

Euro Area Outlook

It is time to be range-bound optimistic again!

**PIIE Semi-Annual Global Economic Prospects Session
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OUR NEW CHIEF
ECONOMIST, WALLY,
WILL TELL US WHAT
TO EXPECT IN THE
COMING QUARTER.



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THE EXCHANGE RATE
ON DERIVATIVES WILL
TRIGGER A BUBBLE IN
MONETARY POLICY AND
DEFLATE THE YEN.



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I TOTALLY
UNDERSTAND
THAT AND
HAVE NO
QUESTIONS.

WOW!
HE'S
GOOD.



WALLY THE CHIEF
ECONOMIST

MY INTERVIEW
WITH YOU IS LIVE
ON THE WEBSITE.



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NOTHING YOU SAID
MADE SENSE, SO I
STRUNG TOGETHER A
BUNCH OF ECONOMIC
JARGON AND CALLED
IT YOUR FORECAST.



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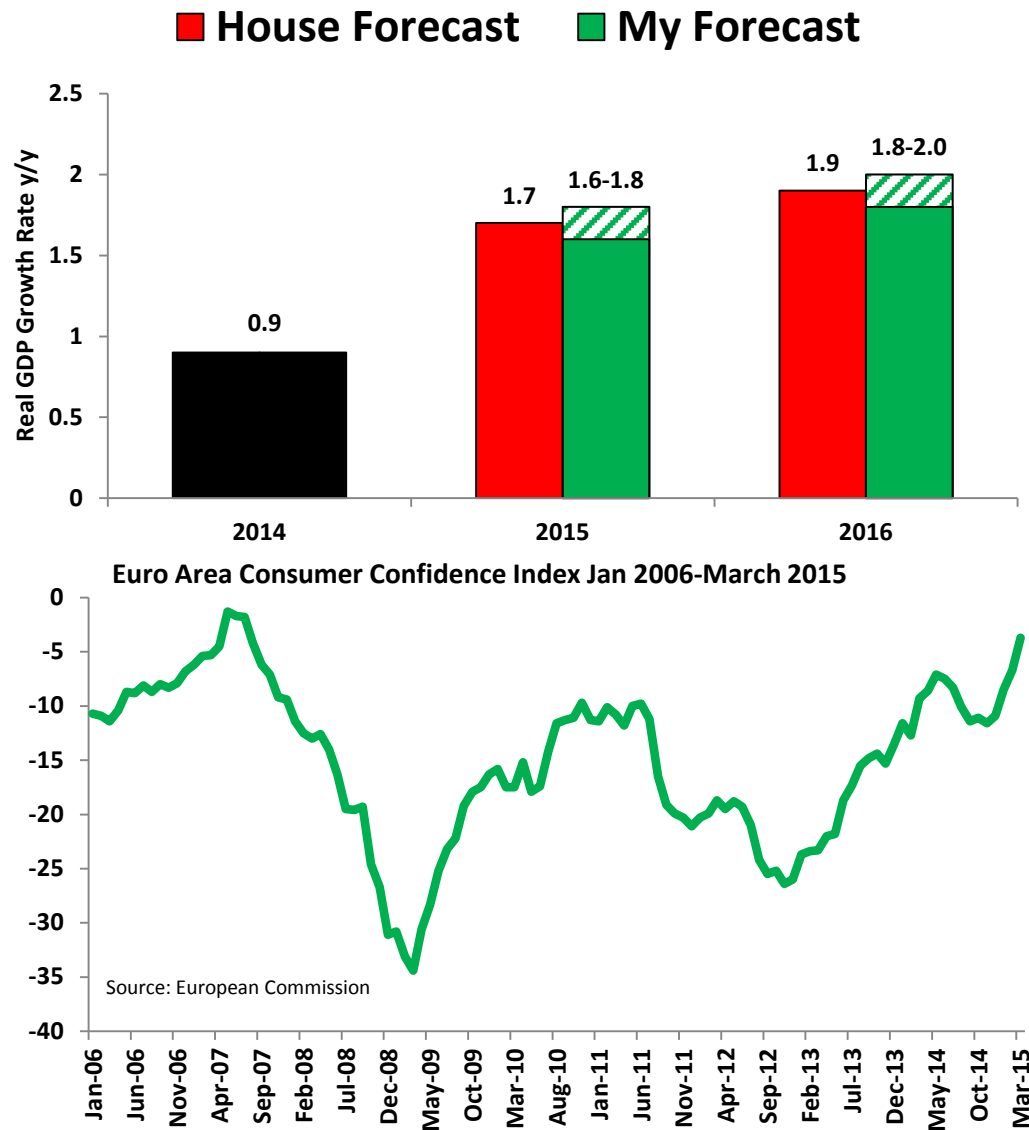
ONE MONTH LATER

ONLY ONE ECONOMIST
ACCURATELY PREDICTED
WHEN THIS BUBBLE
WOULD BURST.



