The Macroeconomic Outlook and the Impact of the Global Crisis in the Euro Area

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Abstract
This paper provides general analysis and evolution of macroeconomic and financial indicators in the euro area, during the recent crisis 2008-2009. The financial market turmoil that began in 2007 led to a severe global economic downturn. The causes of the crisis, the effects on global financial markets, and the spillover to the economy are permanently examined by the analysts, but the final conclusions are not clear yet. The conclusion of this paper is that the global activity is recovering at varying speeds in some countries, tepidly in many of the advanced economies but solidly in most emerging and developing economies.

Keywords: Global economics crisis, Global crisis debate
JEL Code: G10

1. Introduction
Today the financial crisis looks to be mostly behind us, and the economy seems to have stabilized and is beginning to grow again. The global recovery has been stronger than expected, as confidence has picked up among consumers and businesses as well as in financial markets. World real GDP growth reached about 3¼ percent on an annualized basis during the second quarter of 2009 and rose to over 4½ percent during the second half of the year. Activity in emerging and developing economies is leading the way the financial conditions remain more difficult than before the crisis, especially in advanced economies.

In Europe, by the 2009 year’s end the Central and Eastern Europe region showed cleared signs of having weathered the economic storm. Regional stock and bond markets staged a slow recovery from the losses of 2008-2009. Interbank lending rates fell and long-term yields rose in most Central and Eastern Europe countries, signaling a stabilization of the region’s fragile financial systems. Central and Eastern Europe exports, which had plummeted in response to falling demand in Western Europe, began a gradual rebound. The contraction of regional GDP (Gross Domestic Product) had bottomed out, setting the stage for the resumption of economic growth in 2010.

2. Macroeconomics outlook
According to the current update, the economic outlook for the European Union remains broadly unchanged. GDP is projected to grow at 0.7% in both the European Union and the euro area in 2010 [1].

The inflation projections also remain largely unchanged at 1.4% and 1.1% in the European Union and the euro area, respectively. Uncertainty surrounding these projections remains rife, as recent developments in financial markets illustrate well (Figure 1 and Figure 2).
Figure 1. Contribution to GDP growth in the European Union (Annual percentage stage)

Source: Eurostat; Ifo Institute calculation [2]

Figure 2. Economic growth in the EU member countries (2009)

Source: Eurostat; 2009; Ifo Institute Calculation [2]

Regarding by economic growth trends (Figure 3 and Figure 4), the close interconnectivity of the EU economies also illustrates the degree to which the growth prospects of Central and Eastern Europe hinge on the resurgence of demand in Western Europe, which represents upwards of 80% of CEE exports.

Figure 3. Economic growth in the EU member countries (2010)

Source: Eurostat; 2010; Ifo Institute Calculation [2]
Most of the EU-15 countries are expected to resume GDP growth in 2010. But projected growth rates in the CEE region’s primary export markets (Germany, France, Italy, Netherlands, Sweden, UK) (Figure 5) are tepid and dependent on fiscal/monetary stimulus programmes whose effects will soon dissipate. Growth of underlying consumer demand in Western Europe will remain weak in the coming years as the repercussions of the Great Recession slowly unwind.

Central and Eastern Europe’s growth prospects are therefore guarded. Regional economic output fell by 5% in 2009, surpassing the GDP contraction of the Euro area (4.2%), the United States (2.7%), and Latin America (2.7%). The International Monetary Fund forecasts a 2010 GDP growth of 1.8% in the CEE region, above the Euro zone and US but below Developing Asia, Latin America, Middle
East, and Africa. The economic landscape of Central and Eastern Europe looks very different to its pre-recession form. Many previously wealthy countries have slid by the wayside, while the former underdogs, such as Poland, have thrived. Romania suffered one the region’s biggest GDP contractions in 2009 (8.5%), reflecting both the impact of the global recession and the suspension of capital flows to a country that was running an unsustainable current account deficit. (Figure 6).

The International Monetary Fund projects mildly positive growth (0.5%) of the Romanian economy in 2010. But Romania’s large size and strong resource base indicate substantial scope for growth in coming years. By the International Monetary Fund’s estimate, Romania will reach 5.0% GDP growth by 2014. [3] The studies consider that Romania will get out of recession with a delay of 2-3 quarters after the euro area, a report of the institution specialized in transactions and investments shows, and the growth generated by exports will be able to get Romania out of recession but economic growth in 2010 might be under the general estimated level because of the reduction of budget deficit to 5.9% of GDP this year (from 7.2% in 2009).

