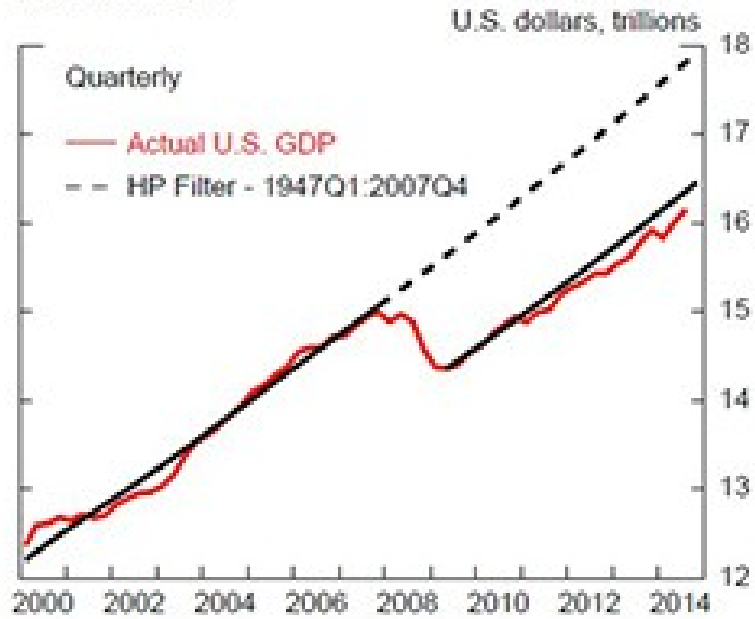
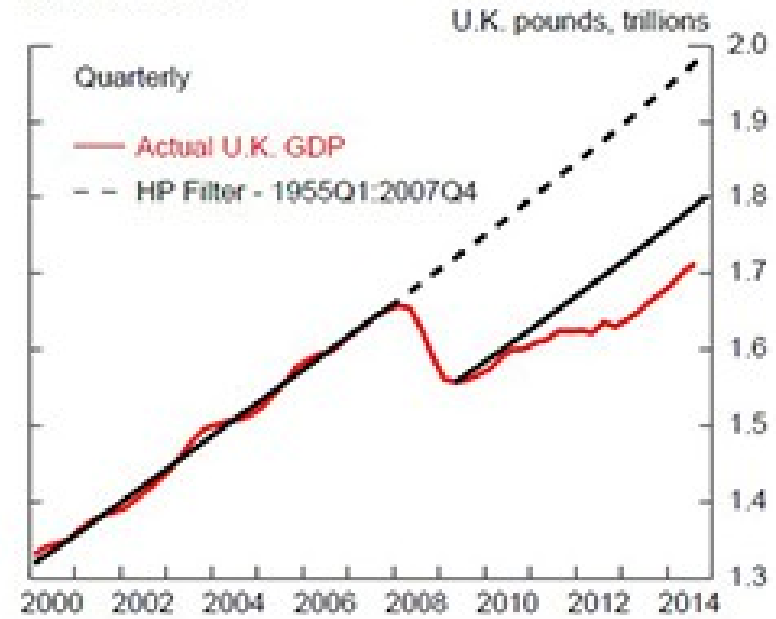


