

The Euro Area in the current crisis

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Growth Rebalancing”**

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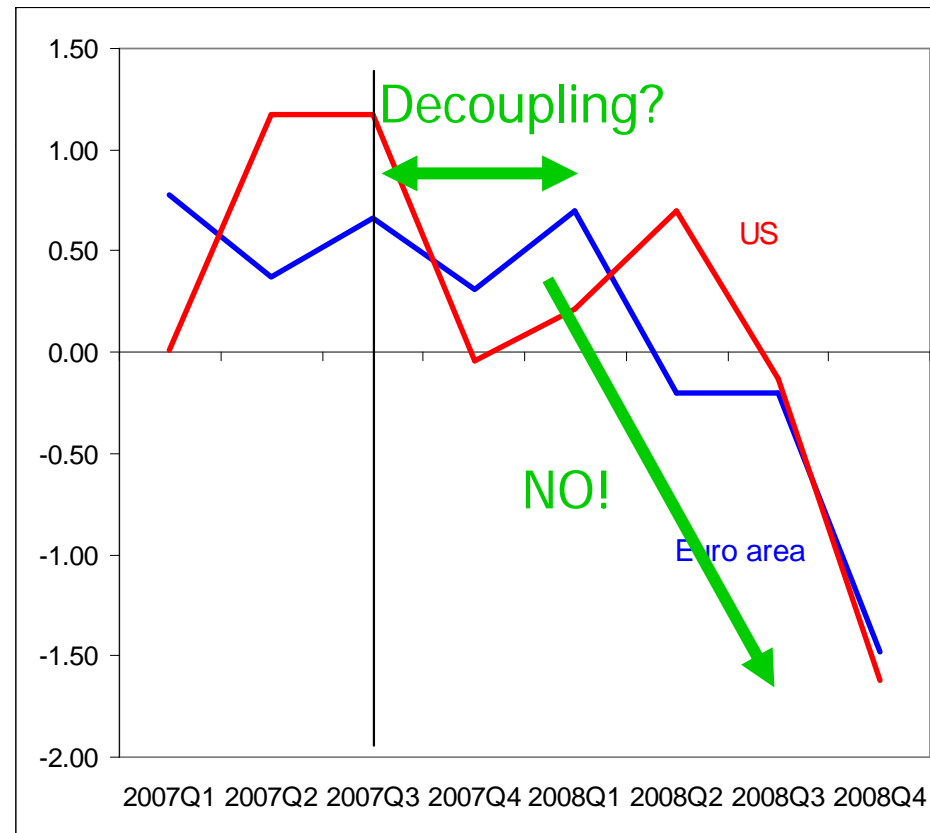
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Outline

