Roads to recovery

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The Great Recession 2008-2013

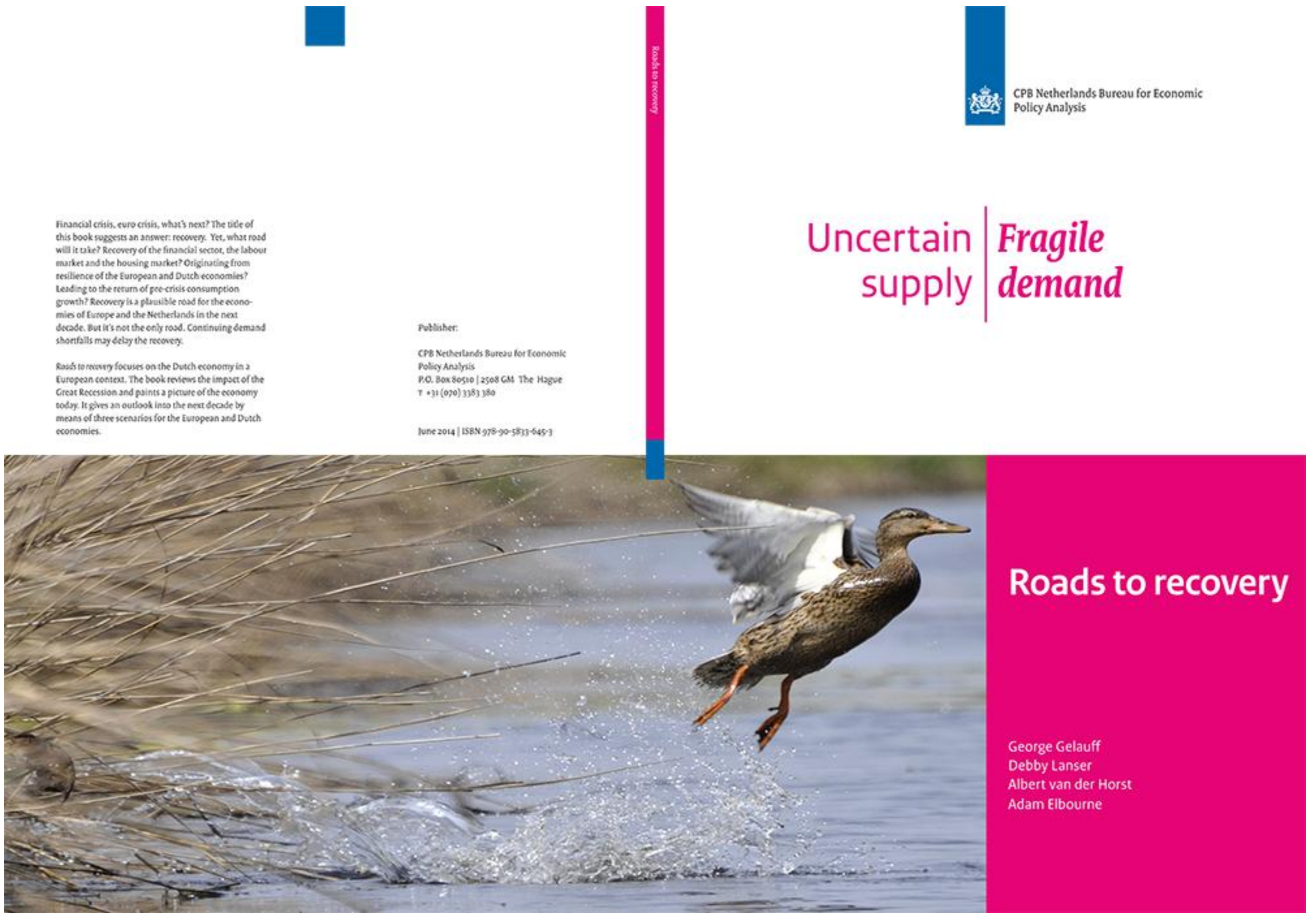
- Financial crisis:
  - Global imbalances
  - Risk perception
  - Complex and risky financial innovations

- Euro crisis:
  - International risks and national supervision
  - Banks and sovereigns: suffocating embrace
  - Consolidation

- 2014, where are we now?

- 2014-2023, what are the roads to recovery?

