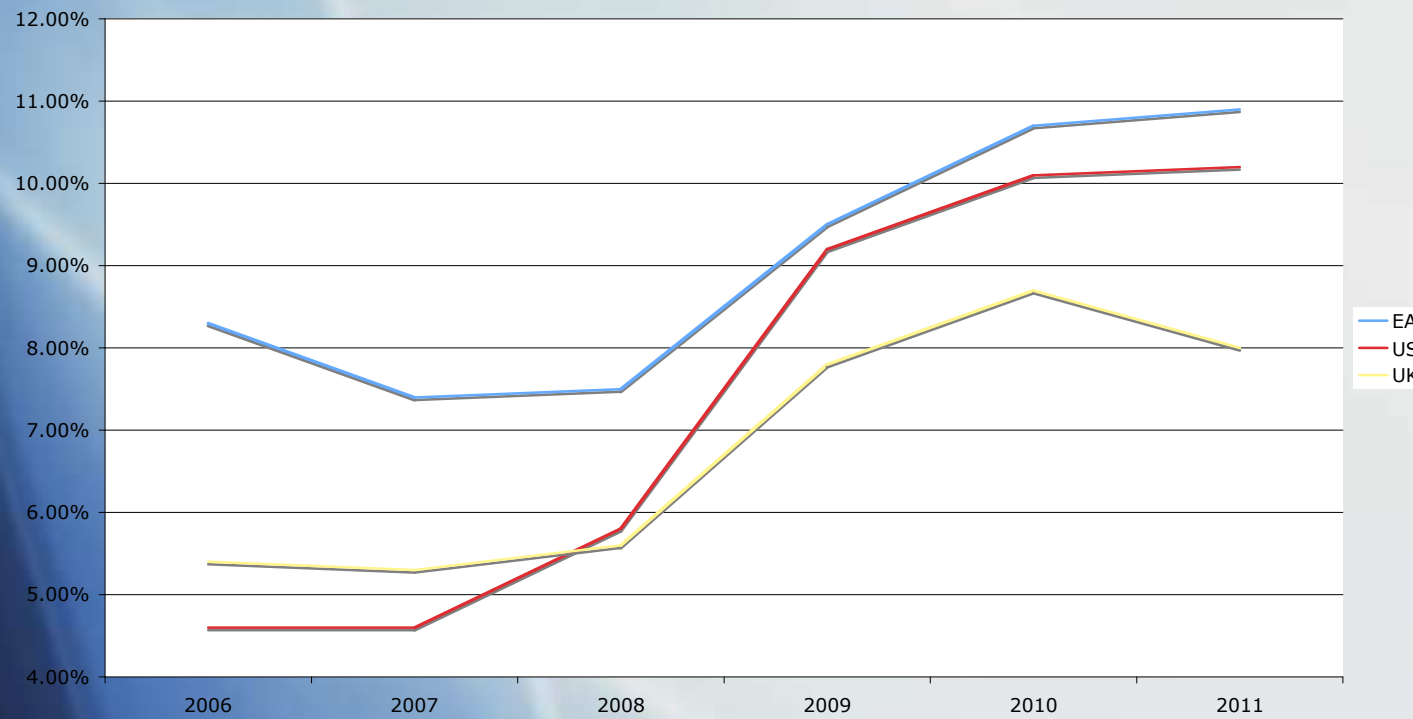
# The Crisis and the Euro Area

- 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

