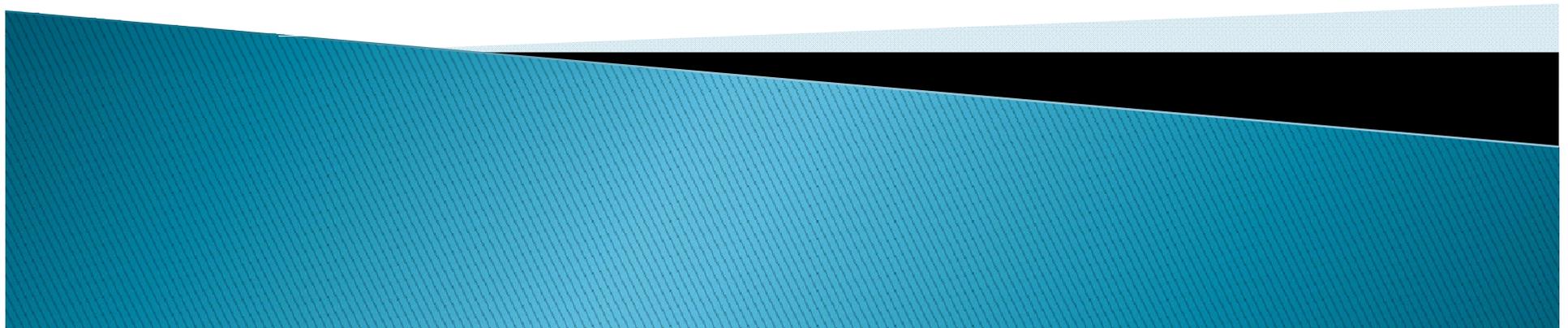


Implications of the Euro Crisis for the Rest of the World

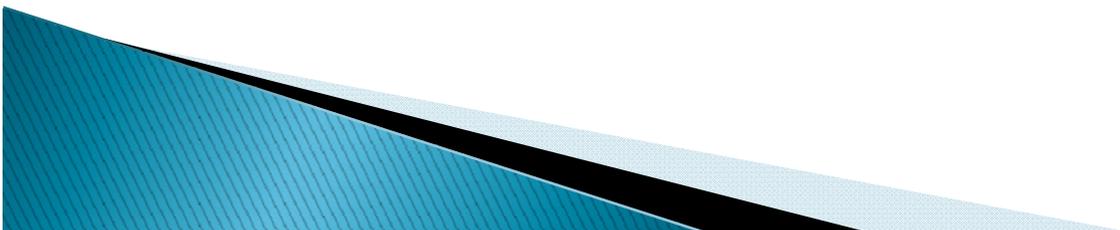
Presentation by William White

50th Anniversary Meeting of SUERF
Banque de France
Paris, 22 November, 2013



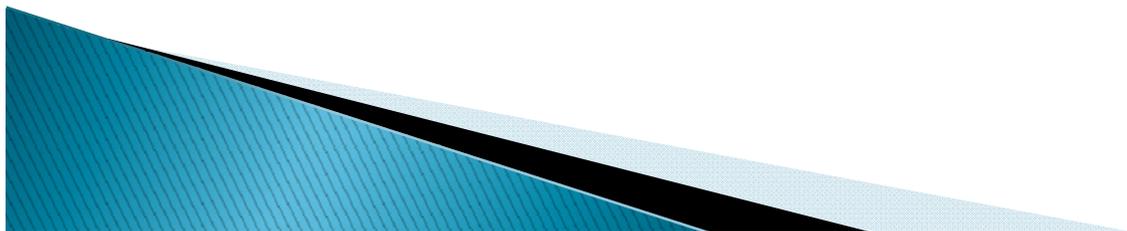
What do we really know?

- ▶ 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



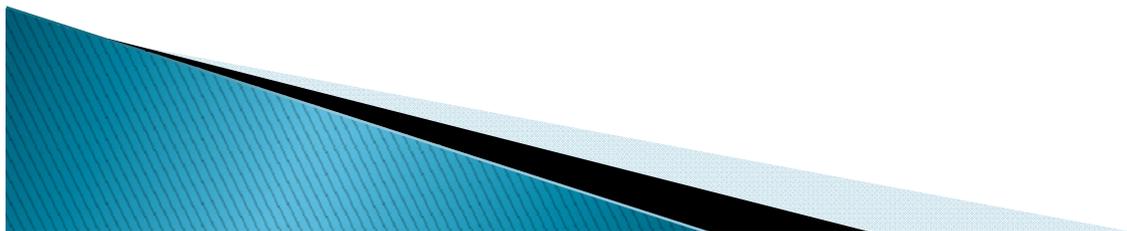
Alternative scenarios for the euro zone

- ▶ 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)



