

The euro zone quartered

By [Céline Antonin](#), [Christophe Blot](#), Sabine Le Bayon and Danielle Schweisguth

This text summarizes the [OFCE's 2013-2014 forecast for the euro zone economy](#).

After six quarters of decline, GDP in the euro zone has started to grow again in the second quarter of 2013. This upturn in activity is a positive signal that is also being corroborated by business surveys. It shows that the euro zone is no longer sinking into the depths of depression. It would nevertheless be premature to conclude that a recovery is underway, as the level of quarterly growth (0.3%) is insufficient to cause any significant reduction in unemployment. In October 2013, the unemployment rate stabilized at 12% of the workforce, a record high. Above all, the crisis is leaving scars and creating new imbalances (unemployment, job insecurity and wage deflation) that will act as obstacles to future growth, especially in certain euro zone countries.

Several factors point towards a pick-up in economic activity that can be expected to continue over the coming quarters. Long-term sovereign interest rates have fallen, particularly in Spain and Italy. This reflects that the threat of a breakup of the euro zone is fading, which is due in part to the conditional support announced by the ECB a little over a year ago (see [Friends of acronyms: here comes the OMT](#)). Above all, there should be an easing of fiscal austerity, given that the European Commission has granted additional time to several countries, including France, Spain and the Netherlands, to deal with their budget deficits (see [here](#) for a summary of the recommendations made by the European Commission). Driven by the same mechanisms that we have already described in our previous forecasts, a little higher growth should follow this

easing of austerity (-0.4 GDP point of fiscal effort in 2013, down from -0.9 point in 2013 and -1.8 in 2012). After two years of recession in 2012 and 2013, growth is expected to come to 1.1% in 2014.

Nevertheless, this growth will not be sufficient to erase the traces left by the widespread austerity measures implemented since 2011, which pushed the euro zone into a new recession. In particular, employment prospects are improving only very slowly because growth is too weak. Since 2008, the euro zone has destroyed 5.5 million jobs, and we do not expect a strong recovery in net job creation. Unemployment could fall in some countries, but this would be due mainly to discouraged jobseekers withdrawing from the workforce. At the same time, less austerity does not mean that there will be no austerity. With the exception of Germany, fiscal consolidation efforts will continue in all the euro zone countries. And whether this is achieved through a reduction in public spending or an increase in the tax burden, households will bear the brunt of the adjustment. At the same time, the persistence of mass unemployment will continue to fuel the deflationary pressures already at work in Spain and Greece. The improved competitiveness that results in these countries will boost exports, but at the expense of increasingly undermining domestic demand. The impoverishment of the countries of southern Europe is going to be aggravated. Growth in these countries in 2014 will again be lower than in Germany, Austria, Finland and France (Table).

As a consequence, the euro zone will be marked by increasing heterogeneity, which could wind up solidifying public opinion in different countries against the European project and making the governance of the monetary union more difficult as national interests diverge.

Table. Growth in the euro zone

In %

| | 2013 | | | | 2014 | | | | 2012 | 2013 | 2014 |
|-----|------|------|-----|------|------|-----|-----|-----|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | | | |
| DEU | 0,0 | 0,7 | 0,2 | 0,3 | 0,3 | 0,4 | 0,4 | 0,4 | 0,9 | 0,9 | 1,5 |
| FRA | -0,2 | 0,5 | 0,0 | 0,2 | 0,3 | 0,4 | 0,4 | 0,4 | 0,0 | 0,1 | 1,3 |
| ITA | -0,6 | -0,3 | 0,0 | 0,1 | 0,1 | 0,2 | 0,2 | 0,2 | -2,4 | -1,8 | 0,4 |
| ESP | -0,4 | -0,1 | 0,0 | 0,0 | 0,2 | 0,3 | 0,3 | 0,3 | -1,6 | -1,4 | 0,7 |
| NLD | -0,4 | -0,2 | 0,3 | 0,3 | 0,3 | 0,3 | 0,4 | 0,4 | -1,3 | -1,1 | 1,1 |
| BEL | 0,0 | 0,2 | 0,2 | 0,4 | 0,4 | 0,4 | 0,6 | 0,6 | 0,3 | 0,1 | 1,6 |
| IRL | -0,6 | 0,4 | 0,2 | 0,3 | 0,4 | 0,4 | 0,4 | 0,4 | 0,1 | -0,5 | 1,4 |
| PRT | -0,4 | 1,1 | 0,0 | 0,2 | 0,2 | 0,3 | 0,3 | 0,3 | -3,2 | -1,7 | 1,0 |
| GRC | 1,1 | 9,6 | 0,5 | -1,1 | -3,9 | 1,2 | 1,3 | 1,5 | -6,4 | -4,1 | -0,4 |
| AUT | 0,1 | 0,1 | 0,3 | 0,3 | 0,4 | 0,4 | 0,4 | 0,4 | 0,6 | 0,4 | 1,3 |
| FIN | -0,2 | 0,2 | 0,3 | 0,4 | 0,4 | 0,5 | 0,5 | 0,5 | -0,8 | -0,9 | 1,7 |
| EUZ | -0,2 | 0,3 | 0,1 | 0,2 | 0,3 | 0,4 | 0,4 | 0,4 | -0,6 | -0,3 | 1,1 |

