

World Economic Situation and Prospects

Weekly Highlights

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Uncertainty and the Outlook for the euro area

The euro area has been in recession since the end of 2011 with six consecutive quarters of negative growth. In the UN World Economic Situation and Prospects (WESP) 2013 mid-year update, the recession is forecast to end and positive growth to resume during the second half of this year and then to strengthen slightly in 2014. Despite this anticipated pick-up, the negative growth carry-over from 2012 coupled with the negative growth in the first half of this year leads to a forecast of a second consecutive annual decline in GDP of 0.6 per cent in 2013, with the gradually improving activity showing up as an increase of 1.1 per cent in 2014.

This forecast is subject to a high degree of uncertainty, however, and depends particularly on two key assumptions, that world trade continues to strengthen and that there are no major flare-ups of the euro area sovereign debt crisis. Similar forecasts were made at the beginning of 2012, but were proved wrong by further eruptions of the sovereign debt crisis, which led to sharp rises in the sovereign bond yields of the crisis countries and significant declines in consumer and business confidence for all countries in the region. The new ECB policy of Outright Monetary Transactions (OMT) has so far acted as a circuit-breaker in the sovereign bonds market; despite the political crisis in Italy and banking crisis in Cyprus, sovereign bond yields have barely moved. However, these two episodes have yielded a steady decline in confidence since March of this year.

A natural question is what if these assumptions proved incorrect. What if world trade remained sluggish, not picking up until later, and what if further episodes in the debt crisis meant that consumer and business confidence remained low? Using the World Economic Forecasting Model the impact of these downside uncertainties can be examined.

Looking first at the impact of a delayed pickup in world demand, if world demand were 0.3 per cent lower than expected in 2013 and 0.7 per cent lower in 2014, euro area GDP would be 0.1 per cent lower than baseline growth in 2013 and 0.3 per cent lower in 2014 (see figure below). Secondly, an extended period of weak confidence would hurt consumption and investment spending, leading GDP growth to decline by 0.4 per cent lower in 2013 and 0.4 per cent in 2014. Finally the combined effect would result in GDP growth being 0.5 per cent lower in 2013 and 0.7 per cent lower in 2014, which is the growth profile of continuing recession, followed by stagnation, with a weak rebound delayed until later in 2014.

Effects of Trade and Confidence on GDP Growth in the euro area

	2012	2013	2014
Baseline forecast for GDP growth	-0.6%	-0.4%	1.1%
Impact of Less Global Demand	-0.6%	-0.5%	0.8%
Impact of Decline in Confidence	-0.6%	-0.8%	0.7%
Combined Impact	-0.6%	-0.9%	0.4%

Source: UN/DESA, World Economic Situation and Prospects 2013 mid-year update.