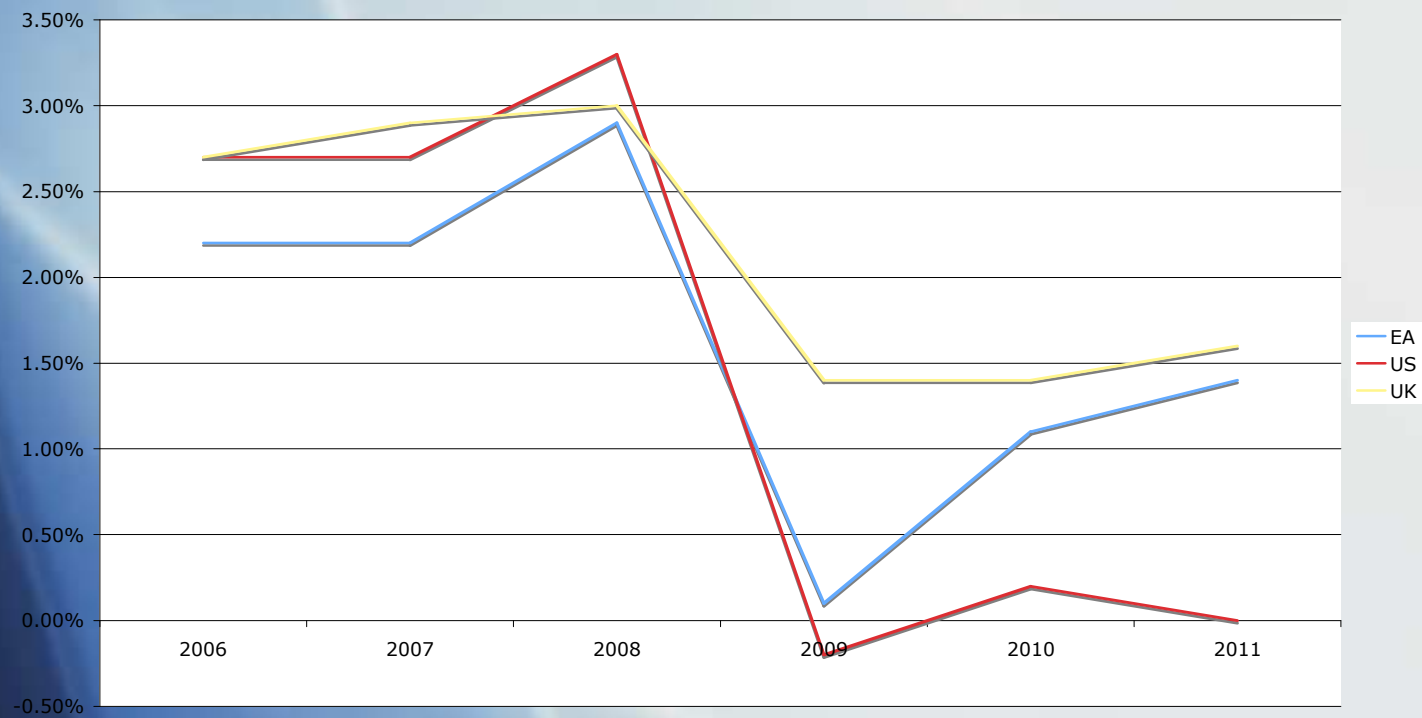
**Figure 1**  
**Growth Before and After the Crisis**