Sources : Eurostat, OFCE calculations and forecasts, October 2013.

The crisis on a plateau

By [Xavier Timbeau](#)

This text summarizes the [OFCE's 2013-2014 forecast for the world economy](#).

Six years after the onset of the financial and economic crisis, the acceleration in global growth expected in 2014 (Table 1) could have given hope for an end to the slump. While the sovereign debt crisis in the euro zone is of course over, and represents an important step, nevertheless aside from a few positive figures there is no indication that the crisis is at an end. Economic activity in the euro zone has reached a plateau, and the mechanisms underlying the sovereign debt crisis in the zone – in particular fear of default on public and private debt – could see the economies of the United States, Europe, the United Kingdom, and Japan plunge again at any time.

Table 1. Outlook for global growth

Annual growth rates, %

| | Share ¹ of the total | Real GDP | | |
|---------------------|------------------------------------|----------|------|------|
| | | 2012 | 2013 | 2014 |
| EZ | 15,5 | -0,5 | -0,4 | 0,9 |
| GBR | 3,2 | 0,1 | 1,3 | 1,7 |
| USA | 20,8 | 2,8 | 1,5 | 2,4 |
| JPN | 6,3 | 2,0 | 2,0 | 1,0 |
| Developed countries | 53,5 | 1,3 | 0,9 | 1,7 |
| World | 100 | 2,8 | 2,5 | 3,1 |

1. Weighting based on 2008 GDPs and PPPs, estimated by the IMF.

Sources : IMF, OECD, national sources, OFCE calculations and forecasts, October 2013.

The crisis is global and has features that have been rarely if ever seen in the past. Sovereign interest rates are, for instance, exceptionally low, except in countries where the financial markets are skeptical, but which account for little in the overall mass of public debt. This indicates a situation of a liquidity trap in which conventional monetary policy has reached its limits and where the ability of the monetary institutions to articulate a self-fulfilling future is crucial. However, as in the 1929 crisis, debate is raging about this capacity, raising numerous questions about an exit to the crisis. Monetary policy is at the heart of this uncertainty: are the extraordinary measures being taken stopping the economies from going over the brink? Would it be a good idea to lift these measures? Or is this really just an improvised makeshift with inflationary consequences that will be the source of the next crisis?

Economic activity, as measured by the GDP of the euro zone as a whole, is no longer contracting. Despite this, existing idle capacity is not being re-mobilized. Yet as long as the economies continue to be marked by idle capacity, the impact of the crisis will continue to be felt throughout the society. Wherever you look – GDP per capita, output gaps or unemployment – the indicators describe a plateau that is well below the level of 2007. The persistence of unemployment that is markedly above its equilibrium level is, for instance, swelling the ranks of the long-term unemployed, many without

benefits. The high level of unemployment is undermining social cohesion and threatening societies built on integration through work. The unemployed are thrown onto family or social security benefits, which are themselves subject to fiscal cutbacks. Young people entering the labor market are facing delays in gaining access to employment and will long bear the scars of that initial period of joblessness in their wages and their careers.

