

The Eurozone's Three Crisis

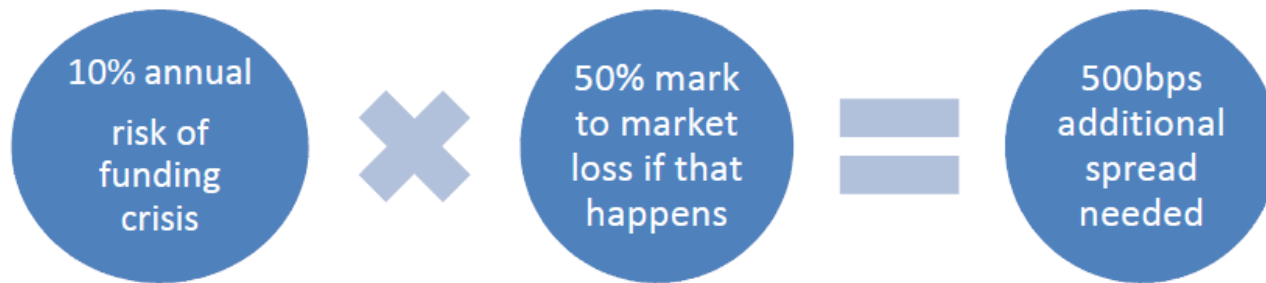
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June 11, 2012
Infiniti Conference

A Debt Crisis

- Italy the poster-child. Fragility of 120% debt ratio.
- Solutions?
 - Super-sized ESM, perhaps with banking licence.
 - Debt restructuring. PSI and OSI.
- Political problems.
 - Readiness to use ECB resources in this manner
 - Willingness to comply with conditionality.

Peter Boone's Graph on Italy

Italy's Dangerous Situation



Ceteris Paribus, Italy needs an additional 6% GDP primary surplus to keep debt stable !