Euro Area – Range Bound Optimism

- EA Forecast for 2015 is 1.6-1.8%, and 1.8-2.0 % in 2016
- EA likely to grow faster than potential (@ max. 1.5%) in the coming years
- A cyclical recovery ≠ structural recovery
- EA potential growth rate might well be lower than 1.5%
- Has the crisis been wasted (some reform progress vs. re-accumulating hysteresis)?

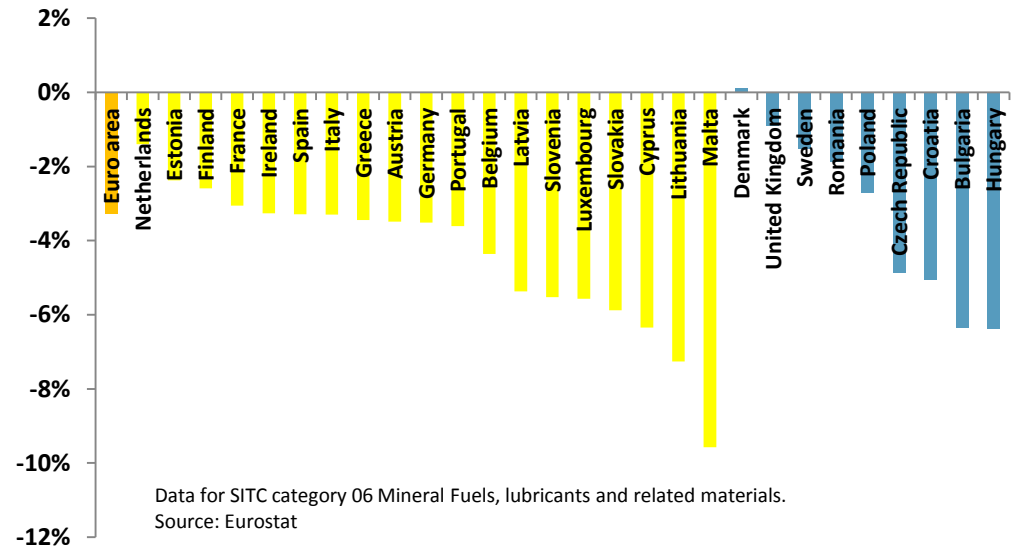


Euro Area – Range Bound Optimism

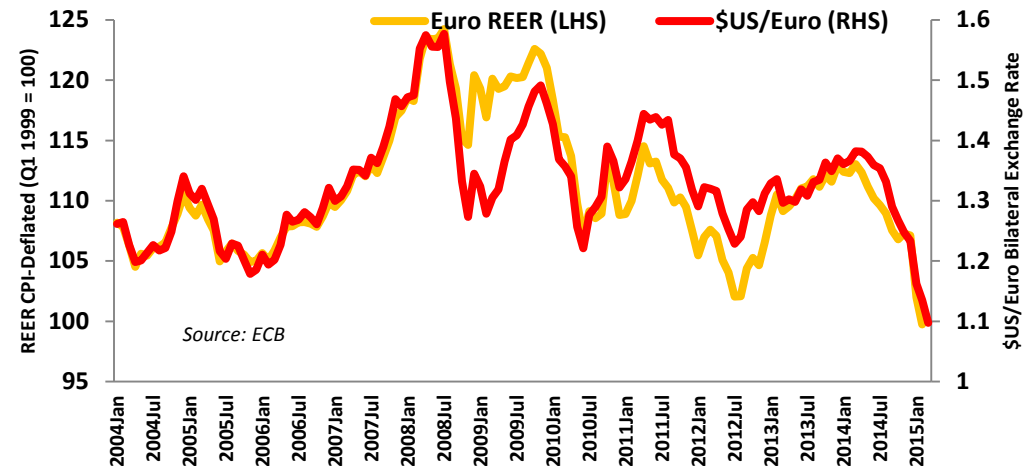
Cyclical growth outlook benefits from several supporting factors:

- Oil prices matter, when you have a 3+% of GDP trade deficit in oil alone
- Monetary policy looser than previously imagined possible (from a positive supply shock!)
- € exchange rate down ~15% on trade weighted basis in 12m
- Negative economic impact of Ukraine crisis abating
- “True core” and “reform periphery” both doing increasingly well for a more balanced expansion