- Impact
- Policy responses
- Conclusions

Impacts

- Growth

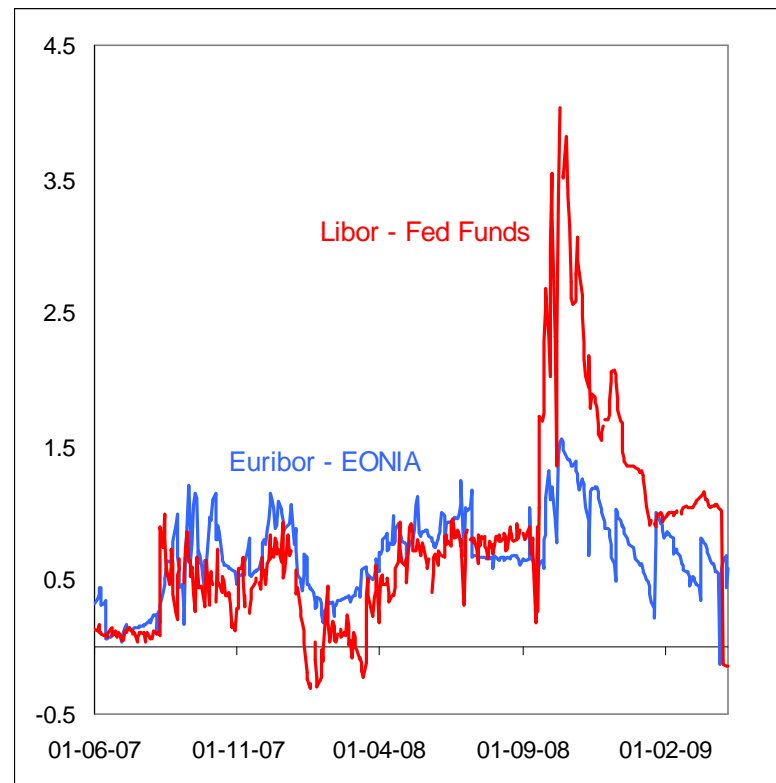


Impacts

- Growth
- Financial markets

Loss of control
over interest rates

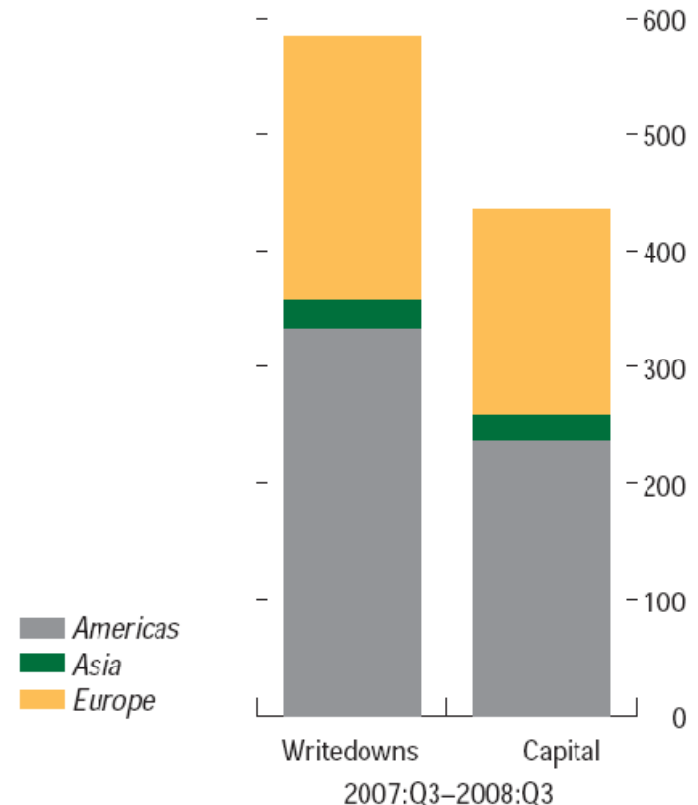
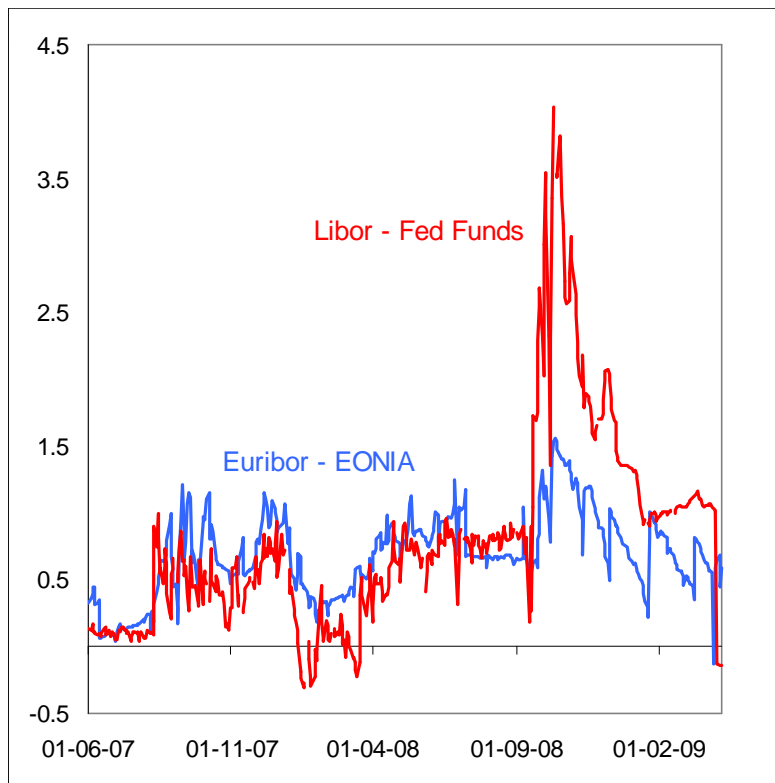
Not much difference



