

International Conference  
Financial Crisis: Institutions and policies  
Mendel University, Brno

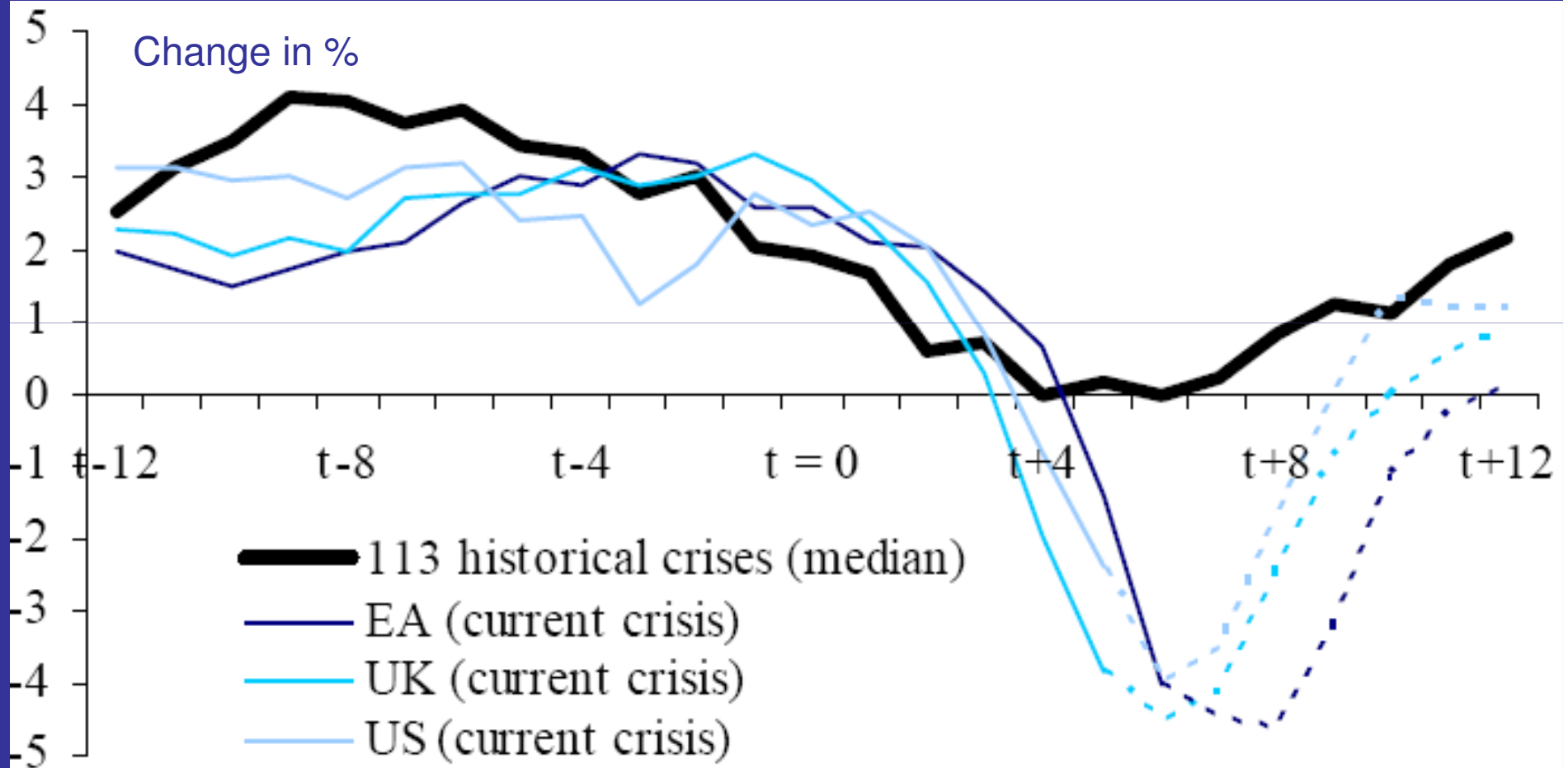
# **GROWTH CRISIS AND THE EMU**

## **Challenges and prospects**

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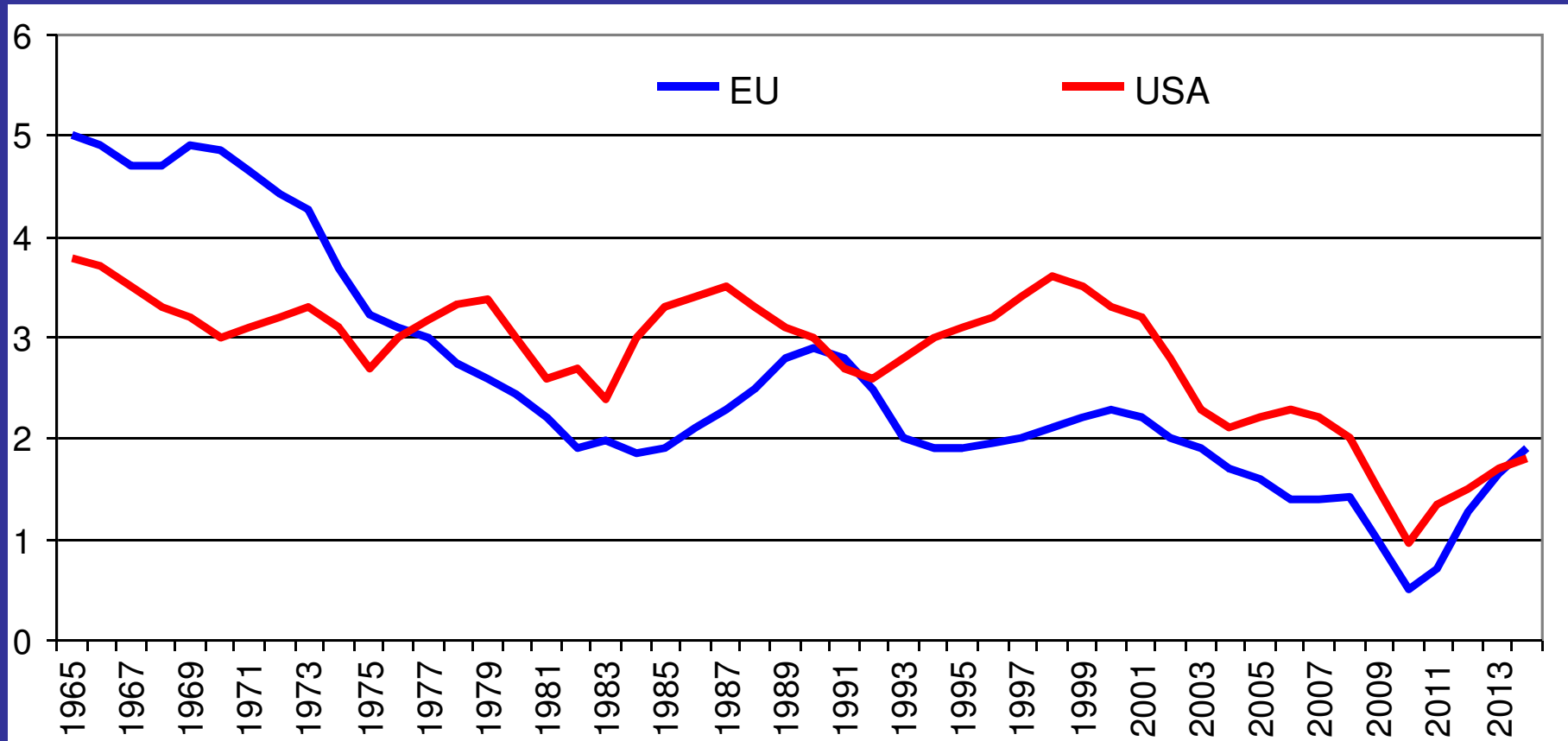
# GDP



