Perspectives on Europe

Jean Pisani-Ferry(*)
Bruegel, EUI and Peterson Institute for International Economics

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(*) With research assistance by David Xu
Since 2018, Europe’s growth rate has slowed to about 1%

Real GDP, Percentage Change from One Year Ago

Source: Eurostat; Bureau of Economic Analysis; FRED
Anatomy of the recent European slowdown: Domestic demand has not replaced exports

Contributions to EU Real GDP Growth

Source: Haver Analytics; author's calculations.
Why? Global trade growth has stalled

Global Import Volume, 2015-2019 (2010=100)

Source: CPB (Netherland Institute for Economic Research)
Germany has been hit hard (and UK has suffered from Brexit-related hiccups)

Contributions to Real GDP Growth, By Country

Percentage Points

0 0.4 0.8 1.2 1.6

Consumer Spending  Gross Fixed Capital Formation  Government Spending  Net Exports

Spain  France  Italy  Germany  UK

Source: Haver Analytics; author's calculations.
High Brexit-related volatility in the UK

Figure 8: There have been large offsetting contributions to GDP growth from net trade and gross capital formation for the second consecutive quarter

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 2 (Apr to June) 2019

Source: ONS
Alternative Brexit arrangements

Theresa May’s Borders
(permanent backstop arrangement)

Boris Johnson’s Borders
(renewable 4-years arrangement)

Taxes
Money
Services
regulation
(light border)

Regulation
(food, goods)

Tariffs
Regulation
(food, goods)
Brexit: Potential consequences

Brexit Scenarios Update

*Partnership Scenarios*
- Wide range of possibilities (customs union, regulatory arrangements)
- No major disruption

- **Limited macroeconomic impact** ($\approx -2\% \text{ for UK, } -0.4\% \text{ for EU}$), much of which has already taken place

*No-deal Scenarios*
- Disruptions at the border, investment affected
- Sudden transition to trade on WTO terms
- Longer-term roadblocks to trade in goods and services with the EU

- **Significant macroeconomic impact** (BoE: - 6\% for UK, - 1.5\% for EU)
The outlook: Downside risks

Not a recession yet, but downside risks:
• Weak momentum
• Combination of supply and demand shocks
• Global trade policy uncertainty
• European uncertainty
What if the recession risks materialises?
Eurozone: almost no room for further monetary easing

QE and forward guidance have successfully taken the eurozone yield curve into negative territory

No significant room for further easing (short of helicopter money)
## Eurozone: Little fiscal space (within the rules)

<table>
<thead>
<tr>
<th>Country</th>
<th>« Minimum benchmark » Budget Balance</th>
<th>2019 Budget Balance</th>
<th>Fiscal Space Within the Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>-1.5</td>
<td>1.1</td>
<td>2.6</td>
</tr>
<tr>
<td>France</td>
<td>-1.4</td>
<td>-2.6</td>
<td>0</td>
</tr>
<tr>
<td>Spain</td>
<td>-0.8</td>
<td>-2.9</td>
<td>0</td>
</tr>
<tr>
<td>Italy</td>
<td>-1.4</td>
<td>-2.4</td>
<td>0</td>
</tr>
</tbody>
</table>

Longer term
Climate action: The new European frontier?

Greenhouse gas emissions for the EU-28: Historical, 1990-2017, Targets, 2030 (-50%) and 2050 (carbon neutrality)

Source: Eurostat and EU Commission documents
Macroeconomic consequences of climate action

**Macroeconomics**
- Additional investment: up to 2% of GDP per year (2021-2050)
  - R&D
  - Energy supply and infrastructure
  - Residential
  - Transportation
- Public finances
  - Justification for debt-financed investment (cf. Dutch plan)
- Potential growth

**Global consequences**
- Change in EU saving-investment balance
- Change in EU fiscal stance?
- Trade
  - Pricing of carbon
  - Adjustment at the border?
Spares
Real GDP, 1999-2019: US, UK and Eurozone

Source: Fred data
Real GDP, 1999-2019: Main Eurozone countries

Source: Fred data
Eurozone potential output growth (ECB estimates)

Estimates of potential growth

(percentage changes)

Source: European Commission, IMF, OECD and ECB staff calculations.
Notes: The dark blue area indicates the range of estimates by international institutions, and the light blue area indicates interval estimates based on the UCM-PF model presented in Box 1 (with an uncertainty band of plus/minus two standard deviations around the point estimate).

Source: Andersson et al., ECB Economic Bulletin 7/2018
November 2018 BoE Brexit scenarios

Modelled scenarios based on different assumptions about Brexit

Source: BoE, EU withdrawal scenarios and monetary and financial stability, A response to the House of Commons Treasury Committe, November 2018
Updated BoE Brexit scenarios

Real GDP, 2016Q2=100

Assumptions:
- Abrupt move to WTO terms
- EU and UK apply common external tariff bilaterally
- Disruptions at the border

Source: Letter by Gov. Carney to Treasury Select Committee, 4 September 2019
OECD Brexit impact assessment

A no-deal Brexit would have large costs

UK GDP
% difference from baseline

Euro area GDP
% difference from baseline

Note: The direct effects include a decline in UK export volumes, declines in EU countries’ exports with the impact on individual countries dependent on the extent of their direct trade with the UK, a depreciation of the sterling upon exit, a decline in labour-augmenting technical progress due to lower trade openness and a decline in inward migration. The uncertainty effect captures a rise in investment risk premia. No monetary and fiscal policy response is assumed beyond already announced measures, which are incorporated in the baseline.

Source: OECD calculations, using the NIGEM global macroeconomic model.

Source: Economic Outlook September 2019