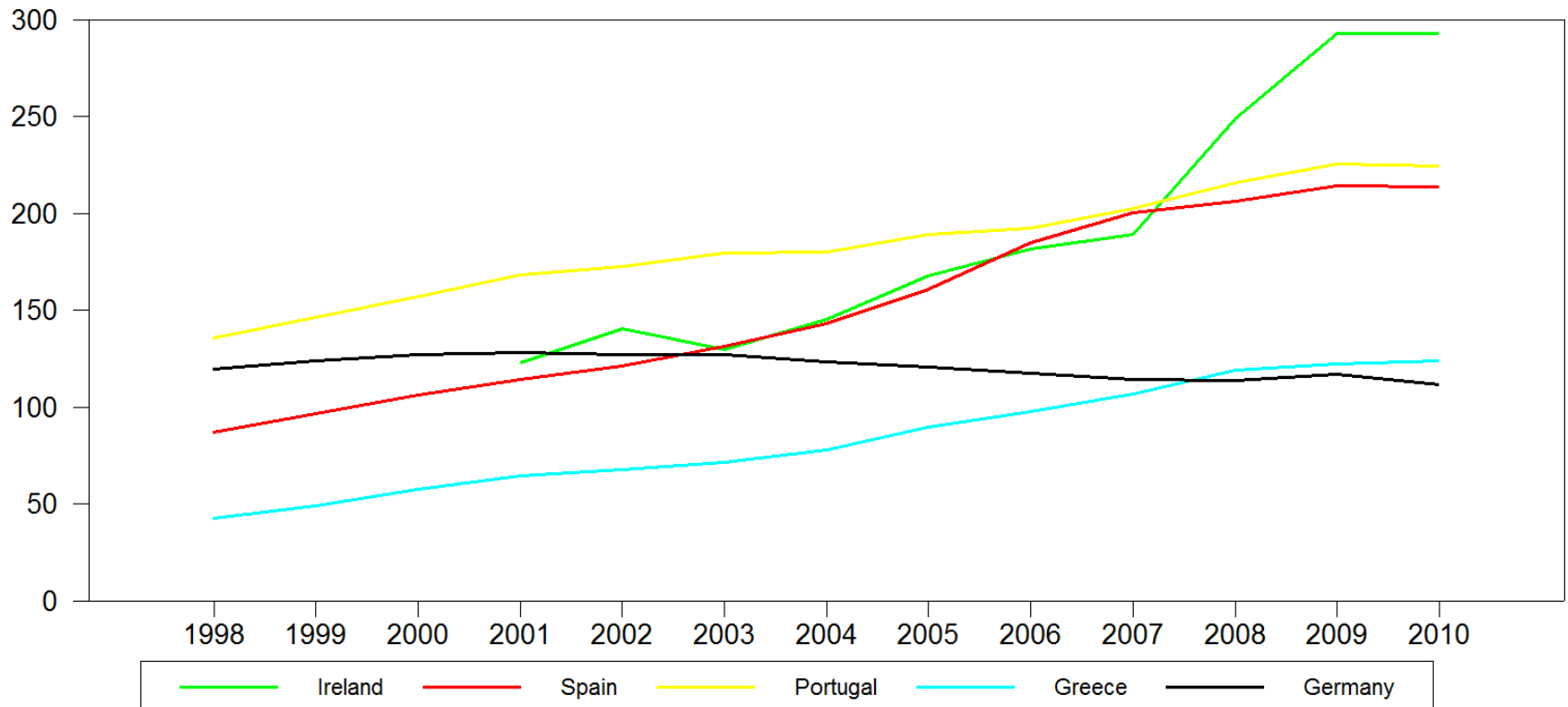
A Banking Crisis

- Linked to fiscal crisis but would exist even without it. Key element in potential quick meltdown of the euro.
- Solutions:
 - Euro-wide bank recapitalisation fund.
 - Euro-wide deposit insurance.
- Political will for this? Practical readiness? Not this weekend there wasn't.
- Practical problem: Redenomination insurance?

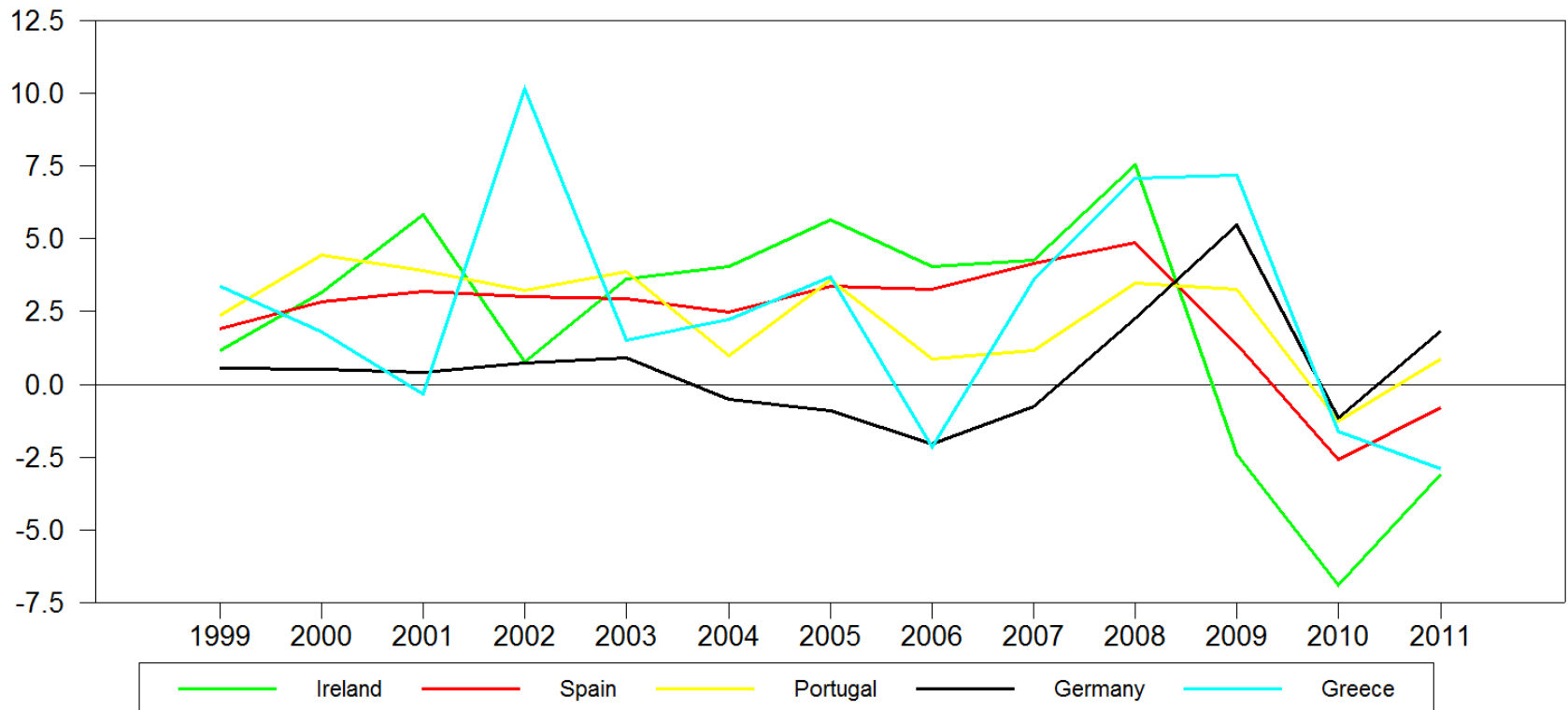
A Growth Crisis

- Eurozone as a whole has a serious growth problem: Average growth over 2000-2011 of 1.2 percent per year.
- Periphery has high levels of private debt.
- Can only pay down both public and private by growing fast and running current account surpluses.
- But periphery also has serious competitiveness problems. Unit labour costs ran ahead of core for many years.
- Hard to solve with nominal GDP growth, with fiscal adjustment and low ECB inflation target.

