How to make the euro a lasting success?

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The Context:
Factors supporting and hindering Europe's growth
Global growth and geopolitical risk

• Global growth rates rising again
  - Only 3.0% in 2016, lowest global growth since 2009
  - Rebound expected, 3.4% in 2017
  - USA bounces back after weak first half of 2016
  - Brazil and Russia returning to growth
  - Slowdown and restructuring of Chinese economy
  - 2016 trade growth slowest since financial crisis

• Tense (geo)political climate
  - Instability in the Middle East and North Africa;
  - Russia – Ukraine conflict
  - Refugee crisis
  - Rising populism and risk of protectionism
Oil prices: low, but set to rise

- World Bank foresees oil prices rising by 25% this year

Source: European Commission Autumn Forecast 2016, ICE
ECB's expansionary monetary policy

Source: ECB
More than before, growth will have to come from *domestic demand*
Today's challenges:
A moderate and uneven recovery
Growth is better (but needs to be sustained)

GDP annual growth rate

Source: Eurostat, European Commission Winter Forecast 2017
Deficits are down (but balanced stabilisation and consolidation needed)

Source: Eurostat, European Commission Winter Forecast 2017
Unemployment decreasing (but still high)

% active population

Total unemployment

Source: Eurostat, DG ECFIN
EU employment rates are up (but uneven)

Source: European Commission
We are on the right track, but we still have a long way to go
Convergence and fragmentation: We are one, but we're not the same
Spreads as indicator of (mis)trust

10-year government bond yield spreads vis-a-vis German bonds

Source: DG FISMA
Financial (re)integration of the euro area

Price-based and quantity-based Financial Integration Composites (FINTECs)

Source: ECB
Hard-hit countries gaining ground

Source: Eurostat, European Commission Winter Forecast 2017

Surplus countries: BE, DE, LU, NL, AT, FI
Deficit countries: other EA MS
Private debt deleveraging, but slow and uneven

Consolidated household debt

Consolidated debt of NFCs

Source: Eurostat, European Commission calculations
Income inequality is diverging

- Gini coefficient for **EU28 has been stable** for the past 10 years

*Source: Eurostat*
Nothing can replace *reform and responsibility*

Economic and Monetary Union works if and only if we *make it work*...
But if we don't...

"Monetary Union without a sufficient degree of convergence of economic policies is unlikely to be durable and could be damaging to the Community"

Jacques Delors
President of European Commission
1985-1995
The tools we have:
Improved economic governance since the crisis
European Semester

• Economic crisis highlighted need for closer economic and fiscal policy coordination between Member States

• Economic policy priorities supporting economic growth and job creation:
  - Boosting investment
  - Structural reforms to strengthen competitiveness
  - Fiscal responsibility
European Semester cycle

1st phase (November – January): EU
- Annual Growth Survey
- Macroeconomic Imbalances Procedure
- Commission opinion on draft budgetary plans (presented in October)
- Euro area recommendations

2nd phase (February – April): Member States
- Country Reports
- Stability/Convergence Programmes
- National Reform Programmes

3rd phase (May – July): EU
- Country Specific Recommendations

February 22 – Commission’s economic analysis of EU Member States due ("country reports")
Investment (I)

• **Investment Plan for Europe**
  - European Fund for Strategic Investment (EFSI)
  - Mobilising €315 billion of public and private investment in 3 years
  - Supporting investment projects in real economy
  - Creating an investment-friendly environment

• **Better and more effective use of EU Structural and Cohesion Funds**
Investment (II)

- **EFSI extension** to €500 billion by 2020

- Commission also plans to:
  - **Improve geographical coverage** - stronger emphasis on local technical assistance in Member States
  - **Simplify combination of EFSI funding with other EU funding sources**, eg European Structural and Investment funds.
Structural reforms: EU level

- EU Internal Market
  - Goods and Services
  - Digital Single Market
  - Energy Union
  - Capital Markets Union

- Better regulation for jobs, growth and investment
Structural reforms: national level

• Robust labour market, creating jobs
• Upskilling and re-skilling working people of all ages
• Shift tax burden away from labour
• Adequate social security systems in flexible and ageing society
• Flexibility in goods and services markets
• Enhancing R&D, both quantity and quality
• Improving governance
Fiscal Responsibility

• **Maastricht Treaty** (1992): fiscal rules and procedures

• **Stability and Growth Pact** (1997): strengthening surveillance and coordination of national fiscal and economic policies

  • **Preventive Arm**
    - Medium-Term Budgetary Objectives
    - Stability and Convergence Programmes

