

Is the eurozone crisis over – and what about Greece?

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Economics Commentator, *Financial Times***

Eliamep Lecture

16th December 2015

Athens, Greece

Eurozone crisis

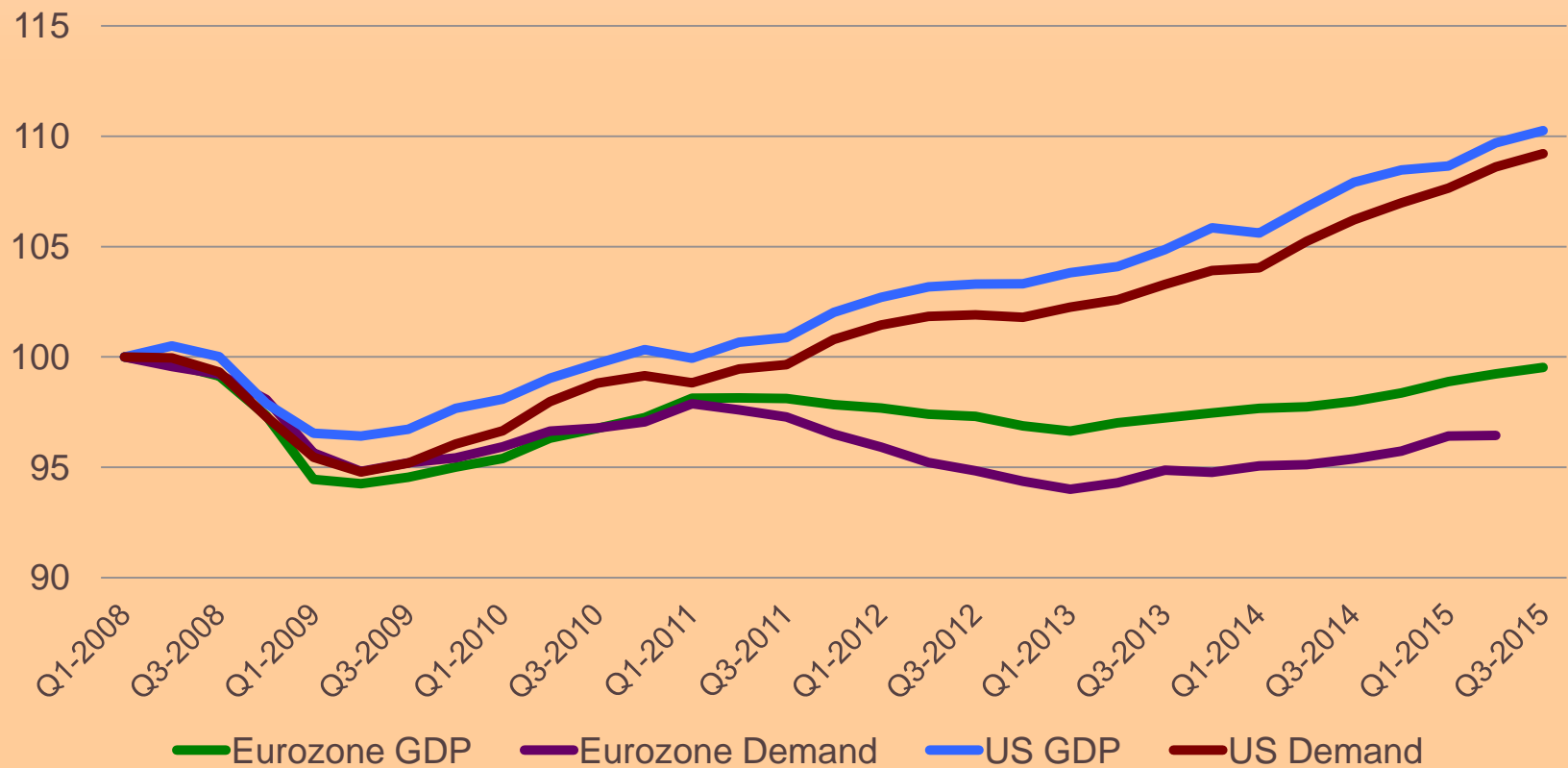
- Illusory “recovery”
- Germany’s eurozone
- Crisis-hit countries
- Challenges of a bad marriage

1. Illusory recovery

- The eurozone crisis has stopped getting worse
- But output and employment are very weak
- The European Central Bank was the main actor
- But adjustment and reform have also taken place

1. Illusory recovery

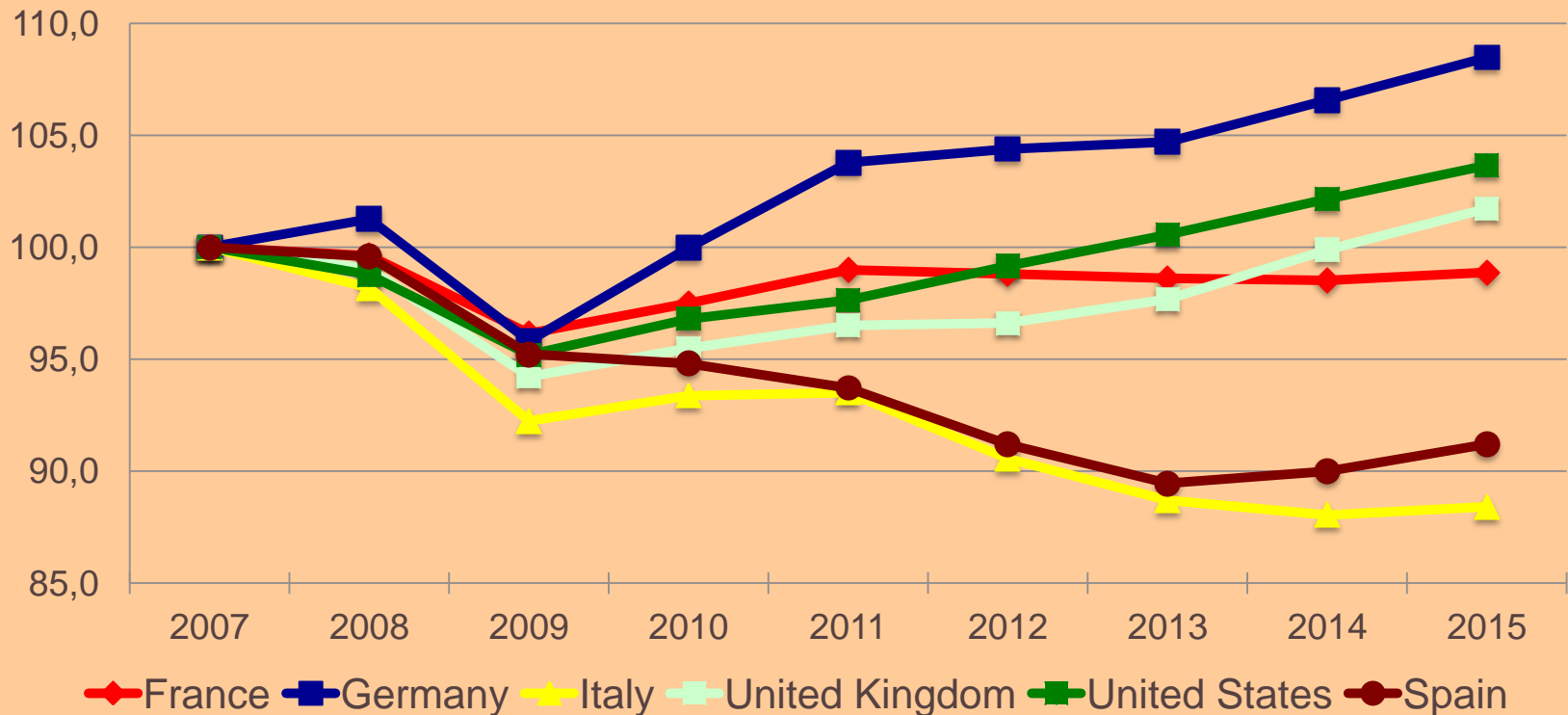
DIVERGENCE BETWEEN THE US AND EUROZONE REAL GDP AND REAL DEMAND



1. Illusory recovery

DIVERGENCE IN LIVING STANDARDS

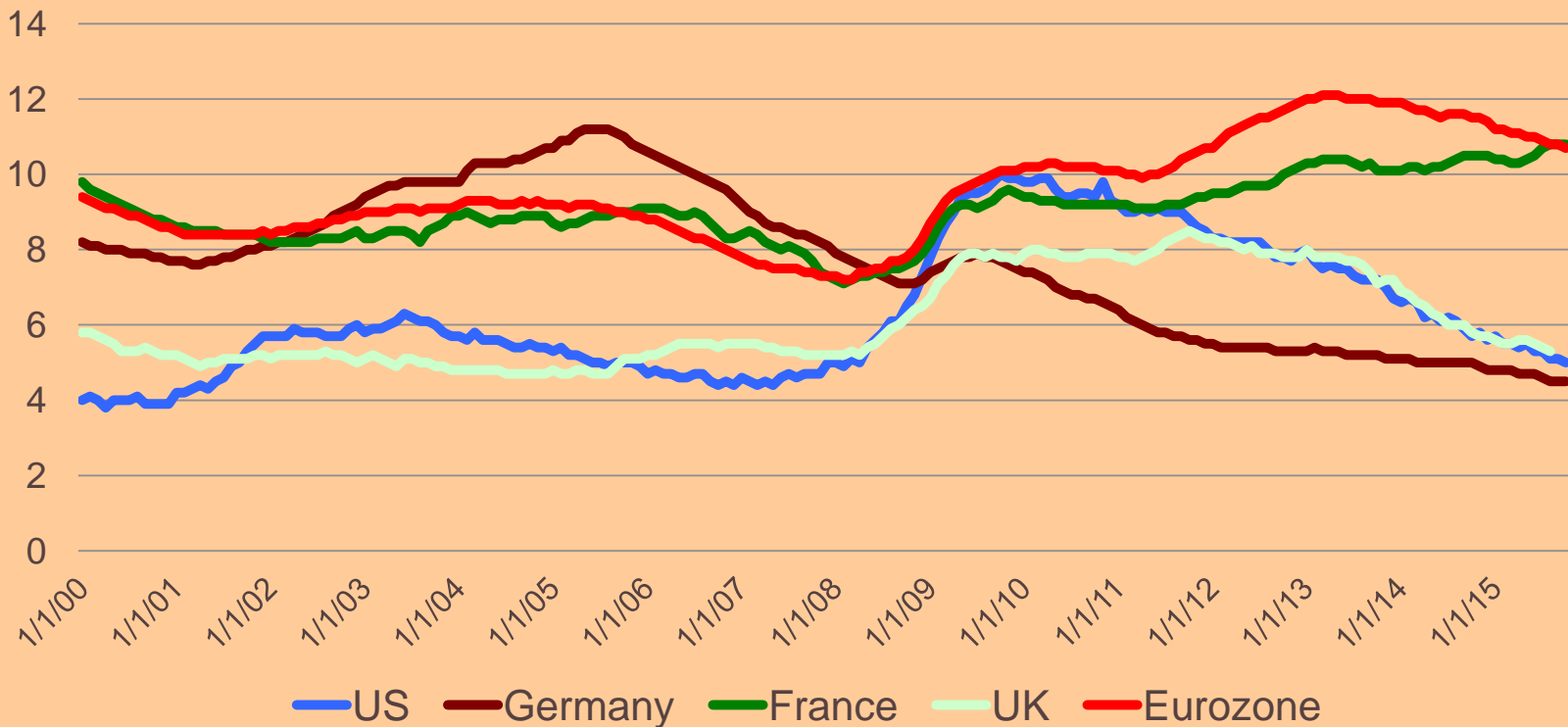
GDP PER HEAD (2007 = 100; at purchasing power parity; 2015 is a forecast) (Source: The Conference Board)



