Le cauchemar allemand

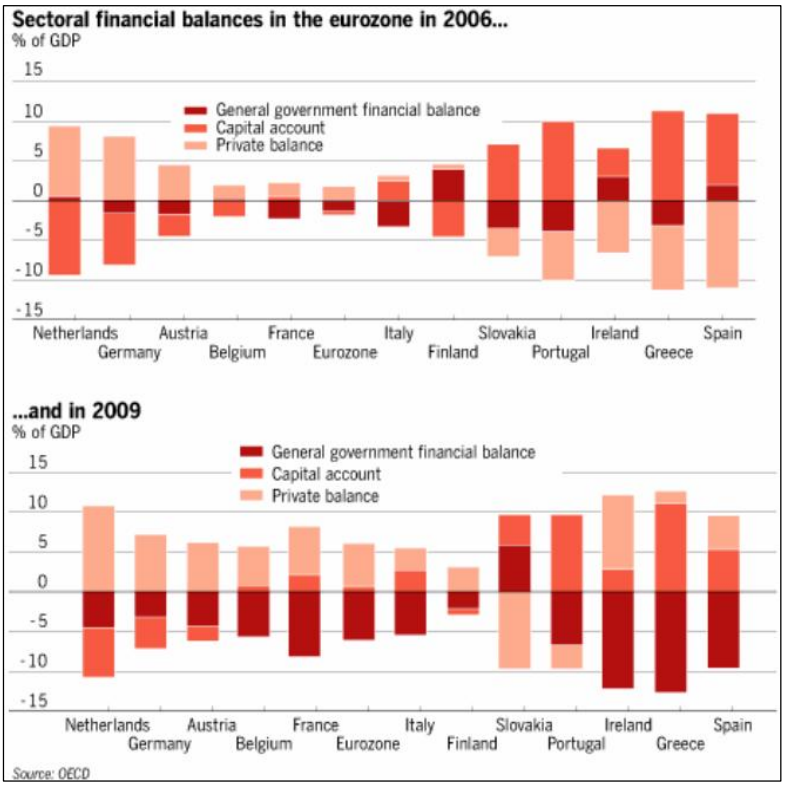
- ✓ Martin Wolf, “Germany's eurozone crisis nightmare”, *Financial Times*, March 9 2010
- ✓ Martin Wolf, « Cauchemar à Berlin », *Le Monde*, 17 mars 2010
- ✓ Edward Harrison, “Spain’s woes and Germany’s export model could mean double dip”, March 11, 2010
- ✓ Edward Hugh, “German Exports and that Looming Double Dip”, 11 March 2010

Germany's eurozone crisis nightmare

Martin Wolf, *Financial Times*, March 9 2010

Ever since the federal republic was founded, Germany has had two over-riding strategic objectives: sound money and European integration. These were the twin imperatives learned from the calamities of the early 20th century. The euro embodies these aims. Now they conflict with each other.Is the right answer to rescue sinners, thereby strengthening the cohesion of the eurozone, but threatening monetary stability? Or is it to let sinners default, thereby strengthening monetary credibility, but weakening cohesion? Germany could avoid such choices before the single currency: uncompetitive countries simply devalued. Unfortunately, the domestic German debate assumes, wrongly, that the answer is for every member to become like Germany itself. But Germany can be Germany – an economy with fiscal discipline, feeble domestic demand and a huge export surplus – only because others are not. Its current economic model violates the universalisability principle of Germany’s greatest philosopher, Immanuel Kant.

The idea that countries are in difficulty because of their own sloppiness is easy to reach in the case of Greece. According to the latest Economic Outlook from the Organisation for Economic Co-operation and Development, gross public debt was 115 per cent of gross domestic product last year, the general government deficit was 12.7 per cent of GDP and the current account deficit was 11.1 per cent.



This, then, would be a classic case for intervention by the International Monetary Fund. Normally, the latter would offer temporary liquidity support in return for a devaluation and fiscal stringency. Yet the German government rejects the idea that an outside body should dictate policy to a country that shares Germany’s money. It suggests, instead, that a European Monetary Fund should be created, to provide conditional liquidity support. Under the direction of the other members of the eurozone, the EMF would dictate fiscal policy to the sinner.

