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Eurozone: Maintaining the reform momentum remains a must

The eurozone economy is moving in the right direction, gradually tackling economic imbalances and becoming more resilient in the process. However, despite ongoing signs of improvement, the road ahead is still long and the pace of adjustment moderate at best. With the risk of complacency running high, sticking to the reform course remains a must – for former program countries as well as Germany.

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THE GOOD: ECONOMIC STABILITY ON THE RISE

Prospects for the eurozone economy are improving. At 1.5% in 2015, economic growth was still not exactly booming. It has, however, gained in breadth and resilience. This is illustrated by the latest results for the Allianz Euro Monitor, which with the help of 20 indicators encompassing the categories “Fiscal sustainability”, “Competitiveness”, “Employment and productivity” and “Private and foreign debt” measures macroeconomic imbalances in the eurozone. The indicators are given a score of 1 to 10 (best score), the average of which provides the overall rating.

In 2015 the average rating for the eurozone as a whole rose for the third consecutive time to 6.6 points – a score that signals a middling performance – up 0.2 points on the previous year. The gains in economic health were widespread: Fifteen countries saw their ratings rise in 2015, with only three witnessing a deterioration compared with the previous year. Moreover, for the first time since 2007 not a single country featured at the critical end of the scale (average rating of 1-4 points) which signals large and dangerous imbalances. Now that the eurozone’s economic health is showing signs of improvement, has the time come to relax the reform momentum?

THE BAD: STILL A LOT OF ROOM FOR IMPROVEMENT

The currency union has made substantial progress since the height of the debt crisis in 2012, reducing economic imbalances and raising the overall economic health in the process. Despite moving in the right direction many eurozone economies still have a long way to go before the currency bloc achieves an average rating consistent with a “good” performance (8-10 points). Bottom-placed Cyprus and Greece with respective ratings of 4.6 and 5.0 points clearly still have a lot of room for improvements, but even Germany, which took the Euro Monitor’s pole position for the second consecutive year, barely qualified with a rating of 8.1 points. In part, the eurozone’s mediocre average rating reflects the deep economic scars left by the debt crisis. To date the vast majority of member states have barely started to tackle these legacies, including high public debt and unemployment. Not surprisingly these are the two lowest-rated indicators within the Euro Monitor spectrum. Given the size of the imbalances, it

would be irresponsible to hope that the moderate eurozone recovery will whittle them down.

THE UGLY: FISCAL CONSOLIDATION MOMENTUM COMES TO A HALT

Given the ongoing need to improve economic stability in the eurozone further, the gradual pace at which economic imbalances are actually being reduced is a concern. Even more worrying, however, is the outright reversal of reform momentum in one key area. The results of the Euro Monitor show that while the eurozone economy in 2015 improved in the categories “Employment and productivity” and “Competitiveness”, no progress was made in the section “Private and foreign debt” while the rating on “Fiscal sustainability” actually declined slightly. In fact, in 2015 the assessment of the currency bloc’s public finances deteriorated for the second year in a row despite favorable conditions for fiscal consolidation given accelerating economic growth and declining interest rates. In 2015 the government debt ratio fell for the first time since 2007, but the eurozone’s debt burden at close to 91% of GDP remains excessive. The current state of public finances in the eurozone provides no basis for a relaxation of the consolidation drive.

REFORM MOMENTUM NEEDS TO BE MAINTAINED ACROSS THE EUROZONE

The past few years have shown that most of the structural weaknesses that many EMU countries are grappling with can only be resolved over a long period of time. The most important thing, however, is that reform and consolidation are maintained to get things moving in the right direction and that progress is made in reducing imbalances.

The Euro Monitor’s "progress indicator” – a sub-indicator focusing only on the indicators that assess shorter-term progress or retreat – provides a good gauge of the reform momentum at country level. It suggests that beyond the cyclical recovery of the eurozone economy which has helped lift all boats – the average rating –, the improvement was largely driven by adjustments recorded in the former program countries. At the same time, those countries with fewer structural imbalances have displayed more subdued reform ambitions in recent years. While it is not surprising that countries with a lower potential for improvement also have less homework to do, the risk remains that these countries will become complacent. In fact, “core countries” including Finland, the Netherlands, Austria and France have all seen their Euro Monitor ranking deteriorate compared with their relative positions in 2000.