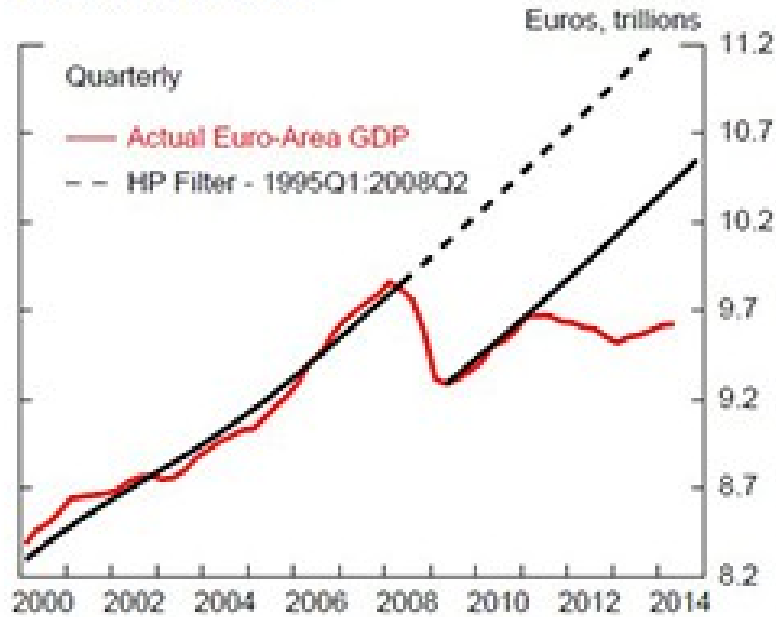
U.S. Real GDP



U.K. Real GDP



Euro-Area Real GDP

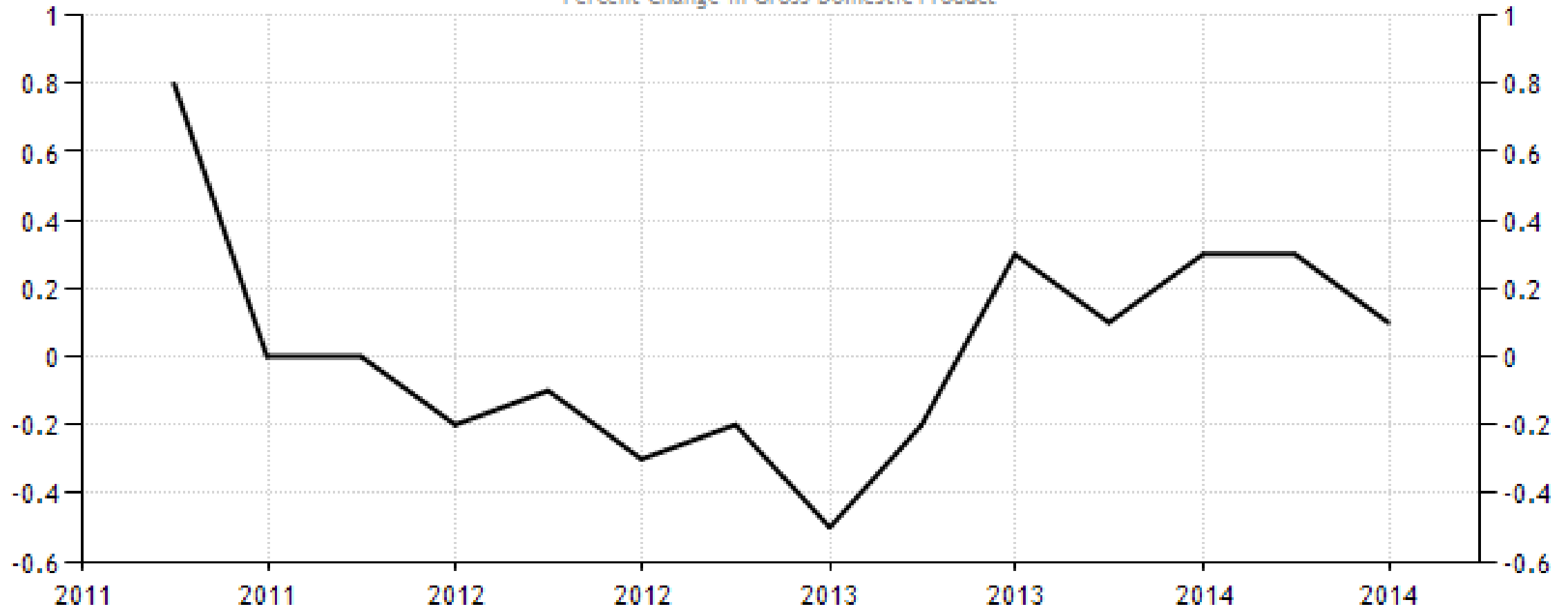


Canadian Real GDP

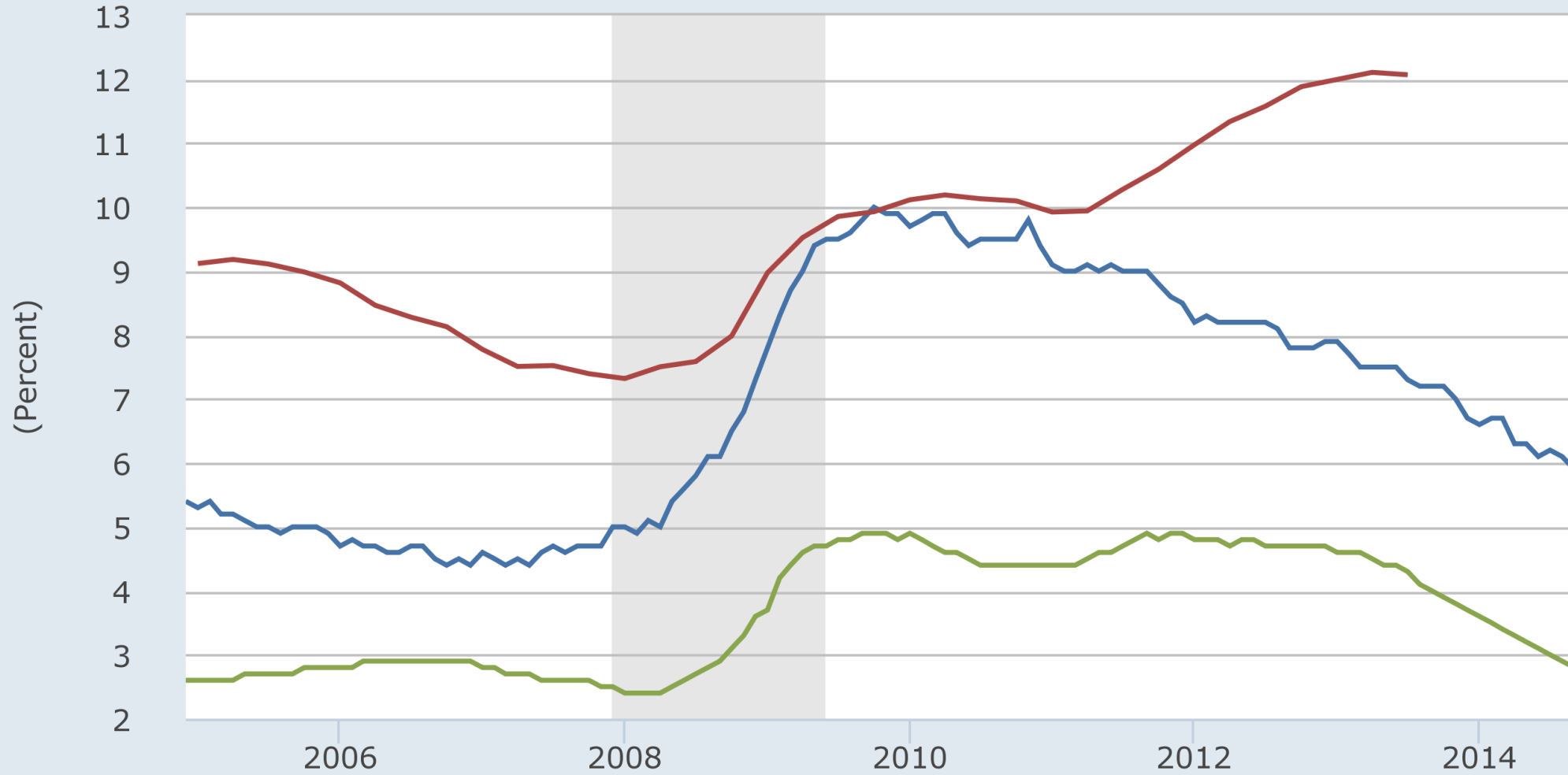


EURO AREA GDP GROWTH RATE

Percent Change in Gross Domestic Product



- **Civilian Unemployment Rate**
- **Registered Unemployment Rate for the United Kingdom©**
- **Unemployment Rate: Aged 15-64: All Persons for the Euro Area©**



Shaded areas indicate US recessions - 2014 research.stlouisfed.org

Overall HICP inflation rate by countries: October 2014

Legend

- <1
- ≥ 1 - <1.5
- ≥ 1.5 - <2
- ≥ 2 - <2.5
- ≥ 2.5 - <3
- ≥ 3 - <4
- ≥ 4 - <5
- ≥ 5 - <6
- ≥ 6

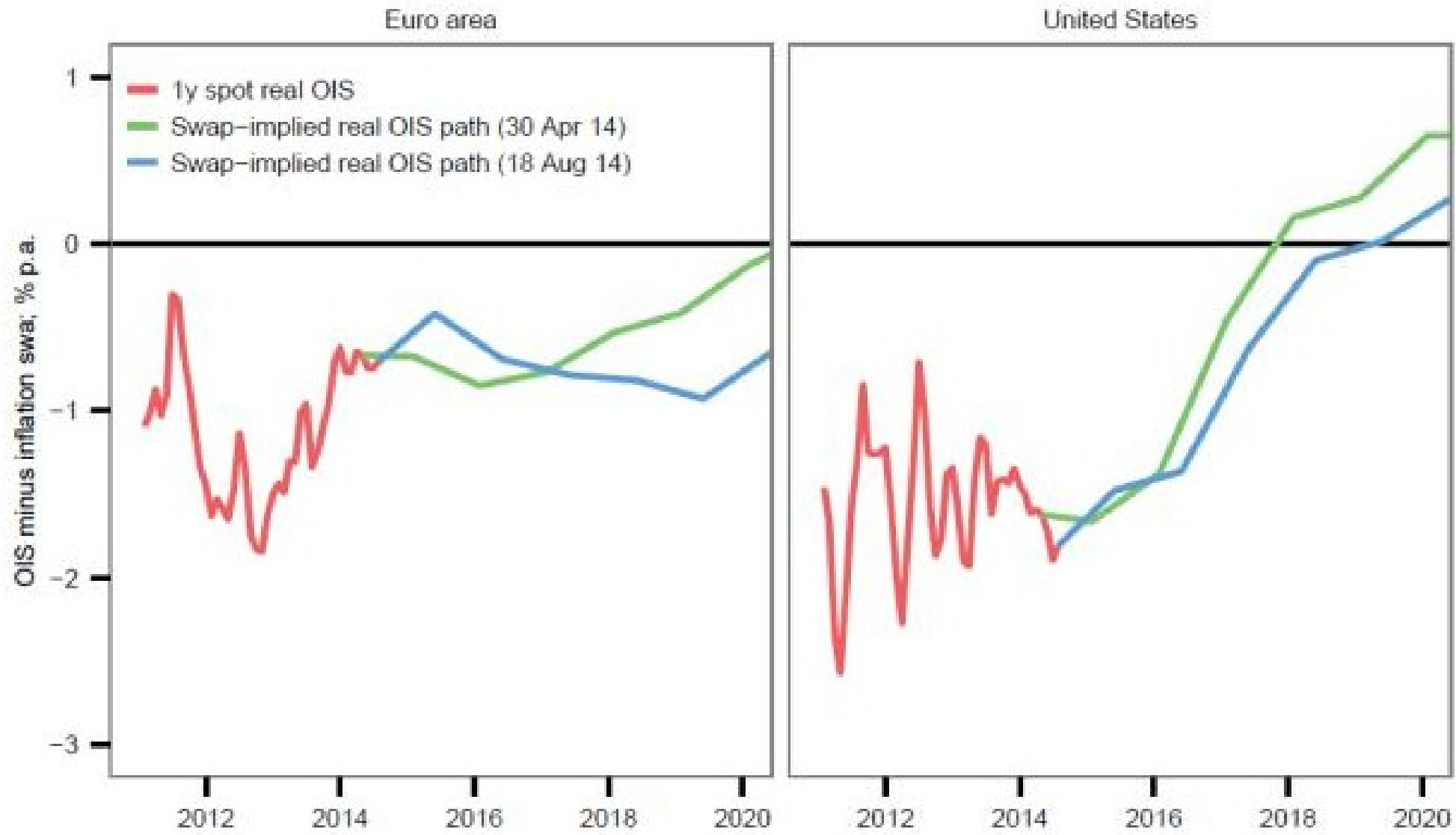
Euro area: 0.4% (EU: 0.5%)

