Analysis

Euro countries recovered from crisis at different paces

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Following the steep contraction caused by the financial crisis, there have been substantial differences in economic performance across the different countries in the euro area. Some countries experienced a double recession from which recovery has been slow. In others, the economy picked up at a steady pace, and in some cases actually rather quickly. The stressed economies in the euro area have also recovered at varying speeds. Healthy economic structures seemed to have facilitated a speedier recovery. At the moment, the four largest euro area economies are growing at a rate above their potential output. Nevertheless, their long-term growth prospects differ from each other.



Rate of recovery in euro countries varies

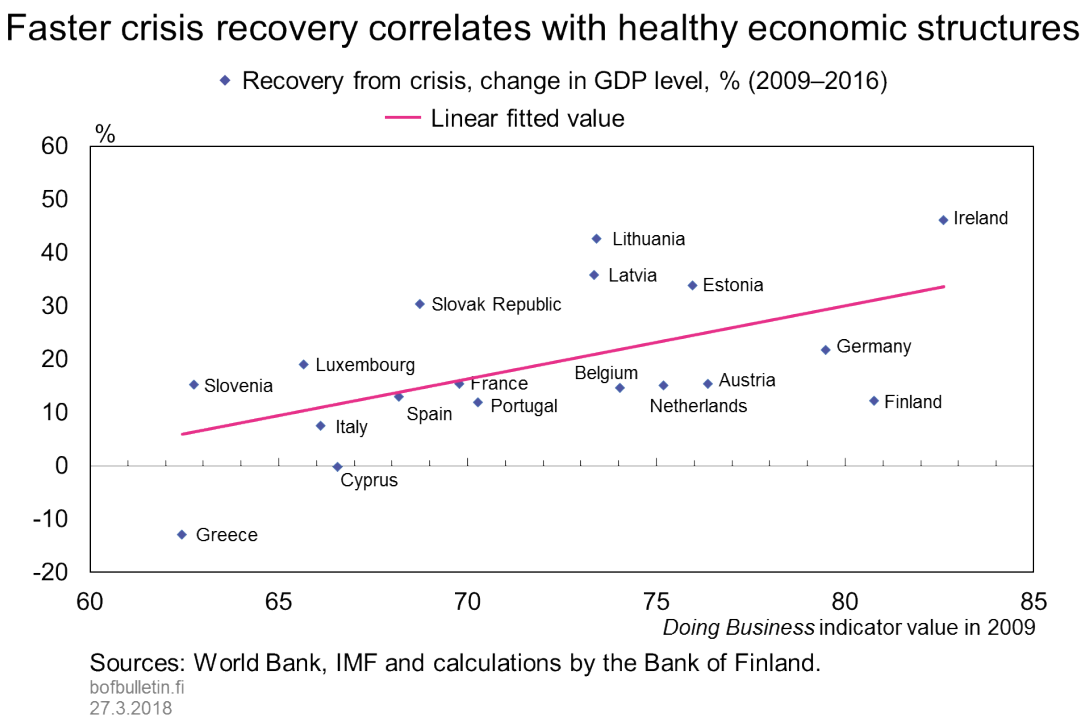
In the early stages of the financial crisis in 2008–2009, all current euro area countries fell into a deep recession when, as a result of the global recession, both exports and investments contracted significantly. Since then, euro area countries have performed in varying ways (Chart 1).

Recovery from the financial crisis has ranged from rapid (e.g. Ireland), steady (e.g. Germany and

France), slow (e.g. Italy and Portugal) to almost non-existent (Greece). However, countries cannot be rated in such a straightforward way, and even if GDP development for any two countries was similar, the reasons for their performance may vary significantly. To better understand future developments, it is important to understand which factors reduced the effects of the crisis in some countries and helped them to recover quickly.

It is also important to realise that the countries that bore the brunt of the crisis have recovered at very different rates. Greece, Ireland, Portugal, Spain and Cyprus received external financial support through an EU/IMF programme once they got into serious difficulties in 2010–2013. Of these countries, recovery was rapid particularly in Ireland, and partly also in Spain, while the GDP of Greece has scarcely moved from the rock-bottom figures it plunged to during the crisis.

Chart 1.



Sources: World Bank, IMF and calculations by the Bank of Finland.
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Some euro countries suffered a double recession in 2011–2012 as a result of the sovereign debt crisis and problems in the banking sector.[1] It was not until 2017 that countries such as Spain that were hit by the double recession managed to recover to the pre-crisis level of 2008. Italy's GDP is still below its pre-crisis level. Countries with a double recession also still have unemployment rates that are higher than in 2008, although the situation has notably improved in recent years. The investment rates in these countries are still well below pre-crisis levels. There are several reasons for the poor investment development, such as deleveraging of debt by the private sector.

