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Euro-Zone Economy Splits Optimists From Pessimists

- By IRWIN STELZER



The near- and longer-term economic future of the euro zone is becoming clearer, and it is not a pretty sight. Or might not be. That depends on whether you believe the economists at the European Central Bank, or their equally esteemed counterparts at the International Monetary fund. The ECB crowd sees a bright future stemming from the new austerity programs being adopted by, or imposed on, the wastrel Club Med countries and Ireland, not to mention only slightly less profligate France. As deficits are brought down, private-sector confidence will return, and sustainable growth become the euro zone's future.

Don't bet on it, counter the IMF economists. Austerity-now will bring the current very fragile recovery to a screeching halt, reduce growth and tax receipts, making it even more difficult for Greece and other countries to reduce their deficits.



Associated Press

Riot police clash with protesters at the Acropolis in Athens last week.

Meanwhile, the devaluation of the dollar—that is, after all, what the Federal Reserve Board's decision to launch QE2 comes to—is driving up the euro, making it less likely that an export-led strategy will prove a viable path to growth and prosperity. Especially since the Chinese have made it clear that abandonment of their manipulation of the yuan is not in the world's near-term future.

There seems broad agreement on some things. The first is that it is not certain that austerity programs will survive the electoral cycles in many country. France's president, Nikolas Sarkozy, is facing mounting opposition to his plan to extend the retirement age from 60 to 62 years for some workers, and he might be turfed out of office, along with his relatively modest reform program when the 2012 elections roll around. Spain's socialist government now seems likely not to survive for very long, and its austerity program might be modified by its successor government. No surprise that there are riots in the streets of Athens. The unemployment rate has risen from 9.6% to 12% in the past year and, say the trade unions, is headed to Spain's level of 20%. That would make it extraordinarily difficult for the government to maintain its austerity program. Since tax revenues are falling, and interest payments are headed towards 8% of GDP in 2013, estimates Citigroup Global Markets, Greece will find it increasingly difficult to avoid bankruptcy. And it is unclear whether Ireland will avoid restructuring, now that its deficit exceeds 30% of GDP after its latest bank bailout.

Whether the modification of these and other austerity programs is a good or bad thing we leave to the economists at the ECB and the IMF. But there is general agreement that growth in the euro zone and the larger EU will in any event remain puny. The Economist Intelligence Unit, in its just-released report, says, "Concerns about the economic health of the euro zone persist," and is forecasting that growth in Western Europe will reach only 1.1% next year, and at or below 1.7% at least through 2015, beyond which it wisely declines to look.

Chris Williamson, chief economist at Markit, the financial information services company, is slightly less certain. Given a slowing in global trade flows and stagnation in labor markets in major countries, he wonders whether growth in the French-German core can offset "an

increasing number of peripheral countries ... [that] appear to be sliding back into recession." With industrial production in France declining, and German exports under pressure from a falling dollar, a manipulated yuan, Korea's intervention to weaken the won, and a faltering recovery in America, I can't help wondering just how powerful the German engine has to be to tow the European economy into positive growth territory.

Only Goldman Sachs economists remain determinedly cheerful. They feel that Germany is indeed the engine that could, and that German consumers will awaken from their decade-long slumber. As they put it, "We expect private consumption—which has been stagnant for 10 years—to develop more dynamically from here..." My inclination is to read "expect" as an optimist's substitute for "hope," especially since the Goldman Sachs team sprinkles its latest report with, "The German economy is set for a slowdown ... trade activity and manufacturing orders show a loss of momentum ... subpar growth for the remainder of 2010."

All is not gloom, at least in the longer-term. The Irish government is coming to grips with the fact creditors of its banks must share in the losses now being imposed entirely on taxpayers, and is resisting pressure to raise its corporate tax rate from a growth-inducing 12.5% to French, Belgium, German and Spanish growth-stifling levels of 30+%. Spain is forcing mergers and restructuring on its cajas, the small, politically controlled regional banks that were excessively generous to credit-craving property developers. The Italian economy continues to grow. The word "reform" is no longer the policy that dare not speak its name.

Small beer compared to the negative forces playing on the European economies, but not to be ignored.

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