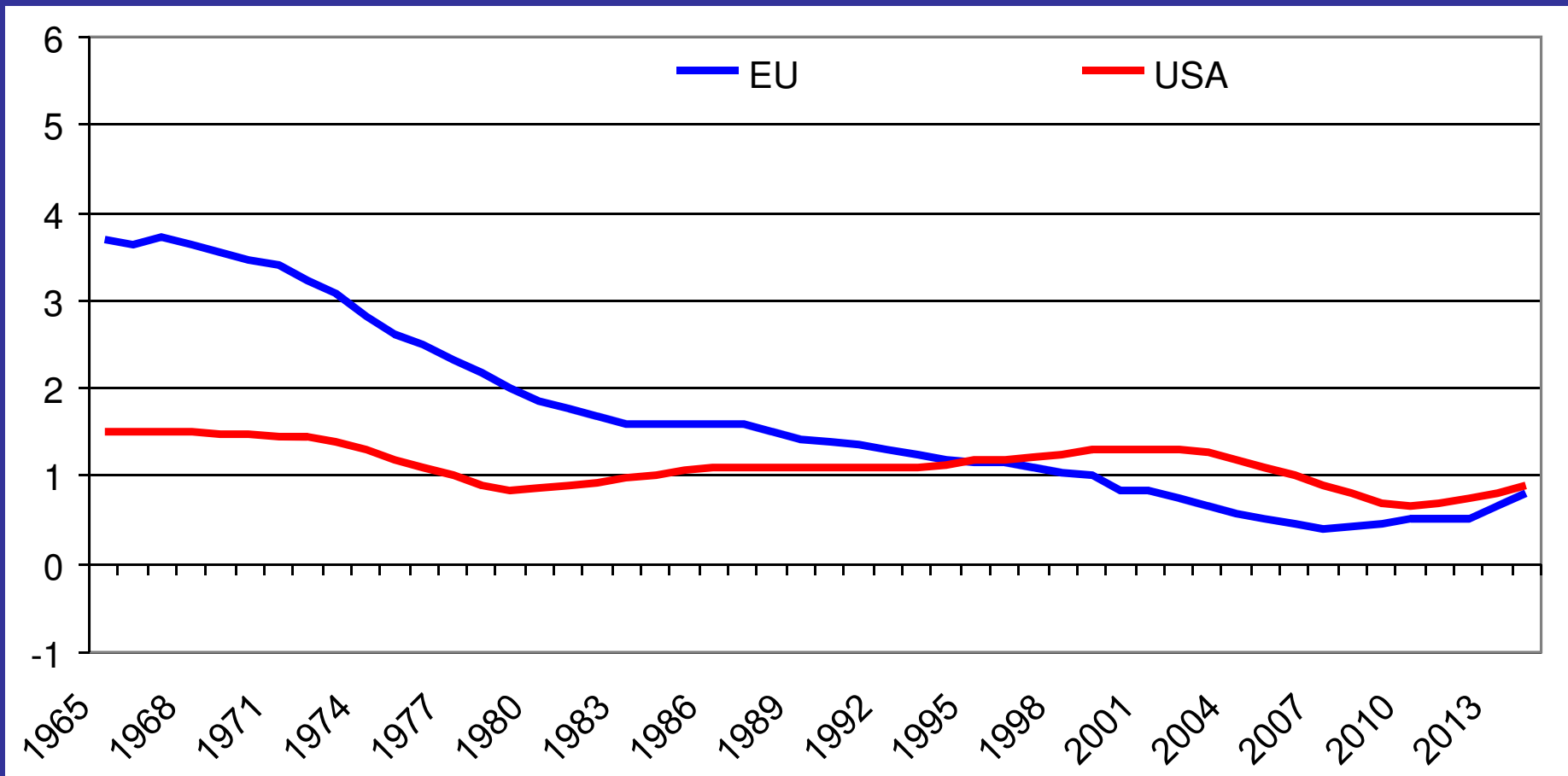
# Crisis and potential growth

- The fall in output is not only a cyclical deterioration
- The erosion of the European growth potential

# Potential growth rate



# Contribution of TFP to the growth

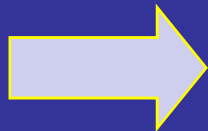


# Crisis and potential growth

- The fall in output is not only a cyclical deterioration
- The erosion of the European growth potential