**Figure 2**  
**Unemployment Before and After the Crisis**



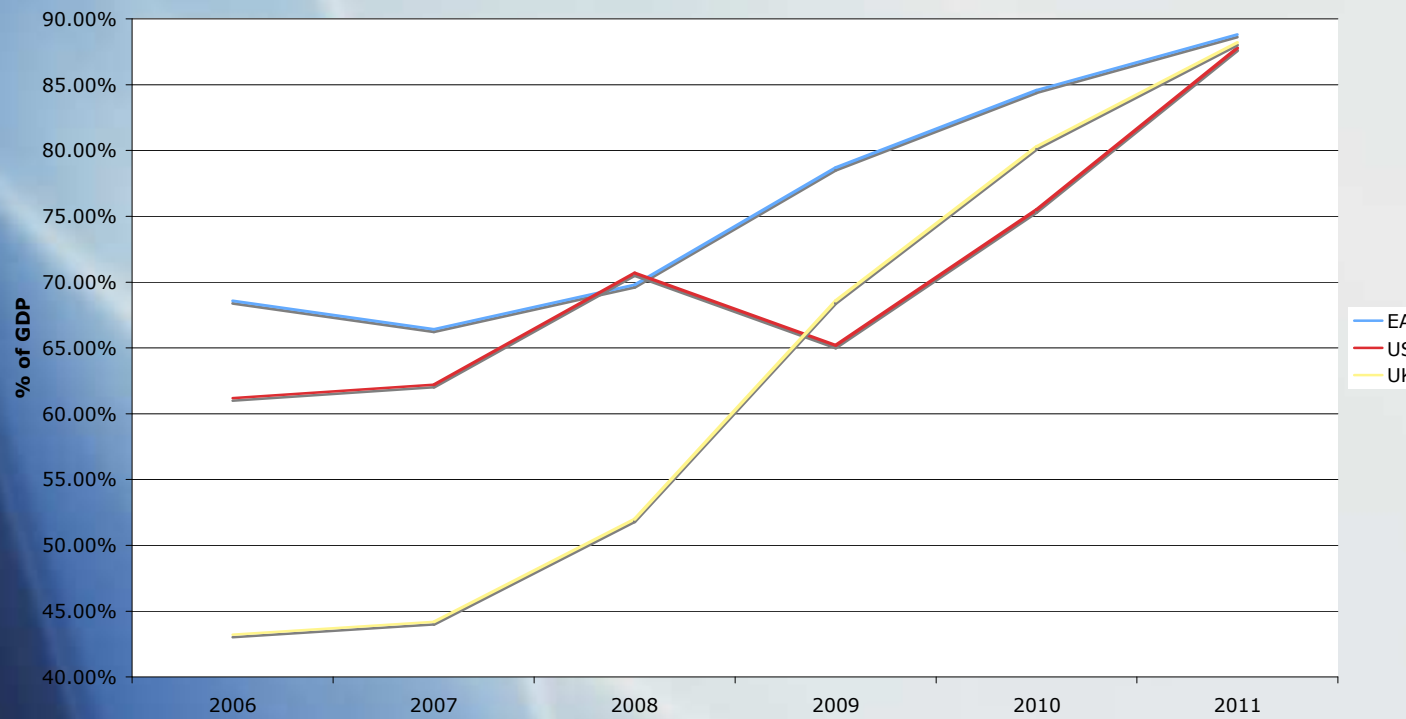
**Figure 3**  
**Inflation Before and After the