

»» The whole euro area is recovering – the whole euro area ...? Yes!



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Euro area is growing at a uniform rate

The euro area is finally leaving the debt crisis behind. The upswing is entering its fifth year and extends across the entire currency area. The economy is now growing in all countries including Greece.

The breadth of the upswing also becomes clear when we analyse the output gap, the discrepancy between actual economic output and output with normal capacity utilisation. If we compare the output gap of the current year with the one of 2016 – estimated and forecast by the EU Commission – we see an economic revival in almost all 19 euro area economies (see figure). It is only in two countries that the economy is losing some momentum. In both Malta and Ireland, however, the output gap remains positive and the cyclical situation therefore is good.

In the four euro heavyweights, it is particularly in Spain and Italy that the business cycle is picking up. With its dynamic catching-up process, Spain is

advancing from having the third-largest negative output gap in 2016 (the figure excludes Greece as an outlier) to being the only major economy with over-utilisation of production capacity in 2017. Italy's progress is also noteworthy.

Business cycle symmetry is important for monetary policy and reforms

Synchronous economic development in the member states is of great value for the currency union. After all, uniform growth facilitates the single monetary policy, for example. According to the EU Commission's forecast, the euro countries' output gaps in 2017 are as close as they have been in only few of the nearly 20 years of euro area history. As a result, the individual member states' demands on monetary policy are similar and monetary policy is less likely to lead to distortions.

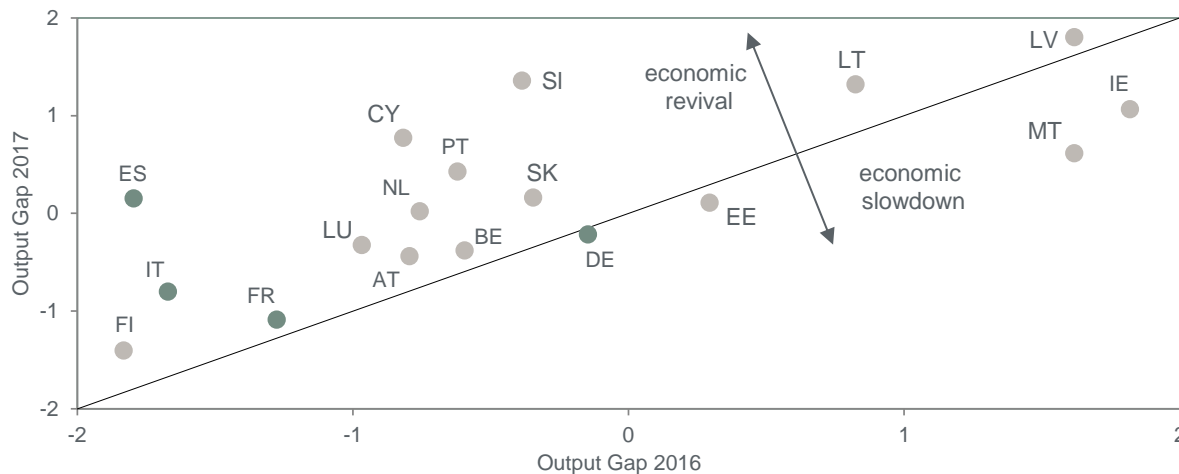
Comparable economic circumstances and similar positions in the business cycle also create a favourable environment for the further institutional development of the euro area.

Politicians pressing for reforms alone might not be enough to set in motion a significant renewal process. What is also required are compatible ideas about the right reform pathway. Diverging priorities can also be attributed to differences in the countries' current economic situation. While states that negotiate from a position of strength could promote more ownership and autonomy, others that are in a precarious economic situation tend to favour redistribution and fiscal transfers.

Apart from that, economies' structural characteristics naturally play an important role, and divergences between the business cycles remain. For example, it will take a long time for the Greek economy to recover fully, and Italy's upturn is still not resting on a solid basis. But the economic conditions of 19 diverse economies will never fully converge anyway. So the right time to initiate reforms in the euro area is now. ■

Figure: Broad upswing in the euro area

In per cent of potential GDP, forecast for 2017, note: without outlier Greece (output gap 2016 -9.8%, output gap 2017 -7.6%)



Source: Ameco