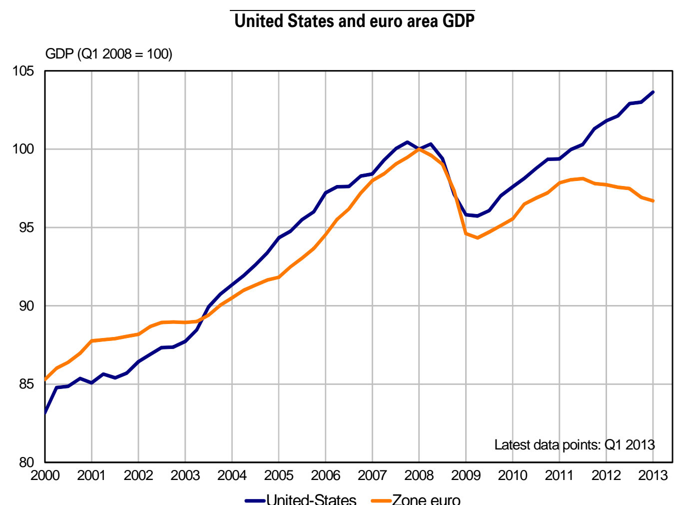
No. 114
July 2013
TRÉSOR-ECONOMICS

Why the GDP growth «gap» between the United States and the euro area?

This study was prepared under the authority of the Directorate General of the Treasury (DG Trésor) and does not necessarily reflect the position of the Ministry of Economy and Finance and Ministry of Foreign Trade

- Since the sovereign debt crisis in the euro area intensified in the summer of 2011, the growth paths of the United States and the euro area-which were closely linked beforehand, even during the crisis-have been diverging. In 2012, U.S. growth held firm at 2.2%, whereas the euro area slipped into a new recession, with GDP growth in negative territory at –0.6%. This divergence is mainly due to the relative vigour of U.S. private-sector growth engines. In the euro area, by contrast, only one factor can cushion the economic downswing: foreign trade.
- The U.S. economy has weaker automatic stabilisers and a more flexible labour market than the euro area, which explains its generally wider cyclical swings and justifies the use of more responsive macroeconomic policies. During the 2008-2009 crisis, the United States experienced a milder contraction than the euro area thanks to a more substantial stimulus package. However, the adjustment in employment and wages was greater in the United States, preserving the financial position of businesses.
- Another important factor in the current divergence is the policy mix. In 2011-2012, the fiscal consolidation was milder in the United States than in the euro area, where it intensified during the sovereign debt crisis owing to the constraints of fiscal rules and pressures from financial markets. Moreover, the U.S. adjustment has been gradual and is taking place amid an economic recovery. In the euro area, by contrast, fiscal consolidation plans largely concern the weakest countries, where private demand is adjusting in a context of balance sheet adjustments. As a result, the plans are generating crosswinds due to the strong commercial ties among EU Member States. Because of financial fragmentation, the private sector's access to funds is harder in the euro area than in the United States, particularly for the most troubled countries.
- In the years ahead, however, the divergence may narrow. Financial conditions in the euro area have distinctly improved since summer 2012, thanks to the measures implemented by the European Central Bank (ECB) (including the announcement of outright monetary transactions [OMT]), and the announcement of the creation of a single supervisory mechanism-the first step toward a banking union. The efforts still needed to cut the public and current-account deficits are greater in the United States than in the euro area. Over the medium term, U.S. public finances are in a weaker structural position than those of the euro area.

United States and euro area GDP



Sources: BEA, Eurostat.

MINISTÈRE DE L'ÉCONOMIE ET DES FINANCES
MINISTÈRE DU COMMERCE EXTÉRIEUR

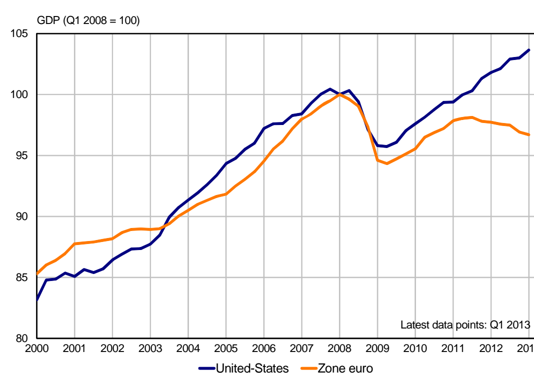
1. The U.S. and euro area growth paths, hitherto closely linked, have been diverging since mid-2011, mainly because the euro area's private-sector growth engines have stalled

Despite the fact that the 2007/2008 crisis originated in the United States, the country's economy has been slightly less impacted. Between Q4-2007 and Q2-2009 , GDP fell 4.7% in the United States versus 5.2% in the euro area. After mid-2009, the two regions registered broadly similar recoveries, but that ceased to be the case in mid-2011, when the sovereign debt crisis spread to Spain and Italy. Since mid-2011, the growth dynamics have been diverging sharply (see Chart 1), with major disparities between countries.

In 2012, the growth gap between the United States and the euro area reached nearly three points at 2.2% versus –0.6%, because the private-sector engines, which underpin US growth stalled in the euro area.