CPB Book, June 19 (see www.cpb.nl)



One objective, Three questions

Three questions:

- Setting the scene:
  - What can we learn from recent developments?
- Taking score:
  - What can we learn from other crises?
  - What is the damage?
- Building blocks:
  - Which challenges and risks are ahead?

One objective:

- Where will the Dutch economy head for in the next decade?

2014, the facts

- Low GDP growth, but at least the economy grows
- Low inflation, but still positive
- High unemployment, with first signs of decline
- High government debt
- Low interest rates, low CDS-spreads
- ...

2014-2023, our assessment

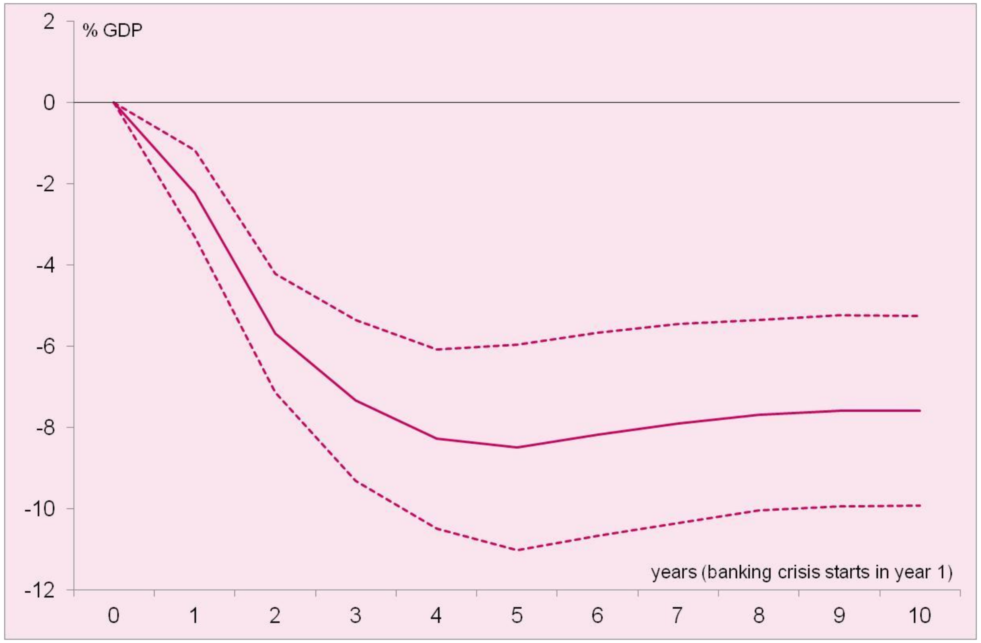
- The economy is resilient, but demand remains fragile
  - in Europe and the Netherlands

- Resilient
  - productivity growth will resume
  - labour markets will return to equilibrium
  - recovery of the economy will weaken the deleveraging challenge

- Fragile
  - deleveraging may delay growth
  - consolidation may harm growth
  - credit supply may limit investment and consumption

Productivity will resume growth (after a permanent loss)

- Banking crisis are associated with large, permanent declines in productivity relative to the previous trend.
- Reproduction of Serra-Cexana in Chapter 4 of *Roads to Recovery*
- No evidence that banking crises have a long-run effect on the growth rate of productivity



What might explain losses in productivity?