- What is the impact of the crisis on the European growth potential?

# Potential growth in the EU27 (long-term)

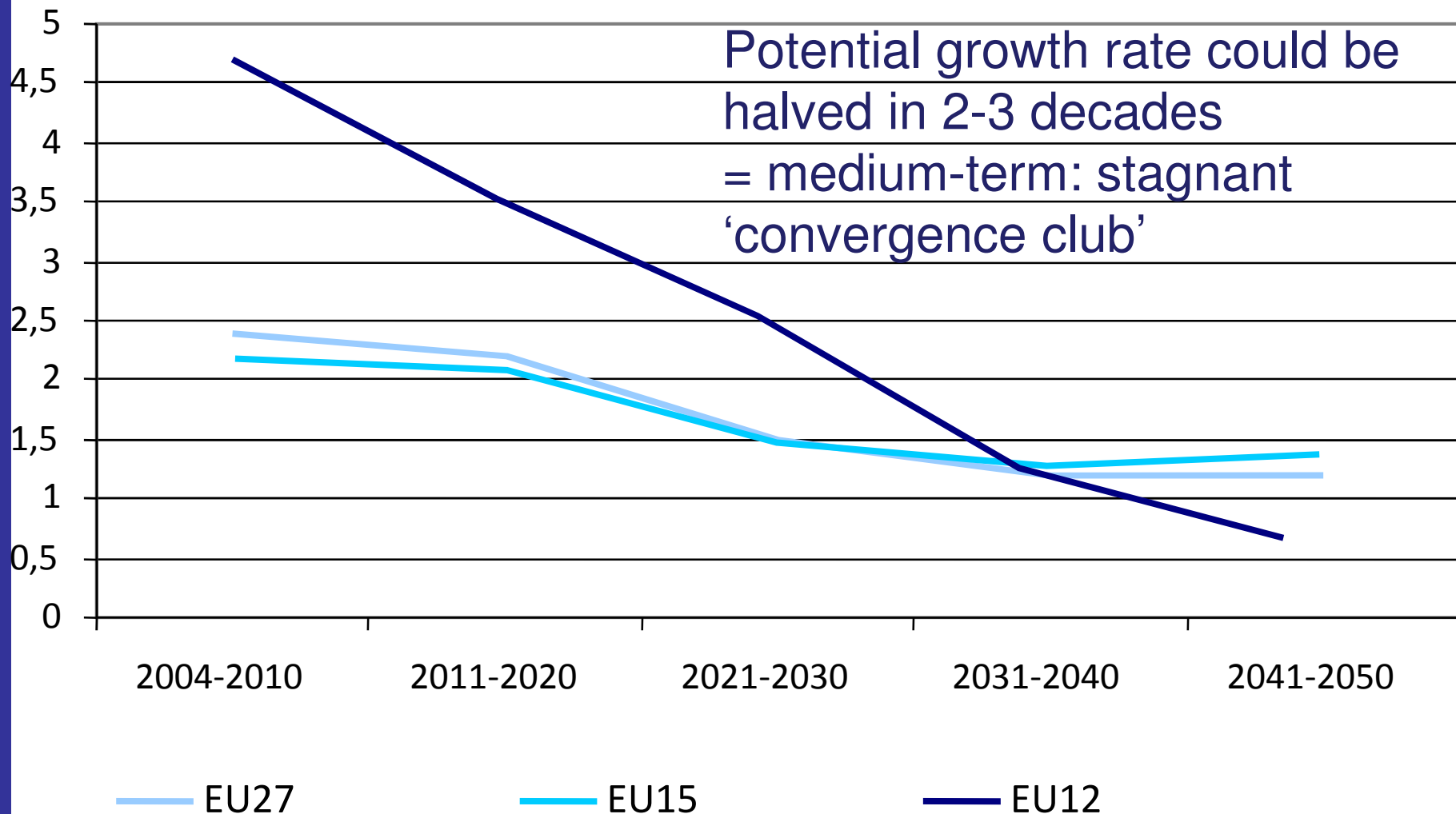
- decline in the potential growth rate in EU27
- the decline is much higher in the EU12 than in EU15
- output in the EU12 will expand far more rapidly at the beginning than in the EU15 countries,  
**i.e. the convergence process will continue**
- but as time passes the pace of convergence will slow down, and then stop