Impacts

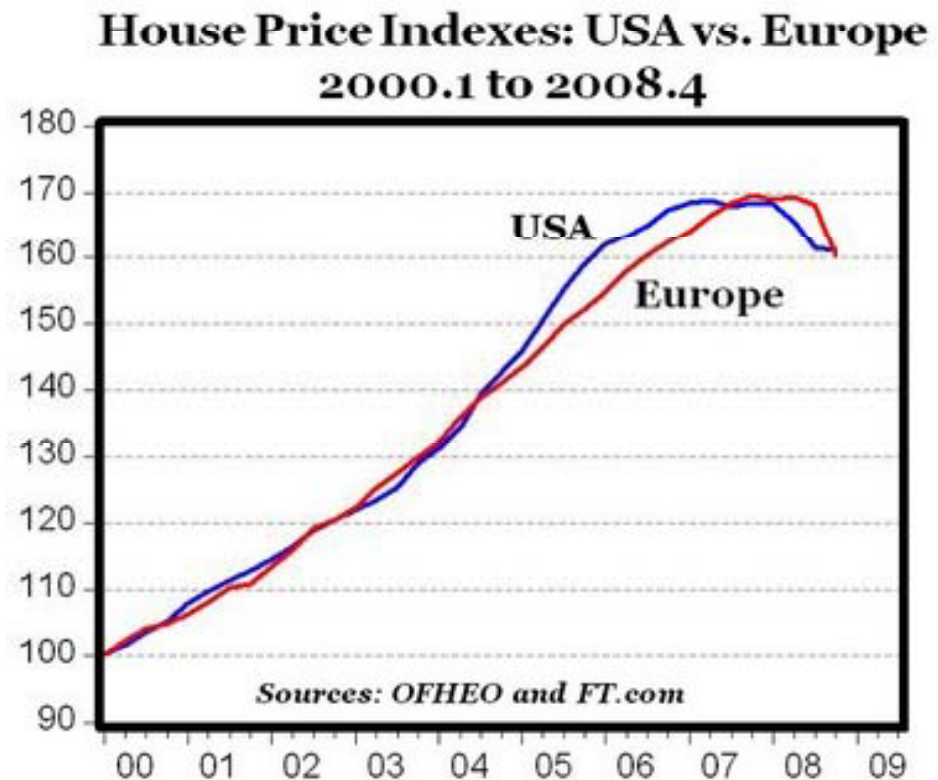
- Growth
- Financial markets

Again, limited difference



Impacts (or causes?)

- Growth
- Financial markets
- Housing prices
 - Similar lag
 - Causality?
 - Housing?
 - US?



