The (so-called) crisis of the euro

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The role of crises within capitalism

- Destroy excess capital; forcibly adjust credit magnitudes back into line with production
- Impose restructuring on firms, branches and international position of national economies
- Strengthen subordination of working class: in Euro area relatively limited during recent crisis until so-called crisis of the euro in May 2010
Key phases of crisis in Euro area
I. Financial crisis

• Broke August 2007, deepened September 2008

• Europe banks made big losses due to large-scale investments in toxic US securities (pg.15)

• Financial collapse prevented by state injections of capital & loan guarantees (pg.16)
II. Economic crisis

• Slump in output Q4 2008 & Q1 2009

• Impact in Europe due to (a) slump in trade, and (b) collapse of credit

• Depth and duration of slump cushioned by expansive (national) fiscal programmes

• Large decline in tax revenue

• Big increase in fiscal deficits and government debt (pg.17,18,19)
III. Sovereign debt crisis

• Triggered in May 2010 by Greek difficulties in refinancing public debt (pg.20)

• Failure of European Union to respond rapidly (German reluctance) led to speculation against euro

• Euro area governments eventually agreed to provide €110 billion funding for Greek debt; despite ECB resistance IMF involved

• Speculation against euro continued; fed by concerns about Spain and Portugal’s external liabilities (largely private)
III. Sovereign debt crisis (cont’d)

- Euro area governments agreed to create $440 billion European Financial Stability Facility; strongly pushed by US

- EFSF complemented by €60 billion for balance of payments support from EU and €250 billion from IMF

- ECB began to purchase Greek, Spanish & Portuguese government debt (largely sterilised)
IV. Social crisis

- Major cuts in wages & public spending forced on Greece, Spain & Portugal
- Cuts already introduced in Ireland
- Plans for fiscal contraction announced in other countries (Italy, Germany, France ... )
Policy issues
Polarisation in Euro area

• Greek fiscal deficit stems from low revenues rather than high spending; but Greece only weakest link in chain of imbalances in Euro area

• Germany: real wages risen less than productivity; falling unit labour costs; growth dependent on export surplus (pg.21,22)

• Southern Europe: real wages risen by more than productivity; rising unit labour costs; stronger growth of domestic demand; current account deficits (pg.24,25)

• Significant financing of southern European deficits (government & private) by banks in northern Europe (pg.27)
Polarisation in the Euro area (cont’d)

- ECB ‘stress tests’ of banks not considered convincing

- Need for coordinated European fiscal policy; not so-called ‘independent’ fiscal council (a la ECB) to impose fiscal retrenchment
Currency rivalry

- Abrupt shift in Euro area fiscal stance partly due to political delay in responding to debt issue; but dramatic edge imparted by highly unstable international monetary relations (pg.28)

- Depreciation of dollar re. euro 2002-2008 (interest rate differential); improvement in US trade balance 2007; but potentially dangerous strategy (1979!)

- Challenges to lead role of dollar: China (Chou), UN (Stiglitz Commission), Japan (Hatoyama)

- Threat to global financial stability 2008 → ‘flight to safety’ (US govt securities); euro depreciated 20%
Currency rivalry (cont’d)

• As threat of global collapse receded, euro recovered 2009 (interest rates!)

• Uncertainty about Greek debt → extensive forward selling of euro → pressure on euro governments to respond

• Euro area countries relatively protected from x-rate crises (cf. Eastern Europe); but crisis highlights need to supersede international system based on dollar and private capital
## Estimates of bank write-downs, 2007-1010 ($ billions)

<table>
<thead>
<tr>
<th></th>
<th>Estimated holdings</th>
<th>Estimated write-offs</th>
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<tbody>
<tr>
<td>US</td>
<td>12,561</td>
<td>885</td>
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<tr>
<td>Britain</td>
<td>8,369</td>
<td>604</td>
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<td>Euro area</td>
<td>22,901</td>
<td>814</td>
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</table>

*Source: IMF, Global Financial Stability Report, April 2010*
Government support for banks

Euro area government deficits (% GDP)

Source: Eurostat
Euro area government deficits (% GDP)

Source: Eurostat
Euro area government debt (% GDP)

Source: Eurostat
Germany: Labour productivity & real wages
(1980 = 100)

Source: OECD
Germany: Labour productivity & real wages
(1980 = 100)

Source: OECD
Germany: Labour productivity & real wages (1980 = 100)

Source: OECD
Change in unit labour costs, 2000-2007 (%)
Trade balances, 2000-2007 (€ billion)

Source: Eurostat
Source: BIS Quarterly Review, June 2010
Bank exposure to Greece, Ireland, Portugal & Spain (End Q1 2010, $ billion)

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<tr>
<th>Country</th>
<th>Public sector</th>
<th>DE</th>
<th>ES</th>
<th>FR</th>
<th>IT</th>
<th>OEA</th>
<th>GB</th>
<th>JP</th>
<th>US</th>
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<td>Greece</td>
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<td>23.1</td>
<td>0.9</td>
<td>27.0</td>
<td>3.3</td>
<td>22.9</td>
<td>3.6</td>
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<td>8.8</td>
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<td>16.5</td>
<td>5.9</td>
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<td>0.2</td>
<td>8.7</td>
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Source: BIS Quarterly Review, September 2010
Euro – US dollar exchange rate

Source: European Central Bank
Long-term interest rates
(10 year government bonds spread over Germany, %)

Source: Eurostat
GDP growth 2000-2007 (%)

Source: Eurostat