Members of the German government also want penalties to be imposed. Among the ideas are: suspension of European Union subsidies, the “cohesion funds”, to countries that fail to observe fiscal discipline; suspension of voting rights in ministerial meetings; and even suspension from the eurozone. A less controversial idea is to enforce fines already permitted under the EU’s “stability and growth pact”.

Yet, establishing the EMF would require a new treaty, as would exclusion from eurozone institutions (while a country could not be stopped from using the euro itself). Fining countries in fiscal difficulties has proved unworkable in the past. Today, most members would need to be fined. Dream on! We must note an even greater difficulty. The notion that the big threat is fiscal indiscipline is false. Greece is a special case. Today’s fiscal excesses are not the result of fiscal indiscipline, but of private indiscipline. The latter, moreover, was an inherent element in the workings of the eurozone itself. It is how the eurozone economy balanced, at a reasonable level of overall demand, in the pre-crisis period.

The point is best understood from the financial balances of eurozone members in 2006, before the crisis, and 2009, at its height (see charts). The balance between income and expenditure in the private, government and foreign sectors must sum to zero. In 2006, Germany, the Netherlands and Austria ran huge private surpluses, relative to GDP, while the private sectors of Portugal, Ireland, Greece and Spain ran huge deficits. Fiscal positions seemed under control everywhere: Ireland and Spain even ran substantial (albeit illusory) fiscal surpluses. Meanwhile, the private surpluses of Germany and the Netherlands were offset by huge capital outflows. In all, we see private disequilibria, but the illusion of fiscal stability, with countries more or less in line with treaty criteria for fiscal deficits.

Then came the crisis: overextended private sectors retrenched. By 2009, the private sectors of almost every member were running a huge surplus: they are all Germans now! So what are the offsets? The answer is: fiscal deficits. The picture for Ireland and Spain is dramatic. In the short run, it is impossible to shift external balances quickly, particularly when domestic demand in the surplus countries is so weak.

Now Germany insists that every country should eliminate its excess fiscal deficit as quickly as possible. But that can only happen if current account balances improve or private balances deteriorate. If it is to be the latter, there needs to be a resurgence in private, presumably debt-financed, spending. If it is to be the former, there are two choices: first, current account balances must deteriorate elsewhere in the eurozone, entailing a move to smaller private surpluses in countries like Germany. Or, second, the overall balance of the eurozone must shift towards surplus – a “beggar my neighbour” policy.

In practice, the most likely outcome of such fiscal retrenchment would be a slump in countries with large external and fiscal deficits. Given the lack of competitiveness of such external deficit countries and the weakness of demand elsewhere in the eurozone, such slumps might become very long-lasting. The question is whether populations would put up with this. If not, political crises will emerge, with inherently uncertain consequences.

Let me put the point starkly: Germany’s structural private sector and current account surpluses make it virtually impossible for its neighbours to eliminate their fiscal deficits, unless the latter are willing to live with lengthy slumps. The problem could be resolved by a eurozone move into external surpluses. I wonder how the eurozone would explain such a policy to its global partners. It might also be resolved by an expansionary monetary policy from the European Central Bank that successfully spurred private spending in the surplus countries and also raised German inflation well above the eurozone average.

Germany is in a trap of its own devising. It wants its neighbours to be as like itself as possible. They cannot be, because its deficient domestic demand cannot be universalised. As another great German philosopher, Hegel, might have said, the German thesis demanded a Spanish antithesis. Now that the private sector’s bubble has burst, the synthesis is a eurozone fiscal disaster. Ironically, Germany must become less German if the eurozone is to become more so.

Cauchemar à Berlin
Martin Wolf, *Le Monde*, 17 mars 2010

Depuis la création de la République fédérale, en 1949, l'Allemagne s'est fixé deux objectifs stratégiques prioritaires : monnaie saine et intégration européenne. Ces deux impératifs sont les leçons tirées des calamités de la première moitié du XXe siècle. L'euro incarne ces objectifs. Or, aujourd'hui, ils se trouvent en contradiction l'un avec l'autre.

