

# Europe and the Global Financial Crisis

~ Impact, Strategy for the Recovery, and the EU's Role in the G-20~

*ANU Centre for European Studies*

**Peter Bekx**  
European Commission  
Director International Economic and Financial Affairs, DG ECFIN

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## Outline

- Part I: The impact of the Financial Crisis on the European financial markets
- Part II: The current economic situation in the EU
- Part III: Challenges facing the EU
- Part VI: Outlook and policy responses

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Part I: Financial Crisis

## The Financial Crisis: causes

Current account balance for key countries

Source: European Commission

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Part I: Financial Crisis

## The financial crisis hitting world markets

Stock market indices

Oil prices

Source: European Commission

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Part I: Financial Crisis

## Increasing spread of sovereign bond yields since mid-2008

10-year sovereign bond yields

Source: European Commission

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Part I: Financial Markets

## Recently, loan growth has been increasing slightly

- Especially growth of loans to households
- Loan growth to the private sector is still negative, but is expected to become positive soon
- Lending to non-financial corporations increased in February 2010 for the first time in more than one year

Source: European Commission

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In order to tackle the crisis, the EU implemented unprecedented policy stimulus

- Fiscal stimulus overall 5 to 6% of GDP over 2009 and 2010, of which 3% coordinated through the European Economic Recovery Plan
- Monetary stimulus
- Measures to stabilize the financial system: resources potentially committed worth 30% of GDP

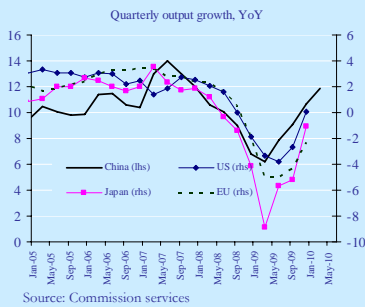


### Reforms in the financial sector : regulation and supervision

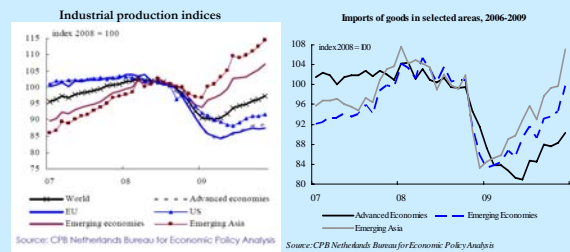
- Global strengthening of regulation and supervision
- EU has taken the lead on implementation:
  - Macroprudential supervision: European Risk Board
  - EU coordination of microfinancial supervision
    - » European Banking Authority
    - » European Insurance and Occupational Pensions Authority
    - » European Securities and Market Authority
  - Extending scope of regulation
    - » Credit rating agencies
    - » Alternative investment funds (hedge funds)
    - » Over-the-counter derivatives
  - Improving incentives for sound risk management: retention requirement of 5% for securitisation



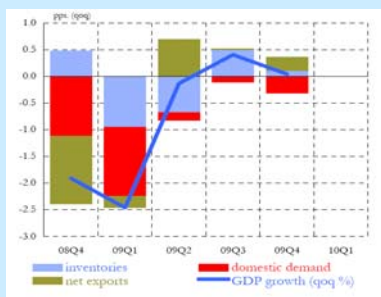
As a result, the current global economic situation has improved



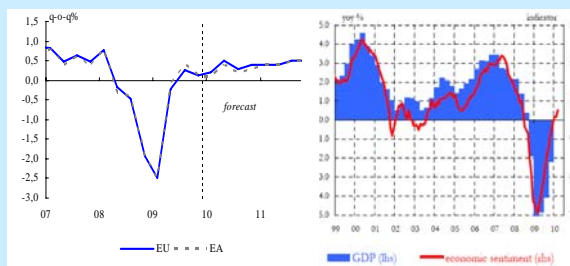
The different pace of recovery



- The weak performance of EU GDP growth was mainly due to the low domestic demand



### Current economic Situation in the EU



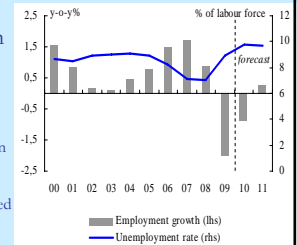
## Weak support from the labour market to domestic demand

- Increase of unemployment rate to 9.6% in the EU in February 2010 (and to 10% in the euro area)
- In 2009, employment decreased by 1.8% in the EU
- Increased internal flexibility coupled with nominal wage concessions have prevented more significant labour shedding so far
  - given the decline in output, this had led to significant increases in unit labour costs
- The unemployment rate is forecast to increase to close to 11% in the EU by 2010



## Impact on the Labour market

- Sharpest increase in unemployment rate have been registered in countries facing the largest downturns in economic activity:
  - Baltic countries, Ireland and Spain
- Most affected groups:
  - Temporary contract, self-employed
  - Low and medium-skilled
  - Craft workers
  - Service workers