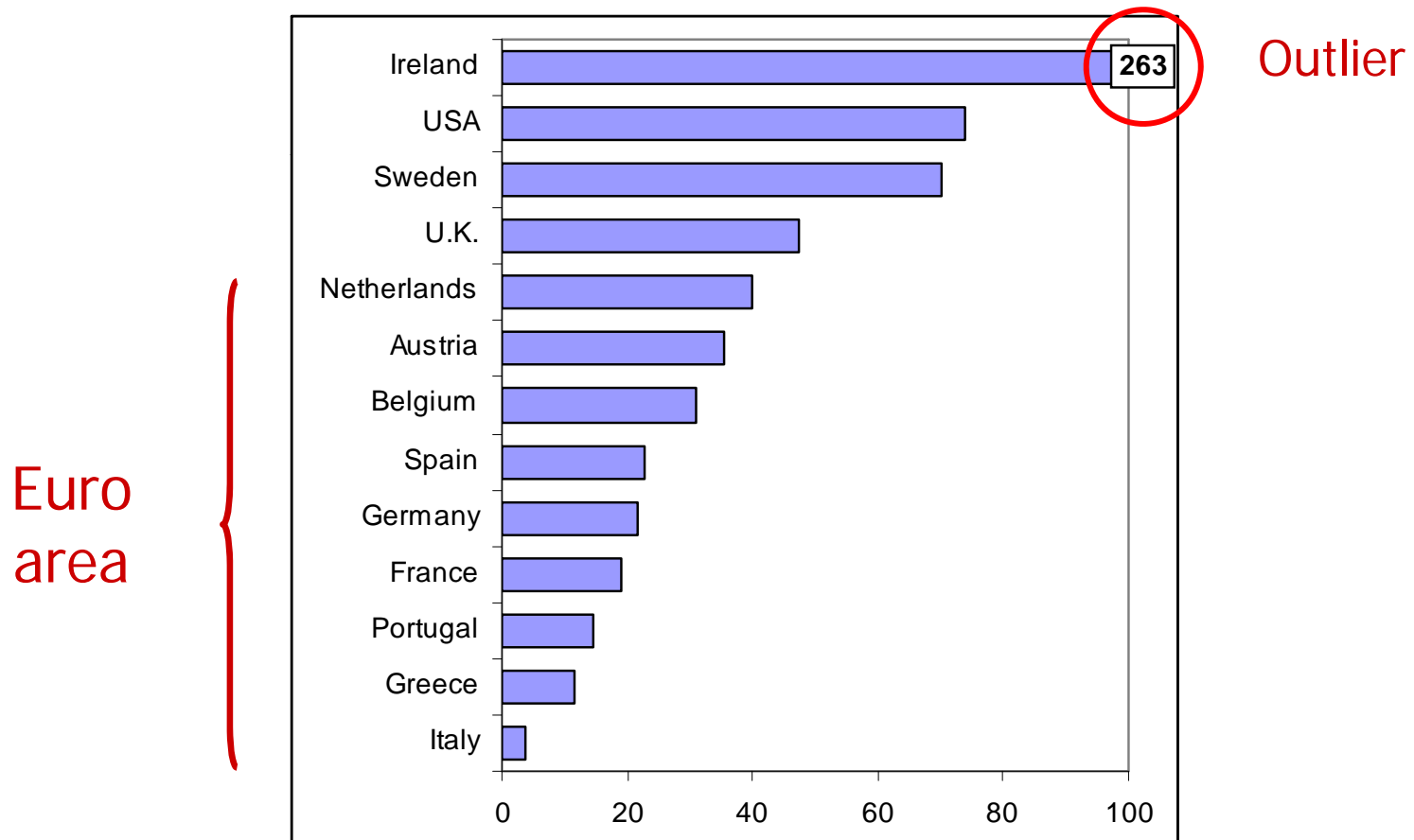
Impacts (or causes?)