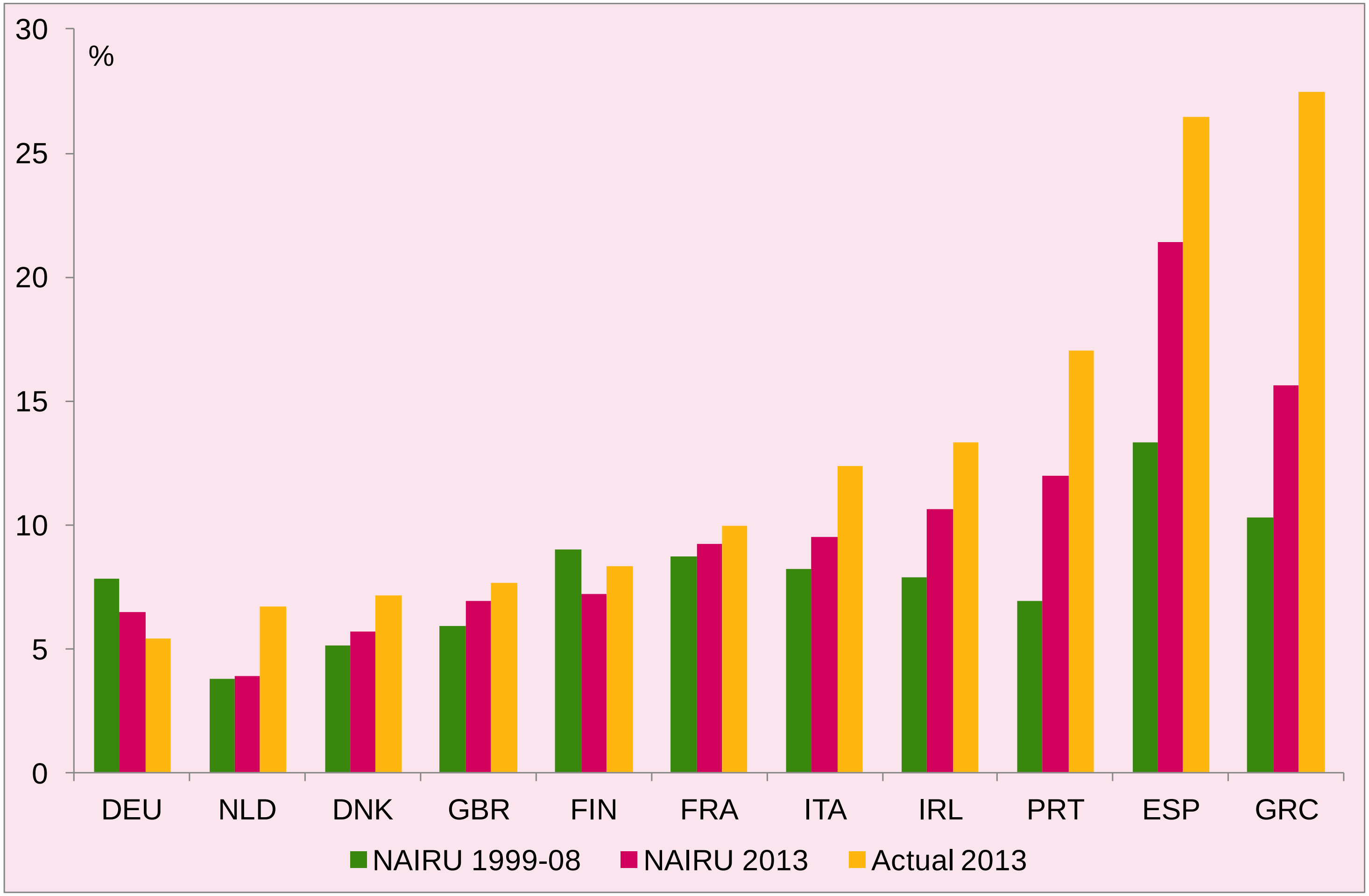
- Mechanisms
  - low price of risk before crisis -> bubble
  - loss of skills during unemployment
  - less R&D (lower expectations)
  - more R&D (lower opportunity costs)
  - fiscal austerity

- Much unknown
  - Just as Great Depression, 1930s

Labour market will return to equilibrium

- When aggregate demand recovers,
  - employment follows suit
  - unemployment returns to the natural rate
  - discouraged workers return
- Hysteresis: no evidence
- Scarring (loss of skills): some evidence
- The Great Recession does not permanently affect labour supply, but may have affected the human capital of the long-term unemployed

