“Recessions that are either accompanied by financial crisis or are global in nature are deeper and more protracted than average.” (IMF).

I – The economic and financial crisis in the European Union: where do we stand?

Recovery “green shoots” should not let us fall into complacency.

1) Industrial production which fell 20% on a year-to-year basis last February shows little sign of stabilization. The total volume of toxic assets does not seem on the decrease. Consumer confidence is at all times low, and there is widespread worry about job losses.

Industrial production has plunged

Index, January 2000 = 100

Source: Datastream
Unemployment will rise substantially
(in percentage of labour force)

World trade growth has plummeted
Annualised quarter on quarter growth, %
The transmission mechanism of the financial crisis to the real economy has been the downturn in the amount of corporate investment which has collapsed. On the other hand, household consumption has been more resilient, thanks mainly to the fall of oil prices and of the overall rate of inflation. Furthermore, as the other transmission mechanisms of the financial crisis have played with different intensities on the various European economies, we observe discrepancies among the countries:

- The German economy is paying a high toll to the crisis because of the world trade collapse;
- Other countries like the UK and Spain feel the pain of highly depressed housing markets.

2) If we look at the policies to face the crisis, views across the Atlantic are not fully convergent.

a) Countries of Continental Europe feel more dubious for adopting larger fiscal stimuli: their higher level of public and social expenditures act as a more powerful automatic stabilizer than in the US. Furthermore, as the IMF points out: “Fiscal stimuli are more effective with moderate debt levels... Countries with debt levels of 60% or more of GDP should expect no benefit from fiscal stimuli”.

b) On the monetary front, Central Banks acted not only through their policy rates but also expanded their balance sheets. A move made necessary by the huge increase of the demand for the base money (the money of the Central Bank) and the decrease in the velocity of circulation of money.
Inflation falls to very low levels

*Year-on-year growth rate, %*

Central banks have expanded their balance sheets

*Last observation: 27 March 2009*

Note: Inflation is based on consumer price index (CPI) for Japan, PCE deflator for the US, and harmonised index of consumer price for the Euro area.

Source: OECD.

Source: Datastream
The Banking sector is playing a greater role in Continental Europe than in the US for providing credit. Securitization is much more developed in America.

At the ECB council, even though the debate is currently open, mainstream members are reluctant, at least for the time being, to zero interest rate policy and quantitative easing. Whereas the FED (and the Bank of England alike) side step the banking sector with programmes of acquisitions of private and even public bonds, the ECB embarks on non-conventional measures but through banks, by supplying them with unlimited amounts of liquidity at a fixed interest rate.

c) The same type of differentiation across the Atlantic is also visible on the treatment of “toxic assets”. While the US administration clearly favour public-private partnerships and market mechanisms, and are also reluctant to nationalize banks because “it is likely to undermine rather than to create confidence” (President Barak Obama), European authorities are putting in place a bank by bank approach and are ready if necessary to take significant public stakes in their capital even to the point of their nationalization.

II – The contribution of European Union Institutions to solving the crisis

The European Union may claim credit for some of its past decisions: the Euro prevents member states from competitive devaluations which were common practice in the pre-Euro period. We also hopefully created a single market which aim is precisely to create a true level playing field for European firms free of any protectionism measures and obstacles to competition.

We should have a better use of the European level to tackle some aspects of the crisis where it could bring some added value. Four topics come to mind.

a) Removing the toxic assets from the bank balance sheets

The European Union should be more associated to the national clean up of member states (because cross border banks have a transnational dimension, but also because one of the duties of our European institutions is to avert breaches to competition). One of the proposals is the creation of a European Union stability fund aimed at financing the removal of toxic assets funded by European bonds issues. Is this a realistic suggestion? Anyhow we definitely
need a cross country approach to this very important issue in which the European Commission should be more involved.

b) The regulatory environment
The de Larosière report suggests the creation of a European system risk council for macroeconomic supervision and a decentralized European system of financial supervision for micro-prudential supervision. This is an opportunity to overcome beggar-thy-neighbour national approaches and make the choice of an “enhanced, pragmatic sensible European cooperation for the benefit of all”.

c) Eastern and Central European emerging countries
Europeans should be more involved in the search for better financial stability of the countries around the Euro zone. Many initiatives should be encouraged like balance of payments facilities, macro-financial assistance, bilateral swap facilities, etc.

d) Last but not least, macroeconomic cooperation because global macroeconomic imbalances are the underlying cause of the crisis. We have this kind of problem in the European Union itself: between Germany and France, Italy and Spain… Will the crisis be the catalyst for a more stringent political framework to enforce macroeconomic discipline among member states?