1. Illusory recovery

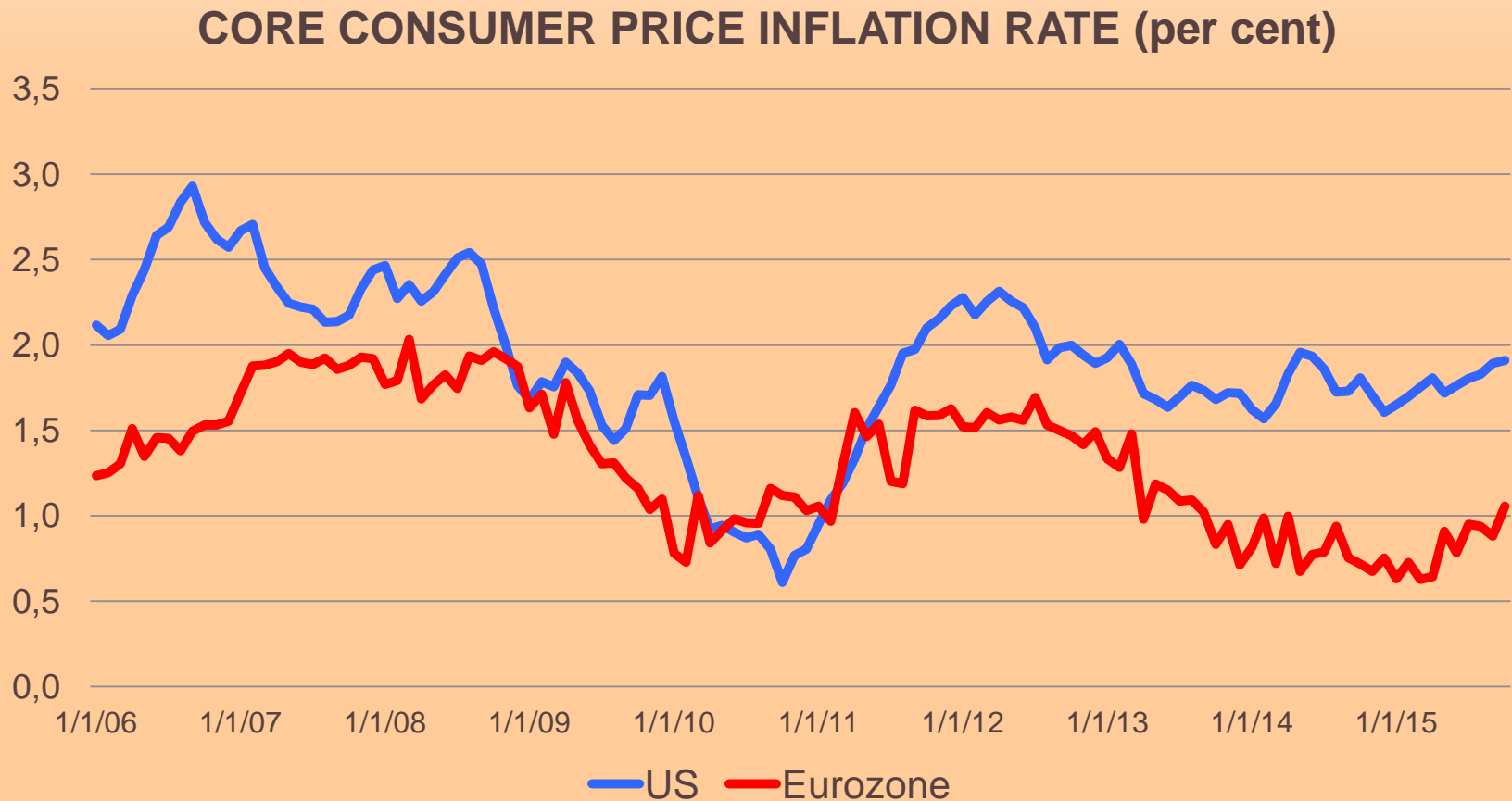
SLOW TURNAROUND IN UNEMPLOYMENT

UNEMPLOYMENT (per cent of the labour force)
Source: OECD



1. Illusory recovery

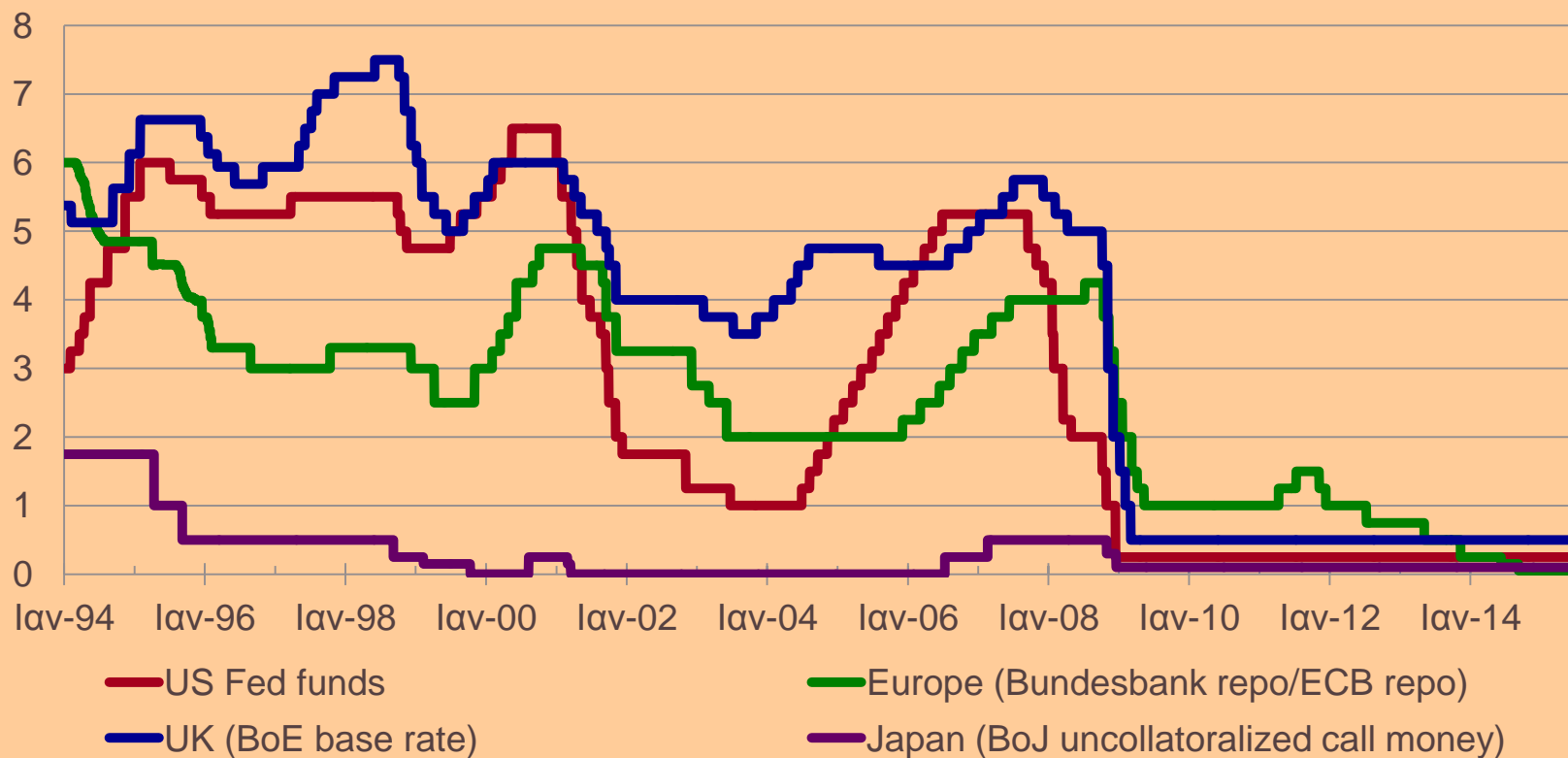
CAUGHT IN A “LOW-FLATION” TRAP



1. Illusory recovery

THE ECB GETS THERE FAR TOO LATE

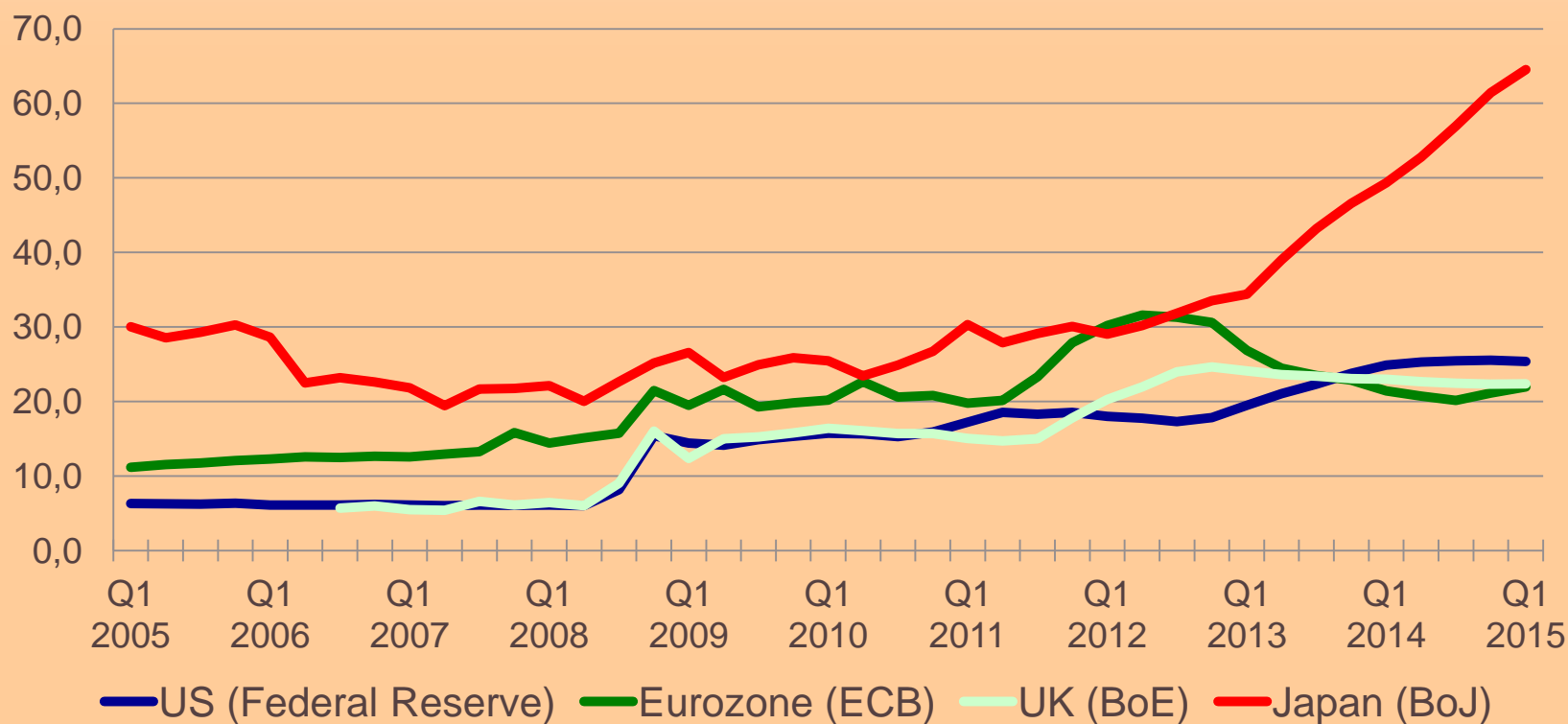
OFFICIAL POLICY RATES
(Source: Thomson Reuters Datastream)