Crisis**



**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.

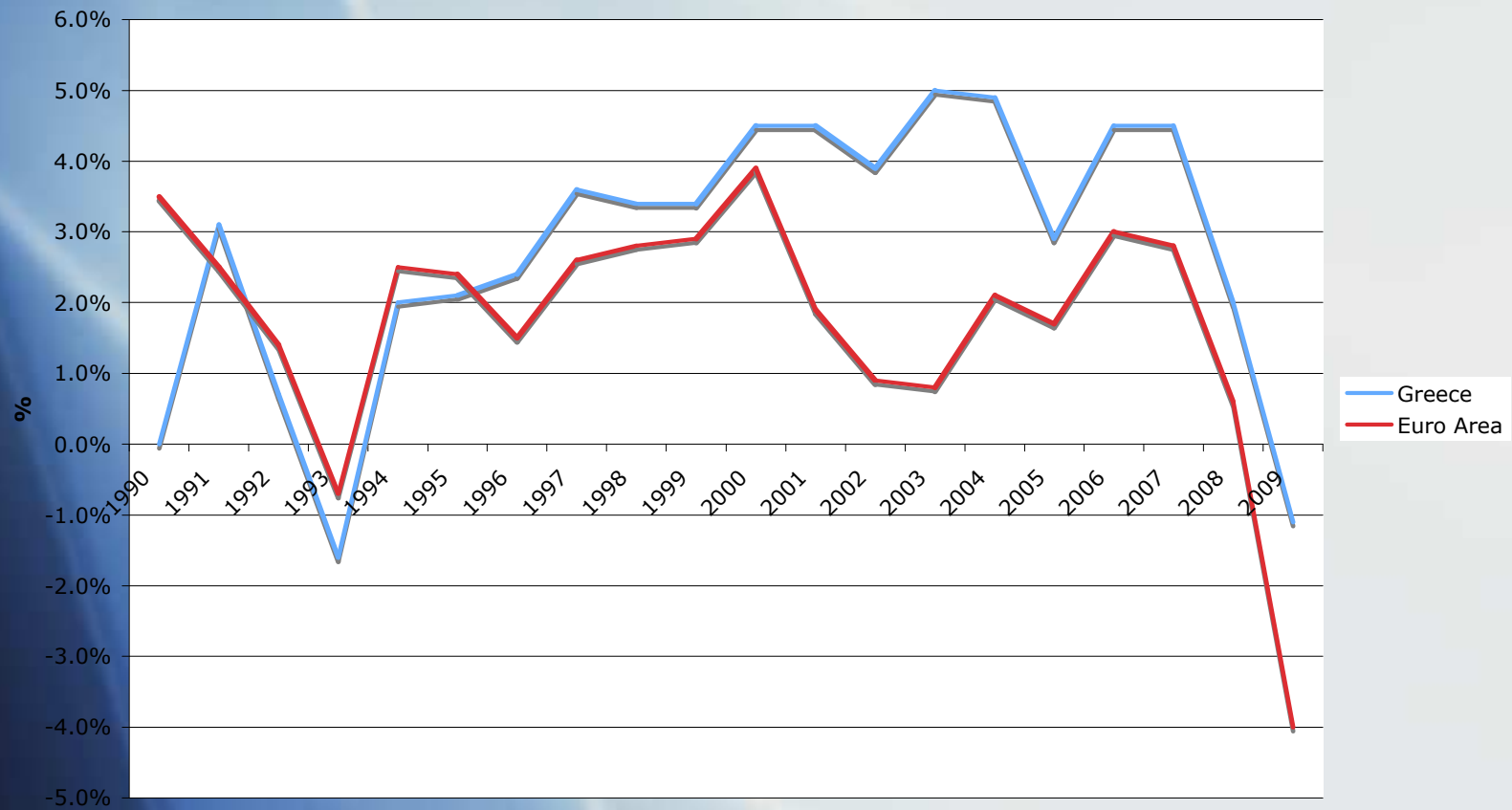
# Three reasons for the Confidence Crisis

