Implications of the Euro Crisis for the Rest of the World

Presentation by William White

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What do we really know?

- Economies are not machines but complex adaptive systems
- Conventional forecasting models useless
- Global policy makers have retreated into national and conflicting beliefs
- Unprecedented policy experimentation adds to the uncertainty
Alternative scenarios for the euro zone

- Market confidence is maintained (orderly outcome)
- Market confidence is lost but then regained through policy action (a disorderly outcome)
- Market confidence is lost and not regained (an extremely disorderly outcome)
Why a disorderly outcome seems most probable

- Current calm is not sustainable
- Short term palliatives still untested
- Longer term requirements inadequate
- Approach to banking “union” is backward
- Policy will eventually rise to the challenge
- But disorder could breed more disorder
How the crisis might spread worldwide

- The euro zone is BIG
- Real side links via trade, FDI and value-added chains
- Financial links via banks, shadow banks, financial markets and exchange rates
- Confidence effects and rising correlations
- Especially during crises
Every region is vulnerable to external shocks

- US growth most advanced but still fragile
- Abenomics could backfire
- China adapting to a new growth model
- Emerging markets have imported “imbalances” and sometimes inflation
- Record high household debts and house prices in many countries
Assessment by the IMF and OECD

- IMF warns “An assessment of the euro zone debt crisis, especially if stress were to spread to the core, could have major global consequences”
- OECD warns “An intense euro zone crisis would have large, adverse spillover effects around the world”
- Neither institution does scaremongering
OECD simulation results for growth in 2014

<table>
<thead>
<tr>
<th>Region</th>
<th>Shock</th>
<th>Forecast</th>
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<tbody>
<tr>
<td>EURO ZONE</td>
<td>-4.9%</td>
<td>-3.6%</td>
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<tr>
<td>US</td>
<td>-3.1%</td>
<td>-0.5%</td>
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<tr>
<td>JAPAN</td>
<td>-2.6%</td>
<td>-1.1%</td>
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<tr>
<td>CHINA</td>
<td>-2.4%</td>
<td>5.3%</td>
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<tr>
<td>World</td>
<td>-2.6%</td>
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Assumptions «extreme» or not extreme enough?
Limited room for global policy response

- Fiscal and monetary policy in AMEs near limits
- Need for bank restructuring makes this worse
- EMEs better placed but face tensions
- Need for global liquidity and the role of the FED
- Trade deals impeded by rising unemployment
- Structural reforms take time
- International monetary reform stalls
Unintended political consequences

- Radical governments in Europe and elsewhere
- Diminished global influence for Europe
- The dangers of a bipolar world
- Military budgets decline as insecurity increases
- And old alliances are threatened
Conclusion

- A disorderly euro zone outcome could have huge negative externalities
- It should and could be avoided
- But will take “courage and magnanimity” from all euro zone members
- Which NON euro zone members should STRONGLY encourage