On the other hand, some countries managed to avoid a double recession and, having first experienced a big drop, have since enjoyed steady or even strong growth. Such economies include, for example, the euro area's biggest countries, Germany and France. These reached their pre-crisis GDP levels by 2013. Although the investment rate has been subdued there, too, investments did nevertheless exceed the pre-crisis level in 2015 and have since been very close to the levels before the crisis.

The financial crisis resulted in Ireland and the Baltic countries in a severe GDP contraction, but since then these countries have recovered quickly. Production rates reached pre-crisis levels on average during 2014. The economic performance of Greece, in contrast, has been poor, and GDP growth is seriously lagging behind the other euro area economies. The Greek investment rate has also been exceptionally low and is currently the lowest in the euro area.

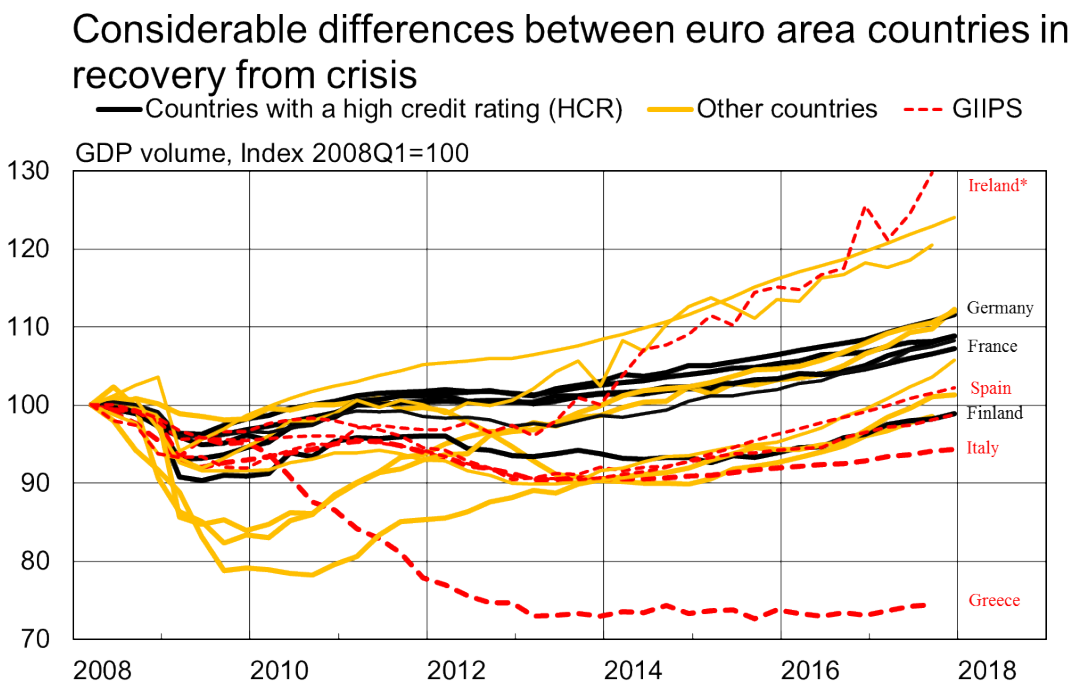
A flexible corporate-sector operating environment supports growth

Economic structures have a major impact on crisis recovery.[2] One way to gauge the operation and flexibility of economic structures is the World Bank's Doing Business indicator which compares business environments in 190 countries.[3] Chart 2 shows the current euro countries' Doing Business indicator values in 2009 and economic recovery since 2009. According to the chart, countries with healthy corporate operating environments when the global financial crisis started (high indicator value) do indeed seem to have been enjoying good growth by 2016.[4]

In countries where the operating environment is poor, such as Greece, Cyprus and Italy, economic growth has been modest since the financial crisis hit. In Portugal, Greece and Cyprus, the precondition for financial support within the stability support programme was that economic structures be improved, which is reflected in the Doing Business indicator by the improved figures since 2009.

In Ireland, on the other hand, where recovery has been rapid, and in Germany, which has grown well, the economic operating environment was already healthy in 2009. The Baltic States have also recovered apace from the financial crisis, supported according to the indicators by a good corporate operating environment in 2009, which has also shown considerable additional improvements since then. Finland is an exception, because Finnish economic recovery has been tardy despite a healthy operating environment. This is partly due to the exceptionally serious problems experienced by the export sector.

Chart 2.