- 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

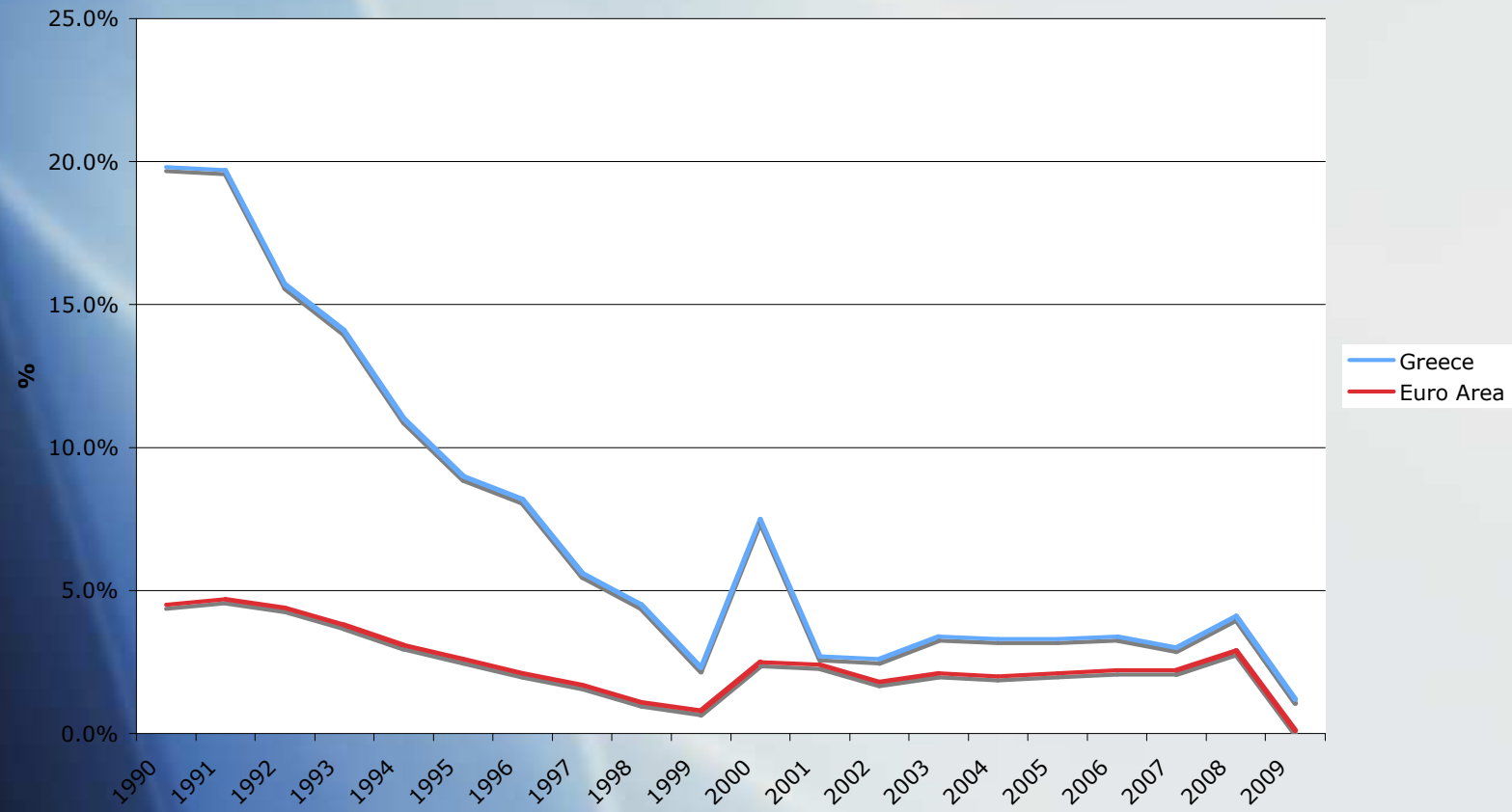
# The Fundamentals of the Greek Economy

- 