**Possibility of divergence!**

significant differences among individual countries (due to different productivity dynamics and demographic tendencies)

# Development of potential growth rate





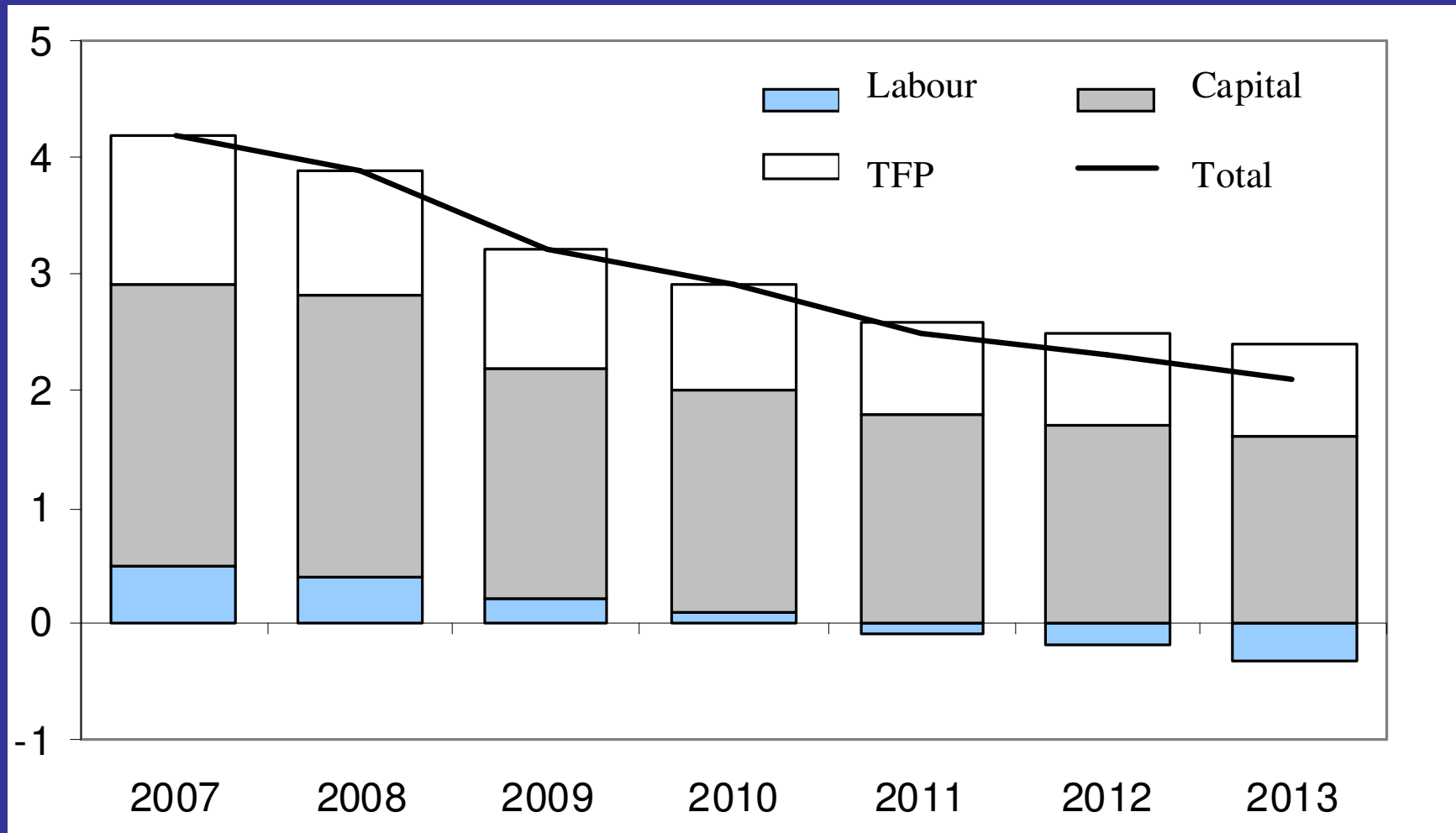
# Risks of the current crisis

- it is a real risk that
  - weak potential growth performance
  - and slow recovery can be expected in that prolonged period.
- main reasons explaining that:
  - lack of confidence (households, firms)
  - increase in the cost of capital
  - pervasive credit constraints and higher borrowing costs
  - changing attitude
  - slower growth in TFP
  - permanent destruction in human capital ("hysteresis" effect -Blanchard and Summers), increase in structural unemployment rate (NAIRU)
  - collapse of world trade, higher degree of protectionism threatens
