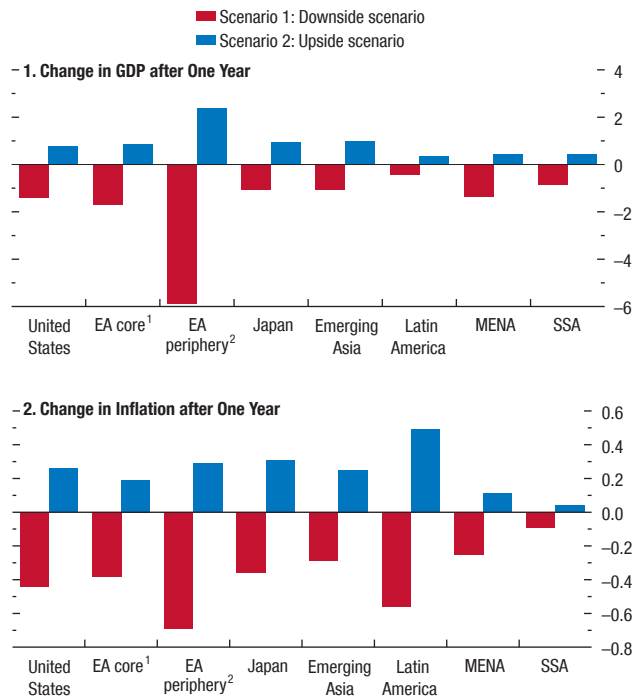


Figure 1.13. Upside and Downside Scenarios
(Percent or percentage point deviation from WEO baseline)

The Global Integrated Monetary and Fiscal Model (GIMF) is used to consider a scenario in which policy is initially unable to prevent the intensification of euro area sovereign and banking stress as well as a scenario in which policy action quickly alleviates the current level of stress. The model contains two blocks of euro area countries, those with acute fiscal sustainability issues (referred to as “periphery”) and those with less acute fiscal sustainability issues (referred to as “core”).

The intensification-of-stress scenario (red bars) assumes that policymakers delay taking sufficient action to prevent a sharp intensification of financial stress. Consequently, deleveraging by euro area banks leads to a sharp credit contraction in periphery countries but milder contraction elsewhere. Credit in periphery countries falls €475 billion below the WEO baseline in 2013, while that in the core countries falls by €50 billion. Concerns about fiscal sustainability raise periphery sovereign spreads 350 basis points in 2013; however, subsequent policy action results in spreads falling thereafter and returning fully to baseline by 2016. The core countries’ sovereign risk premium is assumed to decline by 50 basis points in 2013 as a flight to quality within the euro area occurs. Sovereigns in the periphery are forced into more front-loaded fiscal consolidation, averaging an additional 2 percentage points of GDP in 2013. Risk concerns are also assumed to spill over to all other regions, with corporate risk premiums rising by 50 basis points in advanced economies and 150 basis points in emerging market and developing economies in 2013. The capital flight is assumed to benefit the U.S. sovereign, with the risk premium falling by 50 basis points in 2013. Monetary policy is constrained at the zero interest rate floor in the G3 countries (euro area, Japan, United States), whereas elsewhere monetary policy eases to help offset the impact on market interest rates of rising risk premiums.

In the scenario in which policy is able to alleviate the stress (blue bars), credit in the euro area expands relative to the baseline and sovereign spreads decline. In the periphery countries, credit expands by roughly €225 billion relative to the baseline, and sovereign spreads decline by roughly 200 basis points in 2013. In other advanced economies, corporate spreads fall by 50 basis points in 2013, and in emerging markets, the decline is 100 basis points.



Source: GIMF simulations.

Note: EA = euro area; MENA = Middle East and North Africa; SSA = sub-Saharan Africa.

¹Core countries are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Luxembourg, Malta, Netherlands, Slovak Republic, and Slovenia.

²Periphery countries are Greece, Ireland, Italy, Portugal, and Spain.