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Euroland Should Prepare for More Ups and Downs in Its Yo-Yo Economy

- By IRWIN STELZER



Cheer at a bit of good news, and it is soon overtaken by bad news. That seems to be the story of euroland.

- Ireland reassures the markets by bailing out its banks. Good news. Ireland goes to the markets to raise money and pays four percentage points over bunds. Bad news.
- High earnings lift sentiment in Germany reports Commerzbank. Good news. Sentiment in the financial community in Germany drops again as a slump is expected, reports Commerzbank. Bad news.
- Spanish Prime Minister José Luis Rodríguez Zapatero tells this newspaper, "I believe that the debt crisis... has passed." Very good news. Despite paying exorbitant interest rates, Portugal, which hasn't done very much to reduce its budget deficit, can persuade investors to buy only €750 million (\$1.01 billion) of its debt, the low end of its €1 billion goal and, along with Ireland, might have to join Greece in seeking emergency financial aid. Very bad news.

I could continue this yo-yo description of euroland affairs were it not that I will run out of good news to juxtapose against the bad. The slowdown in America means that this engine of worldwide growth is at least for now on the sidings. And any thought that Europe's economy had decoupled from America's is now seen as wishful thinking.



Retuers

José Zapatero offers some good news only for it to be outweighed by the bad.

More important even than the bad news from America is the news coming out of euroland. It is not only that some countries—Portugal being the leading example—are having trouble putting austerity plans into action. That would be bad enough. But the European Central Bank demands more spending cuts. "Credible and ambitious consolidation raises expectations of future economic growth..." it insists. Ireland, trying mightily to satisfy the ECB, is finding that cutting spending and raising taxes might just be producing the downward spiral that American President Barack Obama and Britain's shadow-chancellor-in-waiting Ed Balls have been warning about. Ireland is cutting spending, but either because of those cuts, or in spite of them, its economy is contracting at an annual rate of close to 5%. That reduces tax revenues, adds to social spending, and—as John Maynard Keynes might have advised were he still with us—will make it highly unlikely that Ireland will reach its goal of reducing its deficit from 11.6% of GDP (not counting bank bailouts) to 3% by 2014.

James Nixon, chief European economist for Société Générale, told the Times of London that unless Ireland gets an €80 billion bailout, its public finances are condemned to a "long, arduous, slow death."

There is worse. If Ireland and Portugal do queue up behind Greece, begging bowls rattling, they will be doing so at a time when their euroland colleagues, facing an EU-wide slow-down, will be most unhappy about bailing them out. Greece has already locked in a €110 billion rescue package from the European Financial Stability Fund, and estimates are that Portugal (€70 billion) and Ireland (€80 billion)

would bring the demand on the EFSF to €260 billion—unless Spain, with unemployment above 20% and its regional banks, or cajas, reeling under the burden of duff property loans, joins the hand-out queue. That is not far from the limit of the guarantee capacity of the EFSF, once a variety of mandated reserves and deductions from its theoretical €440 billion in available funds are factored in.

Most of these problems could be more easily resolved if only growth in the euro zone were as robust as it was only a few months ago. But the Purchasing Managers' Index for both the service and the manufacturing sectors dropped this month, although remaining about the 50 level that signals growth. So it is to be slow growth for the euro zone as a whole, with Germany pulling the area economy forward with less force, against the increasing drag created by problems in the peripheral economies.

The reasons for Germany's reduced ability to power euroarea growth are two. For one thing, its exports are likely to be hurt by the U.S. slowdown and the recent fall in the dollar. For another, German banks will have to reduce lending sharply, by an estimated one-third in the case of local banks—to conform to the new Basel III capital-adequacy rules.

But fear not. When (1) the taskforce headed by European Council President Herman Van Rompuy finishes reviewing (2) the proposals to fine profligate countries, to be unveiled next week by Olli Rehn, European commissioner for economic and monetary affairs, and (3) the proposals are debated in and presumably approved by the European Parliament, all will be well. Assuming of course (4) that Germany, which wants to revise the Lisbon Treaty to apply the new rules EU-wide, and France, which wants nothing to do with a re-opening of the Treaty and therefore wants the fines to apply only in euroland, can resolve their differences. The mills of Brussels grind slowly indeed.

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