- taking all these risks and threats into account more negative growth prospects can be observed

# Crisis and potential growth in the EU

- the potential growth rate in the Euro zone + EU3 will be halved in 2009-2010 compared to 2008 (0,7-0,8%)
  - structural unemployment will increase by 1-1,5%
  - investment – as % of the GDP – will decrease by 3%
  - TFP growth will be moderate
- new MSs (EU8): the potential growth rate falls significantly
- significant difference in the medium term – 2011-2014 tendencies
  - the growth rate in the Euro zone + EU3 will recover by and large
  - prospects of the EU8 are much more unfavourable
    - the financial crisis might generate significant fall in the output level
    - it might have great negative effect on the labour (NAIRU), capital, TFP
    - convergence crisis

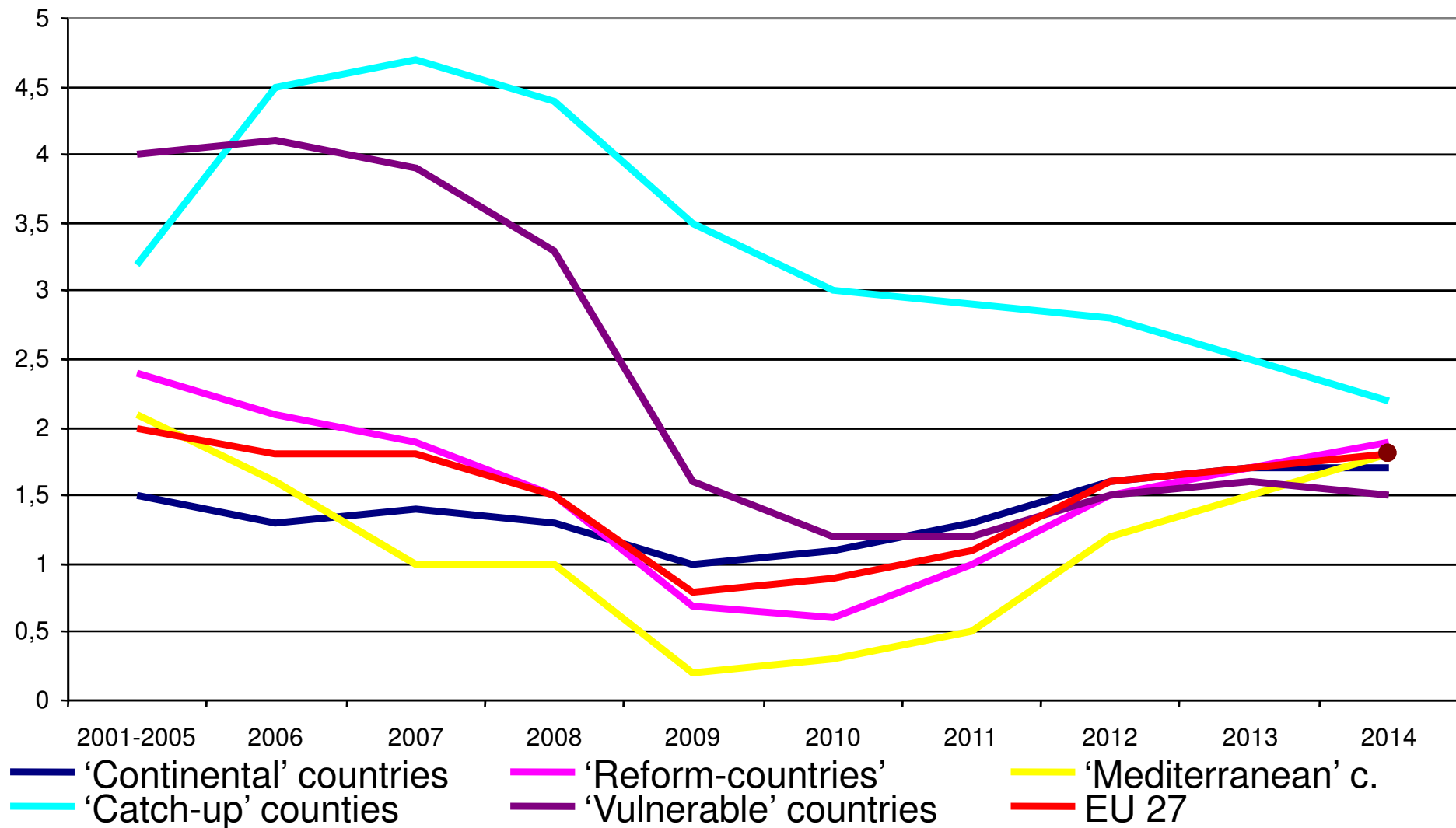
# Potential growth in the new MSs (annual change in %)