Faut-il porter secours aux pécheurs, ce qui renforcerait la cohésion de la zone euro mais menacerait la stabilité monétaire ? Ou bien faut-il laisser les pécheurs aller au défaut de paiement, renforçant ainsi la crédibilité monétaire, mais affaiblissant la cohésion européenne ? L'Allemagne pouvait éviter d'avoir à opérer de tels choix avant la monnaie unique : les pays non compétitifs procédaient tout simplement à une dévaluation. Les Allemands estiment, à tort, que la solution consisterait à ce que chaque membre de la zone ressemble à leur pays. Or l'Allemagne ne peut être l'Allemagne - avec sa discipline budgétaire, sa faible demande intérieure et son énorme excédent d'exportations - que parce que les autres ne le sont pas. Son modèle économique actuel viole le principe d'universalité du plus grand philosophe allemand, Emmanuel Kant. L'idée selon laquelle certains pays sont en difficulté à cause de leur propre négligence est facile à concevoir dans le cas de la Grèce. D'après les dernières *Perspectives économiques* de l'OCDE, la dette publique brute de la Grèce équivalait l'année dernière à 115 % du produit intérieur brut (PIB), le déficit public à 12,7 % et le déficit des comptes courants à 11,1 %.

En d'autres circonstances, cette situation constituerait un motif typique d'intervention du Fonds monétaire international (FMI). Celui-ci proposerait un apport temporaire de liquidités en échange d'une dévaluation et de l'instauration de la rigueur budgétaire. Pourtant, le gouvernement allemand rejette l'idée qu'un organisme extérieur puisse dicter sa politique à un pays qui a la même monnaie que l'Allemagne. Il propose, à la place, la création d'un fonds monétaire européen (FME) qui fournirait un soutien financier assorti de conditions. Sous la direction des autres membres de la zone euro, le FME dicterait sa politique budgétaire au pécheur.

Le gouvernement allemand souhaite également que des sanctions soient imposées : suspension des subventions de l'Union européenne aux pays qui ne respectent pas la discipline budgétaire, suspension de leur droit de vote lors des réunions ministérielles, et même suspension temporaire de leur appartenance à la zone euro. Mais la création

du FME, comme l'exclusion des institutions de la zone euro (même si aucun pays ne se verrait interdire l'usage de l'euro lui-même) exigeraient alors la signature d'un nouveau traité. En réalité, le plus grave problème posé à la zone euro est que la notion selon laquelle le manque de discipline budgétaire serait le grand danger est tout simplement erronée. Les excès actuels de la Grèce ne résultent pas d'une absence de discipline budgétaire, mais du manque de discipline du secteur privé. Cette indiscipline, d'ailleurs, est inhérente au fonctionnement de la zone euro elle-même. C'est grâce à elle que l'économie de la zone euro se maintenait en équilibre, à un niveau raisonnable de demande globale, du moins jusqu'à la crise.

On comprendra mieux ce point en comparant les équilibres financiers des membres de la zone euro en 2006, c'est-à-dire avant la crise, et en 2009, alors qu'elle était à son paroxysme. Le solde entre revenus et dépenses dans les secteurs privés, dans le secteur public et dans celui des transactions internationales, doit être, au final, égal à zéro. En 2006, les secteurs privés de l'Allemagne, des Pays-Bas et de l'Autriche présentaient d'énormes excédents, ceux du Portugal, de l'Irlande, de la Grèce et de l'Espagne, d'énormes déficits. Les positions budgétaires paraissaient partout sous contrôle : l'Irlande et l'Espagne présentaient même de substantiels (quoique illusoires) excédents budgétaires. En fait, les excédents privés de l'Allemagne et des Pays-Bas étaient compensés par d'importantes sorties de capitaux.

Puis la crise est arrivée : les secteurs privés trop expansifs ont comprimé leurs dépenses. En 2009, ceux de presque tous les membres de la zone euro accusaient un énorme excédent. Seule solution pour compenser : le déficit des budgets publics. Car, à court terme, il est impossible de rééquilibrer rapidement les balances extérieures des pays déficitaires sur ce plan, comme par exemple l'Espagne ou l'Irlande, en particulier lorsque la demande intérieure dans les pays excédentaires, comme l'Allemagne ou les Pays-Bas, est aussi faible.