- **Private consumption has been resilient in the United States**, contributing 1.3 points to GDP growth compared with a negative 0.6 points in the euro area. Fuelled by employment and wages, it was the main engine of U.S. growth. In the euro area, by contrast, private consumption remained depressed owing to the impact of job losses on disposable income, to wage restraint in many countries, and to fiscal consolidation. Consumption was also hit by negative wealth effects-notably in Spain and Italy-as well as by rising unemployment and uncertainty.
- **Investment and inventories have also remained fairly buoyant in the United States, gaining 1.2 points versus a 1.4 point decline in the euro area.** For the first time since the outbreak of the crisis, residential investment made a positive contribution to U.S. growth in 2012. By contrast, the weak demand outlook and high uncertainty in the euro area caused a fall in both residential investment-particularly in Spain and the Netherlands-and investment in capital goods.
- **Other demand components have curbed the growth gap between the two regions.** In the United States, foreign trade has had a neutral effect on growth. In the euro area, it is the only growth engine, contributing 1.6 points. The phenomenon is most visible in the peripheral countries of the area, a sign of the current rebalancing of these economies. Their imports have declined because of the recession, whereas their exports have picked up thanks to the gradual reduction in their cost-competitiveness deficit. As regards public consumption, it has been a slightly stronger growth inhibitor in the United States.

Chart 1: United States and euro area GDP

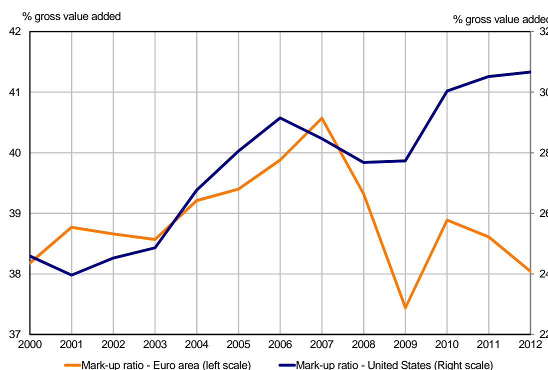


2. The U.S. economy responds more strongly to shocks than the euro area and rebounds more vigourously during recoveries

Automatic stabilisers are weaker in the United States than in the euro area, making the U.S. economy more vulnerable to shocks. Automatic stabilisers are estimated to reduce economic volatility by some 10% in the United States versus 25% in the euro area, with a fairly wide disparity between countries (see Box 1). Shocks are thus dampened more effectively in Europe by a more comprehensive and progressive tax and social-protection system. Although the ultimate impact of the crisis has been milder on American GDP, this was mainly due to the difference in the size of the stimulus packages, which were twice as large in the United States (see below).

During the crisis, a large share of the adjustment in the United States concerned the highly flexible labour market, which allowed businesses to preserve their financial positions. In the euro area, firms trimmed their margins to preserve jobs and wages (see Chart 2). In 2008-2009, the U.S. economy shed nearly 8 million jobs, the unemployment rate doubled (from 4.6% in 2007 to 9.3% in 2009: see Chart 3), and real wages declined by 0.6%. In the euro area, the social partners worked to preserve wages and employment, in particular through the implementation of agreements on partial unemployment in Germany, Italy, and France. Between 2007 and 2009, unemployment consequently posted a milder increase, from 7.6% to 9.6%, and wages continued to rise, gaining 2.4% in real terms. However, these figures conceal sharp disparities between countries, as unemployment surged from 8.3% to 18.0% in Spain and from 4.7% to 12.0% in Ireland. Faced with a loss of competitiveness and a need to reduce their debt, these countries saw their domestic demand collapse.

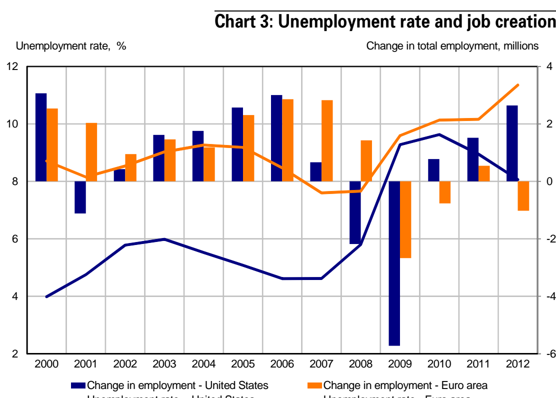
Chart 2: Rate of mark-up of non-financial corporations



Sources: Bureau of Labor Statistics and Eurostat.

How to read this chart: The mark-up ratio of non-financial corporations (ratio of gross operating surplus to gross value added) was 31% in United States and 38% in the euro area in 2012.

Chart 3: Unemployment rate and job creation



Sources: Bureau of Labor Statistics and Eurostat.

How to read this chart: In 2009, 5.7 million jobs were destroyed in the United States and 2.7 million in the euro area, raising the unemployment rate to 9.3% and 9.6% respectively.

Since bottoming out in 2009, the U.S. economy has rebounded more sharply. U.S. businesses have a solid financial base, having entered the crisis with far lower debt levels than their euroarea counterparts (97% versus 133% of value added at end-2008). Thanks to a classic accelerator mechanism, investment rebounded when the economy started to pick up again in 2011. Wages posted fairly brisk gains, underpinning household income and consumption. In the euro area, by contrast, businesses are creating few jobs or are still shedding them, while curbing wage gains to restore profitability. Unemployment is rising. At the same time as slack growth in household income is inhibiting consumption, firms are cutting back on investment and drawing down inventories. These trends are most visible in the weakest economies, i.e., the countries under IMF programmes, Spain, and Italy.

