



Global

Is it the euro area's time to shine?

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Yesterday marked Fathom's first Monetary Policy Forum of 2018, a quarterly event hosted by Thomson Reuters. It featured a debate between William Hynes and Brian Davidson, our lead euro area and US economists, on whether Europe is set to outperform the US in the coming decades. They were joined by distinguished guest Paul Fisher, a former member of the Bank of England's Monetary Policy Committee. Our clients can access the slides from yesterday's event [here](#).

Proceedings began with Brian Davidson laying out Fathom's bullish near-term view on the US economy and predicting that President Trump's tax cuts and spending plans will boost economic growth, both [this year and next](#). He was followed by William Hynes who presented a rosy outlook for the euro area, and reaffirmed Fathom's view that the currency bloc's cyclical upturn will continue through 2018. While both of Fathom's economists agreed on the near-term story, there was much debate about the future of the euro area.

Fathom's central view is that, while some flaws remain, the euro area will continue to muddle through in the coming years. Ultimately, we see only a 5% chance that these flaws cause the currency bloc to fall apart within our forecast horizon, which extends to 2025. Likewise, we attach a 10% probability to our upside scenario where the euro area succeeds in forming a [full fiscal and monetary union](#), which addresses many of the shortcomings in the currency bloc's architecture.

Overview of Fathom growth forecasts					
	2016	2017	2018	2019	Trend
Annual average growth rate %		Central			
Global GDP	2.9 (3.4)	3.8 (3.8)	3.8 (3.9)	3.4 (3.5)	2.25 - 2.75
United States	1.5	2.3	3.2	2.9	1.0 - 1.5
EA	1.8	2.5	2.1	1.6	0.5 - 1.0
Germany	1.9	2.5	2.4	1.7	0.25 - 0.75
France	1.1	1.9	1.9	1.4	0.5 - 1.0
Italy	1.1	1.5	1.1	0.9	0.0 - 0.5
Spain	3.3	3.1	2.7	2.5	0.5 - 1.0

(Using official Chinese GDP)

Source: Fathom Consulting

Euro area economist William Hynes saw encouraging signs of political progress towards addressing the bloc's flaws (Fathom's upside scenario) and also argued that there were other causes for optimism such as rising participation rates and lower aggregate debt levels, relative to the US. With regards to the US, he highlighted the United States' poor record of controlling

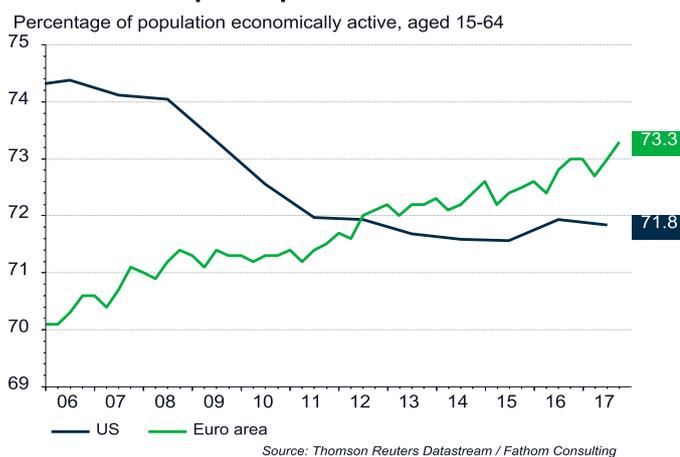
Fathom's Monetary Policy Forum featured a discussion on whether the euro area could outshine the US

William Hynes saw cause for optimism in the euro area's medium-term outlook

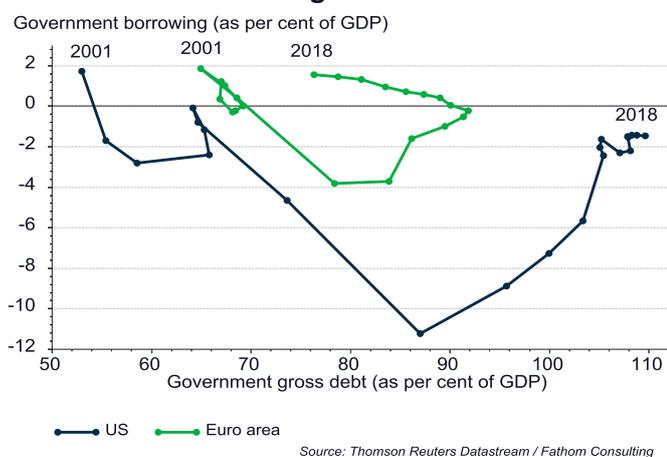


its public finances. Thus far, markets have granted the US a degree of slack, owing to the dollar's privileged status as the reserve currency. He cautioned that this privilege "can be used but should not be abused" or else it might be lost.