1. Illusory recovery

THE ECB GETS TO QE TOO LATE

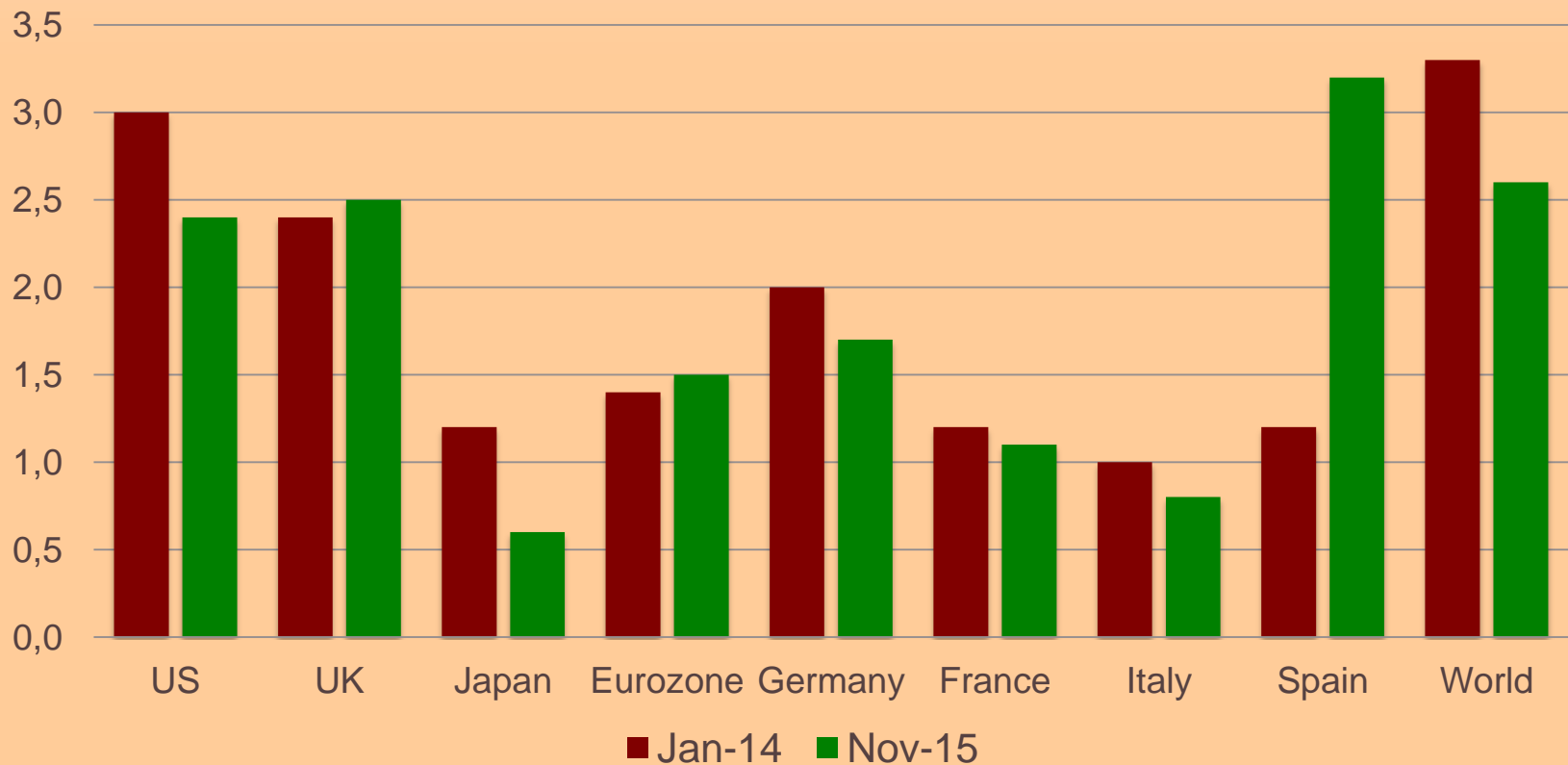
CENTRAL BANK ASSETS OVER GDP per cent) (Source: Thomson Reuters Datastream and Bank of England)



1. Illusory recovery

FORECASTERS ADJUST THEIR VIEWS

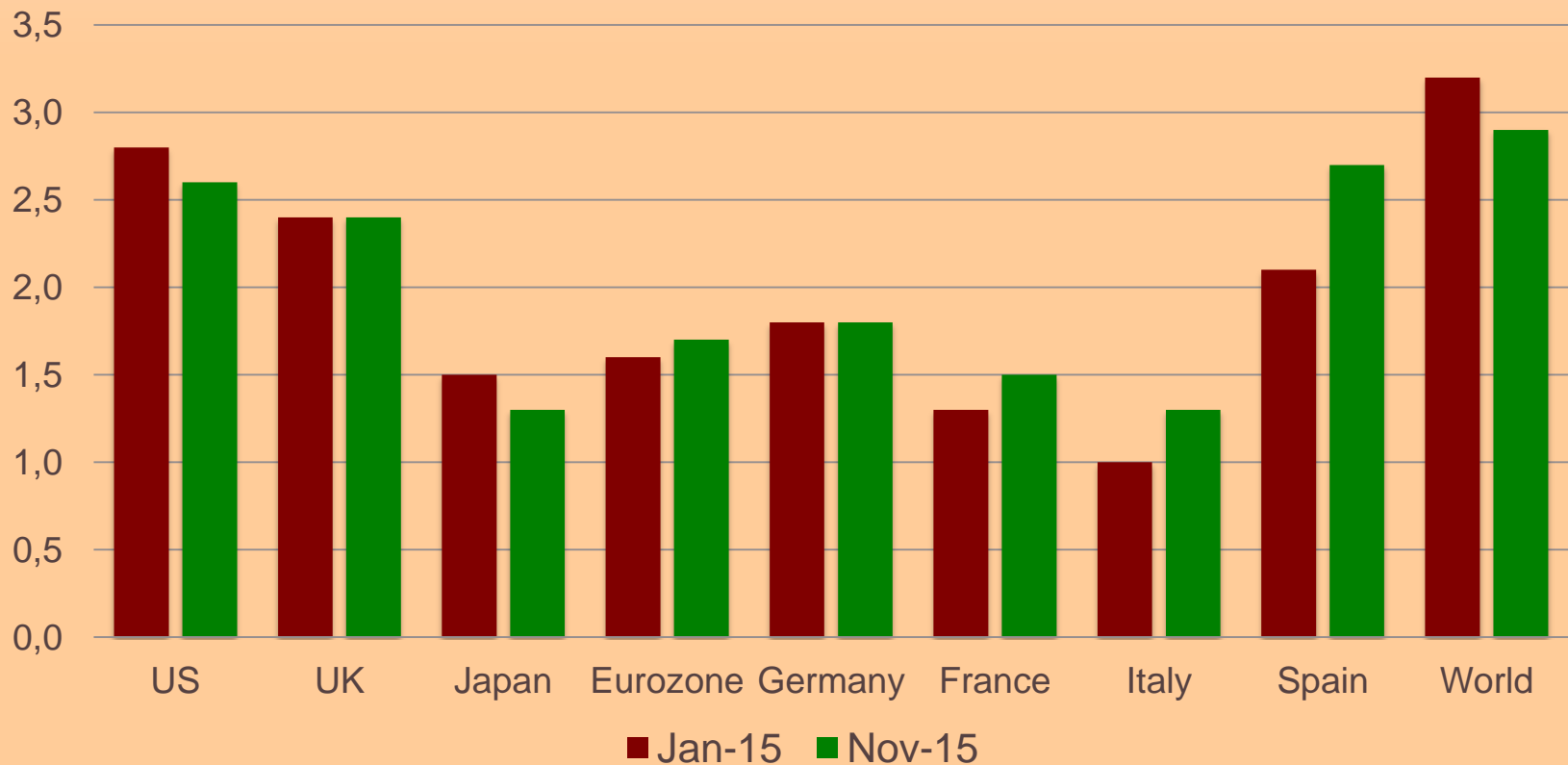
SUCCESSIVE CONSENSUS FORECASTS FOR 2015



1. Illusory recovery

EUROZONE HAS A RECOVERY OF SORTS

SUCCESSIVE CONSENSUS FORECASTS FOR 2016



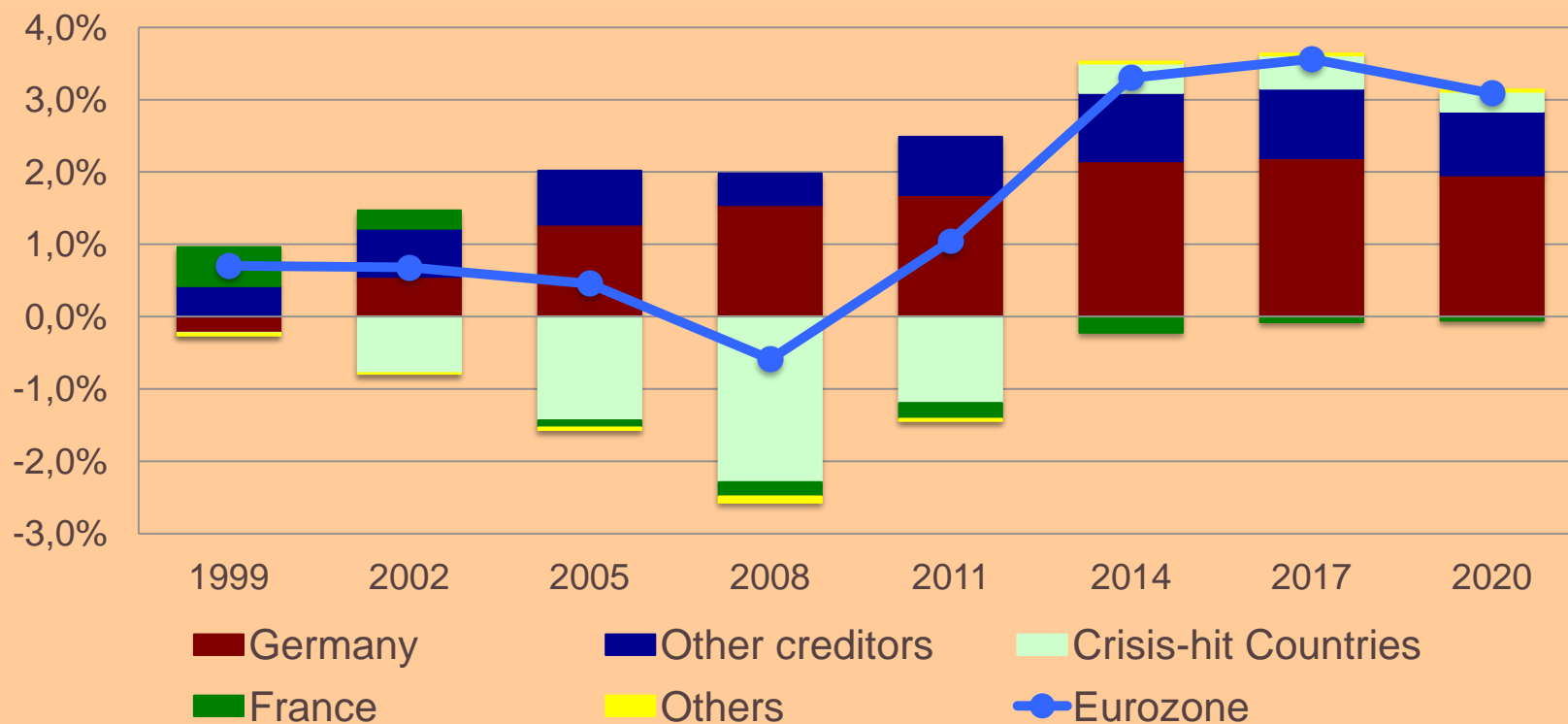
2. Germany's eurozone

- Aggregate demand has been chronically weak
- The eurozone has also externalised its adjustment
- A weak euro has helped