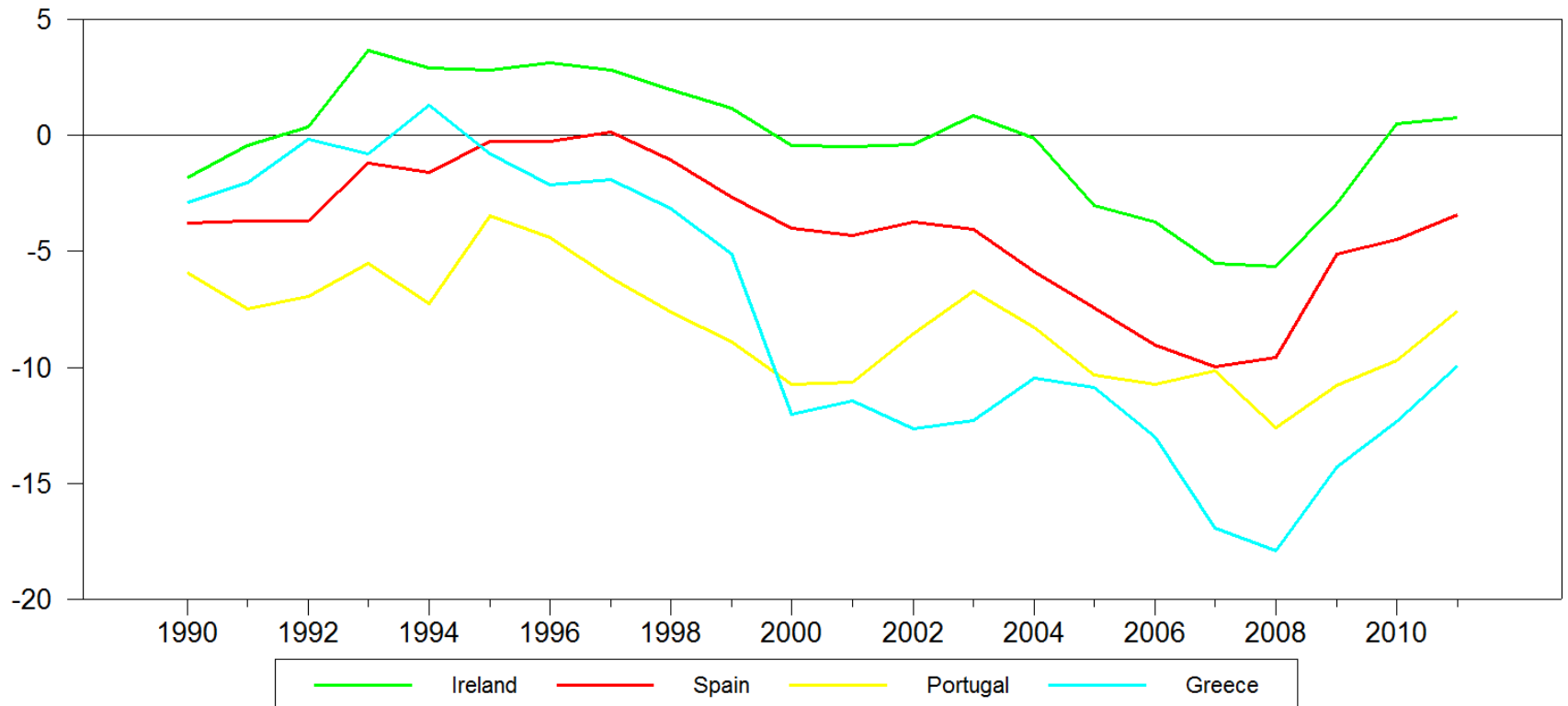
High Private Debt-GDP Ratios



Unit Labour Cost Growth



Current Account Balances



The Endgame

- Massive dislocations for the core if the Euro ends.
- But keeping it together requires major, complex, inter-related policy changes. Are Europe's politicians up to it?
- Economic incentive may be there for core to keep things together but severe political difficulties.
- Few things are permanent and irrevocable: The euro may not prove to be an exception.