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

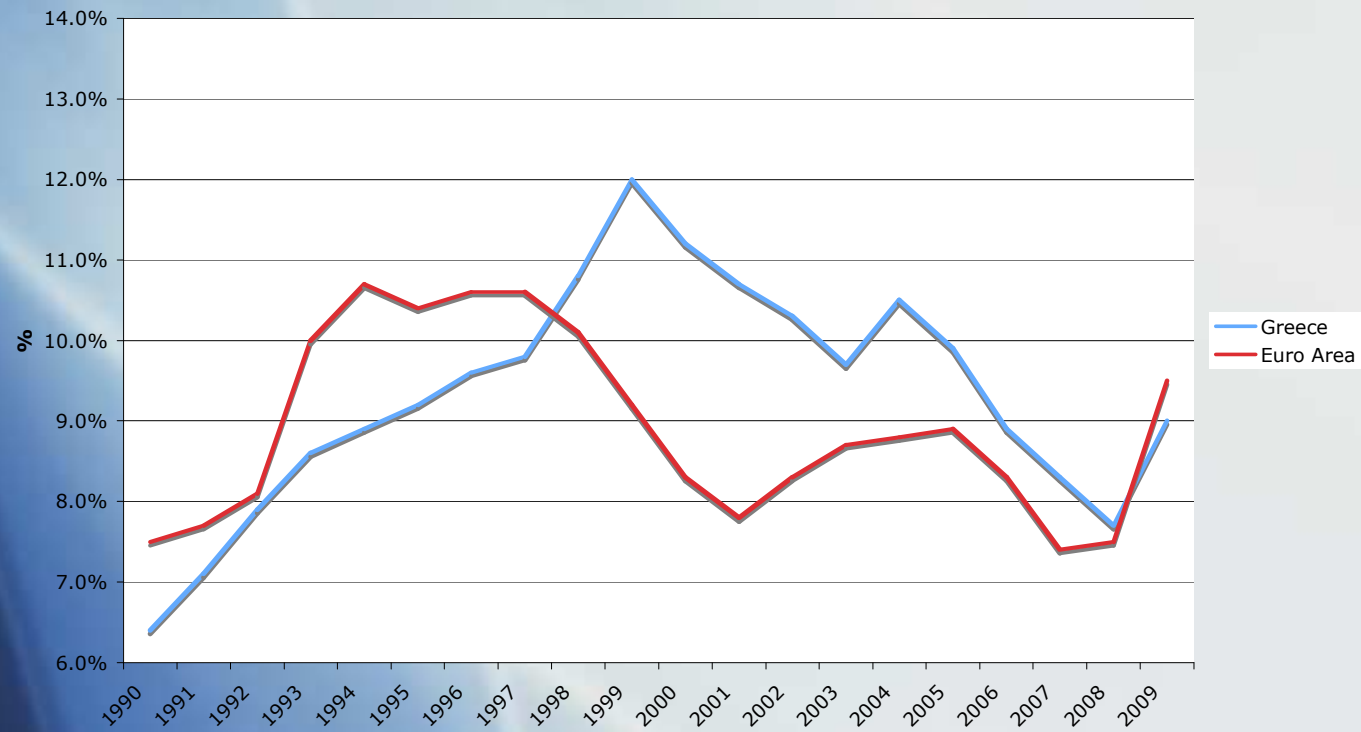
**Growth Rate of GDP**



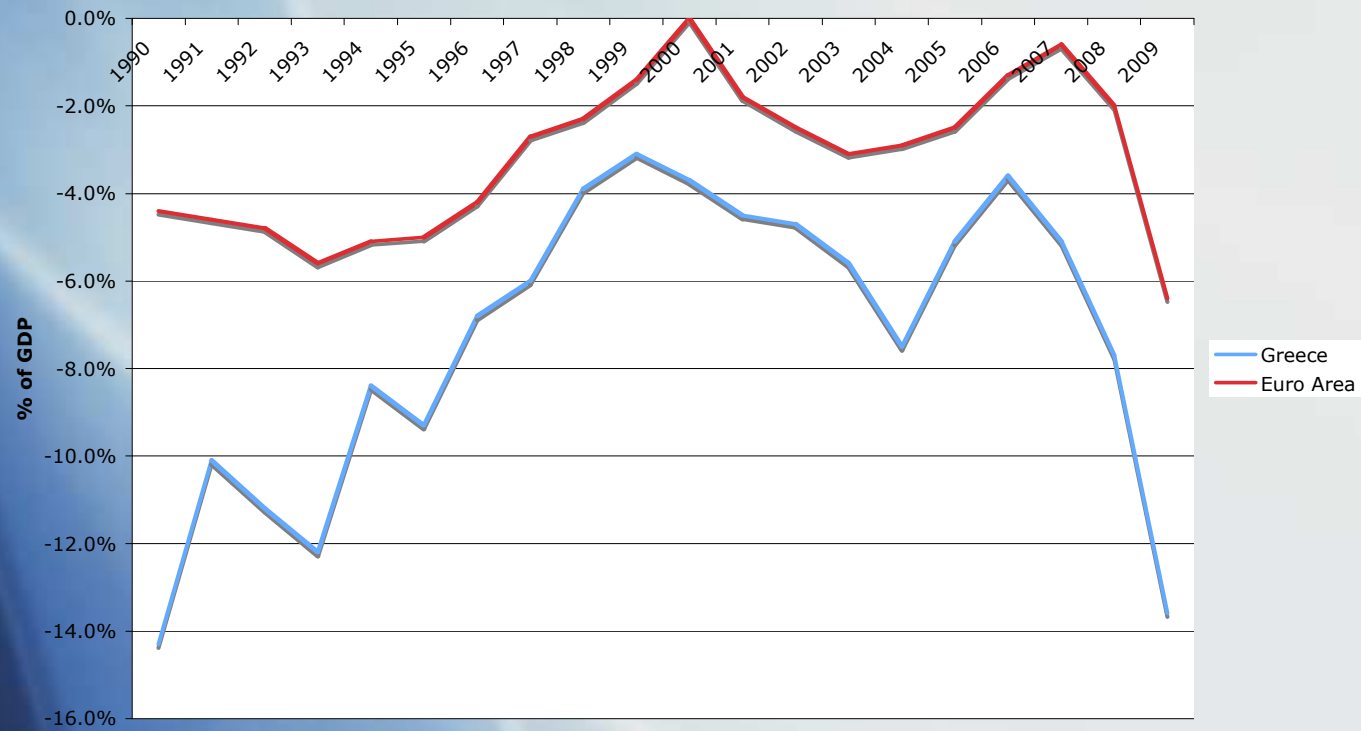