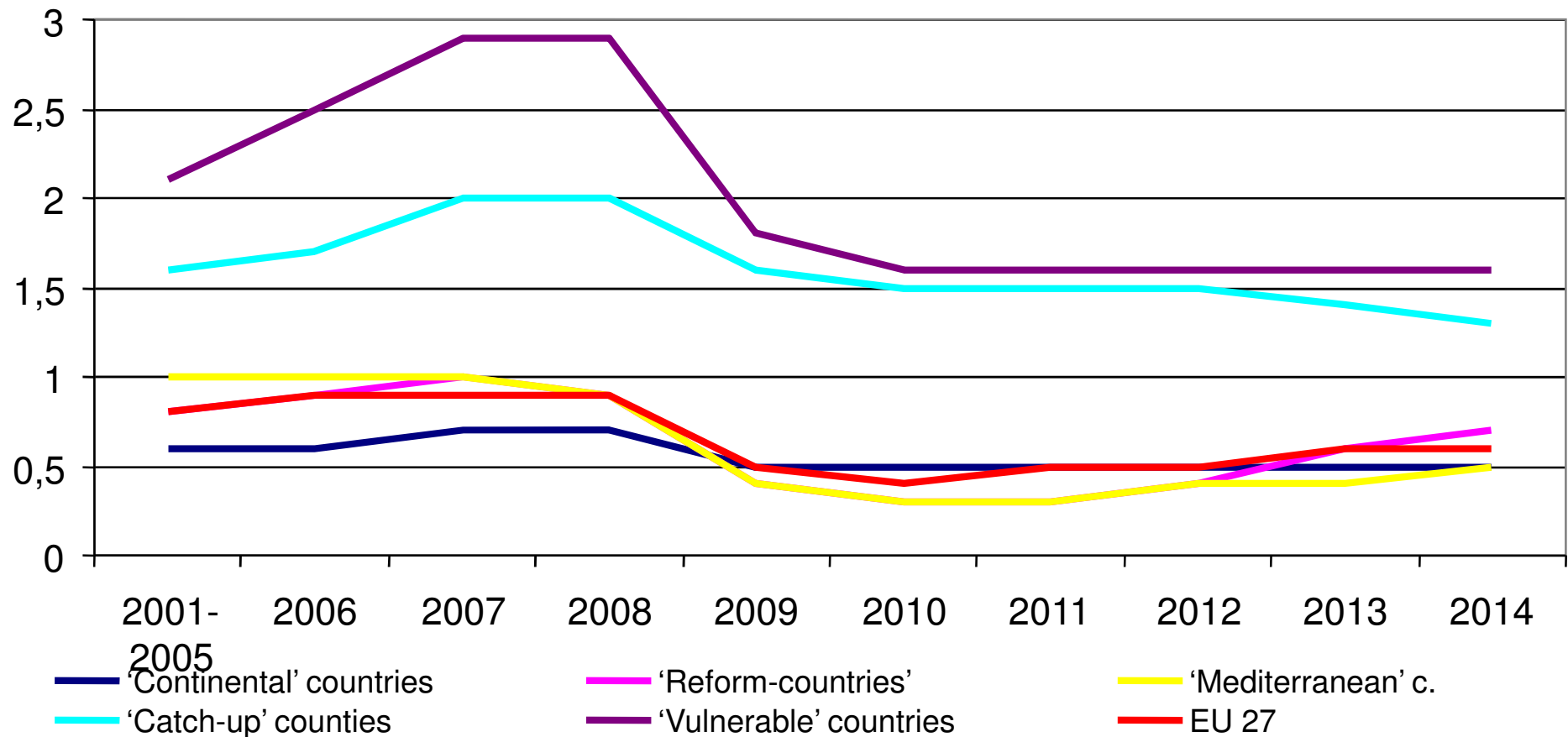
# Main characteristics of the individual country groups