2. Germany's eurozone

TURNING INTERNAL INTO EXTERNAL IMBALANCE

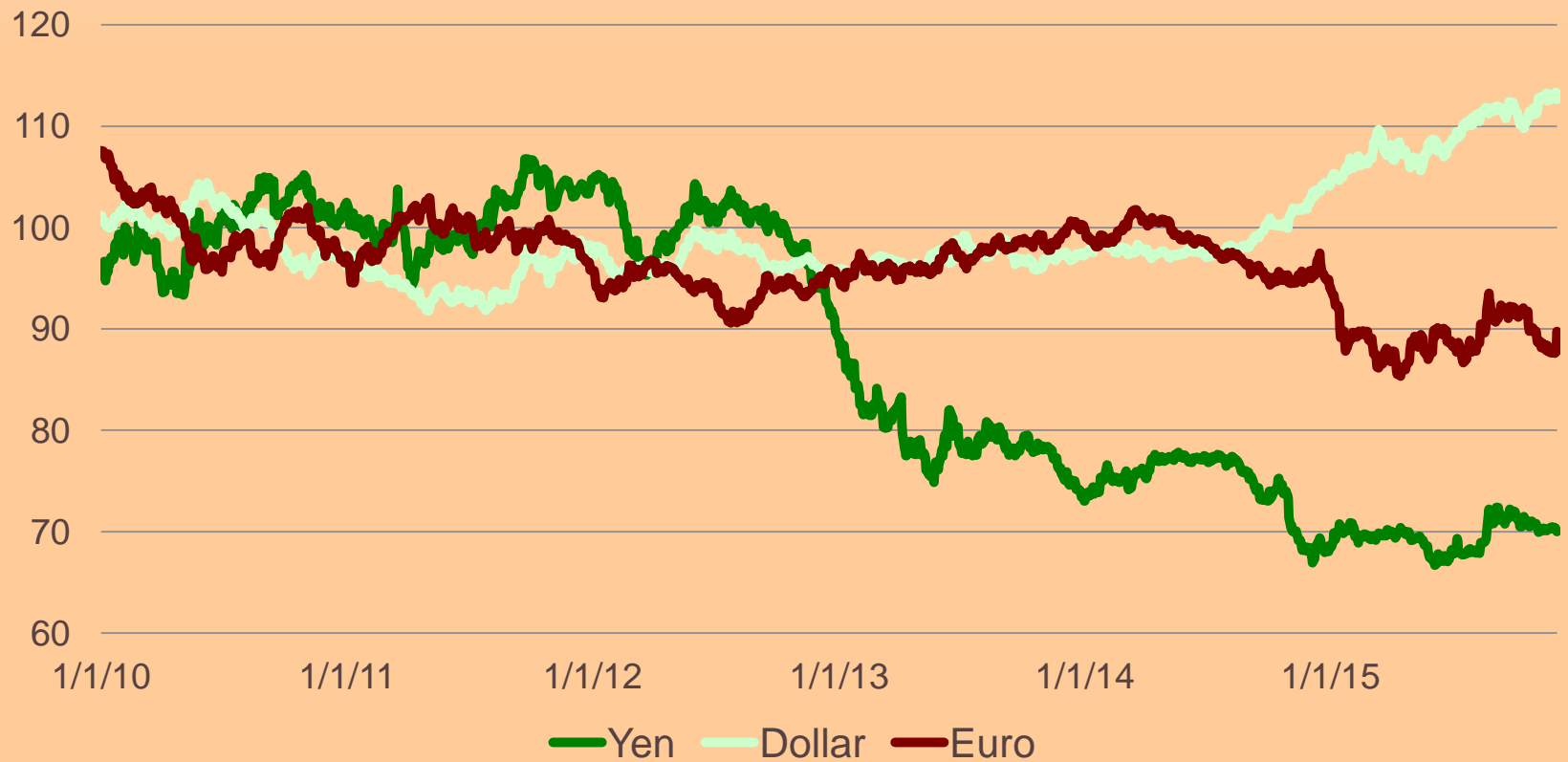
Eurozone Imbalances on Current Account (as per cent of eurozone GDP) (Source: IMF, World Economic Outlook Database)



2. Germany's eurozone

ECB HELPS

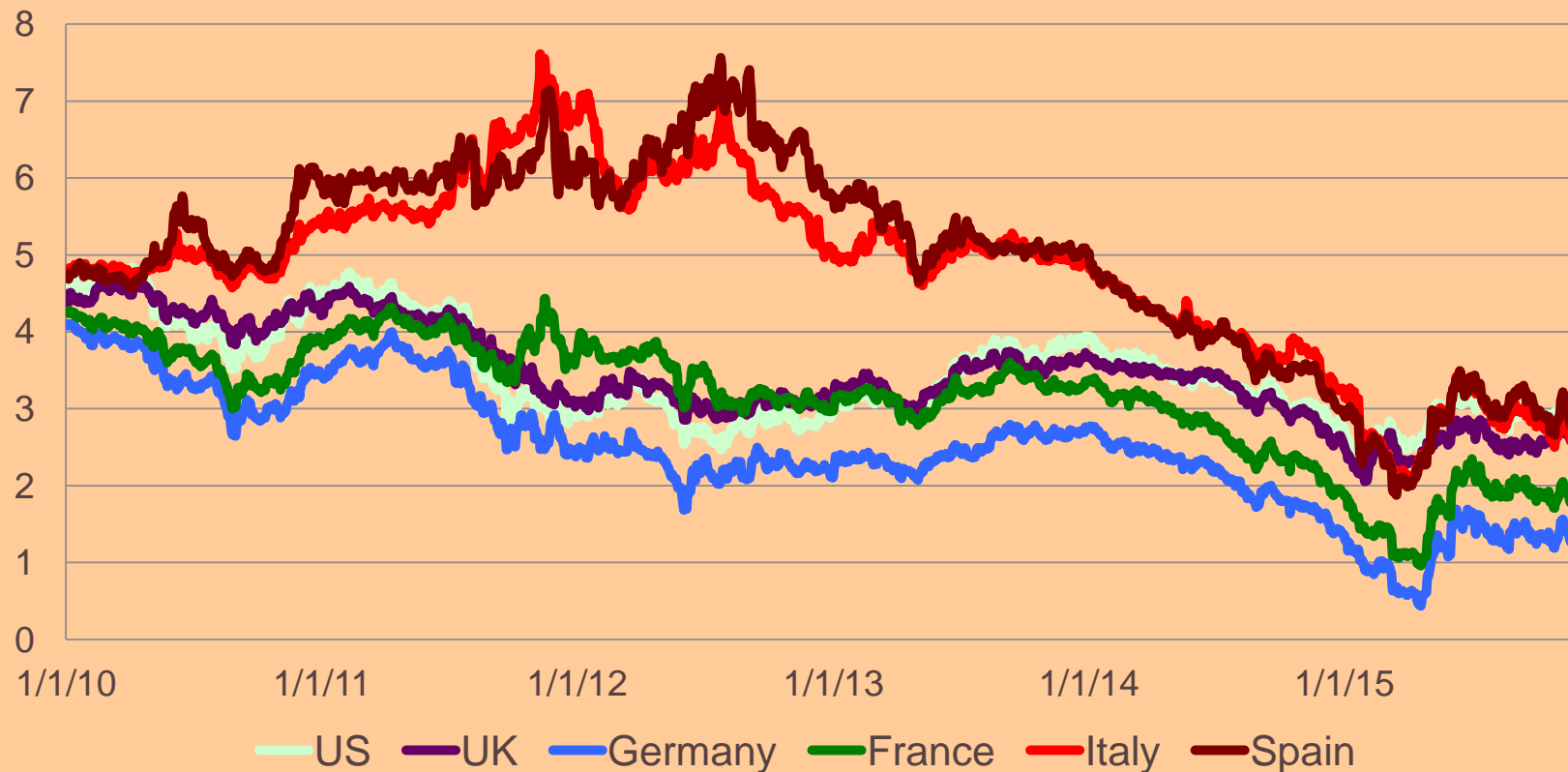
REAL EXCHANGE RATES (JP Morgan)



2. Germany's eurozone

GERMANY'S GAIN IN A DISINFLATIONARY WORLD

YIELDS ON 30-YEAR BONDS



3. Crisis-hit countries

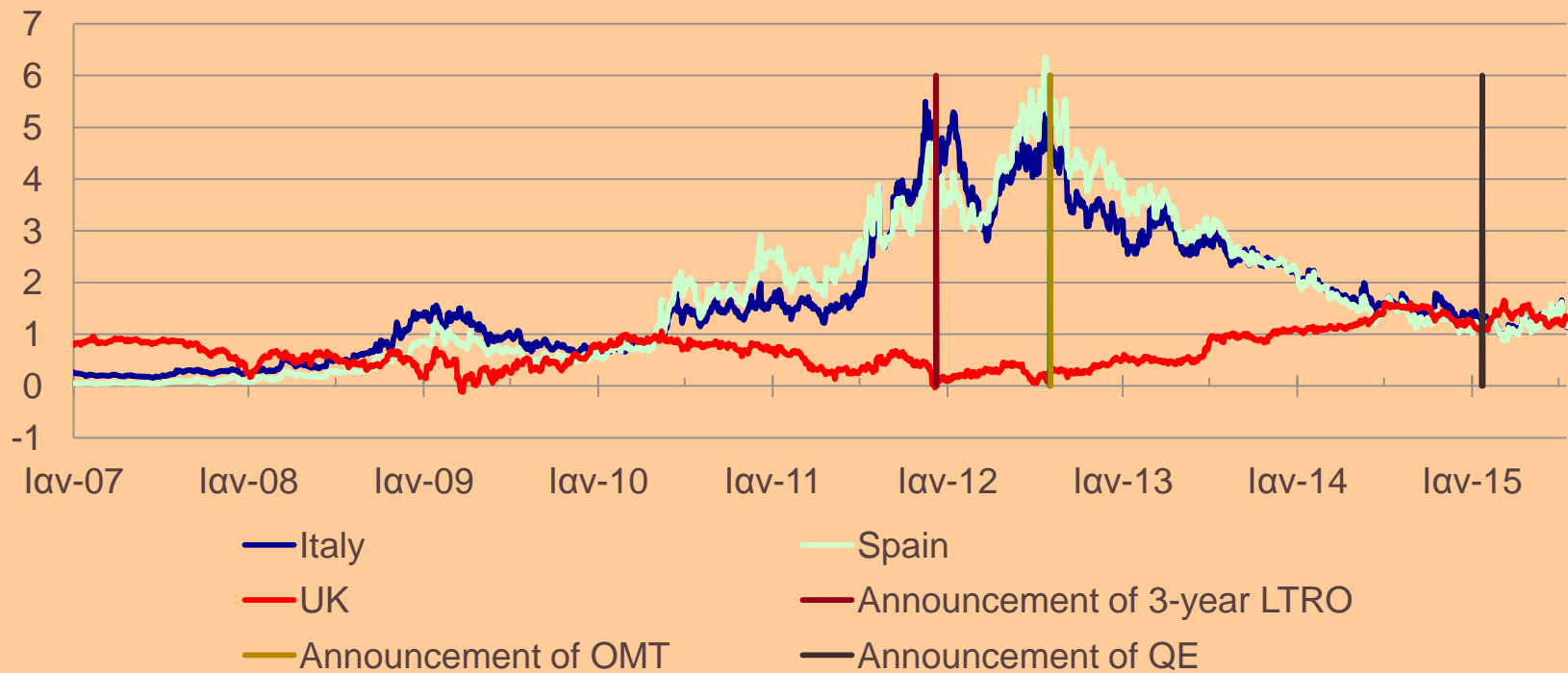
- The ECB has eliminated panic, except in Greece
- All crisis-hit countries are in deep recession, properly defined
- But most are at least growing
- Greece is the exception
- But the crisis has left dreadful scars
- This has been, at least, a lost decade

3. Crisis-hit countries

SURPRISING TRIUMPH OF THE OMT PROGRAMME

SPREADS ON 10-YEAR BONDS OVER BUNDS

(Source: Thomson Reuters Datastream)