Unemployment, actual and NAIRU



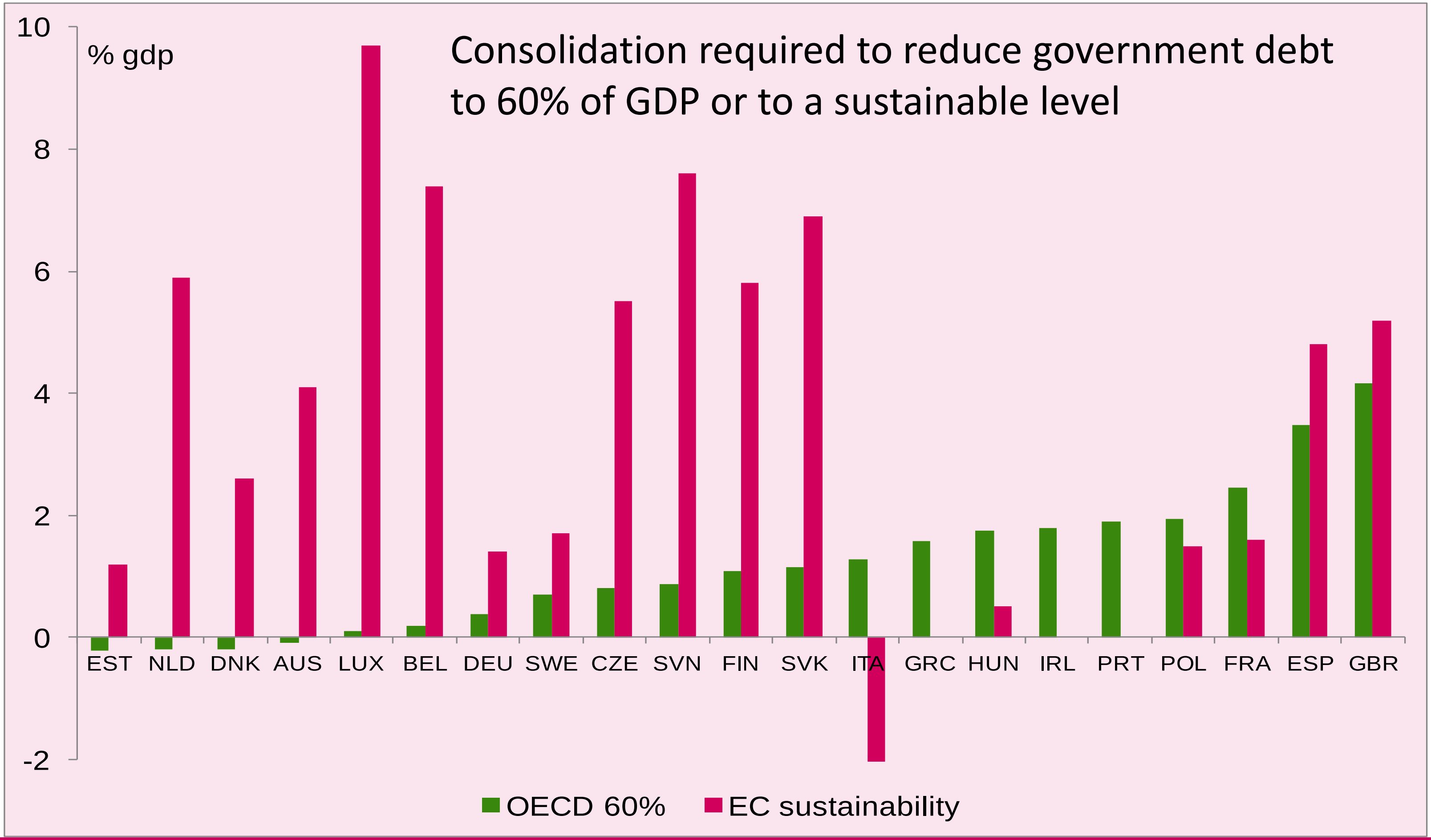
Deleveraging <=> economic growth

- Economic growth may limit need to deleverage
  - limited decline of households wealth
  - assets still higher than liabilities
  - nominal growth may inflate debt problem
  - doesn’t harm recovery