	Potential growth rate (2005)	Current account	EUR	Lisbon-type reforms
Continental (AT, BE, DE, FR)	0,8-1,9	+	+	+
Reform (DK, FI, IE, LU, NL, UK, SE)	1,4-3,4	+ -	+ -	+++
Mediterranean (EL, ES, MT, IT, PT)	0,6-3,3	-	+	-
Catch-up (CZ, CY, PL, SK, SL)	3,5-5,4	-	+ -	+
Vulnerable (Baltic MSs, HU, BG, RO)	3,1-7,0	-	-	- -
EU27	1,8	0,3		

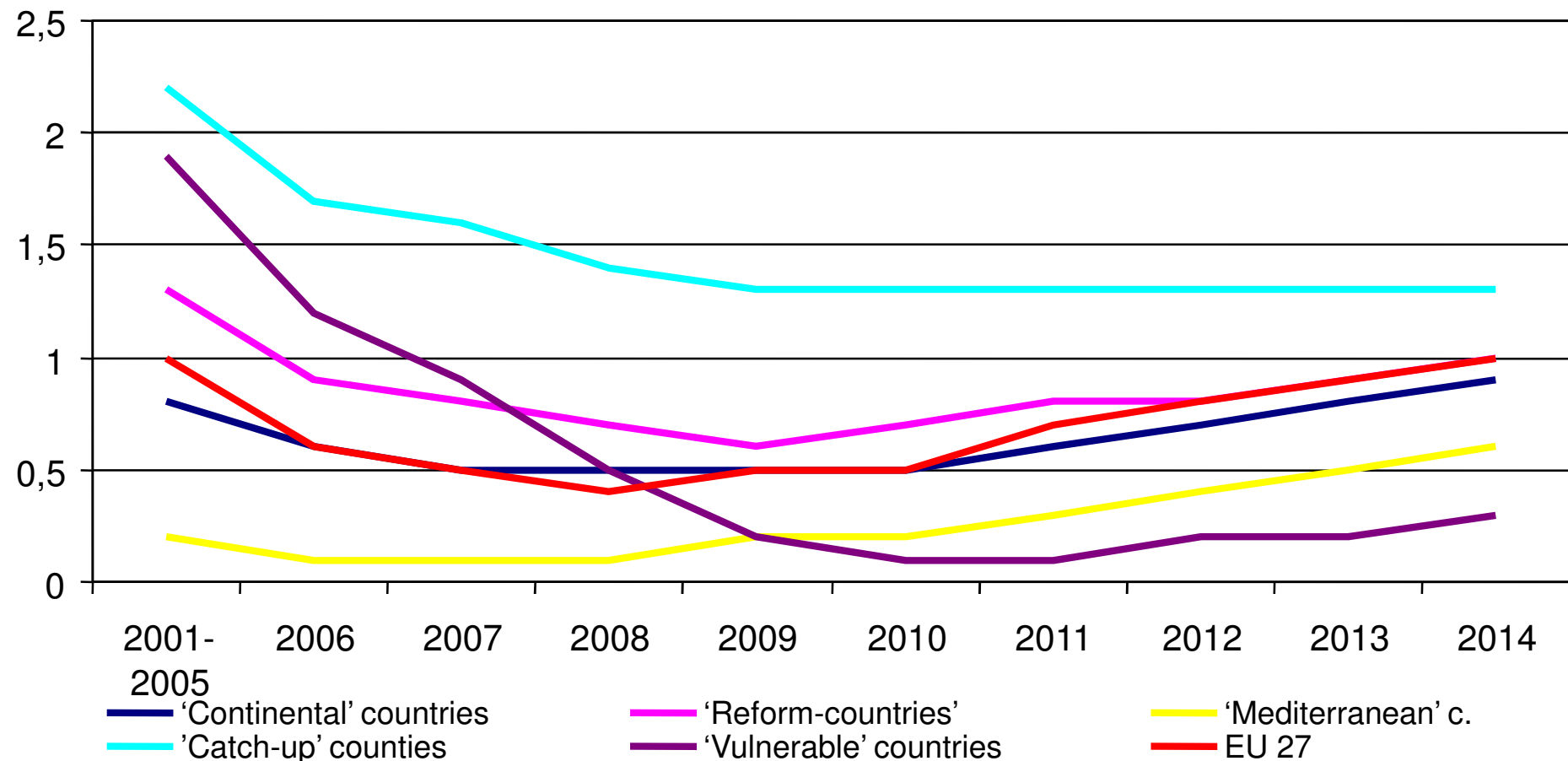
# Potential growth in the country-groups of the EU