But the impact of unemployment extends even further. The fear of losing one's job or seeing one's company close down or be relocated spreads to people with jobs whose salaries wind up being affected or who are forced to accept worse working conditions. Southern Europe for instance is engaged in wage deflation, and through the dynamics of competition, is drawing in its neighbors.

The absence of a recovery is hardly surprising. A widespread massive programme of fiscal consolidation has been conducted in the developed countries. The total fiscal impulses from 2008 to 2013 can be used to make an assessment of the stimulation of the economies during the recession of 2008/09 and then of the fiscal consolidation that followed (Table 2).

Table 2. Fiscal Impulses 2008-2014

In GDP points

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2008-14 |
|---------|------|------|------|------|------|------|------|---------|
| DEU | 0,1 | 0,6 | 1,3 | -1,1 | -1,2 | 0,2 | 0,1 | 0 |
| AUT | -0,2 | 0,3 | 0,5 | -1,4 | -0,3 | -0,9 | -0,4 | -2,4 |
| BEL | 0,6 | 1,9 | -0,1 | 0,1 | -0,6 | -1,0 | -0,5 | 0,4 |
| ESP | 2,4 | 2,0 | -1,4 | -1,3 | -3,4 | -1,6 | -1,0 | -4,3 |
| FIN | -0,8 | 0,4 | 1,3 | -0,7 | -0,3 | -1,4 | -0,3 | -1,8 |
| FRA | -0,1 | 2,7 | -0,5 | -1,8 | -1,2 | -1,4 | -0,7 | -3,0 |
| GRC | 3,0 | 3,2 | -7,6 | -5,5 | -3,9 | -3,3 | -1,7 | -15,8 |
| IRL | 4,9 | 2,2 | -4,2 | -1,5 | -2,0 | -1,7 | -1,7 | -4,0 |
| ITA | -0,5 | 0,9 | -0,7 | -0,4 | -3,0 | -1,5 | -0,6 | -5,8 |
| NLD | -0,4 | 4,0 | -1,1 | -0,5 | -1,4 | -1,5 | -1,0 | -1,9 |
| PRT | -0,1 | 5,0 | -0,3 | -3,7 | -3,9 | -1,5 | -1,5 | -6,0 |
| EA (11) | 0,3 | 1,7 | -0,3 | -1,2 | -1,8 | -0,9 | -0,4 | -2,6 |
| USA | 3,0 | 3,8 | -0,8 | -1,3 | -1,4 | -1,5 | -0,7 | 1,1 |
| GBR | 0,6 | 2,8 | -2,7 | -3,2 | -0,5 | -1,0 | -1,0 | -5,0 |
| JPN | -0,9 | 4,8 | 0,5 | 0,5 | 0,5 | 1,9 | -1,3 | 6,0 |

Sources : National accounts, OFCE calculations and forecasts, October 2013.

The debate on the fiscal multipliers, using empirical analysis based on structural modeling or the systematic review of historical events, validates the causality that runs from fiscal impulses to output gaps. A large part of the output gap in 2013 is due to fiscal consolidation. There is no permanent impact of the crisis on activity, but there is the consequence of unprecedented fiscal austerity.

The developed countries have undertaken this consolidation effort under pressure from the financial markets, backed by the European authorities. The fear of facing difficulty in financing the public debt (a significant proportion of which is renewed every year and which in the developed countries has a maturity of approximately 10 years) or of even losing access to finance altogether was reflected in higher sovereign yields and did not leave the States many alternatives. To regain credit, an ability to reduce the deficit had to be demonstrated, regardless of the price. The resulting consolidation was taken only as a preventive measure. The examples of Greece, but also Portugal, Spain and Italy,

illustrate the risk of not having the public accounts in order. For some, including the economists of the European Commission, it was the massive consolidation undertaken by the Member States that made it possible to end the euro zone crisis. But there is an alternative explanation, one with heavy implications for the desirability of fiscal consolidation: the role played by the European Central Bank and the implicit commitments to solidarity on the part of the euro zone countries were more compelling than economic policies that prolonged and deepened the recession.