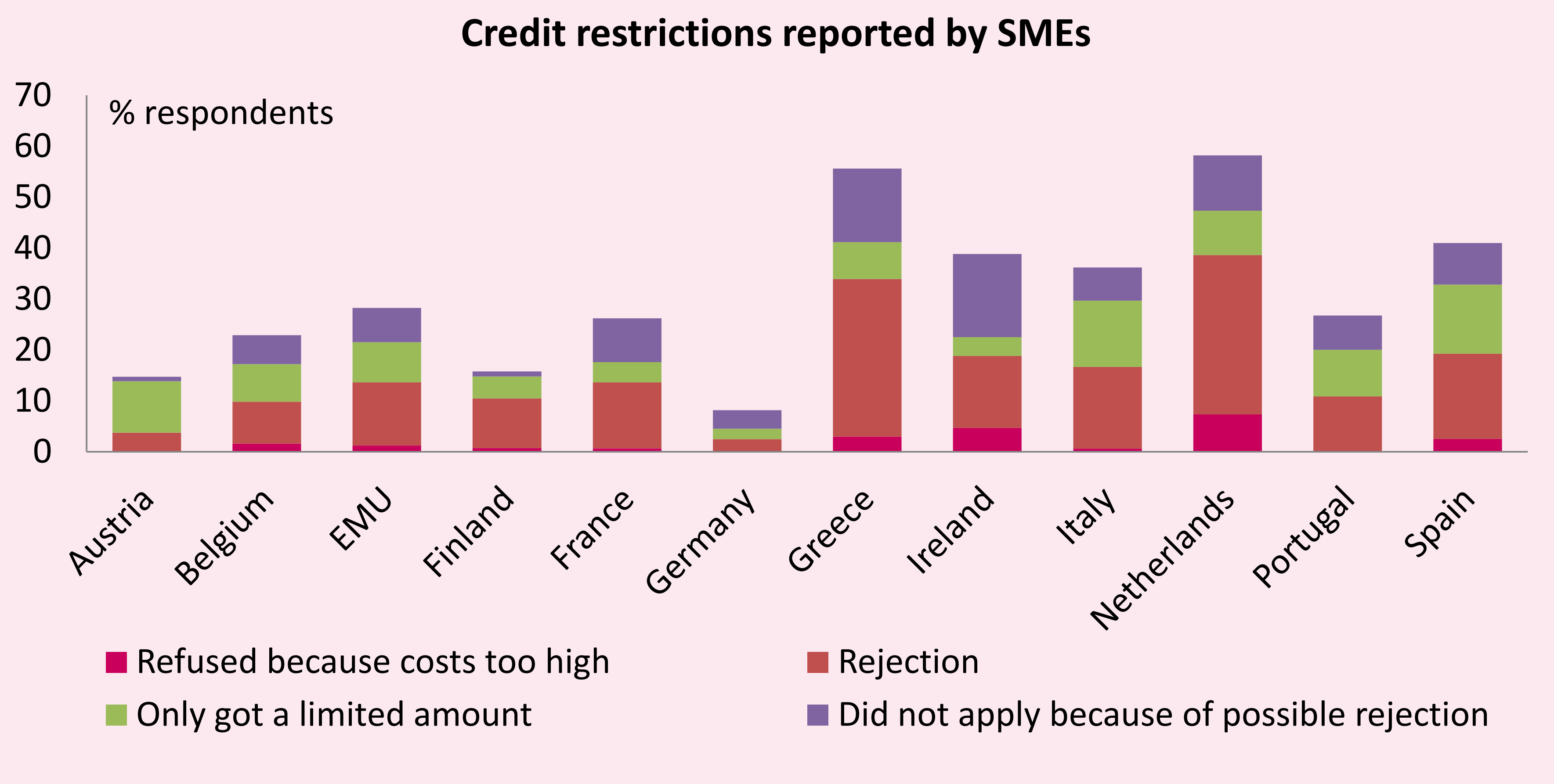
- But, deleveraging may harm growth
  - indicators point at deleveraging
  - households and government (and firms) may all decide to save
  - weakening demand and nominal growth
  - aggravating deleveraging challenge