Box 1: **Automatic stabilisers and their impact on the economy**

Automatic stabilisers denote the spontaneous responses of the tax and social-protection system that attenuate the economy's cyclical swings. For example, the job losses caused by an economic downswing automatically trigger the payment of unemployment benefits that sustain household income and consumption, ultimately dampening the initial effect of the shock on the economy. Conversely, when the economy is expanding, a progressive taxation system slows economic activity as tax levies increase faster than earned income, reducing disposable income and hence consumption.

We can quantify the effect of automatic stabilisers on the economy by comparing the change in GDP after an exogenous shock when the tax and social-protection system operates ("scenario with stabilisers") and when the shock is neutralised, i.e., when revenues and expenditures are set at their structural level ("scenario without stabilisers"). Van der Noord[a] estimated the role of automatic stabilisers in OECD countries in the 1990s using the INTERLINK model as follows:

$$\text{impact auto stab} = \frac{\sqrt{\frac{1}{10}\sum_{1991}^{2000}\left[\frac{(y_t^{ss}-y_t^*)}{y_t^*}\right]^2}}{\sqrt{\frac{1}{10}\sum_{1991}^{2000}\left[\frac{(y_t^{as}-y_t^*)}{y_t^*}\right]^2}} - 1$$

where y^* is potential GDP, y^{ss} is GDP in the scenario without stabilisers, and y^{as} is GDP in the scenario with stabilisers.

GDP with stabilisers is actual GDP. GDP without stabilisers is the output level that would have been observed if public revenues and expenditures had been set at their structural level. This level is estimated by stripping out the cyclical component from actual public revenues and expenditures. The cyclical component is determined by the output gap and the elasticity of revenues and expenditures to the gap.

The impact of automatic stabilisers varies sharply, not only with the scope of the tax and social-protection system but also with the type of shock (demand or supply shock), the degree of openness of the economies, and the monetary policy response.

- In the United States, after a demand shock, automatic stabilisers are reckoned to dampen economic volatility by approximately 10% (8-12% according to Cohen and Follette,[b] 8% according to Auerbach and Feenberg,[c] and 25% according to Van der Noord), but appear to have almost no effect after a supply shock (Cohen and Follette).
- In the euro area, Van der Noord estimates the dampening effect of automatic stabilisers at around 25%, with major disparities between countries: approximately 20% for France, Spain, and Greece, versus over 50% for Germany and Finland. But according to Barrel and Pina,[d] the stabilisers' smoothing effect on cyclical fluctuations is only 11% for the euro area as a whole, 7% for France, and 18% at most for Germany-notably because stabilisers are relatively inefficient in coping with supply shocks. Using the MESANGE model, Espinoza[e] estimates that stabilisers attenuate demand shocks in France by about 10% the first year and 20% by the end of the second year. However, they appear to be less effective in response to a supply shock and could even prove pro-cyclical in certain cases such as an oil shock.

a. Van den Noord, P. (2000), "The size and role of automatic fiscal stabilisers in the 1990s and beyond," OECD *working paper*.
b. Cohen and Follette, (2000), "The automatic fiscal stabilizers: quietly doing their thing", *FED of New York Economic Policy Review*, avril.
c. Auerbach A.J. et Feenberg D., (2000), "The significance of federal taxes as automatic stabilizers", *Journal of Economic Perspective*, American Economic Association, vol. 14(3), pp. 37-56, Summer.
d. Barrel R. et Pina A. M. (2003), "How Important are Automatic Stabilizers in Europe ? A Stochastic Simulation Assessment", *Economic Modelling*, vol. 21, pp. 1-35.
e. Espinoza, R, (2007), « Les stabilisateurs automatiques en France », *Économie et prévision*, 1/2007 (n° 177), pp. 1-17.

3. Fiscal policies have been widening divergences, especially since summer 2011

During the crisis, both areas stimulated their economies, but the United States did so more massively. In 2008-2010, the growth gap between the United States and the euro area reached one point of GDP. At the same time, the stimulus was twice as powerful in the United States, whose primary structural balance shifted by a negative 5.9 points of potential GDP versus a negative 3.0 points in the euro area according to the IMF (see Chart 4). The U.S. federal government immediately adopted two massive stimulus packages for a combined total of nearly $1 trillion (see Box 2) as well as plans targeting the hardest-hit sectors-the financial, automotive, and real estate sectors. The fiscal consolidation performed by all the state governments under their budget rules was offset, when the crisis reached its peak, by the fiscal stimulus from the federal government. Nearly all U.S. states are required by law to balance their operating budgets. Deficits cannot be covered by debt issuance, unless the debt is earmarked for investment.