- Growth
- Financial markets
- Housing prices
 - Similar lag
 - Causality?
 - Timing
 - Global liquidity
 - Global bubble
 - Main difference: securitization

House price peak	Country	Pre-peak increase (%)	Cyclical peak
2006q3	Ireland	298	2006q3
2006q4	US	61	2007q4
	Denmark	145	2007q3
	Spain	113	2007q2
2007q1	-		
2007q2	Finland	96	2007q4
	Italy	30	2007q3
2007q3	France	92	2008q1
	Sweden	110	2008q1
	UK	164	2007q3
2007q4	Netherlands	146	2008q2

Impacts

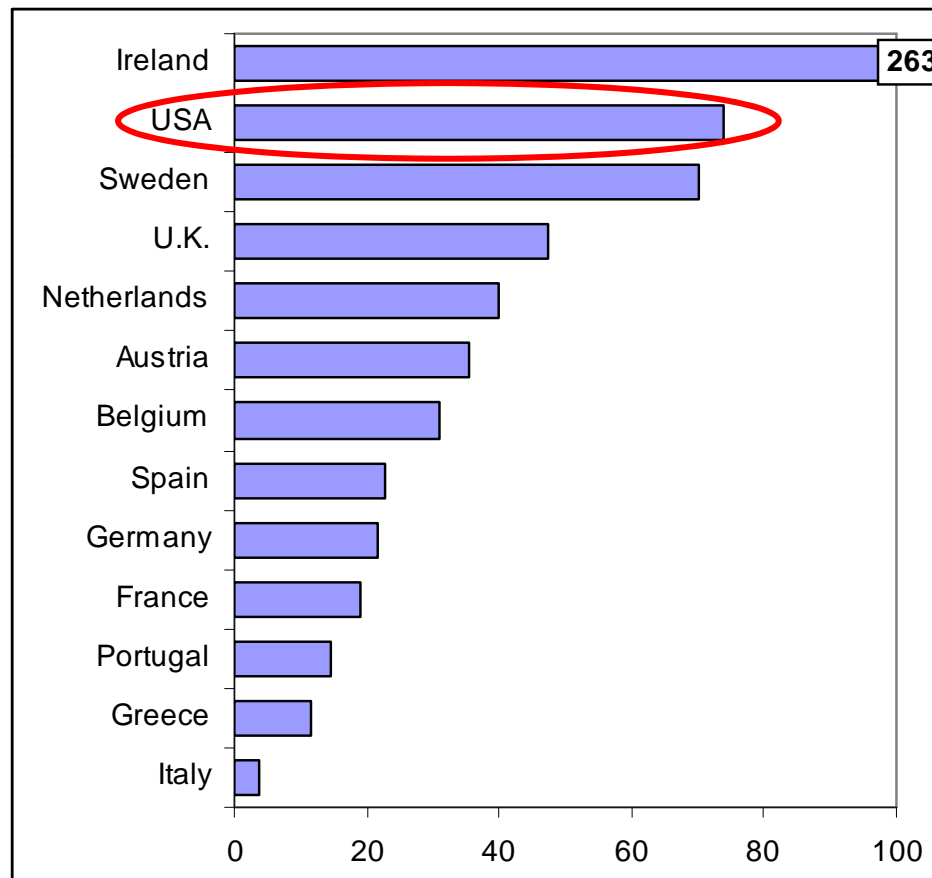
- Financial markets: public support to banks