Indicators pointing at deleveraging

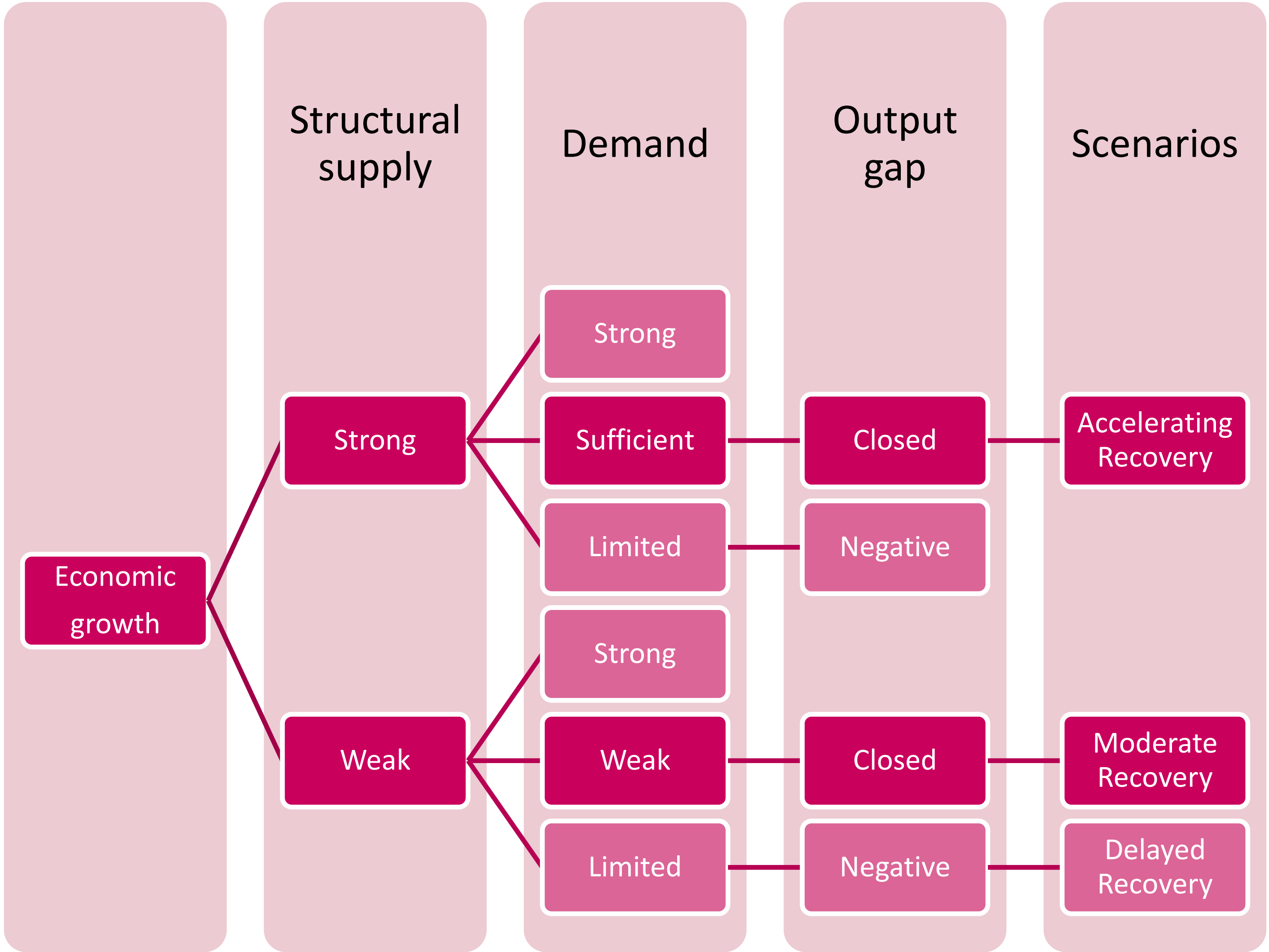
Consolidation may harm growth



Credit supply may limit investment



Three roads to recovery


Structural supply
Demand
Output gap
Scenarios
Economic growth
Strong
Weak
Strong
Sufficient
Limited
Strong
Weak
Limited
Closed
Negative
Closed
Negative
Accelerating Recovery
Moderate Recovery
Delayed Recovery

Three roads to recovery

- The economy is resilient, but the recovery of aggregate demand will take time.
- Depending on strong or weak supply, over the next decade the European economy may grow by 1½% (*Moderate Recovery*) to 2¼% (*Accelerated Recovery*) per year.
- When substantial demand risks materialise the economy will not recover in the coming decade and government debt deteriorates (*Delayed Recovery*).

Three scenarios, 2014-2023

	accelerating recovery	moderate recovery	delayed recovery
Gross domestic product, Euro area	2¼	1½	1
Gross domestic product, USA	3¼	3	3
World trade, weighted (for Nld)	6¾	5	3
Inflation, euro area (ultimo)	2¼	1¾	1
Interest rate, euro area (ultimo)	4¾	4	2¼

A newborn spring and a newborn sound:
I want this song like piping to resound
that oft I heard at summer eventide
in an old township, by the waterside –
the house was dark, but down the silent road
dusk gathered and above the sky still glowed,
and a late golden, incandescent flame
shone over gables through my window-frame.

Gorter, Mei (May), 1889