Box 2: **Main fiscal measures adopted in response to the crisis**

United States

- **Stimulus packages (2008-2010)**
  - ***Banking sector***
    - Ensuring financial stability through the purchase and guarantee of "toxic" assets: TARP (Troubled Assets Relief Program), October 2008.
  - ***Households, businesses, public sector***
    - Tax credits: Economic Stimulus Act of 2008, February 2008.
    - Tax credits, assistance to households in financial need, public investment: ARRA (American Recovery and Reinvestment Act), February 2009.
    - Extension of ARRA measures for households and businesses: Tax Relief Act (Tax Relief Act, Unemployment Insurance Reauthorization Act, and Job Creation Act), December 2010.
  - ***Sectoral measures***
    - Support for the automotive industry (GM, Chrysler): via TARP.
    - Support for the automotive industry (GM, Chrysler): via TARP.
- **Consolidation measures (2011-2012)**
  - Expenditures: 10-year cuts in public spending, BCA (Budget Control Act), August 2011.
  - Revenues: end of stimulus measures (end of reduction in social contributions and tax credits for the wealthiest individuals).

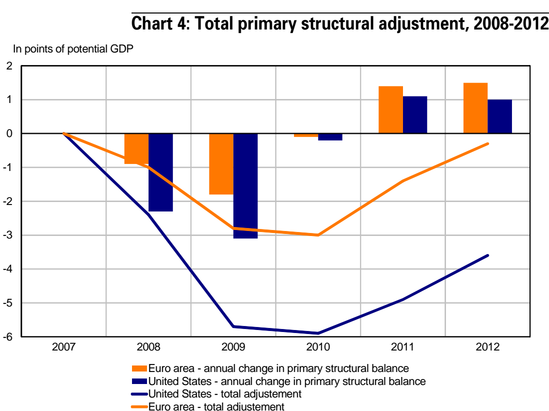
Euro area

- **Stimulus packages (2008-2010)[a]**
  - ***Banking sector***
    - Consolidation measures for bank liabilities (guarantees to facilitate banks' access to medium-term liquidity/resources, strengthening of capital base through recapitalisation/nationalisation).
    - Treatment of impaired assets (clean-up of balance sheets through guarantees, ringfencing or purchase of risky assets).
  - ***Households, businesses, public sector***
    - Wage bonuses, tax relief/deduction, establishment of public investment/R&D funds, support for small businesses.
    - Support for the labour market (partial unemployment, exemption from social contributions, hiring bonuses).
  - ***Sectoral measures***
    - Support for the automotive sector (loans to automakers, car scrapping bonuses).
    - Support for the real estate sector (public housing, tax incentives).
- **Consolidation measures (2011-2012)**
  - Expenditures: cuts in social spending (education, employment, healthcare, pensions), transfer payments to local government, and ministerial spending (current expenditures and infrastructure investment).
  - Revenues: closure of tax loopholes, rise in direct taxes (e.g., property tax, income tax, wealth tax, corporation tax) and indirect taxes (e.g., excise duties, VAT), fight against tax evasion and avoidance.

a. Banque de France (2010), « De la crise financière à la crise économique », *Documents et débats*, january.

Source: DG Trésor.

Chart 4: Total primary structural adjustment, 2008-2012



Sources: IMF, Fiscal Monitor, April 2013, DG Trésor.

How to read this chart: In 2012, the structural adjustment in the euro area amounted to 1.1 points of potential GDP, bringing the total structural adjustment for 2007-2012 to a negative 0.3 points of potential GDP. In the United States, the structural adjustment came to 1.3 points of potential GDP in 2012, bringing the total structural adjustment to a negative 3.6 points of potential GDP for the same period.

Since 2011, the euro area has achieved a slightly greater fiscal consolidation than the United States. The euro area's structural adjustment, partly conducted in response to market pressure, is estimated by the IMF at nearly 2.7 points of potential GDP in 2011-2012. The U.S. fiscal consolidation came to 2.3 points, despite the far steeper rise of the structural deficit than in the euro area with the adoption of the 2008/2009 stimulus packages.

In particular, the intensification of the sovereign debt crisis and its spread to Spain and Italy in summer 2011 forced the countries concerned to engage in a massive fiscal consolidation, which hit their economies very hard. Since mid-2011, new consolidation measures have been implemented. In 2012, according to the IMF, Spain and Italy improved their cyclically adjusted primary balance by 3.1 and 2.3 points of potential GDP respectively, compared with an initially expected outcome of 0.8 and 1.9 points respectively in September 2011.[1] The steady worsening of their economies in 2012 took the recession to 1.4% and 2.4% respectively (see

(1) IMF, Fiscal Monitor, September 2011 and April 2013.

table). By comparison, the IMF, applying its own methodology, estimates that the fiscal adjustment in 2012 was smaller in Germany (1.4 points) and France (0.7 points), whose economies experienced moderate or stable growth.

The simultaneous fiscal adjustments eroded growth in the euro area as a whole. The European economies are relatively small and closely integrated through trade, hence fiscal consolidation performed in one economy generates negative knock-on effects for the others. This impact is significant and can, in some cases, outweigh the effect of a national plan. For example, the impact of the main euro area partners' plans on Belgium, Portugal, and the Netherlands has been estimated at half a point of GDP growth annually since 2011.