## Inflation Rate



### Unemployment Rate

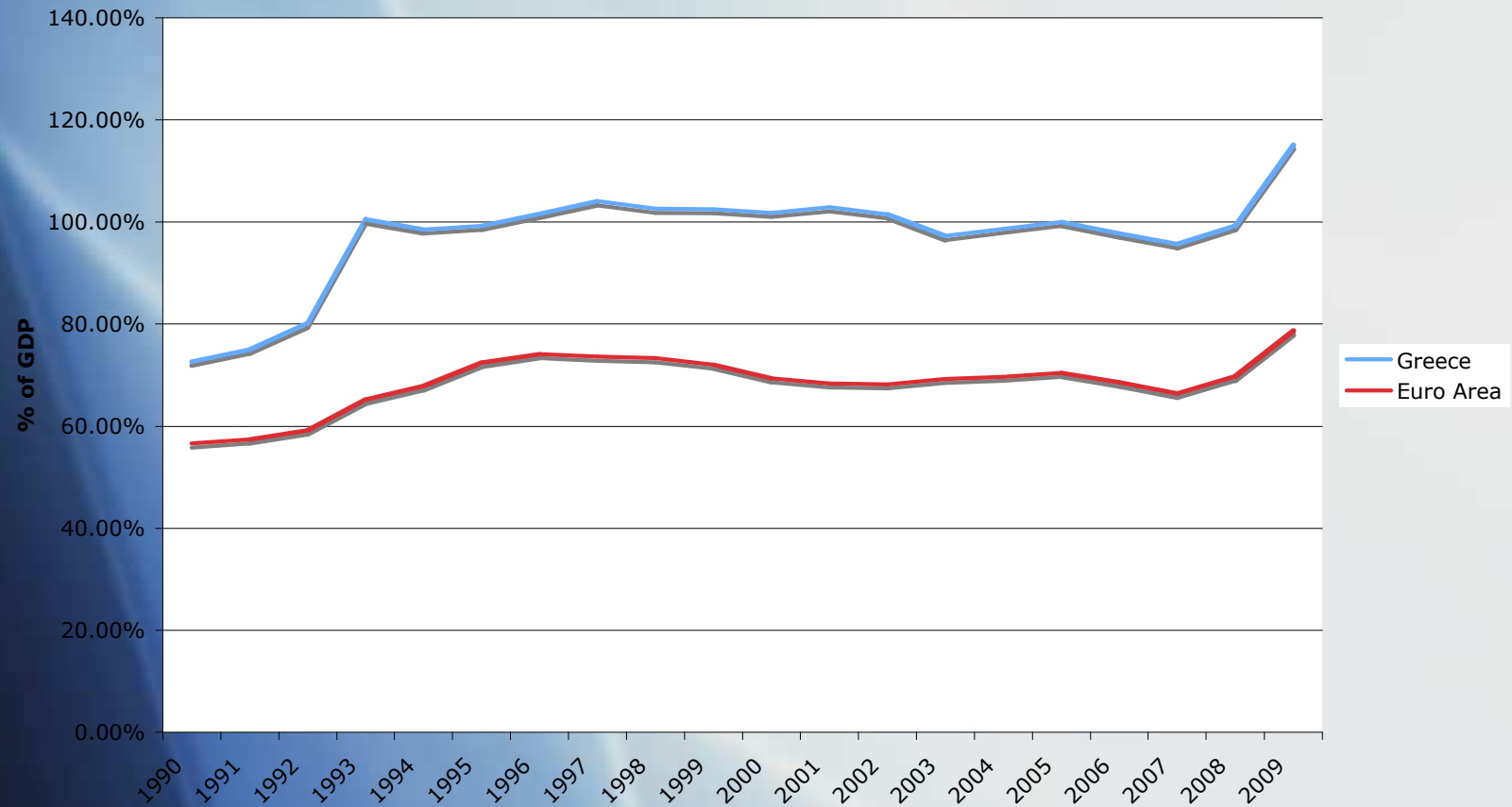


**General Government Balance**





### 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