European Regional Economic Outlook of the IMF

Seminar at Bruegel
17 May 2011

On 17 May 2011 Bruegel hosted the presentation of the "European Regional Economic Outlook" of the IMF, which was launched in Frankfurt on 12 May. The presentation was given by Céline Allard, Deputy Division Chief in the European Department of the International Monetary Fund (IMF), and commented by Guntram Wolff, Research Fellow at Bruegel. The event was chaired by Zsolt Darvas, Research Fellow at Bruegel.

Ms Allard focused on the outlook for Advanced Europe bringing forward policy changes and recommendations for the euro area. The first message of the IMF analysis is that growth is strengthening. External support and fiscal stimulus have been able to reinforce growth, at least to some extent, making it a more stable phenomenon based on domestic demand. In terms of growth and contribution of the different GDP components to growth, the present crisis has done nothing else than mirroring past crisis experience. The overall positive picture, however, masks strong differences between the member States of the euro area. For instance those in the EU periphery, facing a sovereign debt crisis, have been able to get support only from the external sector and, in particular, from the compression of imports. Somewhere in the middle is the UK, where growth has been flat for the last six months and the country has faced quite important short-term uncertainties, in partly due to the acceleration of the fiscal consolidation path previewed by the British government.

Negative spillovers originating from countries in difficulties remained contained despite initial fears. Debt problems (whether private or public) are still relevant in Ireland, Portugal, and Greece and these countries were supported by various EU responses since May 2010. But most banks in other countries and other sovereigns continued to be able to finance themselves on the markets. Therefore, the second positive message is that strong national policies are able to cope with financial markets in turmoil.

Another point is that deleveraging of banks has not affected credit. Credit to households has remained constant, while the level of lending to firms during the crisis followed a cyclical path: first falling and then recovering, as one should expect. This third positive message, however, should be read with a cautionary attitude as banks continue to need to deleverage and it is still an issue if banks will be able to provide enough credit in the future.

Against this background, it could be argued that two forces will counter-set each other. On the one hand the private sector is recovering in line with past crisis episodes, but on the other hand the public sector is facing and will face a period of severe fiscal consolidation. Underpinning a more-positive-than-expected scenario, the fragile and volatile confidence of financial markets asks for a comprehensive policy package, where all the pieces have to be put into action in order to not fall into the traps of a current multiple equilibria scenario.

In order to reach the good equilibrium, the IMF Regional Economic Outlook for Europe proposes to:

- restore the financial markets confidence,
- institute a credible euro area-wide safety net,
- accelerate the financial sector repair,
- strengthen the policy mix as the recovery strengthen,
- put in place a new framework to prevent a replay of the crisis (i.e. monitor imbalances, complete financial integration through a pan-European approach to financial integration).

The presentation of Céline Allard was followed by remarks from Guntram Wolff and then a general discussion.