Tableau : Divergence in euro area figures

	United States	Euro area	Germany	France	Spain	Italy
GPD 2012	2.2	–0.6	0.9	0.0	–1.4	–2.4
Primary structural balance in 2010	–6.7	–2.4	–1.4	–2.9	–6.9	0.8
Structural adjustment in 2011	1.0	1.6	2.3	1.5	1.2	0.9
Structural adjustment in 2012	1.3	1.1	1.4	0.7	3.1	2.3

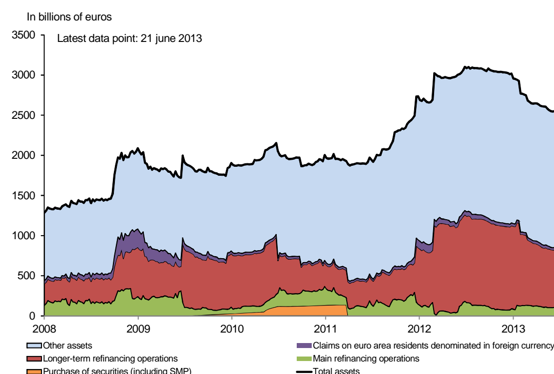
Sources: IMF, Fiscal Monitor - April 2013, BEA, Destatis, INE, INSEE, Istat.

4. Monetary policies have also differed

Since the 2008/2009 crisis, monetary policies have been largely accommodative in both areas but with major differences (see Box 3).

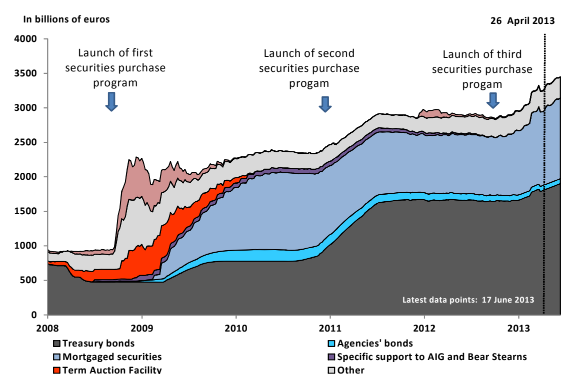
As regards "conventional" monetary policy, while the European Central Bank (ECB) and U.S. Federal Reserve (Fed) have now both set their key rates at near-floor levels, rate cuts have been steeper in the United States. Concerning "unconventional" monetary policy, both the ECB and the Fed have fully served as lender of last resort to the banking system in the first phase of the crisis (2007-2009). In the second phase (2010-2012), the ECB, while refusing to fully act as lender of last resort to governments,[2] mainly intervened to keep the banking system functioning smoothly, then to preserve the very integrity of the euro area. Its purchases of public debt were limited to just over €200 billion, or 2.5% of euro area GDP, but the volume of refinancing transactions for the banking sector rose steeply (see Chart 5), partly helping to ease tensions on sovereign debt. This was followed by the announcement of the OMT programme.[3] Meanwhile, after financial tensions had eased in the United States, the Fed made massive purchases of mortgage-backed securities (MBS) and Treasury bonds to support economic growth and stimulate the recovery of the real estate market. These purchases totaled 20% of GDP and 90% of Fed assets (see Chart 6).

Chart 5: Eurosystem balance sheet assets



Sources: ECB, DG Trésor.

Chart 6: Federal Reserve's balance sheet assets



Sources: Fed, Washington Regional Economic Department (Service Economique Régional) calculations.

With credit demand at a modest level, monetary easing broadly fostered an upturn in asset prices and a decline in the cost of credit, but more significantly in the United States. U.S. monetary policy quickly eased lending conditions for households and businesses alike. Partly stimulated by lower interest rates, the rise in financial and realestate asset prices played a major role in supporting household income, quickening the pace of debt reduction and promoting consumption via wealth effects. In the euro area, after an initial easing, credit conditions tightened as a result of the sovereign debt crisis. This has a negative effect on the financing of the economy, all the more so because bank lending accounts for a greater share than in the United States. For the past few quarters, credit conditions have been gradually easing thanks to ECB interventions. Nevertheless, credit demand remains limp.

(2) The ECB's reluctance to buy up European debt securities is partly due to legal reasons, as European treaties and ECB statutes forbid explicit funding of Member States by the Eurosystem.

(3) The summer of 2012 marked a turning point, with Mario Draghi promising on July 26 that the ECB would do "whatever it takes" (…"and, believe me, it will be enough") to ensure the euro's survival. His statement was followed in August-September 2012 by the announcement of an outright market transactions (OMT) programme, theoretically open-ended but conditional in practice upon a request for financial assistance under the European Stability Mechanism (ESM).