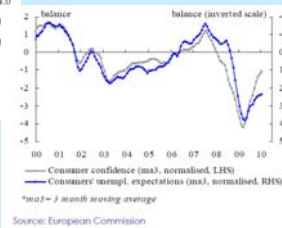
Source: European Commission



## Consumer confidence remains weak...



Source: European Commission

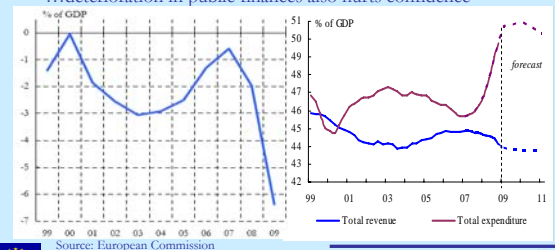


Source: European Commission



## Impact on budgetary positions

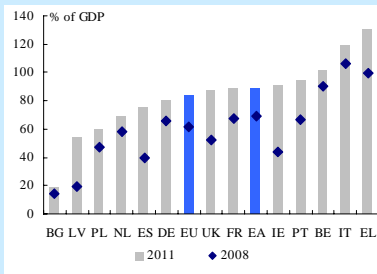
- General gov. deficit in the EU projected to rise from 2.3% to 6.8% of GDP in 2009 and 7.25% in 2010
- ...deterioration in public finances also hurts confidence



Source: European Commission



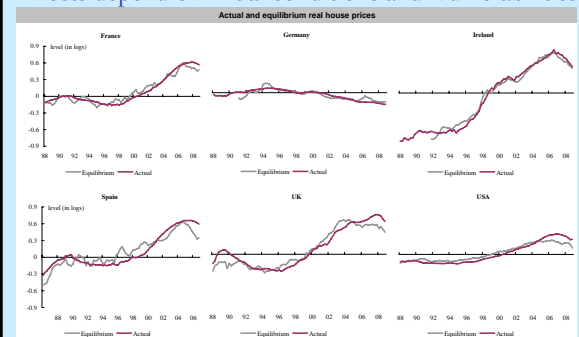
- In 2010, Debt-to-GDP ratio is expected to rise to 79.3% in 2010 and further increase to 83.7% in 2011



Source: European Commission



## Effects depend on initial conditions and vulnerabilities



Source: European Commission



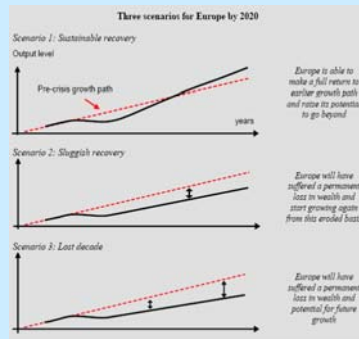
## Impact of financial crisis in the long-term

- Dramatic decline in potential output growth for some member states:
  - Baltic states: decline from 5-6% range to 1-2%
  - Hungary: decline from 3-4% to less than 1%
- The largest member states (Germany and Italy) would comparably be less affected
  - already low potential output growth of about 1% per annum



## Strategy for Recovery

- Need for a strategy to come out of the crisis stronger than before
- → Europe 2020
- → Strengthen the EU's economic policy co-operation framework
- → Improve international cooperation (G20)



The first scenario is the one which we want to achieve with our strategy for recovery Europe 2020 :

So as to make up for recent losses, regain competitiveness, boost productivity and put Europe on an upward path of prosperity.



## Europe 2020

- Smart growth: developing an economy based on knowledge and innovation
- Sustainable growth: promoting a more resource efficient, greener and more competitive economy
- Inclusion growth: fostering a high-employment economy delivering social and territorial cohesion



## The Importance of EU Coordination

- Enhanced fiscal surveillance
- Broader macro-economic surveillance
- A crisis-resolution mechanism



## Is the recovery sustainable?



### Some issues for concern in the current recovery ...

- State of the financial sector in advanced economies
- Reform of the financial system
- Global imbalances
- Currency misalignments
- Fiscal sustainability



### The Global Policy Response

- G20 as the new forum to discuss and cooperate on macroeconomic and financial issues
- Strengthening of the resources of the International Monetary Fund and creation of new financial instruments to counter the crisis
- IFI reform



### Europe's Role in the G20

1. EU is represented by the President of the European Council and the President of the European Commission
2. EU has taken the lead on financial market regulation
3. Support for the framework for strong, sustainable and balanced growth
4. Regional dimension



### EU's Contribution to the G20

- Unique experience on inter-governmental cooperation and compromise-building
- Know-how and expertise on issues of global nature (e.g. climate change, energy security, or development policy)



### G20 agenda

- Priority of the EU:
  - Preserve the G20's effectiveness and legitimacy
- Objectives for G20 in 2010:
  - Provide leadership for the global recovery
  - Strengthen financial regulation
  - Reform international financial institutions
- Next G20 summit in Toronto:
  - Deliver strong and balanced growth
  - Continue to strengthen the financial system in "peacetime"
  - Modernise global financial institutions



### After the Devastation, What Survives?