![Figure 6. Romania- economic situation](image)

Source: Eurostat [2]

As for domestic consumption as noted Foxley [4] considers that it might support recovery in conditions of jobless rate increase and an insignificant crediting increase, and a growth generated by exports could get Romania out of recession. Table 1 illustrates the sharp differences in balance of payments positions between the emerging markets regions of the world. While Latin America and East Asia faced the beginning of the international crisis with positive current account balances, Eastern Europe’s external position was extremely fragile. While countries in Eastern Europe built up large stocks of external debt, in the years previous to the crisis a number of Latin American countries bought back expensive debt and improved the maturity profile of their debt obligations. As noted by Foxley [4], Eastern European countries’ accession to the European Union gave them a false sense of security regarding their ability to enjoy continuous access to international capital markets. Self-insurance through accumulation of foreign reserves was extremely low when the crisis started. [5]

### Table 1. Current Account and Debt Ratios by Regions and Selected Countries

<table>
<thead>
<tr>
<th>Region</th>
<th>Current Account as Percentage of GDP (annual average)</th>
<th>Ratio of External Debt to GDP, 2008 (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003-2007</td>
<td>2008-2010</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>-9.2</td>
<td>-7.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>-13.61</td>
<td>-13.42</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-3.73</td>
<td>-2.92</td>
</tr>
<tr>
<td>Hungary</td>
<td>-7.58</td>
<td>-5.07</td>
</tr>
<tr>
<td>Latvia</td>
<td>-15.72</td>
<td>-8.45</td>
</tr>
<tr>
<td>Poland</td>
<td>-2.95</td>
<td>-4.63</td>
</tr>
<tr>
<td>Romania</td>
<td>-9.46</td>
<td>-8.89</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>-6.95</td>
<td>-5.67</td>
</tr>
<tr>
<td>Latin America</td>
<td>2.7</td>
<td>-0.9</td>
</tr>
<tr>
<td>East Asia</td>
<td>7.5</td>
<td>6</td>
</tr>
</tbody>
</table>


Note: the regional averages do not correspond to the average of the few selected countries in each region

F = Forecast
Financial-market conditions have recovered since early 2009, but balance-sheet adjustment is not complete and uncertainty remains abundant. A muted outlook for investment typically implies a weak labour market ahead, which in turn is likely to dampen private consumption. With many of the main driving forces being still temporary in the EU and globally, the robustness of the recovery is yet to be tested. [8] The primary deficit in both the euro area and the European Union increased by 4.4 percentage points in 2009, after already having increased by, 1.3 percentage points in the euro area and 1.5 percentage points in the European Union in 2008.

Source: European Commission [9]

About price stability and developments in the European Union, the strong disinflation process over most of 2009 was mainly explained by downward base effects from the energy and food components and by a growing slack in the economy. Harmonised Index of Consumer Prices inflation rose somewhat in the last months of 2009, and remained at a very moderate annual rate of 1.0% in the EU and 0.3% in the euro area, as expected in the autumn of 2009. Looking in Figure 8, a sizeable slack in the economy is set to keep inflation in check, offsetting increases in energy and commodity prices. Price stability is expected to be maintained, with Harmonised Index of Consumer Prices (HICP) inflation projections being only marginally revised upwards to 1.4% in the EU and staying unchanged at 1.1% in the euro area. Regarding the risk assessment to the EU growth outlook for 2010 still appear broadly balanced. On the one hand - downside, the situation of financial markets remains highly uncertain and subject to serious adverse risks. On the other hand - upside, the vigour of the global recovery, particularly in Asian emerging markets, and the imminent turning of the inventory cycle in the EU may have a greater impact on domestic demand than currently anticipated. As regards the inflation outlook, risks also appear to remain broadly balanced for 2010.

Source: Eurostat [2]
3. Conclusion
Today, most of the major economies are showing subdued levels of growth, but this does not indicate a strong recovery. The international financial crisis that erupted in developed countries in 2007 adversely affected all developing regions of the world; albeit with very different degrees of intensity. While emerging markets will be the focus of global growth in 2010, most of the CEE countries will be the exception, with “tail risks” across this region remaining significant. In all but a few cases, the CEEs will continue to under-perform economically and to have higher policy and political risks. Countries such as Hungary, Latvia and Romania will struggle to implement fiscal austerity measures while trying to placate increasingly-restive voters as their economies continue to contract. Improved sentiment indicators for the EU point to an expansion of activity going forward, but hard data, especially industrial production and retail sales, have been less encouraging recently. The EU economy is gradually recovering, and certain cooperation between these countries has made recovery easier, while leading to sustainable growth. Actions each of them is important as they may have great influence on the responses and evolution of other countries.

The main conclusions of this paper are:

1. The financial and economic crisis that was unleashed in 2007 is having its most serious and profound effects on emerging and developing countries, especially those with the lowest incomes.
2. In the years prior to the financial crisis, the poorer countries had already been hit by the food crisis, with a rise in commodity prices that adversely affected the ability of hundreds of millions of people to meet their needs; the energy crisis, and the climate crisis, the consequences of which can be seen more acutely in developing countries, which are having to deal with damage to their harvests and the destruction of their infrastructure.
3. The East European member countries of the European Union were hit hard by the world economic crisis. Over the year, real GDP of the new member countries that are not part of the euro area fell by 3.5 percent.
4. Inflation has strongly decreased in all countries, but is – with 5.6 percent in 2009 – still relatively high in Romania.
5. As imports fell more strongly than exports throughout the region, the current account deficits have been reduced quite clearly.
6. The economic crisis induced governments all over the world to pursue expansionary fiscal policies; consequently, the public finance situation in the member countries of the European Union has deteriorated sharply.
7. The financial crisis has had an exponential effect on the deterioration of the situation that low income countries had already been starting to experience.

References: