

EMU 11: VIBRANT ECONOMIC AREA?

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Euroland: Relatively Bright Future...

"Euroland will keep the distinction of being the most vibrant economy in the world."

Euroland will keep the distinction of being the most vibrant economy in the world. The rest of the world, however, will remain or begin to show a relative decline. The U.S. economy will most likely slow next year, and Asia still has a way to go before a full recovery.

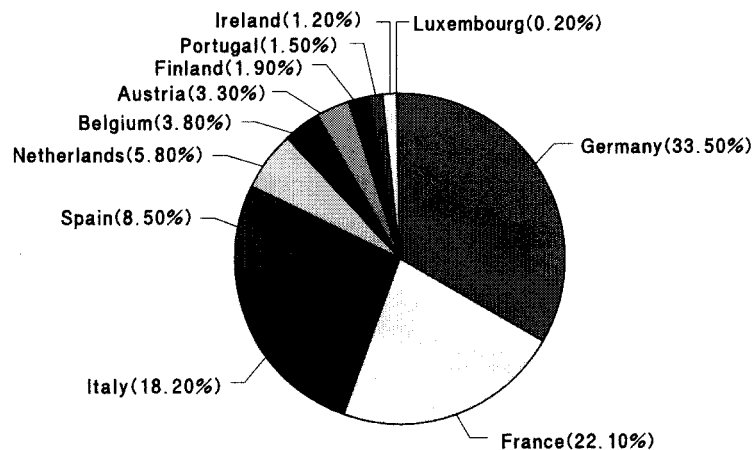
Euroland has several positive factors. First, European fiscal policy has already turned from pre-EMU austerity to neutrality this year, contributing to a recovery in domestic demand, and Europe's new center-left governments will probably implement modest fiscal stimulus packages next year. Second, central bank benchmark interest rates were already much lower in Europe than they were in the U.S. and the U.K., even before the latest moves which lowered the 3-month repo rates from 3.3% to

3%. Third, consumers are benefiting from low import prices, notably for raw materials like oil.

On the other hand, most leading economic indicators are turning down due to the slowdown in global export markets, even though domestic conditions are generally good and seem likely to remain so. The overseas weakness suggests that economic growth will slow markedly in the fourth quarter and early in 1999. Instead, Euroland and the U.S. are likely to be global importers of last resort next year. It is expected that the stagnation in net exports will subtract at least 0.4-0.5 percentage points from Euroland's GDP growth in 1999. With a more-subdued export outlook, an inventory correction is inevitable, and it could be a drag on GDP in the coming months.

Nevertheless, the recent economic slowdown in Euroland will prove to be temporary and not

<GDP Shares of EMU 11, 1997>



<Economic Outlook for Euroland>

	<i>(unit: %, ECU bn.)</i>			
	1996	1997	1998(p)	1999(f)
Real GDP Growth(y-o-y)	1.6	2.5	2.8	2.4
Unemployment Rate	11.8	11.9	11.2	10.3
CPI(y-o-y)	2.2	1.6	1.2	1.4
Current Account	71.1	104.1	90.0	80.0
Budget Balance (% of GDP)	-4.2	-2.6	-2.5	-2.9

as severe as the 1995~96 downturn. Economic growth will most likely be faster in the peripheral countries than in the core countries because low interest rates will provide bigger boosts to domestic demand in countries like Spain, Portugal, and Ireland.

In these forecasts, the most risky factor is unemployment. By the Maastricht treaty, member countries must observe convergence and stability criteria in their budget deficits (under 3% of real GDP) even after the official launch of the single currency. When a member country experiences severe unemployment problems, inevitably its government will

implement an expansionary fiscal policy if it consists of "new left" officials who regard unemployment as the most important policy agenda. Right wing governments have gone through painful integration processes, satisfying convergence criteria. However, new member governments including Germany may take much a more aggressive attitude against unemployment, sacrificing budget stability. In other words, the new left regimes can make the EMU system unstable, expanding budget deficits to solve high unemployment even though they will drop out of the EMU. This is the most outstanding forecast risk. **VIP**