Aujourd'hui, l'Allemagne insiste pour que chaque pays résorbe aussi vite que possible son surplus de déficit budgétaire. En pratique, la conséquence la plus probable d'une telle compression budgétaire serait un ralentissement économique dans les pays ayant de gros déficits extérieurs et budgétaires. Vu le manque de compétitivité de ces pays et la faiblesse de la demande ailleurs dans la zone euro, ces ralentissements pourraient se prolonger très longtemps. La question est de savoir si les populations seront disposées à les supporter. Si elles ne le sont pas, des crises politiques ne manqueront pas d'éclater, porteuses bien entendu de conséquences incertaines.

Une telle politique serait possible si les balances des comptes courants s'amélioraient ou si les balances privées se détérioraient. Si l'on optait pour la seconde solution, il faudrait susciter une relance, sans doute financée par l'endettement, de la dépense du secteur privé. Si l'on préfère la première solution, il existe deux options : dans la première, les balances des comptes courants doivent se détériorer ailleurs dans la zone euro, et en premier lieu en Allemagne. Seconde option, la balance globale de la zone euro doit se réorienter vers l'excédent - ce qui équivaudrait à du protectionnisme.

Posons le problème crûment : en raison des excédents structurels du secteur privé et des comptes courants de l'Allemagne, il est quasiment impossible que ses voisins puissent résorber leurs déficits budgétaires, sauf s'ils sont prêts à supporter un ralentissement durable de leurs économies. Le problème pourrait être résolu si la zone euro s'orientait vers des excédents extérieurs. Je me demande toutefois comment elle expliquerait une telle politique à ses partenaires mondiaux.

L'Allemagne est prise à son propre piège. Elle voudrait que ses voisins lui ressemblent le plus possible. Or ils ne le peuvent pas, car la demande intérieure déficiente de l'Allemagne ne peut être universalisée. Comme aurait pu le dire un autre grand philosophe allemand, Hegel, la thèse allemande appelait une antithèse espagnole. Maintenant que la bulle du secteur privé a éclaté, la synthèse se traduit par un désastre budgétaire pour la zone euro. Paradoxalement, l'Allemagne doit devenir moins allemande si elle veut que la zone euro le devienne plus !

Spain's woes and Germany's export model could mean double dip

Edward Harrison, March 11, 2010

The first thing to realize is that government deficits are balanced by imports and private savings. I'm talking here about the financial sector balances, of course. The chart to the left from the FT shows you that the collective financial balances in each individual Eurozone country must sum to zero. Where there is a government surplus it is matched by either the capital account or private balances. The same is true for deficits. Take Spain, for example. There, the government's budget was in surplus in 2006 and it had a very large capital account surplus (the financial sector equivalent of a current account/trade deficit). This was matched by a substantial private sector deficit. By 2009, due in large part to an unprecedented housing bust, the government's finances were in tatters. Look at the chart. This is matched by net private sector savings and a capital account surplus. The financial sectors must balance.

This brings me to the second thing to realize. Spain is to Germany as the United States is to China. In a fixed exchange rate environment, the U.S. is running an astonishing current account deficit while China runs an equally outsized surplus. Similarly, you can't have Germany and Spain both running current account surpluses, unless the EU as a whole runs a current account surplus. This is something that Rob Parenteau ably gets across in a recent post.

So, if Germany (or the Netherlands) wants to be the export juggernaut and run a massive current account surplus, this has intra-EU ramifications. The most important is that Germany's (or the Netherlands') current account surplus (capital account deficit) is matched by current account deficits (capital account surpluses) in Spain (Portugal, Greece, Ireland and Italy). That's how it works, folks. You sell more to me than I do to you and I get more cash than you do. There are always two sides to every transaction. It's right there in the data.

The FT's Martin Wolf is on to this and notes in his column yesterday:

In the short run, it is impossible to shift external balances quickly, particularly when domestic demand in the surplus countries is so weak. Now Germany insists that every country should eliminate its excess fiscal deficit as quickly as possible. But that can only happen if current account balances improve or private balances deteriorate. If it is to be the latter, there needs to be a resurgence in private, presumably debt-financed, spending. If it is to be the former, there are two choices: first, current account balances must deteriorate elsewhere in the eurozone, entailing a move to smaller private surpluses in countries like Germany. Or, second, the overall balance of the eurozone must shift towards surplus – a "beggar my neighbour" policy.