Impacts

- Financial markets: public support to banks

- Some link with bubbles,
- But tenuous at best

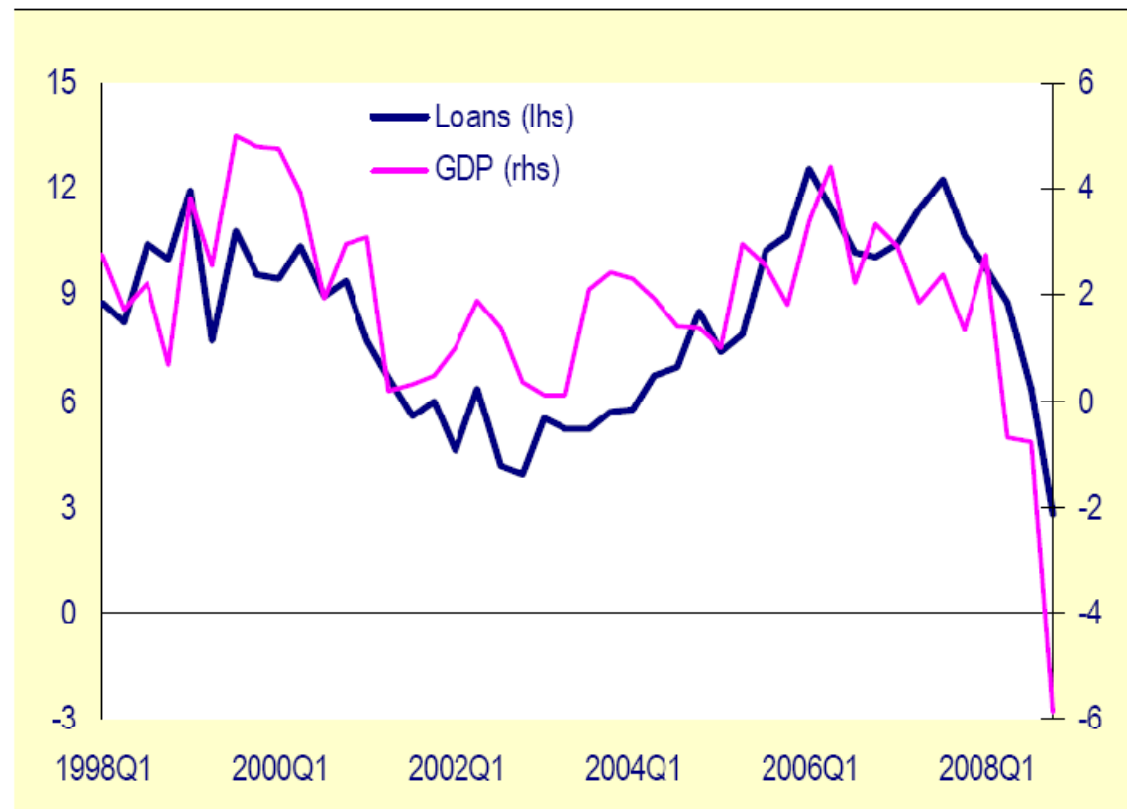


Relatively big

Impacts

- Financial markets: a credit crunch?

Graph 3: **Private sector loans and real GDP**
(annualised q-o-q growth in %– 1998Q1 to 2008Q4)



Wrap-up so far (1)

- Lags and causality: not fully clear
- Best option: house price bubble plus contagion
- Some financial contagion, but not the whole story
- Trade contagion must be brought in
 - But euro area relatively closed
- Greater financial stress in the US
 - Yet bubble no bigger