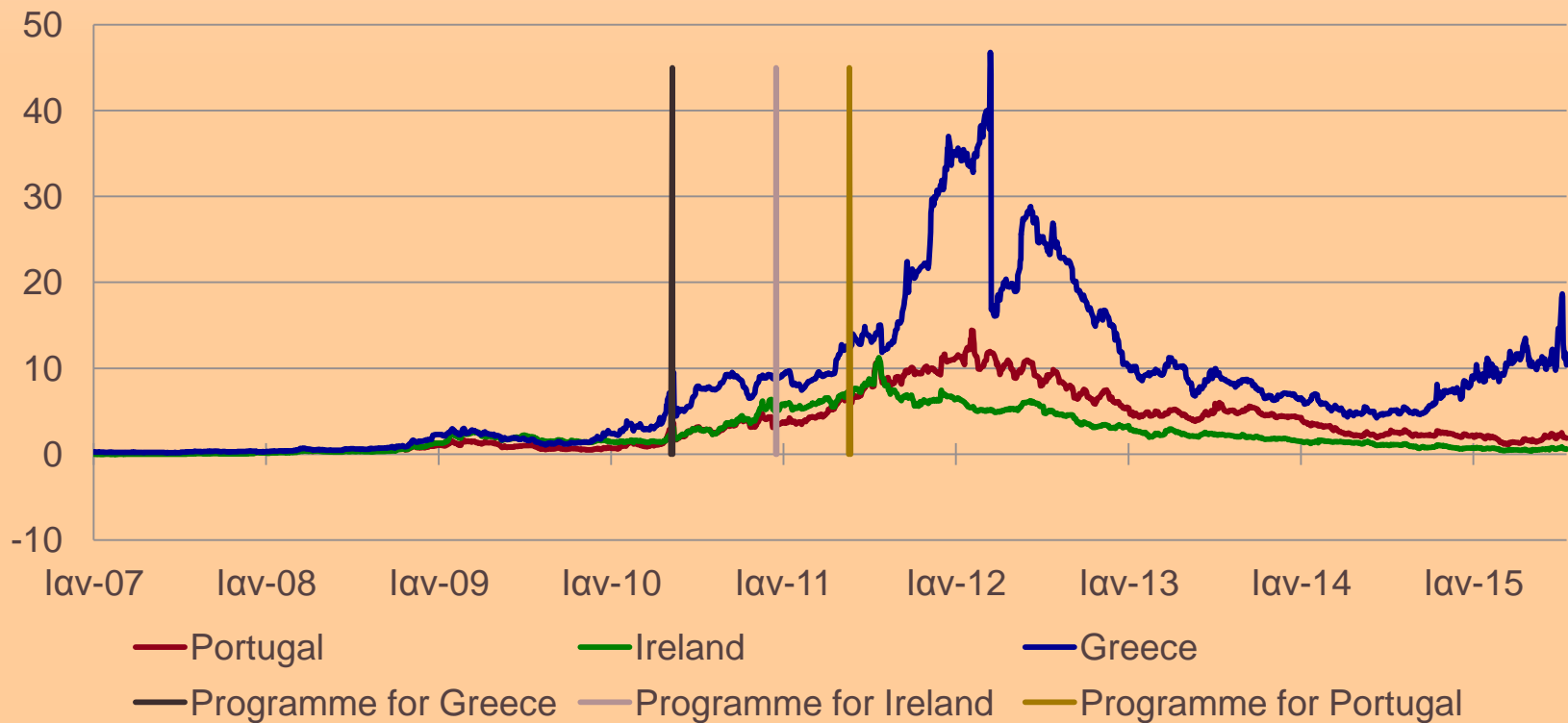


3. Crisis-hit countries

GREECE IS THE EXCEPTION

SPREADS ON 10-YEAR BONDS OVER BUNDS

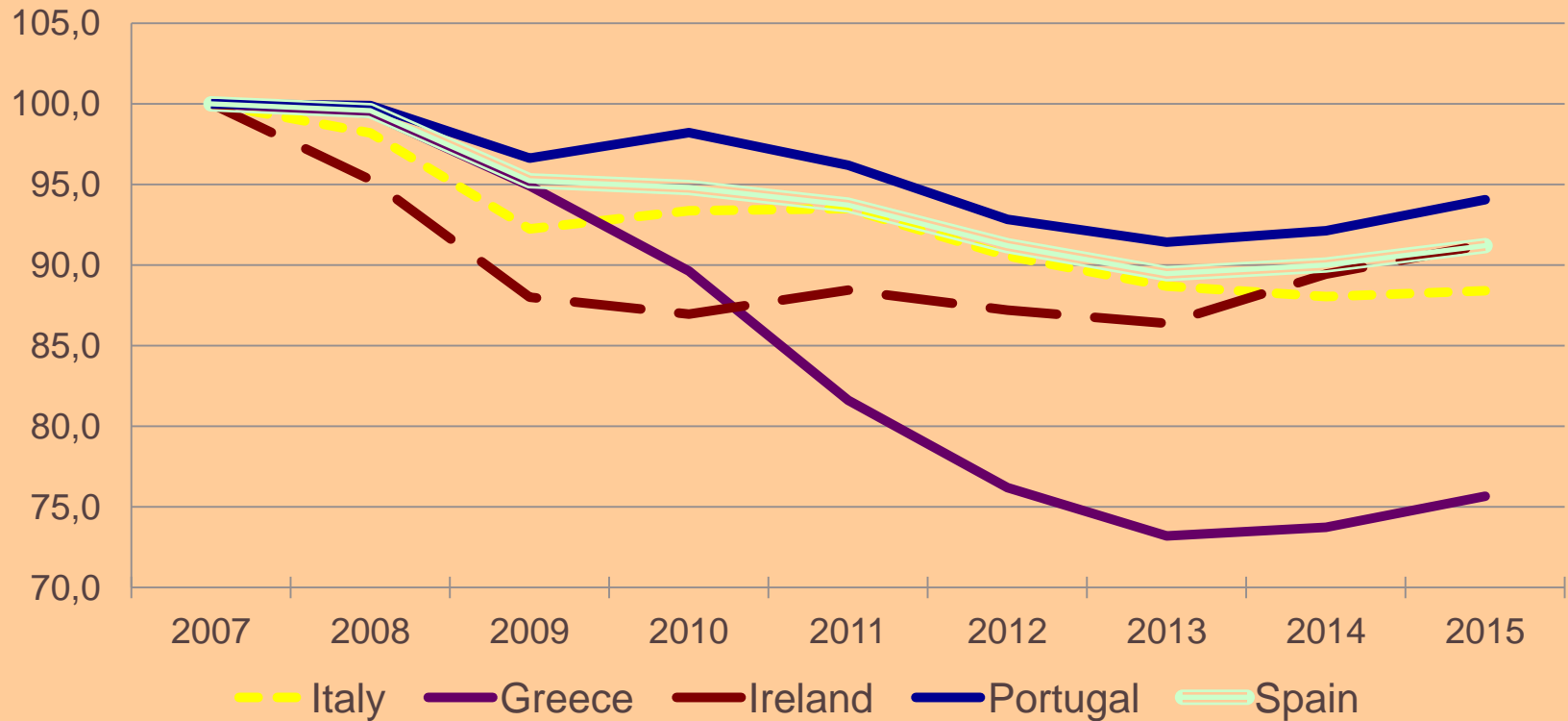
(percentage points) (Source: Thomson Reuters Datastream)



3. Crisis-hit countries

THE COST OF THE EUROZONE CRISIS

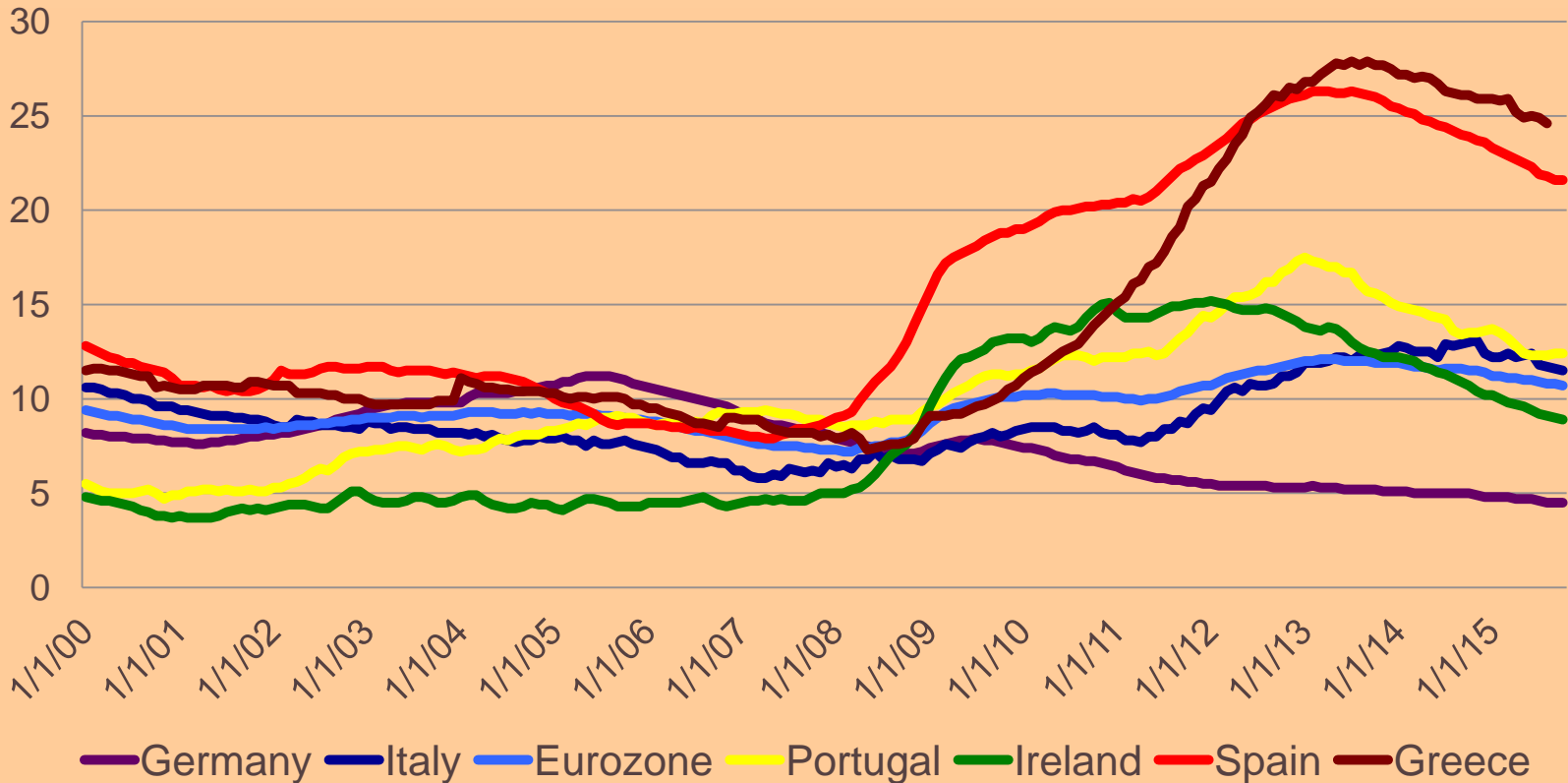
GDP PER HEAD IN CRISIS-HIT EUROZONE COUNTRIES
(at purchasing power parity) (Source: The Conference Board)