The reduction of public and private debt in the economies is the key to exiting the crisis. This demands a clear and reasonable strategy that combines restoring economic activity and cutting unemployment, while maintaining low sovereign interest rates and conducting fiscal consolidation at a moderate pace. This strategy requires mastery of timing, consistency in the policy adopted, and coordination between the States and between economic agents within the States. In the euro zone, this relies on a credible commitment by the Member states to fiscal consolidation in the medium term and a commitment by the European Central Bank to keep spreads at a minimum. Fiscal discipline by the markets does not work – it has to be opposed by a political commitment to economic stability.

France: less austerity, more growth

By [Eric Heyer](#)

This text summarizes the [OFCE's 2013-2014 forecast for the](#)

French economy.

In 2013, the French economy should experience annual average growth of 0.2%, which means that by the end of the year its level of production should return to the level of six years earlier, at the end of 2007. This mediocre performance is very far from the trajectory that an economy recovering from a crisis should be on.

The French economy did however have great potential for recovery: average spontaneous growth of about 2.6% per annum over the period 2010-2013 was possible and would have allowed France to make up the output gap accumulated in 2008-2009. But this “recovery” has been hampered mainly by the introduction of budget savings plans in France and across Europe. For the single year 2013, this fiscal strategy will cut economic activity in France by 2.4 GDP points.

The understanding that the fiscal multipliers were high came late, and occurred only after the austerity plans had already had a negative impact on growth. At the end of May 2013, this awareness pushed the European authorities to give additional time to six EU countries, including France, to correct their excessive deficits. The easing of the Commission's requirements provided a breath of fresh air that enabled the government to relax the austerity measures set for 2014. According to the budget presented in autumn 2013, the domestic impact of the austerity measures will be reduced by 0.5 GDP points between 2013 and 2014; since our partners are also relaxing their policies, a boost to external demand is also anticipated. Overall, the easing of austerity will mean the addition of almost one point of growth in 2014 compared to 2013, despite the still high fiscal multipliers.

In these conditions, growth should come to 1.3% in 2014 on an annual average. By running at a rate still below its potential, the forecast growth will add to the output gap accumulated since 2008 and will continue to hurt the labour

market. The unemployment rate in metropolitan France will rise slightly, reaching 10.9% by end 2014.

As a result of the easing of austerity, the public deficit will be higher than what was initially planned. It is expected to come to 3.5% of GDP in 2014, after reaching 4.1% in 2013, with gross government debt near 95% of GDP next year.

Is the euro area out of recession?

By [Philippe Weil](#)

At its meeting on October 9th, the [Euro Area Business Cycle Dating Committee](#) of the [Centre for Economic Policy Research](#) (CEPR) in London drew on the OFCE for this thorny issue (for the composition of this committee, which I chair, see [here](#)). The Committee's mission is to establish a chronology of recessions and expansions in the euro area, similar to what the National Bureau of Economic Research has done for the United States, [dating back to 1854](#).

This chronology is valuable in two ways.

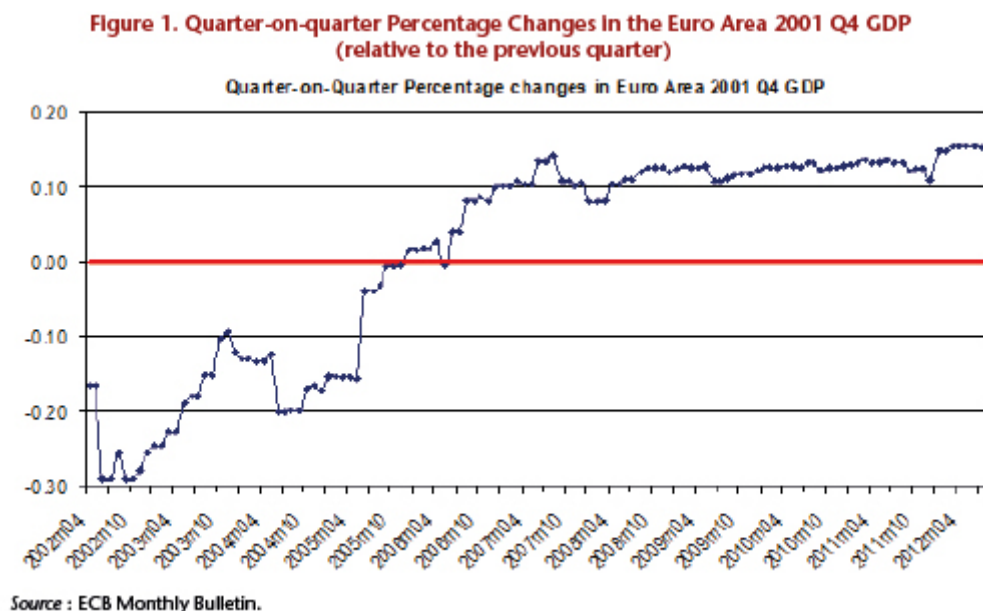
The first is that it allows economists to examine the characteristics of Europe's economic development. Do recessions tend to be short or long-lasting? Frequent or rare? Deep or mild? Is the euro area evolving in concert with the US economy? Is the slowdown in economic activity caused by the financial crisis unusual (more persistent than usual, sharper)? Without a clear definition of the timing of the ups

