The (so-called) crisis of the Euro

Trevor Evans, Berlin School of Economics & Law, September 2010

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: relatively limited in recent crisis until so-called crisis of the euro in May 2010

Key phases of crisis in Euro area

Financial crisis

- broke August 2007, deepened September 2008
- Europe banks made big losses due to large-scale investments in toxic US securities
- financial collapse prevented by state injections of capital & loan guarantees

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

Sovereign debt crisis

- triggered in May 2010 by Greek difficulties in refinancing public debt
- 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)
- Euro area governments (strongly pushed by US) agreed to create $440 billion European Financial Stability Facility; 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)

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
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
- Southern Europe: real wages risen by more than productivity; rising unit labour costs; stronger growth of domestic demand; current account deficits
- Significant financing of southern European deficits (government & private) by banks in northern Europe
- ECB ‘stress tests’ of banks not considered convincing
- Need for coordinated European 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
- 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%
- 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
Euro area fiscal deficits (% GDP)

Source: Eurostat

Euro area government debt (% GDP)

Source: Eurostat
Euro area 10 year government bond yields (%)

Source: OECD

Germany: Index of labour productivity and real wages (1980 = 100)

Source: OECD
Euro area: Change in unit labour costs, 2000 – 2007 (%)

Source: OECD

Trade balance, 2000 – 2009 (€ billions)

Source: Eurostat
Bank exposure to Greece, Ireland, Portugal and Spain (End Q1 2010, $ billions)

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Source: BIS Quarterly Review, September 2010

Euro – dollar exchange rate

Source: European Central Bank

12.09.10