Reforms aimed at boosting future growth are still essential – for all eurozone member states. The former problem countries will need a few years yet before their return to economic stability can be classed as a "done deal". Despite significant improvement, substantial weaknesses and imbalances remain. The post-crisis clean-up cannot yet be concluded. Conversely, countries like Germany cannot afford to rest on their laurels just because their economies enjoy a healthy basis for growth. Otherwise, this healthy foundation could well be eroded over time. Additional efforts will need to be made if the country wants to stop the corresponding parameters from coming under pressure in the future.

EUROZONE AT RISK OF BECOMING COMPLACENT

As the sense of crisis in the eurozone subsides, the need for reform tends to be consistently underestimated: Hardly any governments are still pursuing ambitious reform plans. The reform and consolidation efforts of recent years are bearing fruit, but now is not the time to relax. The competitiveness of the eurozone economy needs to be improved further and the clean-up of public finances driven forward. After all – even if it is unlikely to happen tomorrow – national governments need to prepare for a turnaround in interest rates if they wish to avoid a renewed wave of uncertainty about the sustainability of government debt in a number of countries.

20 indicators to evaluate economic fundamentals and the four key categories of economic stability

C1 Fiscal sustainability

- (1A) Gross government debt as % of GDP
- (1B) General government interest payments as % of GDP
- (1C) General government deficit/surplus as % of GDP
- (1D) Change in the structural balance of general government as % of potential GDP

C2 Competitiveness

- (2A) Exports in relation to GDP
- (2B) Unit labor costs, deviation from the target path of 1.5% rise per year in index points
- (2C) Global merchandise trade shares, exports, deviation from base year 2000 in %
- (2D) Annual change in nominal unit labor costs in %
- (2E) Growth in export of goods (real) - growth in world trade volumes (real) in %-points

C3 Jobs & productivity (Labor market und growth)

- (3A) Unemployment rate in %
- (3B) Employment rate in %
- (3C) Annual change in the unemployment rate in %-points
- (3D) Annual change in employment in %
- (3E) Annual change in (real) labor productivity in %

C4 Private & foreign debt

- (4A) Debt-to-GDP ratio of households
- (4B) Debt-to-GDP ratio of non-financial corporations
- (4C) Net international investment position as % of GDP
- (4D) Debt-to-GDP ratio of households, change over three years in %-points
- (4E) Debt-to-GDP ratio of non-financial corporations, change over three years in %-points
- (4F) Current account balance as % of GDP

Euro Monitor Rating 2015

Rank 2015	Country Code	EWU Member State	Rating 2015	Rank 2014	Rating 2014	Rank 2010	Rating 2010
1	DE	Germany	8,1	1	7,8	1	7,7
2	LU	Luxembourg	7,4	3	7,2	2	7,4
3	SK	Slovakia	7,3	6	6,8	7	5,9
4	IE	Ireland	7,1	10	6,4	18	3,8
5	SL	Slovenia	6,9	7	6,7	9	5,7
6	EE	Estonia	6,9	3	7,2	5	6,3
7	LT	Lithuania	6,8	2	7,5	4	6,4
7	NL	Netherlands	6,8	5	6,8	6	6,2
9	LV	Latvia	6,7	8	6,6	13	5,2
10	AT	Austria	6,6	9	6,5	3	6,9
10	MT	Malta	6,6	13	5,8	10	5,7
12	ES	Spain	6,1	11	6,0	15	4,0
13	BE	Belgium	6,1	12	5,9	10	5,7
14	FR	France	5,8	17	5,4	12	5,2
14	PT	Portugal	5,8	15	5,5	16	3,9
16	IT	Italy	5,7	18	5,1	14	4,7
17	FI	Finland	5,5	16	5,4	8	5,8
18	GR	Greece	5,0	14	5,6	19	2,5
19	CY	Cyprus	4,6	19	3,8	16	3,9
	US	USA	5,5		5,6		5,6

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This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an aging society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

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