  • **Corrective Arm**
    - Excessive Deficit Procedure

• **Sanctions**
Macroeconomic Imbalance Procedure (MIP)

- To identify imbalances early on and ensure necessary reform
- Alert Mechanism Report, In-depth review, Enhanced surveillance for countries with excessive imbalances

### MIP Indicators

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<th>External imbalances and competitiveness</th>
<th>Internal imbalances</th>
<th>Employment indicators</th>
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<tbody>
<tr>
<td>4. Export market share</td>
<td>9. General government gross debt</td>
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<td>5. Nominal unit labour cost</td>
<td>10. Unemployment rate</td>
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<td></td>
<td>11. Total financial sector liabilities</td>
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MIP: Position of Member States

**EURO AREA**
- Italy
- France
- Portugal
- Cyprus
- Slovenia
- Germany
- Ireland
- Netherlands
- Finland
- Spain
- Belgium
- Estonia
- Austria
- Latvia
- Slovakia
- Lithuania
- Luxenburg
- Malta
- Greece

**NON-EURO AREA**
- Croatia
- Bulgaria
- Sweden
- Romania
- United Kingdom
- Hungary
- Czech Republic
- Denmark
- Poland

**Excessive imbalances**
- Estonia
- Austria
- Latvia

**Imbalances**
- Lithuania
- Luxenburg
- Malta

**No imbalances**
- Slovakia
- Belgium
- Denmark
- Poland
Strengthening the Euro Area

- Tighter macroeconomic & fiscal supervision
  - 6-pack, 2-pack, Fiscal Compact
- European Stability Mechanism
- ECB monetary policy
  - Outright Monetary Transactions
  - "Whatever it takes!" (M. Draghi)
- Banking Union
  - Single Rulebook to reduce risks
  - Single Supervisory Mechanism
  - Single Resolution Mechanism (from 1 January 2016)
- Capital Markets Union
A lot has already been done to make the euro more resilient

Our governance structures and policies have been upgraded... but the work continues
Consolidating and completing the EMU: The tools we need
Five Presidents' Report on completing EMU

- **Towards Economic Union - Convergence, Prosperity and Social Cohesion**
  - Recommendation on National Competitiveness Boards
  - Revamped European Semester

- **Towards Financial Union - Integrated Finance for an Integrated Economy**
  - Legislative proposals on EDIS and Risk Reduction
  - Capital Markets Union Action Plan

- **Towards Fiscal Union - an Integrated Framework for Sound and Integrated Fiscal Policies**
  - European Fiscal Board

- **Improved Political Union - Democratic Accountability, Legitimacy and Institutional Strengthening**
  - Stronger engagement with European and national parliaments
The bigger political picture

• 60th anniversary of the Treaty of Rome
  ➢ Commission White Paper on the future of Europe, and reflections on deepening of the Economic and Monetary Union
The work continues, but further steps on EMU depend on the credibility of the current system and the political will to make it work.
Germany's performance
Economic growth in Germany

GDP growth

Source: Eurostat, European Commission Winter Forecast 2017
GDP per capita in PPS (EU28=100)

Source: Eurostat
Unemployment in Germany

Source: Eurostat, European Commission Winter Forecast 2017
Fiscal performance in Germany

- Budget of 2017 **fully compliant** with SGP requirements
- In the **preventive** arm of SGP

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<td><strong>Gross debt</strong> (% of GDP)</td>
<td>79.9</td>
<td>77.5</td>
<td>74.9</td>
<td>71.2</td>
<td>68.2</td>
<td>65.5</td>
<td>62.9</td>
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<tr>
<td><strong>Budget balance</strong> (% of GDP)</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.3</td>
<td>0.7</td>
<td>0.6</td>
<td>0.4</td>
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*Source: European Commission Winter Forecast 2017*
Investment in Germany

- Contributed €8bn to EFSI through KfW
- Strengthening of federal, states' and municipalities' investment: €8.5 billion annually for 2016-2018
- Assistance to states and municipalities for social spending and asylum expenses
- Reform of federal fiscal relations from 2020
Country Specific Recommendations

1. Achieve a sustained **upward trend in public investment**, especially in infrastructure, education, research and innovation, while respecting MTO.

2. Reduce **inefficiencies in tax system**; especially reviewing corporate taxation, local trade tax, modernise tax administration, review rules for venture capital. Step up **measures to boost competition in services sector**, in particular – business services and regulated professions.

3. Increase **incentives for later retirement** + reduce **disincentives to work for second earners**. Reduce high tax wedge for low wage earners and facilitate transition from mini-jobs to standard employment.
Thank you for your attention