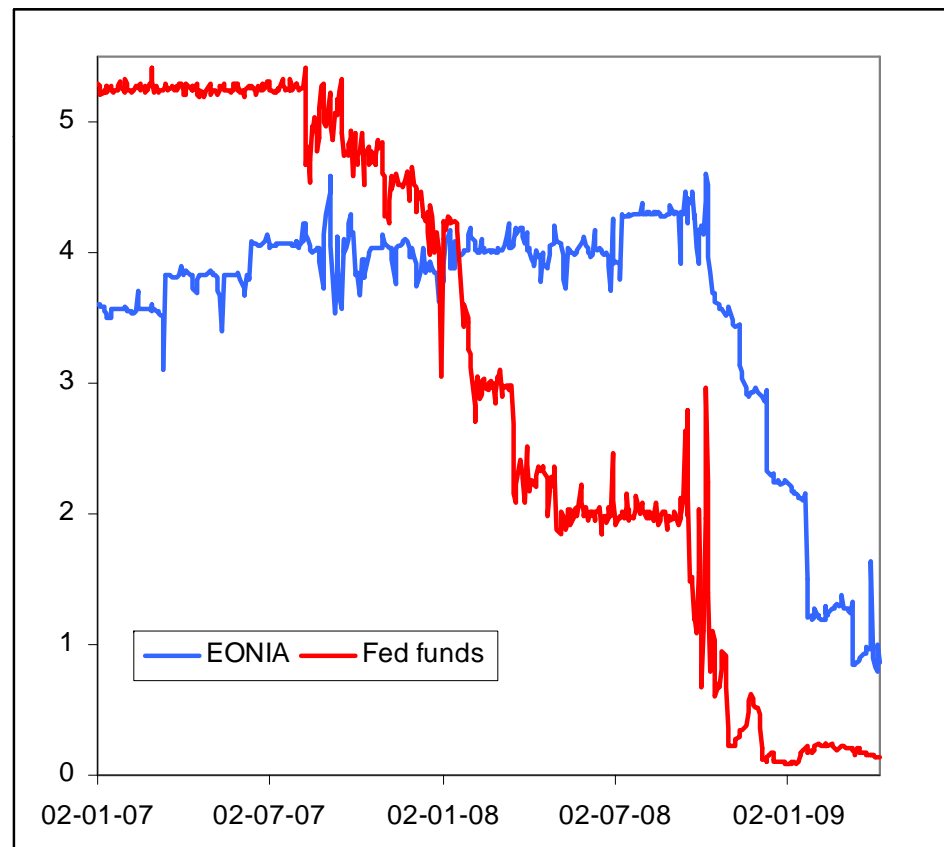
Wrap-up so far (2)

- Why is Europe lagging on the way in?
 - Crisis started in the US
 - Welfare systems
 - Less household exposure to financial markets
- OK, but that would also predict smaller impact

Policy responses

- Monetary policy

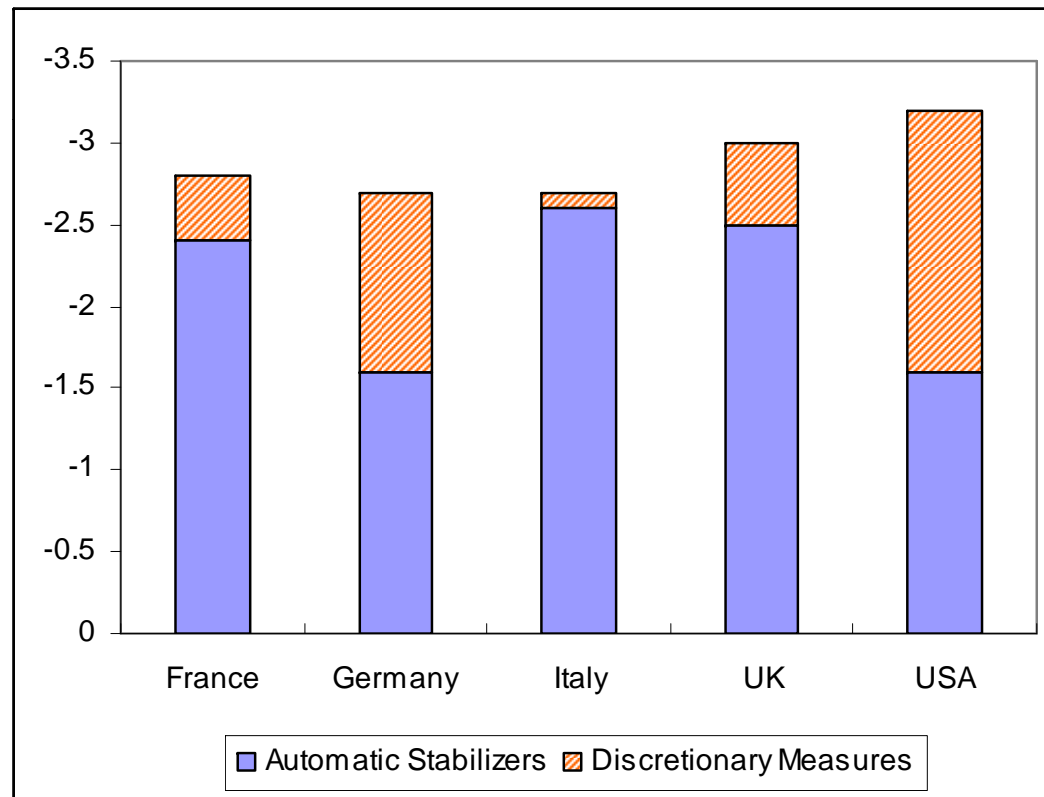
Causality,
again...