3. Crisis-hit countries

UNEMPLOYMENT IN CRISIS-HIT COUNTRIES

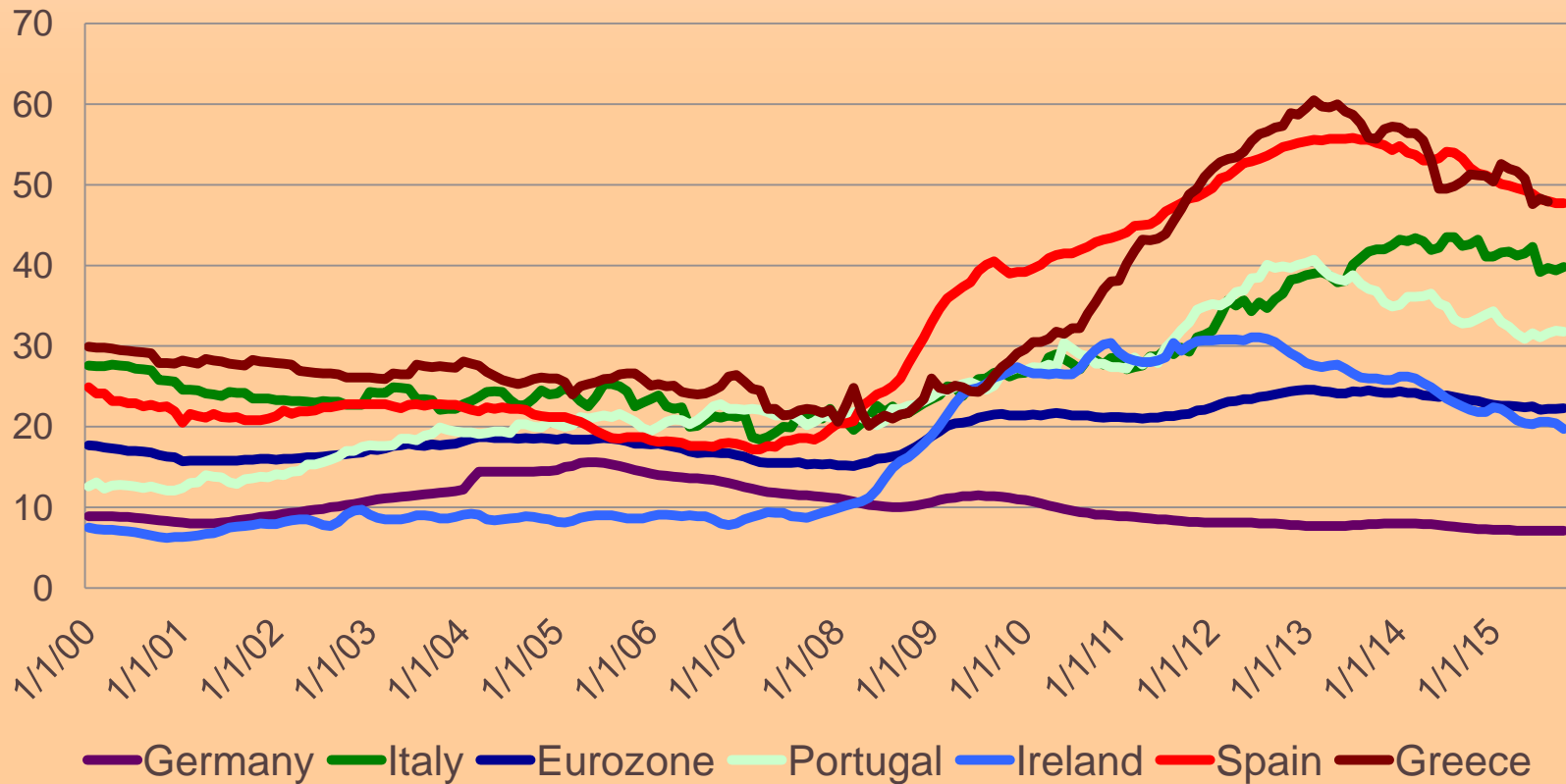
UNEMPLOYMENT RATES



3. Running to stand still

UNEMPLOYMENT IN CRISIS-HIT COUNTRIES

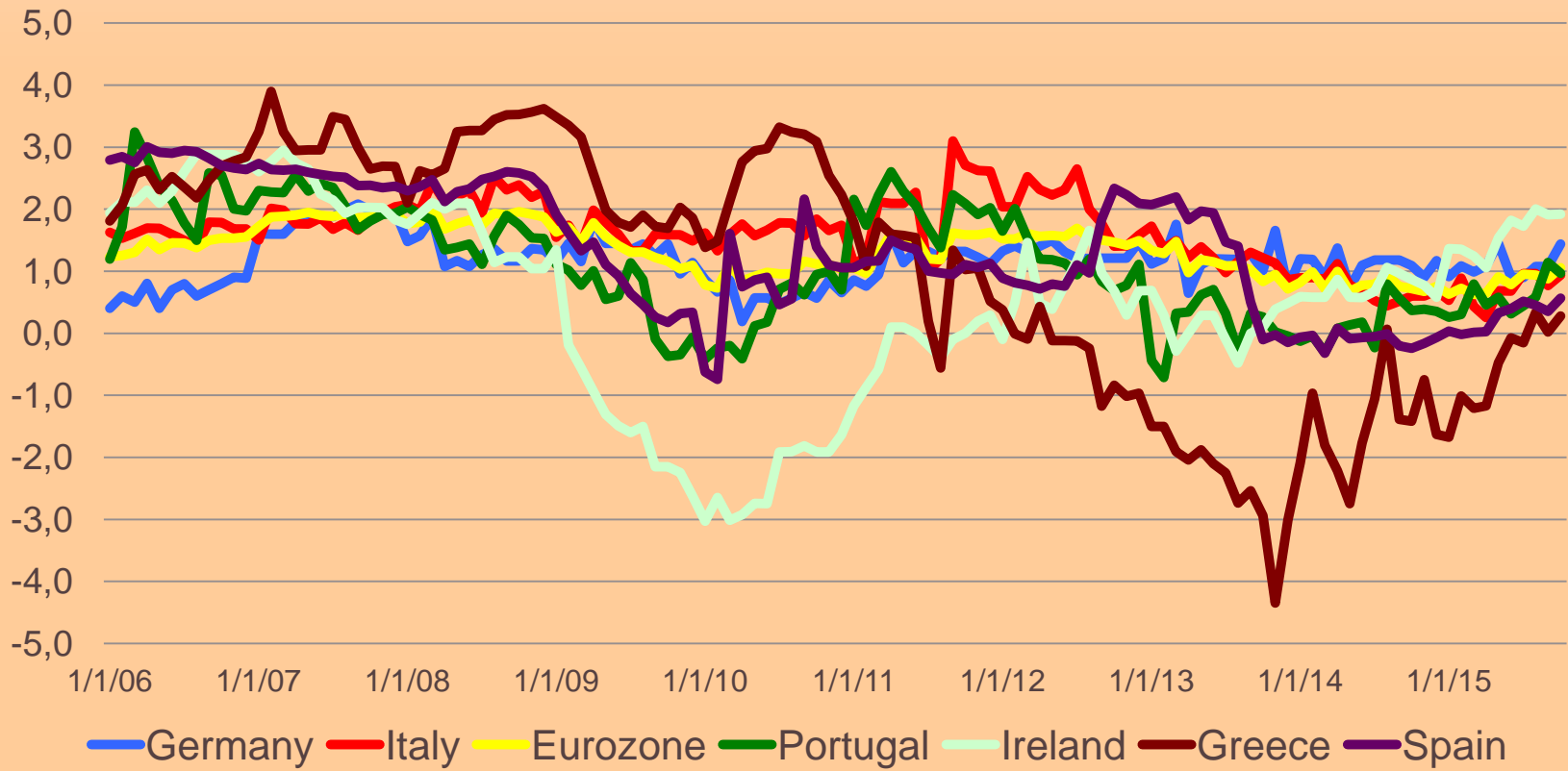
YOUTH UNEMPLOYMENT RATES (15-25)