In practice, the most likely outcome of such fiscal retrenchment would be a slump in countries with large external and fiscal deficits. Given the lack of competitiveness of such external deficit countries and the weakness of demand elsewhere in the eurozone, such slumps might become very long-lasting. The question is whether populations would put up with this. If not, political crises will emerge, with inherently uncertain consequences.

I would add to this by running a brief two-stage analysis of what happens under austerity (sorry, no charts yet). In stage one, we have the FT chart for 2009. Spain has an enormous budget deficit, which is offset by private savings and a capital surplus (more imports than exports). Germany has a smaller deficit and a capital deficit (more exports than imports) matched by a huge private sector savings.

If Spain is forced to run austerity measures as seems likely, in stage two, this shifts their government deficit markedly down. Given Spain's poor labour competitiveness, sticky wage prices and inability to depreciate the currency, all of the adjustment falls onto the private sector in the form of reduced net savings (which could include larger debt burdens). But, the thing to realize is that total GDP in Spain is lower in this scenario, which means total imports are lower, which means Germany's total export volume is lower. This is a deflationary scenario.

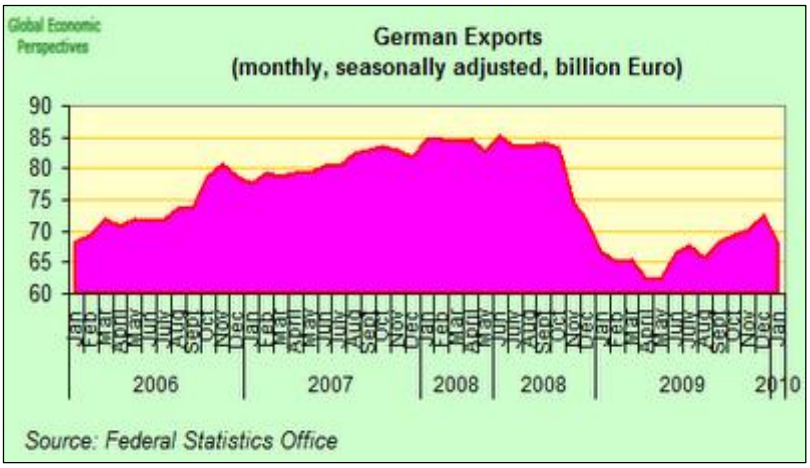
I know for a fact that Germany and Austria (another net exporter) are already cutting back their deficits, Austria via higher taxes. We see Ireland, Spain, Greece and Portugal doing 'austerity' measures to rein in government deficits too. Meanwhile, having seen the financial sector balances chart, you know that austerity means higher debt burdens in those countries, but also lower exports in Germany, which is also cutting back its own Government spending. So, austerity not only kills the Spanish economy and makes it prone to a debt deflation scenario, it also hurts the German export economy while they themselves are cutting back on government deficits.

What you have here is a perfect recipe for a double dip and a serious economic nightmare. Unless Germany can get its consumers to start spending more, Germany and the Eurozone are going to double dip, something Edward Hugh (see below) has already considered even before Germany's crumbling export data were released.

German Exports and that Looming Double Dip

Edward Hugh, 11 March 2010

I hadn't seen an advance release of the January German export data, when I wrote the following on Tuesday, honest injun I hadn't: *"Well, this is only a hypothesis. But if the hypothesis has any validity we should be able to make some predictions on the basis of it. I would make two. Firstly, since East Europe's economies are often dependent for their growth on exports to the West, and in particular to Germany, then we should be able to see some "shadow" of this German process cast out into the East".*