Box 3: Main monetary policy measures adopted in response to the crisis and exchange rate fluctuations since 2007

United States

- **Conventional policies: interest rates**
  - **May 2007-December 2008**: fast, deep rate cuts (from 5.25% to 0-0.25%: see Chart 7).
- **Non-conventional measures for banking sector**
  - **2007-2010**:
    - Currency swaps with fourteen central banks to ensure short-term liquidity supply;
    - *Measures to facilitate banks' short-term refinancing (Term Securities Lending Facility and Term Auction Facility);*
    - Granting of additional liquidity (Funding Facility and Term Asset-Backed Securities Loan Facility).
- **Non-conventional measures in sovereign and real estate markets :**
  - *"Quantitative easing" (QE), extension and modification of Fed balance sheet:*

    (i) **QE1, november 2008**: purchase of $500 bn in mortgage backed securities (MBS) + $100 bn in direct obligations of government-sponsored enterprises (GSEs); March 2009: purchase of $300 bn in Treasury securities + $750 bn in MBS + $100 bn in direct obligations of government-sponsored enterprises (GSEs);

    (ii) **QE2, november 2010**: purchase of $600 bn in Treasury securities;

    (iii) **QE3, september 2012**: "unlimited" program of MBS purchases ($40 bn/month) until "significant" improvement in labour market; since January 2013: purchase of $45 bn/month in Treasury securities with maturities of over three years.
  - *"Operation Twist": maturity extension program (MEP) for Fed portfolio:*

    September 2011 at December 2012: sale of $667 bn in short-term Treasuries to finance purchase of long-term securities.
  - *"Forward guidance": Fed communication strategy to restore confidence and anchor expectations:*

    August 2011: commitment to keep rates low until mid-2013.

    January 2012: commitment to keep rates low until end-2014 and disclosure of previously implicit long-term inflation target of 2%.

    September 2012: commitment extended to mid-2015.

    December 2012: commitment to keep rates low as long as unemployment rate exceeds 6.5%, to the extent that two-year inflation projections stay below 2.5% and long-term inflation expectations remain stable.

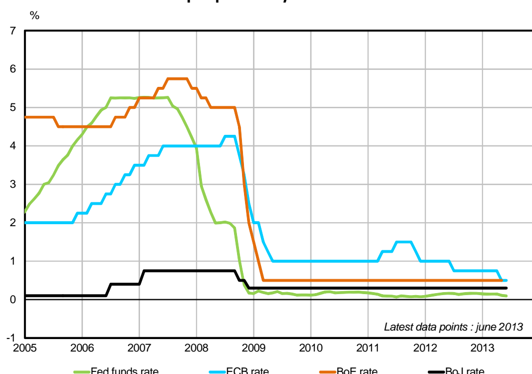
- **Real exchange rate** (see Chart 8):
  - The U.S. real effective exchange rate, after a steep rise at end-2008, eased slightly and has remained relatively stable since mid-2009.

Euro area

- **Conventional policies: interest rates**
  - **October 2008-May 2009**: 325 basis point (bp) cut.
  - **April and July 2011**:two new 25bp rises.
  - **2012**: three consecutive cuts, ultimately lowering the main refinancing rate to 0.75% and the deposit facility rate-which serves as the floor rate for the Euro OverNight Index Average (EONIA) in the interbank market-to 0% (see Chart 7).
- **Non-conventional measures for banking sector**
  - **Since december 2007** :
    - Currency swaps with other central banks (including the Fed), allowing a liquidity supply in foreign currency (dollars).
  - **Since october 2008** :
    - Refinancing operations with unlimited allocation (fixed rate);
    - Maturity extension for refinancing operations (3 months, 6 months, one year, and now 3 years since December 2011);
    - Easing of eligibility criteria for collateral put up for refinancing operations.
  - **September and December 2011**: new enlargement of range of collateral accepted, including additional bank receivables, in conjunction with announcement of 3-year operations.
- **Non-conventional measures in sovereign markets:**
  - **May 2010**: launch of Securities Market Programme (SMP) to purchase securities. Total holdings ultimately reached just over €200 bn or 2.3% of euro area GDP. Renewed in August 2011 for Spain and Italy. Purchases announced as temporary and limited (the markets having factored in a ceiling of €20 bn per week), restraining the programme's impact.
  - **September 2012**: launch of a new programme to purchase sovereign securities (Outright Monetary Transactions: OMT), unlimited in theory but, in practice, conditional upon a request for financial assistance under the European Stability Mechanism (ESM).

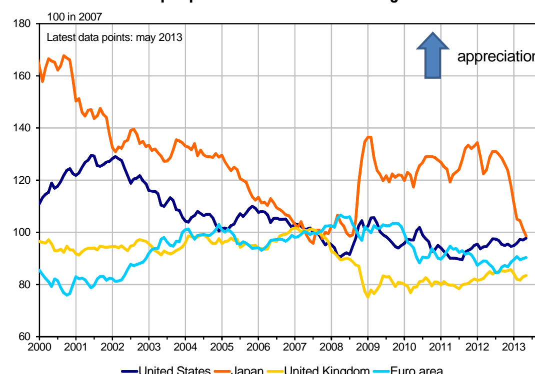
- **Real exchange rate** (see Chart 8):
  - The euro area's real effective exchange rate has depreciated since the crisis, facilitating exports. However, the trend has been reversing in recent months owing to the yen's depreciation, which began in summer 2012.

Graphique 7 : Key interest rates



Source : Data Insight.

Graphique 8 : Real effective exchange rate

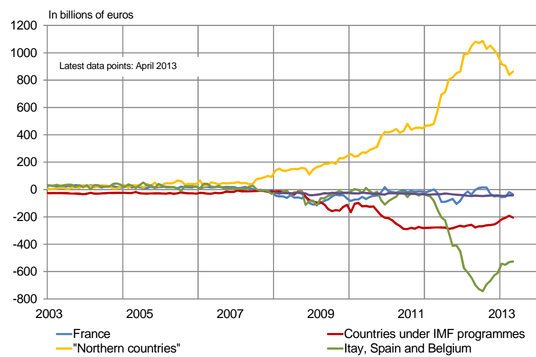


Source : Data Insight, DG Trésor.