Min.: -1.8% (Greece)

Max.: 1.4% (Austria)



Figure 7: Expected real interest rate path in the euro area and the US



German inflation rate



Source: Thomson Reuters Datastream, data to Oct 14

V.Flasseur @ReutersGraphics

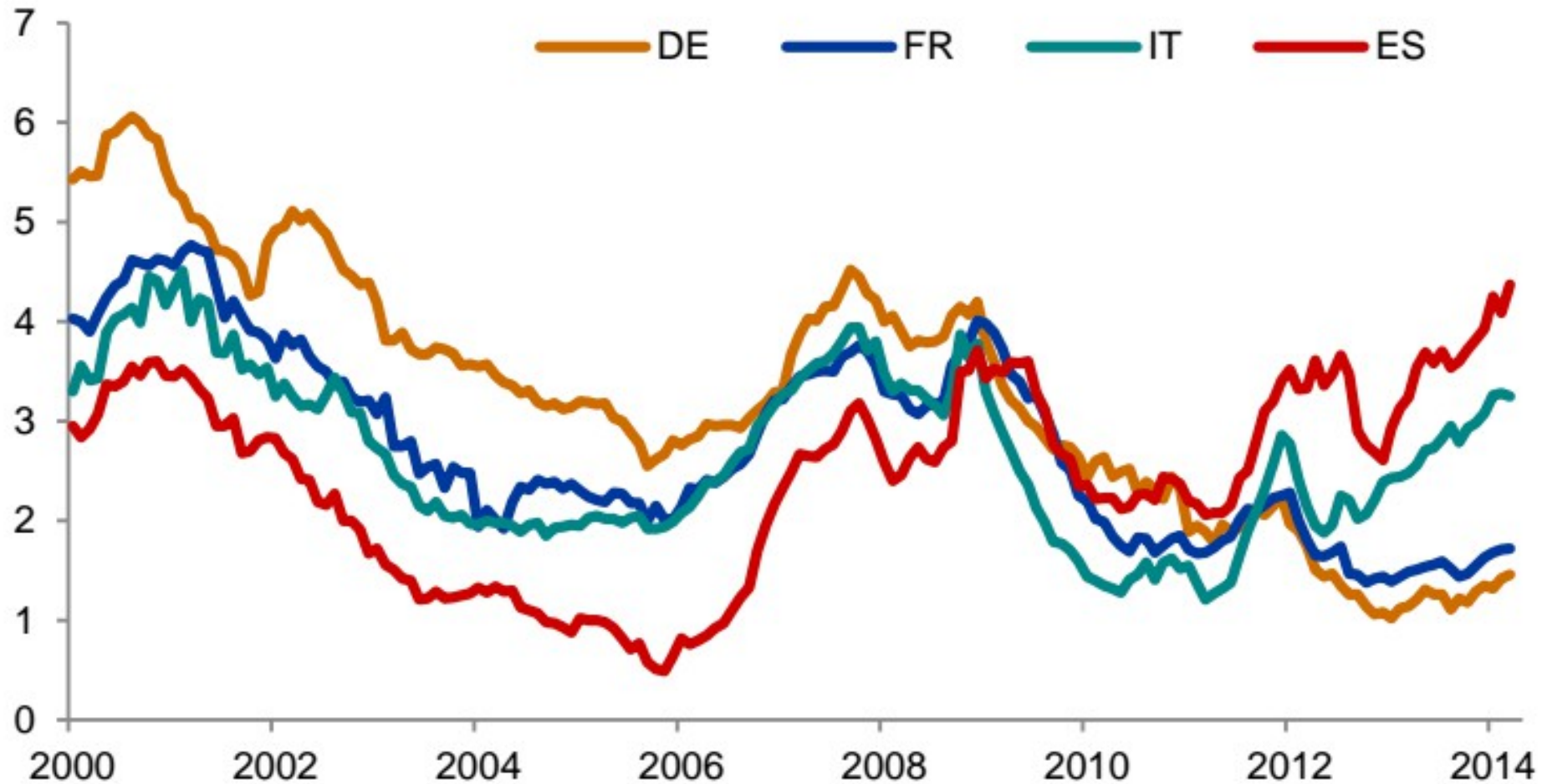
ECB alternatives

- Interest rates already at lower bound. Negative deposit rate has depressed bond yields but not increased bank lending
- Forward guidance: works for a while, but eventually talk has to be supported by action
- Purchases of sovereign bonds (QE) opposed by Bundesbank and German politicians. Legality could be challenged (as with OMT)
- Purchases of private sector assets (ABS). Coupled with TLTRO, intended to persuade banks to lend.

ECB dilemmas

- One-size-fits-all monetary authority cannot resolve monetary policy transmission problems. Real rates far higher in periphery than core.
- Article 123 prevents ECB supporting distressed Euro area fiscal authorities. Markets still convinced by “whatever it takes” – for now. But OMT under legal challenge.
- ECB cannot force banks to lend by throwing money at them. Repairs to bank balance sheets reduce risk of bank failure but do not encourage lending, especially at high risk.