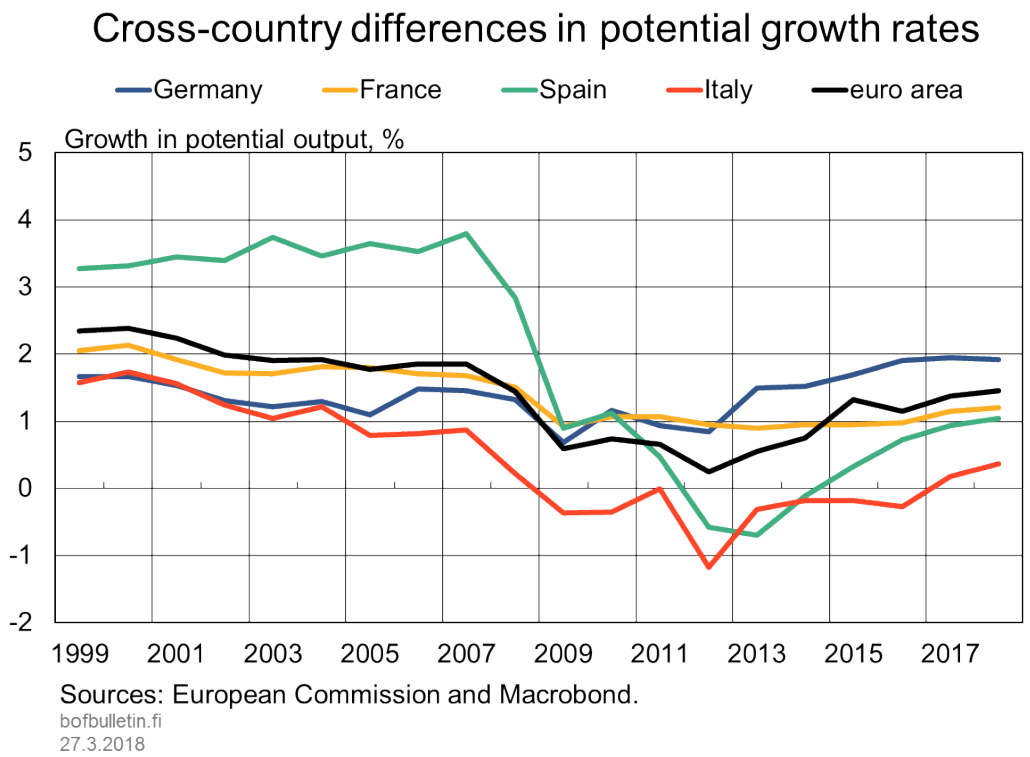


*Ireland's GDP graph has been flattened to remove the strong surge in 2015 caused by multinational corporations' capital movements.
HCR = Finland, Germany, France, Austria, Belgium, Netherlands. GIIPS = Greece, Ireland, Italy, Portugal, Spain.
Sources: Eurostat and Macrobond.
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Long-term developments depend on growth potential

Despite the variety of development paths since the crisis, cyclical conditions have improved in all euro area countries in 2017. For example, the good performance of the four largest euro area countries is manifest in lower output gaps, meaning that their production is close to their potential levels. According to a European Commission estimate,[5] the output gap has turned positive (that is, production levels exceeded potential) or will do so at the latest in 2018 in Germany, Italy and Spain (Chart 3). Output gap estimates, however, vary somewhat, with the IMF,[6] for example, claiming that Germany's output gap turned positive already in 2016. On the other hand, they also project that the output gap will still be negative in France and Italy in 2020.

Chart 3.



Although growth has been strong recently, this is an upswing that is expected to weaken gradually. In the longer term, economic performance relies on potential output growth. The potential growth rate refers to how much an economy can grow without accelerating inflation due to resources being fully utilised. For example, according to the latest European Commission[7] estimate, the potential output increase of the German economy is the highest among the biggest euro countries, at an annual rate of close to 2%. The growth in potential output is estimated at about 1.2% in France, about 0.9% in Spain and about 0.2% in Italy. The longer-term growth prospects of the largest four euro area countries differ from each other because of differences in changes in the proportionate size the of working-age population and in labour productivity. At the moment, the four largest euro area countries are growing faster than their potential output growth.

Notes

1. Finland's GDP also declined again at this time, but this was due primarily to the poor performance of exports. ↑
2. Praet (2015), for example, explains in his speech how economic structures have an effect on both long-term growth and economies' ability to bounce back from crises. See Praet (2015): 'Long-run growth, monetary policy and financing of the economy', presented at 43rd ↑

Economics Conference of Oesterreichische Nationalbank, Vienna, 15 June 2015.

3. The indicator compares private-sector operating environment structures in different countries. These structures include the duration and costs of setting up a business, taxation and the relative incentive of being an entrepreneur in terms of various factors. ↑
4. This observation is valid even if we take into account the depth of the financial crisis a country is in. ↑
5. European Commission's autumn 2017 forecast. ↑
6. IMF WEO, October 2017. ↑

Keywords

economic development, economic growth, euro area, financial crisis, indicators