Since 2008, but at a faster pace in 2010-2011, the euro area experienced heavy financial fragmentation. Banking flows and investment were "renationalised," while banks, investors, and depositors remained wary of countries under pressure. This fragmentation generated interest rate gaps for economic agents inside the euro area. The euro area countries under pressure-Ireland and Greece in 2008, joined by Portugal in 2010 and Italy and Spain in 2011-suffered a massive flight of private capital. By contrast, the countries whose financial position was deemed solid registered a net inflow of private capital. This was mainly due to the repatriation of capital invested abroad. The trend concerned the northern euro area countries including Germany, but also France in 2010 and-before an abrupt reversal in 2011-Italy and Spain (see Chart 9).

Financial fragmentation in the euro area has decreased significantly since summer 2012, in particular after the OMT announcement. Whereas the three-year refinancing operations of mid-December 2011 and end-February 2012 had accelerated cross-border financial segmentation, the OMT announcement prompted a partial reintegration of capital markets in the euro area.

Chart 9: Net TARGET-related claims of national central banks (NCB) on Eurosystem



Source: International Financial Statistics, IMF.

Key: "Countries under IMF programmes": Greece, Ireland, Portugal; "Northern countries": Germany, Netherlands, Finland, Luxembourg; "Small countries": Slovenia, Malta, Austria; data unavailable for other countries.

Note: Net cash positions of national central banks (NCB) on Eurosystem payment system (TARGET2). The estimate is calculated by deducting net claims arising from net issuance of euro banknotes from intra-Eurosystem net claims. Net claims arising from transfers of foreign exchange reserves from NCB to ECB are omitted here because of their negligible amounts.

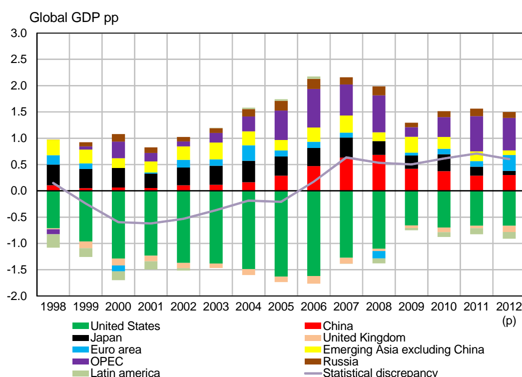
5. The divergence should, however, narrow somewhat in the years ahead owing to the persistence of sharp imbalances in the United States and to the implementation of major structural reforms in the euro area

The United States still exhibits major current account and fiscal imbalances.

The United States remains one of the main contributors to global imbalances. Its current account deficit, which has held steady since the crisis, was still running at 0.7 points of global GDP in 2012. Meanwhile, the euro area's current account has moved from near-breakeven in 2009 to a surplus of 0.3 points of global GDP in 2012 (see Chart 10). Moreover, according to the IMF, U.S. public debt,[4] which was smaller than that of the euro area in 2006, surged in six years to 107% of GDP versus 93% for the euro area in 2012 (see Chart 11). In the short run, the euro area public deficit is expected to shrink. Although the U.S. public deficit will remain higher, it is projected to decline as well-thanks not only to fiscal consolidation but to non-recurring factors in 2013: the payment of dividends by Fannie Mae and Freddie Mac equal to 0.6 points of GDP, and strong growth in tax revenues.[5] The U.S. public debt should stabilise at around 107% of GDP in 2018[6] compared with 90% in the euro area. To lessen its debt burden, the United States must adopt new consolidation measures that will put its public finances on a sustainable path.

The other internal imbalances in both regions are being reduced. In the United States, real estate prices started moving up again in 2012 after four consecutive years of decline. Combined with the positive trend in other indicators-a rise in housing sales, housing starts, and building permits, and a fall in housing inventories-the price rise confirms the recovery in the U.S. real estate market. Meanwhile, U.S. households appear to have nearly completed their balance sheet adjustment (see Chart 12).

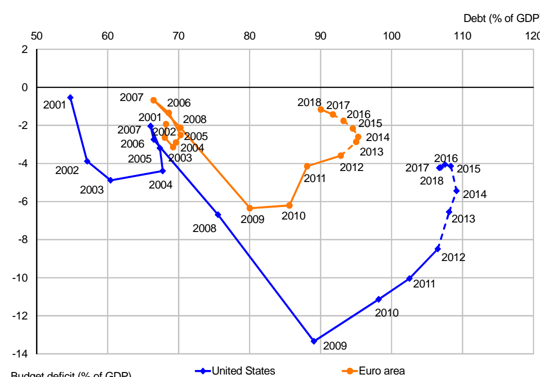
Chart 10: Global current account balances



Source: IMF, World Economic Outlook database, April 2013.

How to read this chart: In 2012, the U.S. ran a current account deficit equal to 0.7 points of global GDP, while the euro area ran a currentaccount surplus equal to 0.3 points of global GDP.