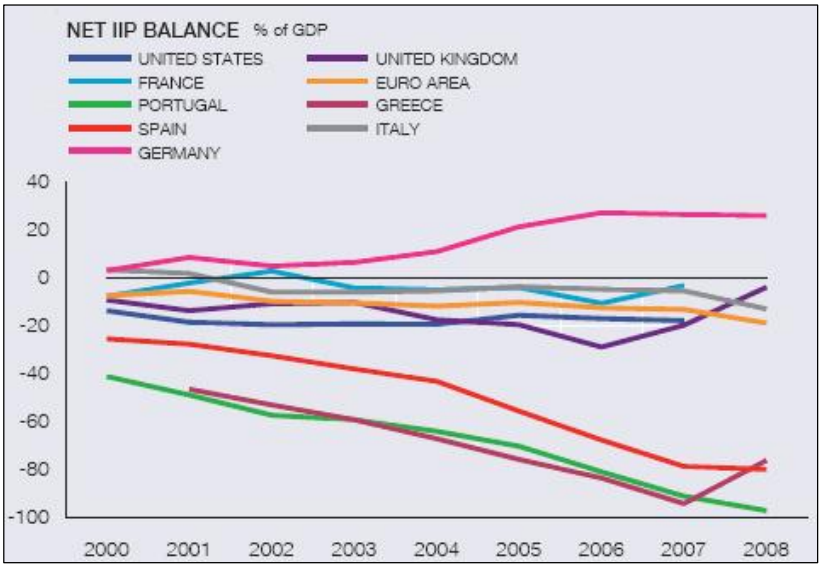


In the second place, we should see the process continue to some extent in Q1 2010. That is, based on what we have seen so far, in Q1 imports should rise, as industrial output in the early parts of the supply chain surges, and net trade should as a consequence be less positive than in Q4 2009. On the other hand, all the imported components awaiting processing should make inventories rise. So that's a prediction. Now we need to wait and see how good it is.I think I outlined in the post itself just how much you could see the impact of the long Eastward shadow cast by the German economy in the industrial output

performance in Central Europe, but little did I expect, when I wrote those words that further confirmation of the hypothesis would come within a mere 24 hours: *"Germany's exports unexpectedly declined in January compared to the previous month, official data showed on Wednesday, highlighting risks of a bumpy recovery in Europe's largest economy.Exports, adjusted for seasonal and calendar effects, dropped 6.3% in January compared to December 2009, the Federal Statistical Office, or Destatis, reported".*

Most analysts expected a 0.5% increase in exports, which posted a monthly rise of 3.4% in December. Imports posted a monthly rise of 6% in January after gaining 5% in the previous month. So we are seeing the imports rising effect, which suggests, since domestic consumption is falling at this point, that those inventories are starting to rise again, given that the expected follow through on exports is nothing like as dynamic as most analysts are suggesting. Oh, I know, I know, we have been having some very bad weather of late...

Axel Weber is forecasting a slight negative performance of the German economy in the first quarter, but in fact things are still not so clear since, as I wrote on Tuesday: *"Given everything I have said above about swings in imports and inventories, I would say German GDP will be very near to stationary again this quarter, with a possible slight upside depending on the inventory swing, but whatever upside we do see will more than likely disappear as quickly as it came when we get to the Q2 2010 data."* In other words, it is all down to inventories again, and these are very difficult to foresee. Nonetheless I would make two more points:



Firstly, the Bundesbank's forecast for growth of 1.6 percent in 2010 is looking rather optimistic at this point, even though GDP was at a very low level last year, so in theory getting some growth should not be that hard.

And secondly, that German recessionary "double dip" that I mentioned back in November does not look so implausible at all at this point. All that is needed is a very slight downward revision to the Q4 2009 data, and Axel Weber's own prediction for very slight negative growth in this quarter to be confirmed, and there we will be, back in recession. Which would only leave us with the French economy – among the EU majors – showing any sign of a robust recovery.

Of course the implications of all this rather technical argumentation are fairly profound. In the first place, as I noted in this post, any talk of the ECB raising interest rates either this year, or in the first half of 2011, would seem to be way, way too premature. And secondly, it is becoming increasingly obvious that Europe's (theoretically) stronger economies are inexorably yoked together with all those supposedly weaker ones, via the Eurozone (and EU27) current account imbalances.

So solving one problem also implies solving the other. Never has the case for a "united we stand, divided we fall" approach been clearer. So gentlemen, please, let's get a note of reality back into all those deliberations about what to do with the problems being faced in countries like Latvia, Hungary, Greece and Spain. We need common solutions to common problems, and we need solutions that work.