3. Crisis-hit countries

RISK OF DEBT DEFLATION

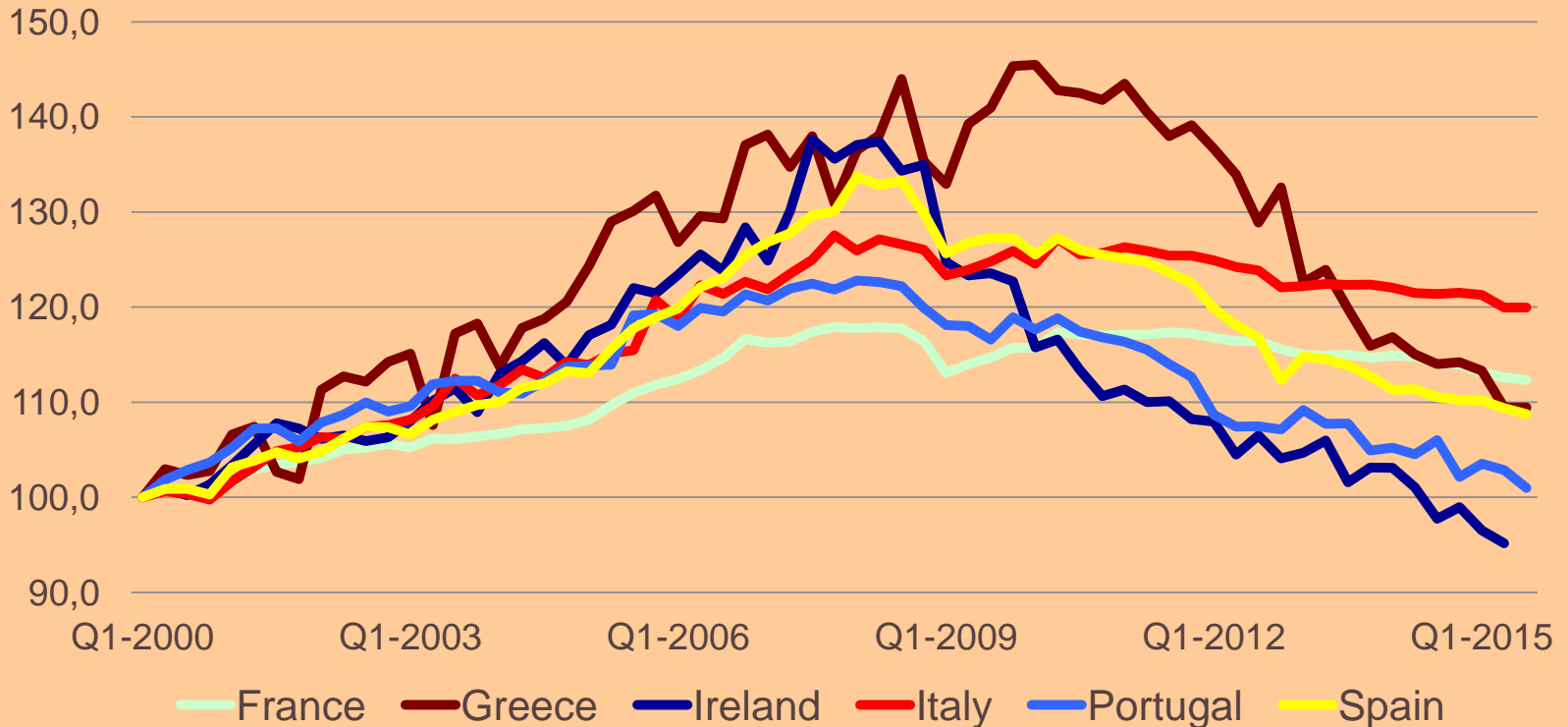
CORE INFLATION IN THE EUROZONE



3. Crisis-hit countries

COMPETITIVE DISINFLATION AND RECESSIONS

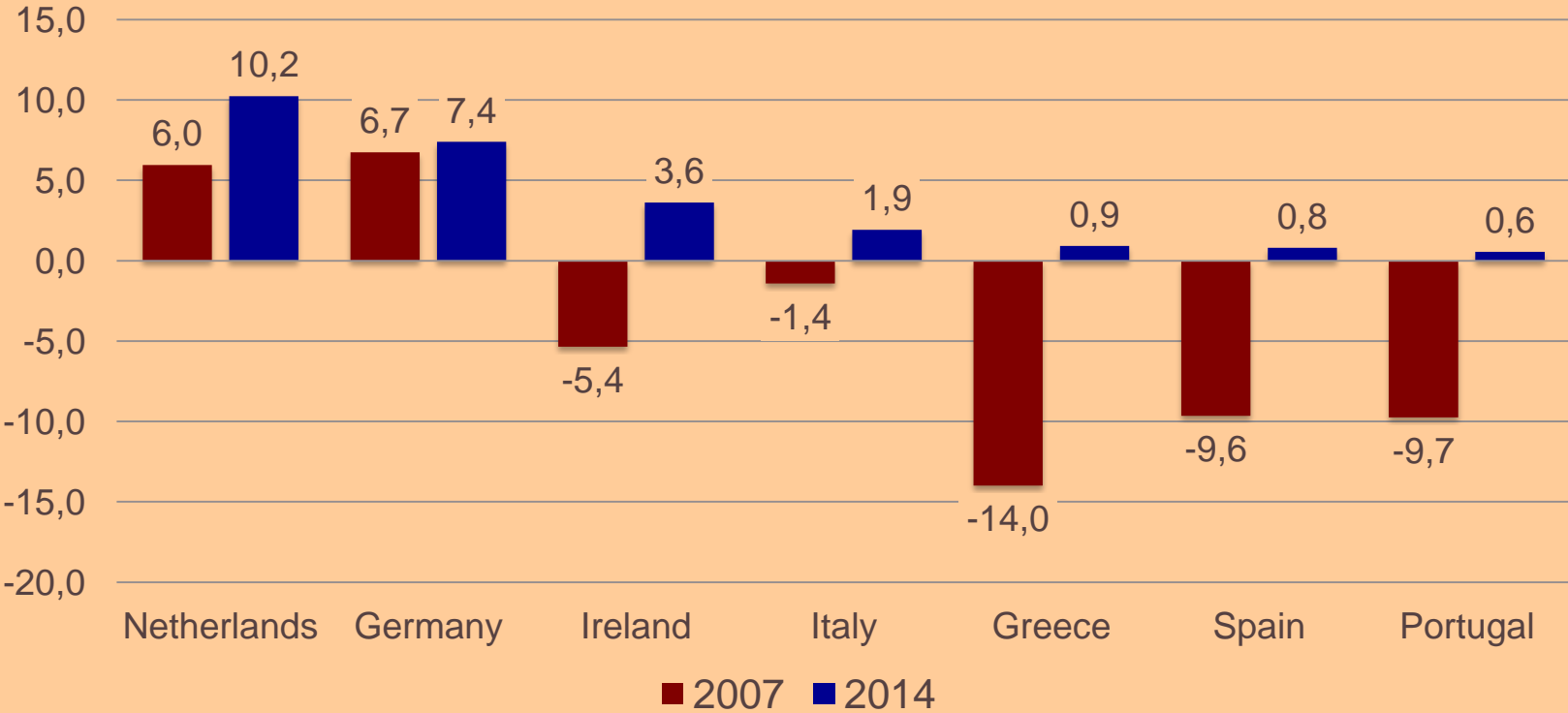
WHOLE ECONOMY UNIT LABOUR COSTS RELATIVE TO GERMANY (Germany = 100)



3. Crisis-hit countries

ELIMINATE CURRENT ACCOUNT IMBALANCES

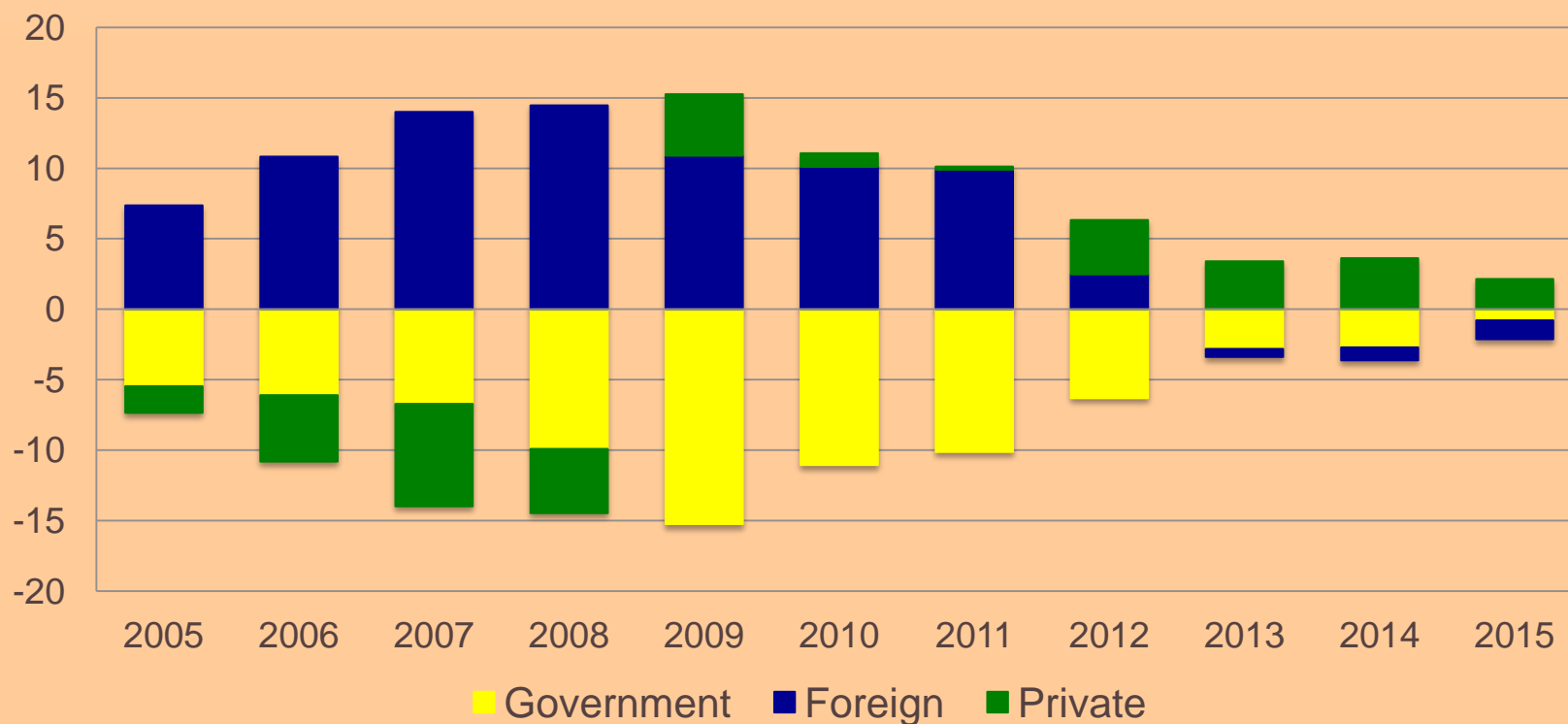
CURRENT ACCOUNT BALANCES IN THE EUROZONE
(per cent of GDP)



3. Crisis-hit countries

THE DISAPPEARANCE OF FOREIGN CAPITAL

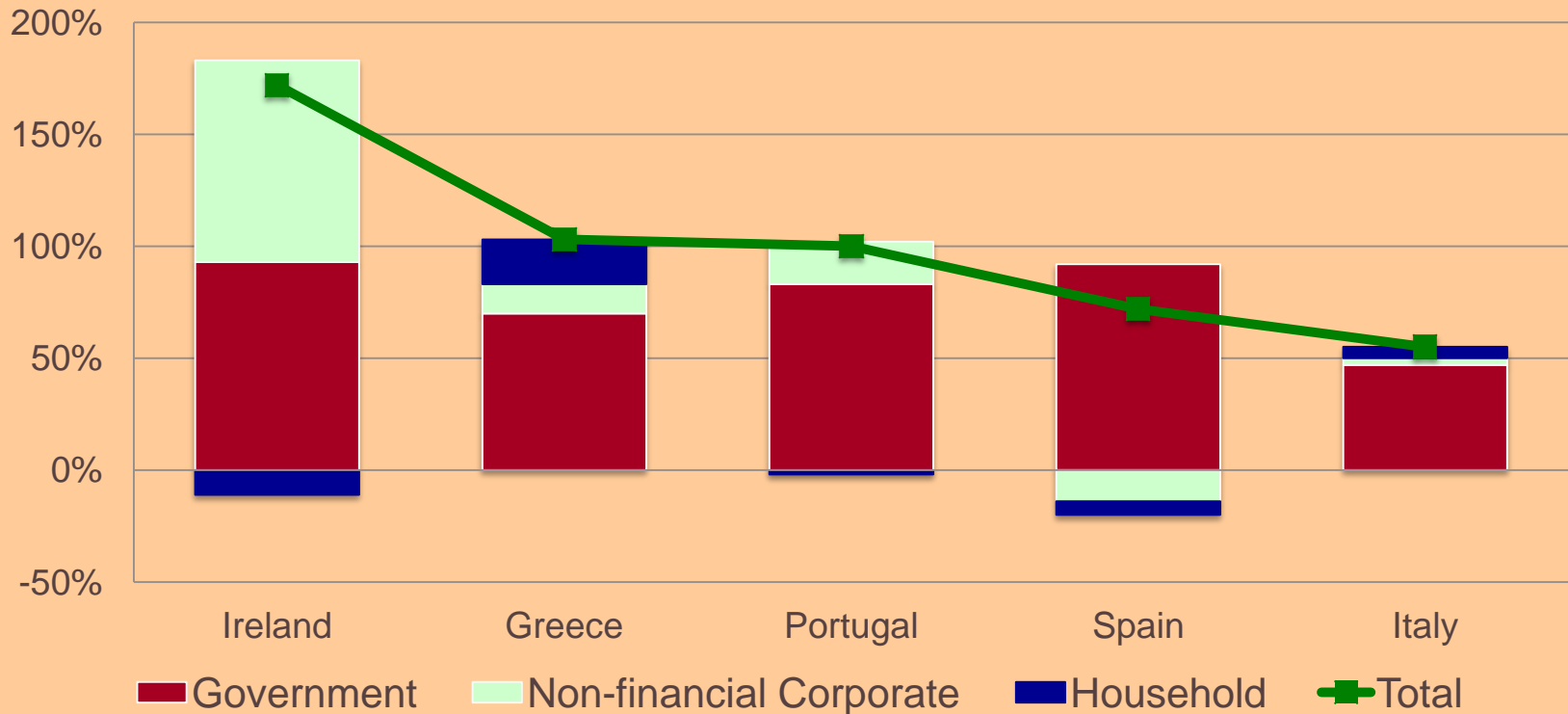
SECTORAL FINANCIAL BALANCES IN GREECE (per cent of GDP) (Source: IMF, World Economic Outlook database)