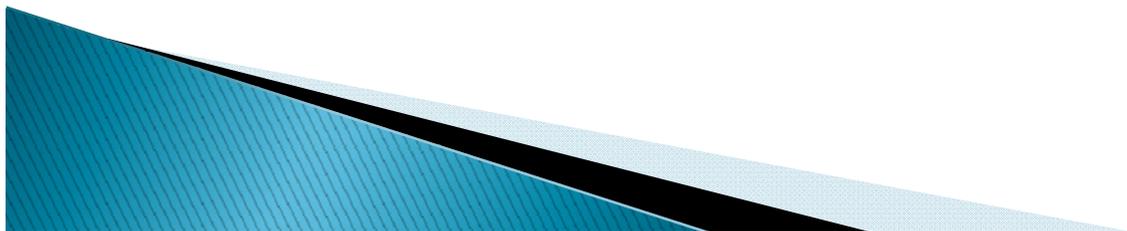
Why a disorderly outcome seems most probable

- ▶ 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



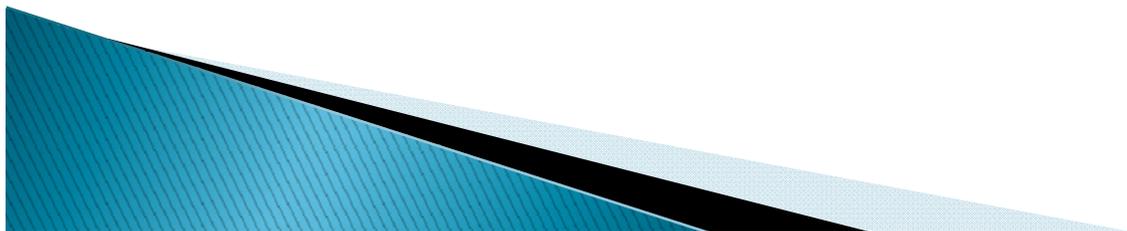
How the crisis might spread worldwide

- ▶ 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



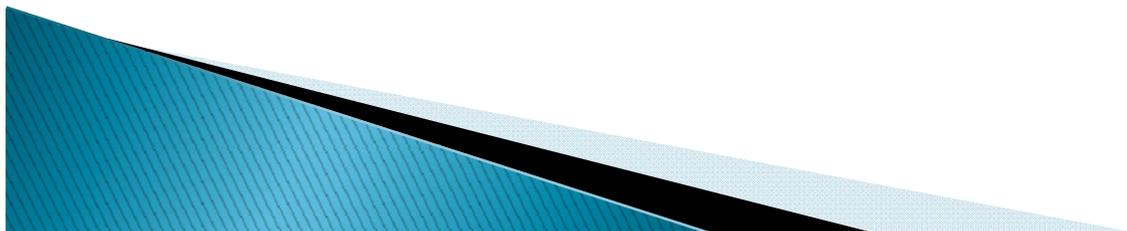
Every region is vulnerable to external shocks

- ▶ 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

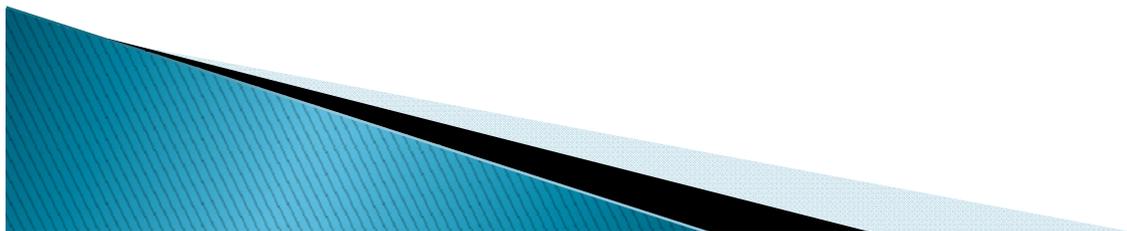


OECD simulation results for growth in 2014

| | | | |
|---|-----------------------|------------|-------------------------|
| EURO ZONE | -4.9 % (shock) | and | -3.6% (forecast) |
| US | -3.1% | | -0.5% |
| JAPAN | -2.6% | | -1.1% |
| CHINA | -2.4% | | 5.3% |
| World | -2.6% | | 0.5% |
| Assumptions «extreme» or not extreme enough? | | | |

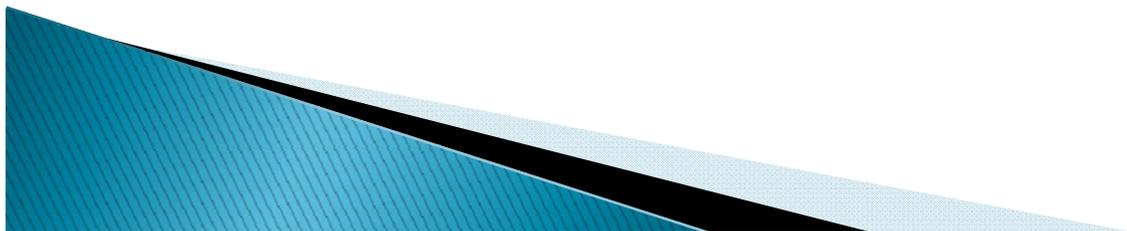
Limited room for global policy response

- ▶ 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