and downs in Europe's economic activity and without a sketch of cyclical fluctuations, we cannot provide answers to these relatively basic questions.

The second advantage of this chronology is that establishing it requires an examination of all aspects of economic activity: GDP, of course, but also consumption, investment and especially employment (number of employed persons, number of hours worked). According to the CEPR's dating exercise, an expansion is a period in which every aspect of economic activity is growing significantly. It is not necessarily an episode of at least two consecutive quarters of GDP growth (much less one quarter!). For example, the CEPR Dating Committee has determined that the countries composing the future euro area were in recession during [the period from the 3rd quarter of 1980 to the 3rd quarter of 1982](#), whereas real GDP had risen for several quarters during this time and it was higher at the end of the recession than at the beginning! The culprits were investment and employment, which fell sharply during this period.

To add to the complexity of the dating effort, the harsh reality of the world of economic statistics should not be forgotten: the statistics reach us late and are subsequently revised, sometimes significantly, over time. Unlike meteorologists who know the temperature at the top of the Eiffel Tower in real time, economists have no idea, for example, of the level of GDP for the current month or quarter. The first estimates are released only several months later (e.g. the first flash estimate of euro area GDP for the third quarter of 2013 will be published by Eurostat only on 14 November 2013), and it might turn out that growth rates that seem positive based on preliminary estimates wind up after subsequent revisions to be negative – or vice versa. By examining all the determinants of economic activity (including employment), and not just GDP, the Committee is guarding against (so far successfully) the imperfections in this data

so as to avoid, for instance, declaring the existence of a recession which turns out to be a statistical mirage that disappears after further review of the data. Thus, the Committee did not report [in September 2003](#) the existence of a recession between 2001 and 2003 even though the data showed a decrease in GDP during that time (but never, it is true, for two consecutive quarters). It concluded that there had been a prolonged pause during a period of expansion. This was a good move, as subsequent revisions of GDP cancelled these quarters of declining economic activity (see Figure 1). Its diagnosis was thus well advised.



So let's get back to the euro area in the state we see it in October 2013. The area hit a [peak in economic activity in the 3rd quarter of 2011](#) and, since going into recession at that time, it experienced quarterly growth that was slightly positive in the second quarter of 2013. The first estimate for the third quarter of 2013 will not be known, as mentioned earlier, until 14 November. There are, it is true, several corresponding indexes indicating that the cycle is in an upwards phase and that the macroeconomic outlook for 2014 is more favourable. But [on 9 October](#) the Dating Committee noted, nevertheless, that it would be premature at that time to conclude that the euro area was out of recession. Indeed, neither the length nor the strength of the putative recovery in economic activity was sufficient to conclude that the recession was already over. This judgment was not based on the absence at that point of two consecutive quarters of GDP growth because this is not the criterion that

(mechanically) guides the Committee's thinking. Nor does it reflect any pessimism about the economic outlook for 2014, because the Committee is not in the business of making predictions. The Committee's assessment is based simply on a review of all the data available at the time it meets. The Committee has not excluded that the euro area is simply going through a pause in the recession it entered a year ago.

Figure 2. CEPR-based Recession Indicator for Euro Area Business Cycles