3. Crisis-hit countries

POST-CRISIS EXPLOSION IN DEBT

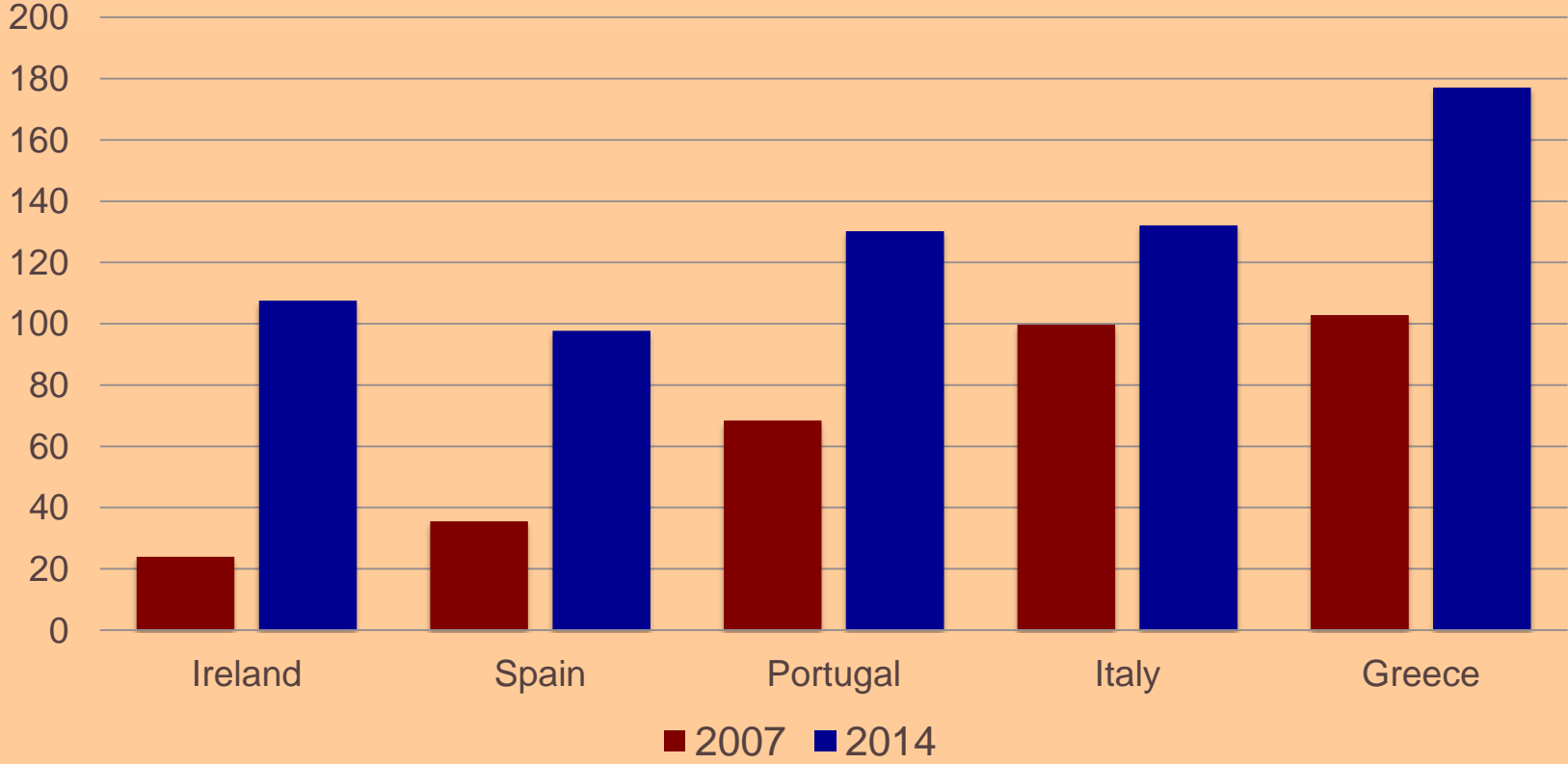
Change in Gross Indebtedness in the Real Economy, 2007-14 (as a per cent of GDP) (Source: McKinsey Global Institute)



3. Crisis-hit countries

RISK OF DEBT DEFLATION

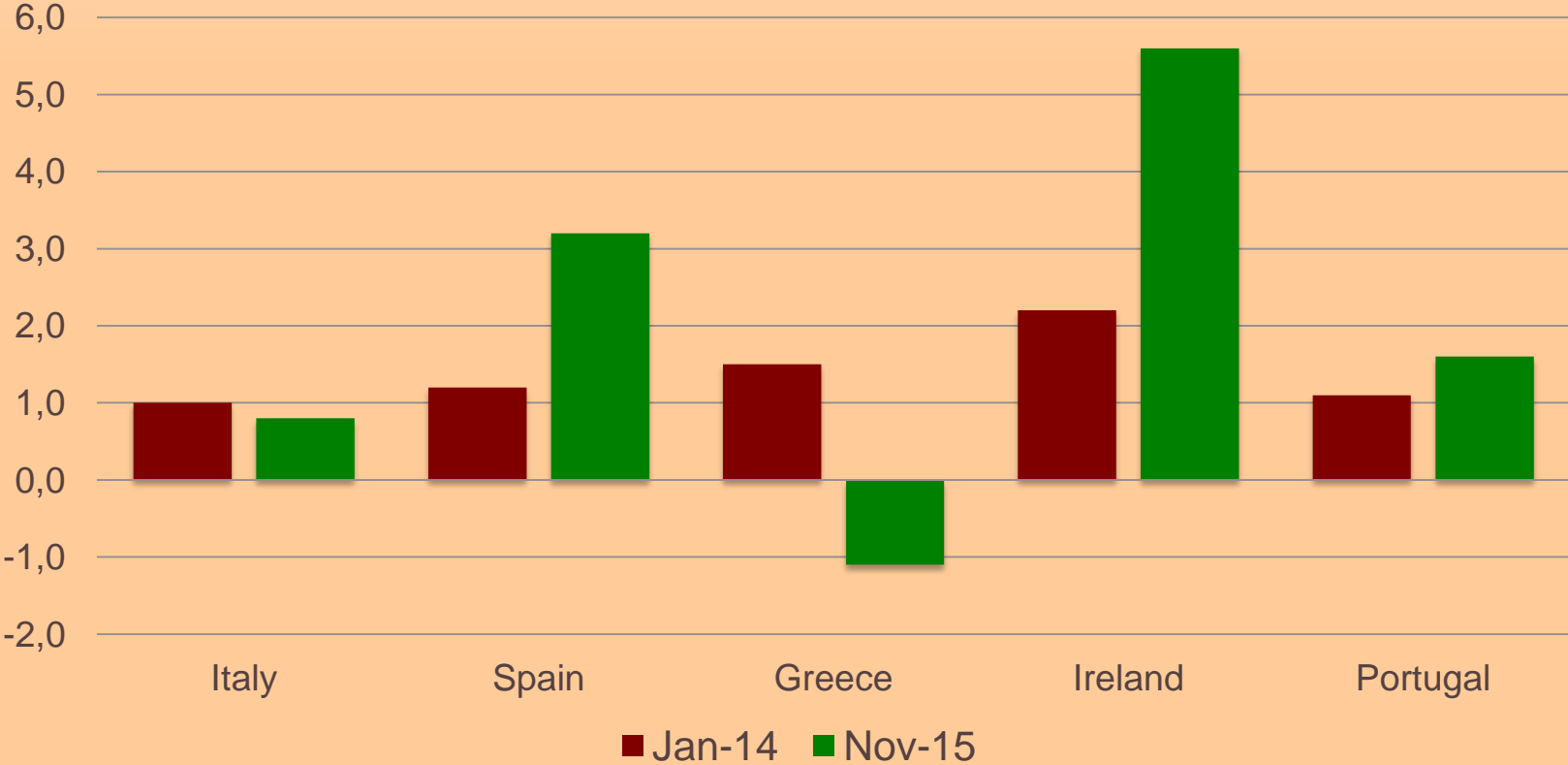
GROSS PUBLIC DEBT (over GDP) (Source: IMF)



3. Crisis-hit countries

GREECE IS NOW ISOLATED

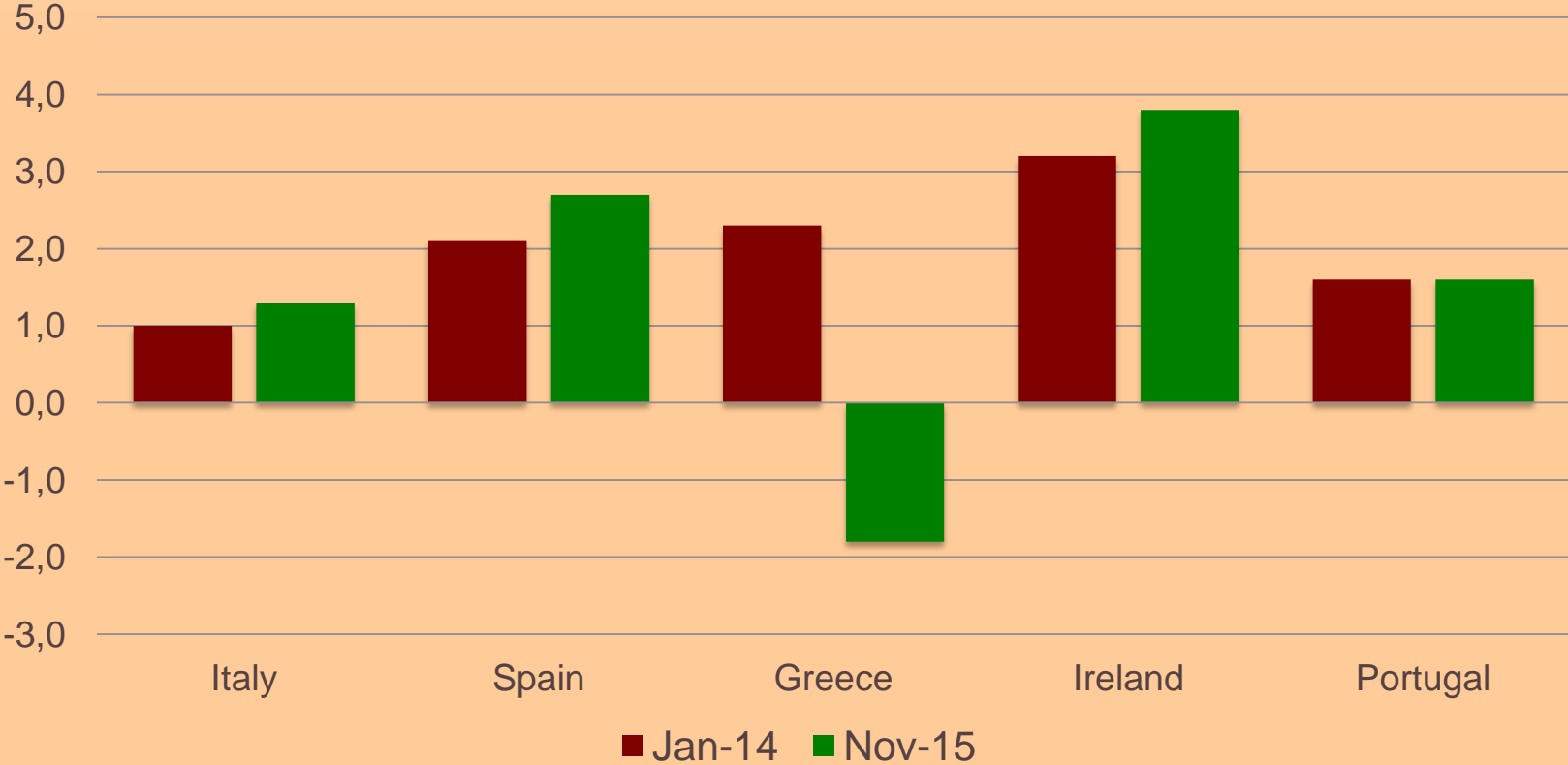
CONSENSUS FORECASTS FOR 2015



3. Crisis-hit countries

GREECE IS NOW ISOLATED

CONSENSUS FORECASTS FOR 2016



4. Challenges of a bad marriage

- The eurozone has dealt with its crisis far too slowly
- But it has made progress:
 - The ECB is almost a normal central bank, except that it cannot act as a normal lender of last resort
 - The European Stability Mechanism is an important back-stop, but it is too small and too hedged with restrictions
 - Some useful (and less useful) rules have been introduced
- Nevertheless, it is not a true “adjustment union”
- It is a “discipline union” that is externalising its failings
- It might well be swept away in the next crisis

4. Challenges of a bad marriage

- The eurozone will not become a true federal union
- Solidarity has been greatly weakened by the crisis
- The eurozone will remain a gold standard mechanism, but with an active central bank
- Challenges for the eurozone if it is to become a “better marriage”:
 - A minimum fiscal union, to back the banking union
 - Greater use of fiscal policy at eurozone and national levels
 - Greater reliance on risk-sharing finance
 - Faster and deeper resolution of bad debt

4. Challenges of a bad marriage

- The challenge for Greece:
 - This is a challenge of development, not just of macroeconomic adjustment
 - The starting point must be a deep and permanent write-down of the present value of Greek debt
 - But, if Greece wishes to stay inside the eurozone, it must become a normal European country, in terms of policies and institutions
 - This will take decades, not years
 - If Greece cannot live with this, it should consider leaving
 - But it has little reason to expect better performance in the long run if it does