Labour force participation rates



Government borrowing



Brian Davidson suggested that it was the distribution of debt that was a challenge for the euro area and questioned whether the political demands of the union might prove too great. He highlighted the worrying rise of populist parties, whose policies often align with national, rather than international, interests. Given this, he was sceptical as to whether President Macron's reform agenda would gain traction. He also argued that loose US fiscal policy could have second-round effects if it enables faster monetary policy normalisation and the slaying of zombie firms.

Brian Davidson argued that populism could remain a challenge for the euro area



In the panel discussion, former Bank of England policymaker and event referee Paul Fisher probed Fathom's economists on various aspects of their presentation material. In response to William Hynes' upbeat but cautious take on the euro area, Mr Fisher agreed that the problem is not with the euro itself, but the euro area's fiscal disconnect.

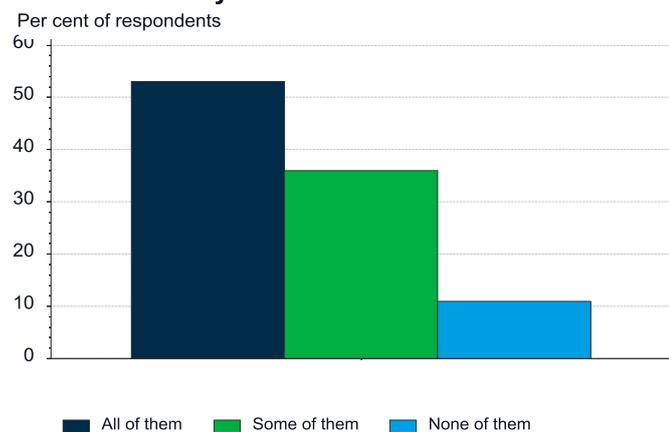
That is a view that Fathom Consulting shares. For the currency bloc ultimately to succeed, further fiscal integration will be needed. In spite of the enormous political will that brought it into being and that has kept it afloat thus far, Fathom's view is that the future of the euro area is far from certain.

Yesterday's audience expressed their confidence in the sustainability of the currency bloc, with over half believing that all 19 euro area economies would still be members in 10 years' time. Panellist and euro area economist William Hynes echoed this view when he argued that "commitment to the project has always won through in the past and will continue to do so."

In contrast, 37% of our audience felt that only some of the existing members would remain, while 11% sided with Brian Davidson's more pessimistic view that the architecture of the union is irreconcilably flawed and that the currency bloc will fall apart.

Former policymaker Paul Fisher stressed that the problem is not with the euro itself, but the euro area's fiscal disconnect

How many of the 19 euro area economies will still be members in ten years' time?

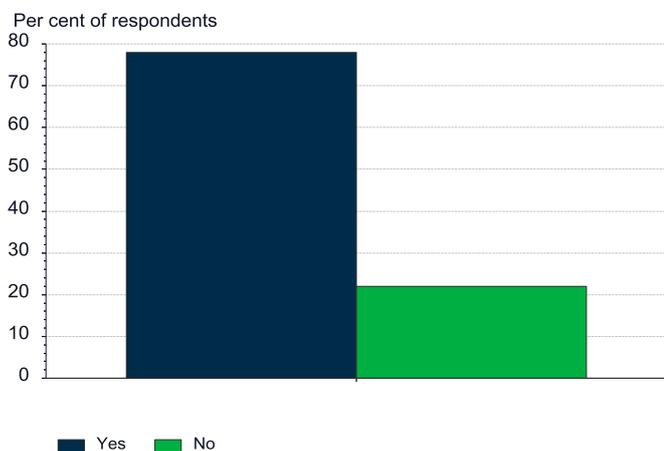


Again, in support of William Hynes' more optimistic view, 78% of our audience felt that the euro had been a net positive for its members. This mirrored a 2017 European Commission survey, which revealed that the highest percentage of respondents on record felt that the euro had been good for their country (see chart below).