Policy responses

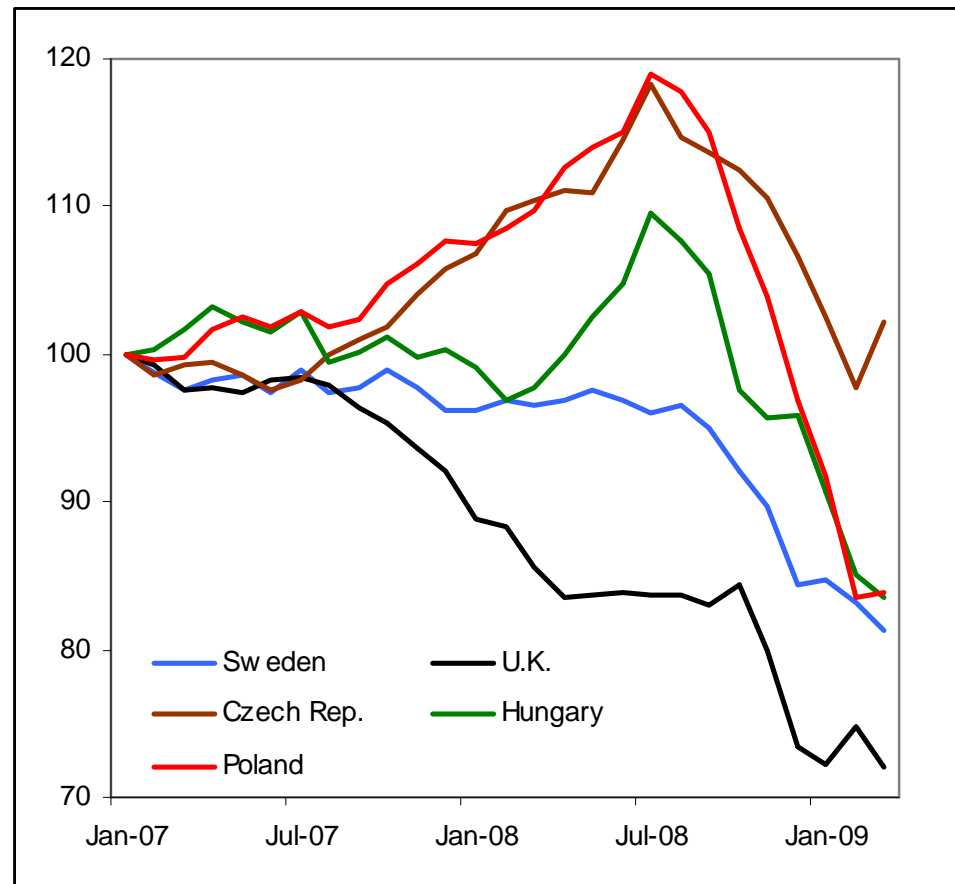
- Fiscal policy

No causality
problem!



The redeeming factor: the euro

Yet, ECB
to the
rescue



Conclusions

- Great euro!
 - One speculation channel cut-off
 - Swap arrangements with non-euro area
- Poor policy inspiration
 - The crisis should have been shallower
 - Collective decision-making
 - Difficult and inflexible
 - Should change “small & open” into “big and closed”
 - Question: why a recession?