Chart 11: Debt and deficit



Source: IMF, World Economic Outlook database, April 2013.

How to read this chart: The IMF estimates the U.S. public deficit and public debt at 8.5% and 107% of GDP respectively in 2012; in the euro area, the public deficit and public debt came to 3.6% and 93% of GDP respectively.

(4) Gross financial liabilities of general government.

(5) Congressional Budget Office, *Updated budget projections: fiscal years 2013 to 2023*, May 2013.

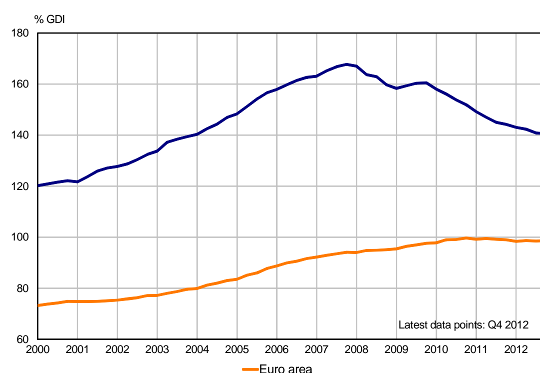
(6) Adjustments to the national accounts in summer 2013, in conjunction with the comprehensive revision of accounting definitions and presentations, should lead to an upward revision of GDP, which would automatically reduce the debt- to-GDP ratio.

In the euro area, real-estate markets are still adjusting in Spain and the Netherlands but prices are rising in Germany. Aggregate prices have therefore remained fairly stable. European household debt, expressed in percentage points of income, has stabilised since mid-2010 at a level that is high by local standards but lower than that of U.S. households.

Moreover, the structural reforms carried out by euro area Member States should raise the area's growth potential and may narrow the gap with the United States.

The OECD puts potential growth in 2012 at 1.8% in the United States versus 0.8% in the euro area. These estimates should, however, be treated with caution. The two economies' output gaps widened substantially after the crisis and are reckoned to have reached the same level in 2012 (see Chart 13). Moreover, the U.S. economy enjoys major strengths. R&D and education spending is higher, and the country is undergoing an energy changeover. In 2011, it became a net exporter of oil products, notably thanks to the massive increase in the production of unconventional energy. The scale of the change will depend, in particular, on the profitability of shale oil gas extraction, its sustainability, and energy substitutability. However, the potential growth gap between the two areas could narrow in the years ahead. For the past two years, the EU has been implementing many structural reforms in the labour market and the market for goods and services. These measures are expected to reduce the structural unemployment rate and raise total factor productivity. Under the opposite scenario, the persistence of a wide output gap could lead to permanent losses of production capacity and hysteresis effects in the labour market.

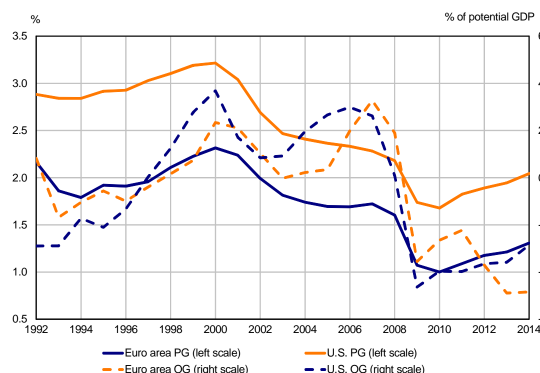
Chart 12: Household debt ratio



Source: Banque de France.

How to read this chart: In Q4 2012, household debt stood at 141% of gross disposable income (GDI) in the United States and 99% in the euro area.

Chart 13: Potential growth (PG) and output gap (OG)



Source: OECD, Economic outlook, May 2013.

How to read this chart: The OECD estimated potential growth in 2012 at 1.8% for the United States and 0.8% for the euro area. The output gap is estimated at approximately 3% for both areas.

Marie ALBERT, Nicolas CAUDAL, Violaine FAUBERT,

Vincent GROSSMANN-WIRTH, Marie MAGNIEN and Amine TAZI

Publisher:

Ministère de l'Économie,
et des Finances et Ministère du Commerce Extérieur

Direction Générale du Trésor
139, rue de Bercy
75575 Paris CEDEX 12

Publication manager:

Claire Waysand

Editor in chief:

Jean-Philippe Vincent
+33 (0)1 44 87 18 51
tresor-eco@dgtresor.gouv.fr

English translation:

Centre de traduction des ministères économique et financier

Layout:

Maryse Dos Santos

ISSN 1962-400X

Recent Issues in English

May 2013

No. 113. The Shadow Banking System in the United States: Recent Developments and Economic Role
Thimothée Jaulin, Benjamin Nefussi

April 2013

No. 112. The world economy in the spring of 2013: a brighter outlook
Pierre Lissot, Amine Tazi

No. 111. How should one assess short-term economic uncertainty?
Raul Sampognaro

March 2013

No. 110. How have the Hartz reforms affected the German labour market?
Flore Bouvard, Laurence Rampert, Lucile Romanello, Nicolas Studer

February 2013

No. 109. Asia in 2020: growth models and imbalances
Stéphane Colliac

http://www.tresor.economie.gouv.fr/tresor-economics