A large majority of yesterday's audience felt that the euro had been a net positive for its members

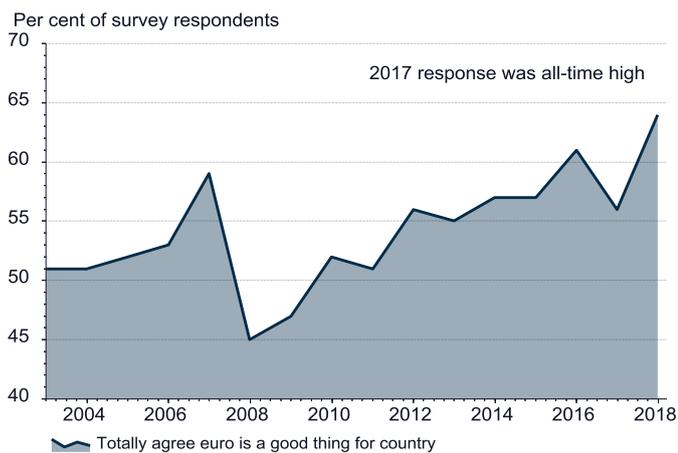


Has the euro been a net positive for its members?



Source: Thomson Reuters Datastream / Fathom Consulting

Approval of the common currency



Source: Thomson Reuters Datastream / European Commission / Fathom Consulting

Pointing to the rise of populist politics in both Europe and the US, one audience member asked about the growing danger of trade wars and the likely implications. As our guest panellist, and referee, Paul Fisher highlighted, all economists tend to agree that trade is good, raising the possibility that with the passage of time President Trump and his protectionist policies will not be viewed favourably, even in the US.

An unexpectedly large proportion of the audience (73%) believed that the president's policies would be net negative for the US economy, even though — as Brian Davidson demonstrated — a combination of fiscal policy and the arousal of animal spirits is acting as a boon for now. Echoing this disillusionment, 95% of the audience also felt that the US would lose influence over the coming decade, although not necessarily to a reformed and well-functioning euro area.

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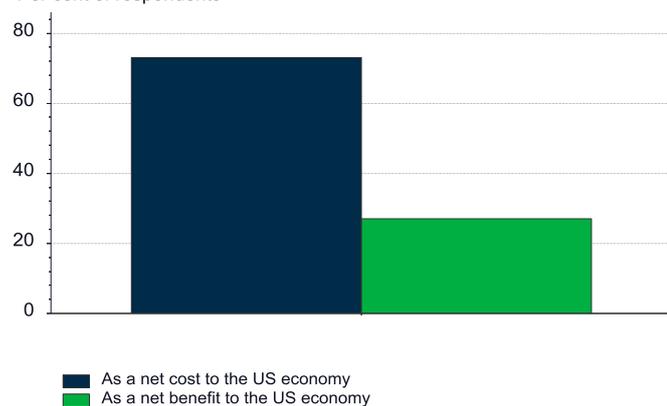




Paul Fisher shared aspects of the audience's scepticism, saying "don't we know how this typically ends, which is you have a period of output growth and inflation, and then you have a subsequent period of recession?" Fathom concurs, after all — as we explained to clients in our recent *Global Economic and Markets Outlook, the dawning of a new error* — what goes up must come down.

How will the economic policies of Donald Trump be seen with the passage of time?

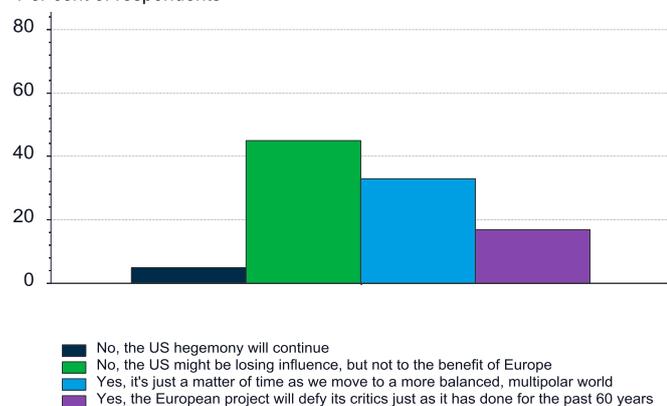
Per cent of respondents



Source: Thomson Reuters Datastream / Fathom Consulting

Will there be a greater role for Europe over the coming decade?

Per cent of respondents



Source: Thomson Reuters Datastream / Fathom Consulting



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