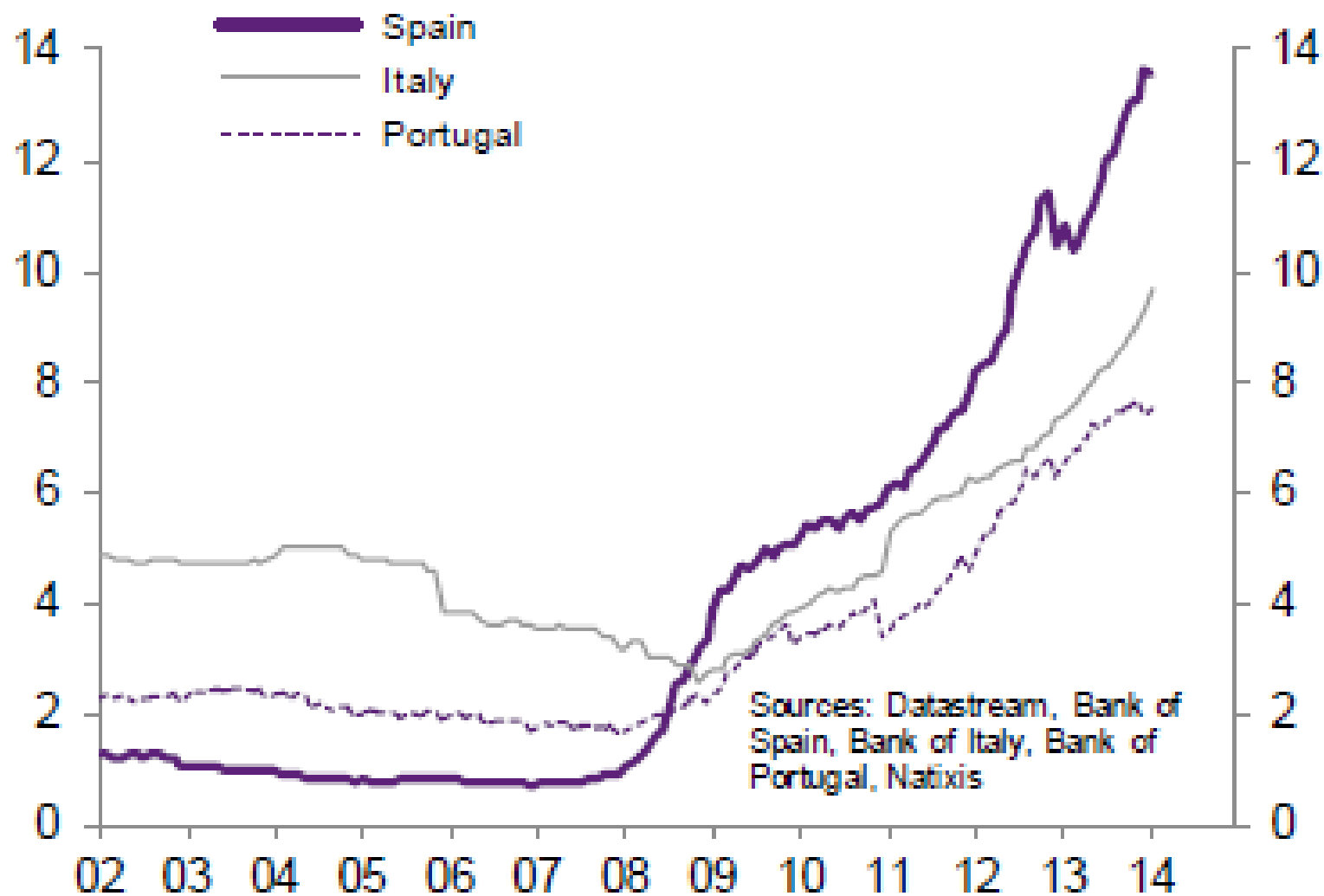
Chart of the Day: Real interest rates at which banks lend to NFC: Fragmentation



Source: ECB, Consensus Economics, BofA Merrill Lynch Global Research

Note: bank lending rates to NFCs (all maturities, amount \leq EUR 1Mil, new businesses), deflated by 1Y Consensus CPI forecasts.

Non-performing loans (as % of total loans)



The Lisbon Treaty

Article 123

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1. Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.

2. Paragraph 1 shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the European Central Bank as private credit institutions.

Euro design faults

- Euro was designed as a “currency without a government”. Lack of federal fiscal authority is a feature, not a bug.
- Hard separation between monetary and fiscal policy impossible in practice. Article 123 prevents ECB from doing its job properly.
- Missing federal level means ECB has to act as fiscal enforcer to prevent currency collapse.

Two alternatives

- Continuing with present design requires:
 - Mechanism to enforce balanced trade and capital accounts between member states
 - Larger role for national Central Banks in managing local monetary conditions
 - Capital controls (as in Cyprus)
 - Possibly parallel local currencies
- Federal Eurozone fiscal authority:
 - Full banking union with common deposit insurance
 - Common debt issuance

Which way are we going?

Federal?

- Juncker programme
- “Draghinomics”

BUT.....

- Opposition to common debt issuance
- Opposition to common deposit insurance and full banking union
- Opposition to federal-level automatic stabilisers

Politics

The Eurozone crisis is above all political.....

.....Is there really a democratic mandate for a “United States of Europe”?