EU Member State Trade Deficit in Oil, 2013 % of GDP



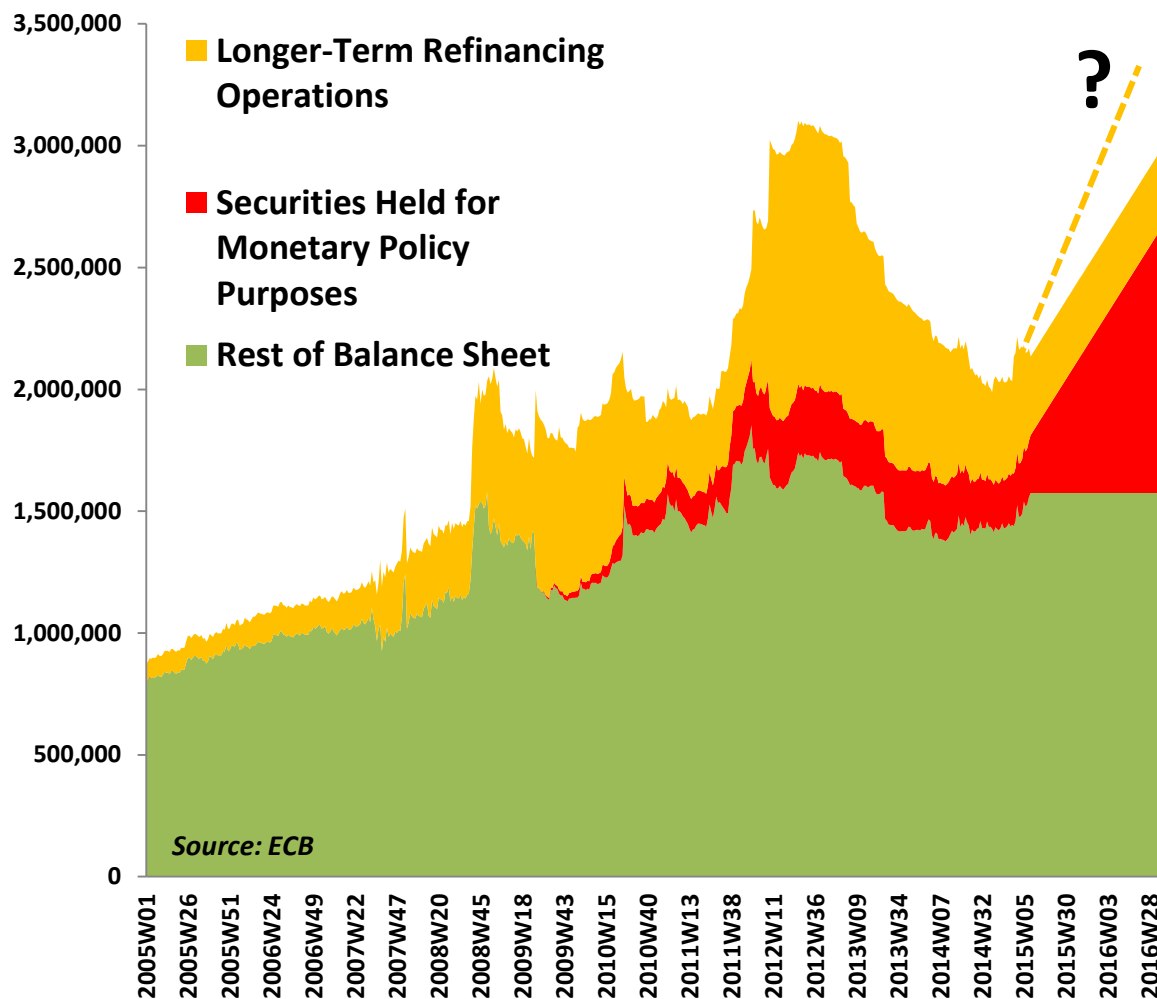
Euro REER and Bilateral \$US Exchange Rate 2004-present