# Contribution of the capital accumulation to the potential growth



# Contribution of the TFP to the potential growth

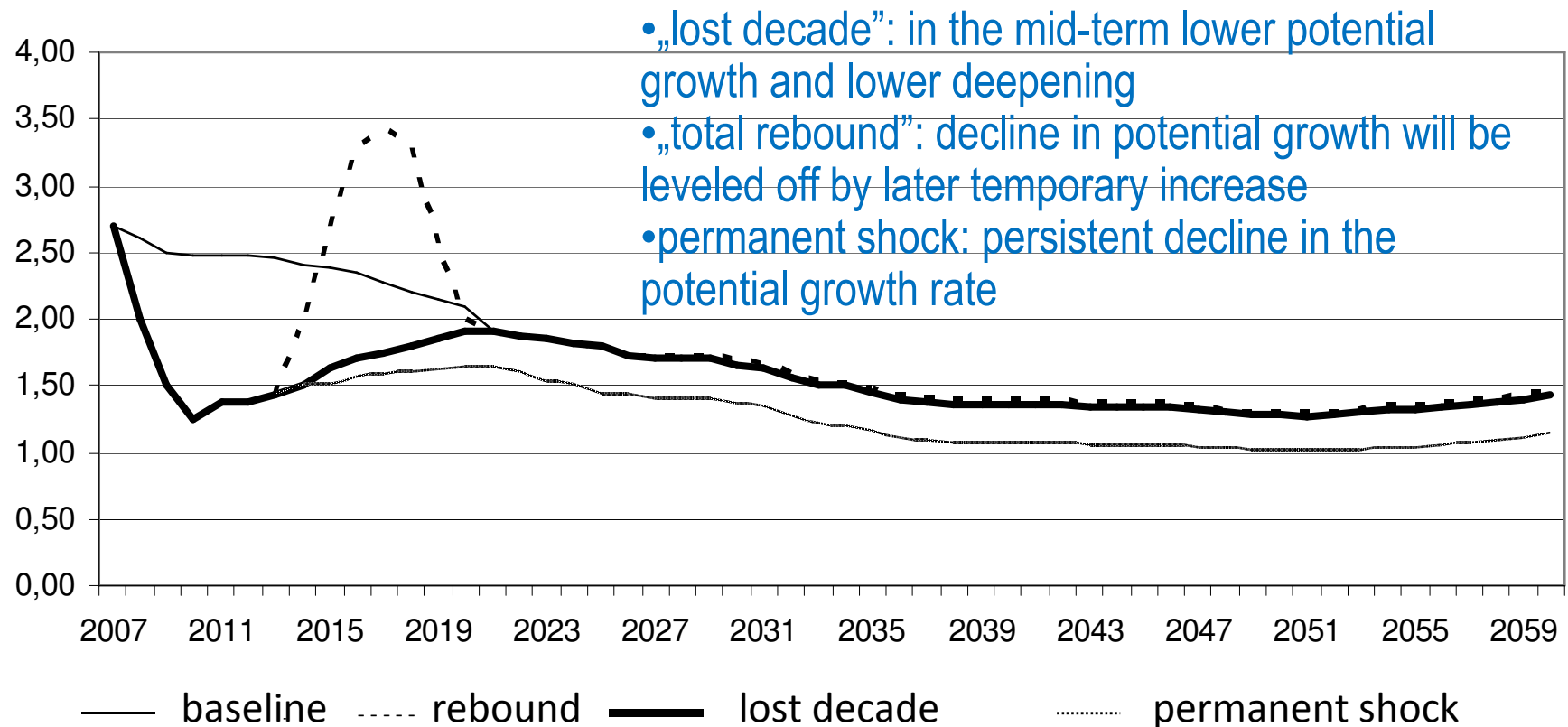


## Potential growth and its factors in the individual country groups (as % of the potential GDP)

	Potential growth rate		Contribution to the potential growth					
	2010	2014	Labour		Capital		TFP	
			2010	2014	2010	2014	2010	2014
Continental	1,1	1,7	0,1	0,2	0,5	0,5	0,5	0,9
Reform	0,6	1,9	-0,3	0,2	0,3	0,7	0,6	0,9
Mediterranean	0,3	1,8	-0,2	0,6	0,3	0,5	0,2	0,6
Catch-up	3,0	2,2	0,2	-0,5	1,5	1,3	1,3	1,3
Vulnerable	1,2	1,5	-0,5	-0,3	1,6	1,6	0,1	0,3
EU27	0,9	1,8	-0,1	0,2	0,4	0,6	0,5	1,0
USA	1,4	2,1	0,0	0,2	0,5	0,9	0,9	1,0



# Potential GDP growth under different shocks (annual growth rate)



# Some conclusions

- Convergence crisis
- Possibility of further erosion of the European growth potential - The trajectory of the steady-state shocks threatens with the complete collapse of the European growth and catch-up model.
- Significance of comprehensive integrated structural reforms

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