ECB MonPol – timely(!) and BIG loosening

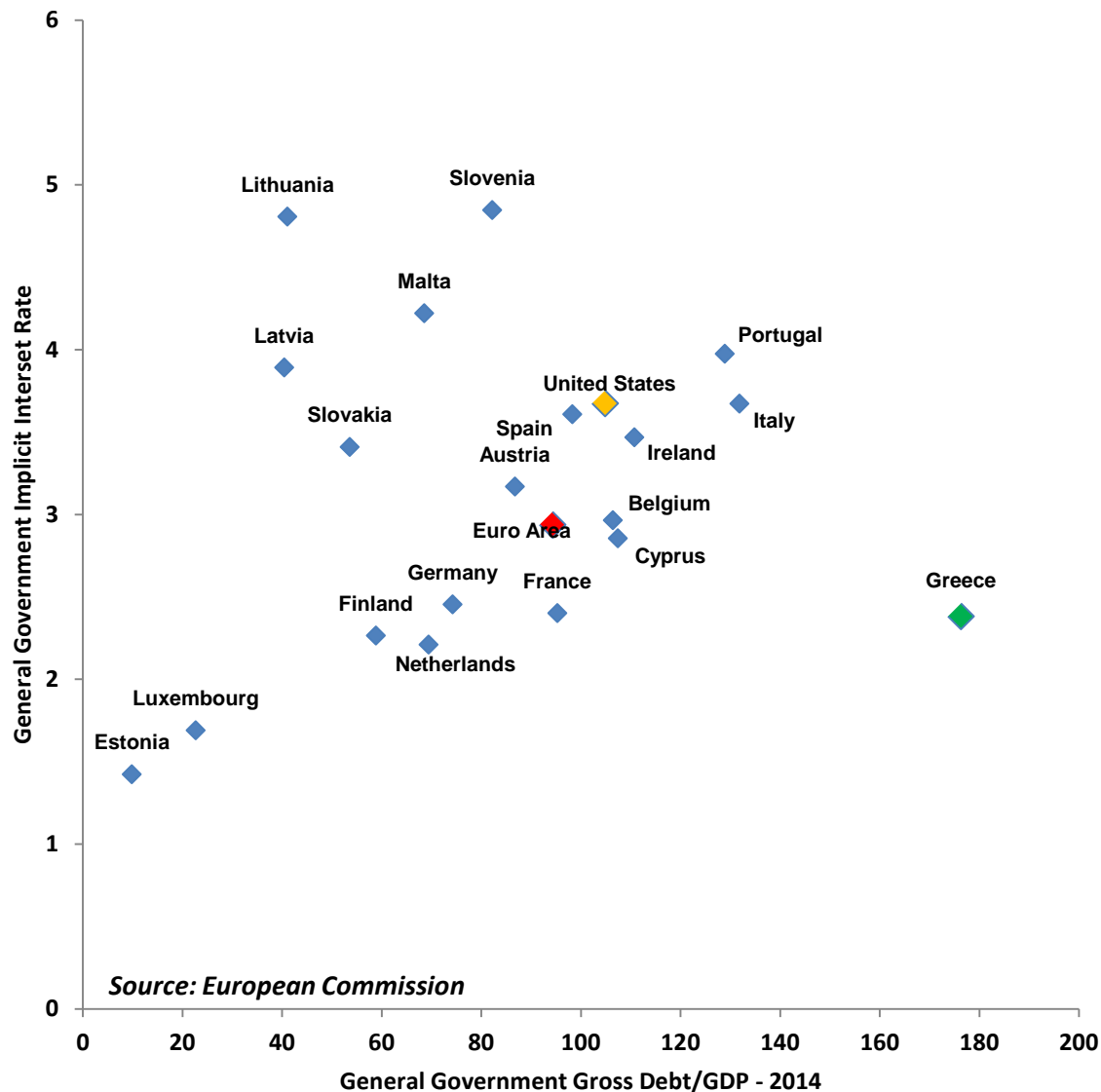
- Jan 22 EAPP is a BIG program
- TLTRO pick-up likely to grow at 5bp and recovery
- “Forward guidance” from TLTROs in place until Sep 2018
- ECB GC retains a hawkish blocking minority
- EAPP likely to continue until Sep 2016, despite cyclical recovery (unemp > 10%)
- Going beyond Sep 2016 will be hard and seems likely “exit will mirror SMP”

Eurosystem Balance Sheet 2005-Present



Greece – A problem mostly for the Greeks

- No contagion from Greece
.....and no Grexit!
- Liquidity and fiscal support will
be drip-fed to Athens
- Damaging to Greek economy
- Syriza has no leverage or other
sources of adequate financial
aid (e.g. ~~Russia~~)
- No public majority for Grexit in
Greece and no EA willingness to
push for it
- Syriza will have very limited
political appeal elsewhere
- BU constrains sovereign's
actions vs. "domestic banks"



Risks And Reasons for Range-Bound

Downside risks to outlook are limited and mostly external

- Oil price rise
- Renewed Russian aggression or economic implosion
- Geopolitics/global growth slowdown and limited policy space with ECB/governments
- Grexit.... Tail-risk at >2%

Growth Will Remain Range-Bound

- Unemployment still high
- Deleveraging still to come
- Structural reform prospects unclear (e.g. political complacency)

Total Consolidated Liabilities, % of GDP

