AUSTERITY OVERLOAD

Periphery Alarmed as Engine Slows Down

The German engine had kept the troubled euro-zone economy chugging along. Now, as Germany appears to be slowing down, periphery countries worry about the negative impact, but also hope Berlin could have a change of heart over austerity.

BY SIOBHÁN DOWLING AND LÁRA HILMARSDÓTTIR

Anti-austerity protestors in Greece; they're louder than ever. Source: Reuters

When Chancellor Angela Merkel headed to Milan last week for a European Union jobs summit, she was greeted with protestors waving anti-austerity banners, throwing flares and clashing with police. It's the usual drill when she visits one of the countries that have borne the brunt of the euro crisis.

Many of those in the European periphery have long been highly skeptical about Berlin's approach to the crisis. Especially Ireland, Portugal and Greece - recipients of the international bail out - have had to meet German-lead demands for cost-cutting, belt-tightening and

WHY IT MATTERS

Now that Germany, the euro-zone's economic powerhouse, is faltering, the crisis countries that received E.U.-IMF bailouts are worried on how it could impact them.

FACTS

Germany's economy is slowing down, contracting 0.2 percent in the second quarter.

Ireland, Portugal and Greece entered bailout programs in which they committed to strict austerity in return for EU-IMF loans.

Germany does not want to use the €450 billion ESM fund to stimulate growth in the euro zone.

structural reform. While their economies have started to improve, many feel the cost has been too high.

Yet with a slew of weak economic data coming out of Germany itself, there is both worry that the engine of the euro zone is faltering and a sense of vindication from those who have long opposed the German approach.

Gustavo Piga, an economics professor at the University of Rome Tor Vergata, said the data backed up those who argued that the current practices are misguided. They "are hurting every single member country," he told Handelsblatt Global Edition.

Last week's economic data certainly made for grim reading. German economic output is slumping, with gross domestic product contracting by 0.2 percent in the second quarter. And industrial output in August dropped by 4 percent, the most since 2009. A group of leading economic institutes now predict that growth for 2014 will be just 1.3 percent instead of 1.9 percent and next year will only be 1.2 percent, not 2 percent.

This is bad news for the rest of Europe: Germany imports 39 percent of its goods and services from other euro-zone countries. The International Monetary Fund last week said that it now sees a 40 percent likelihood of a recession in the euro zone. And deflation is also a distinct possibility.

Given this apparent slump, German Finance Minister Wolfgang Schäuble is under growing attack for his insistence on balancing the budget at home, rather than taking advantage of near zero interest rates to borrow and boost investment at home, for example, in infrastructure.

"Germany should not stick with this policy, but pursue a fiscal expansionary policy," said Taso Mastroyiannis, of Panteion University in Athens. "The European economy is the train, and the German economy is the engine, so you can't stall the engine or press the brakes all the time."

Greece, like the other struggling euro zone countries, has come to rely on the strength of the German economy to keep the euro area ship afloat.

There is also concern in Portugal. "Some of the euro zone economies are still struggling with severe economic imbalances, so any bad news on German industrial production or growth output are worrying signs, specially for extremely vulnerable and weak economies like Portugal,"

explained Luís Faria, president of the Lisbon-based Contraditório think tank.

At the height of the euro crisis, Ireland, Portugal and Greece had to be bailed out with billions of euros by their European Union neighbors to avoid going broke.

Yet over nearly the past two years, the feeling has increased that the worst of the euro crisis was over. Particularly after the European Central Bank said it would do “whatever it takes” to save the euro, markets appear to have calmed down and those countries that had sought bailouts were finally getting their economies in order.

An increasingly isolated Schäuble. Source: Bloomberg

Ireland and Portugal have already exited their bailout programs this year, and Greece this week said it was negotiating to leave the IMF-E.U. program it entered in 2010.

As the biggest country in the zone, Germany provided a sizeable chunk of bailout funds to the periphery countries. In return, it used its clout to push for reforms and cuts, and to push through a so-called fiscal compact, which saw most countries in the European Union commit to stringent budget discipline.

The German approach is drawing increasing criticism. Many argue that instead of pushing for fiscal rectitude, Berlin should have been doing

more to boost growth and employment in particular. Unemployment has soared in most of the peripheral countries, and youth unemployment is catastrophic, at around 40 percent in Spain, Greece and Portugal.

"We have been warning of this," said Veronica Nilsson of the European Trade Union Confederation. "These policies are not creating growth and jobs in Europe."

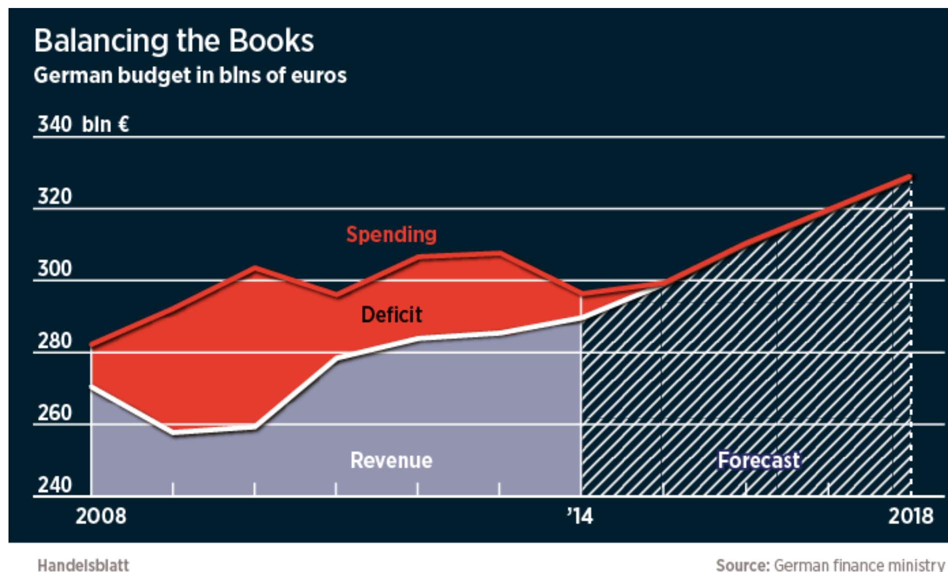
The German economy is "big and important in Europe," Ms. Nilsson added. "When there is no growth and no demand, it is just making everything worse."

The criticism of Germany is two-pronged: Not only is the country not coming up with a pan-European growth program, but its domestic policies actually act to the detriment of many of its euro-zone partners.

Germany hasn't seen the need to boost domestic demand, as it has benefited from the relatively weak euro to help boost its exports, and low wages have allowed it to maintain competiveness over its European neighbors.

However, with the economy starting to slow down in Germany, due to a variety of factors, including geo-political tensions over Ukraine, and a slowdown in emerging markets, there may be increased pressure to take action at home.

"You need a Germany that is more expansive than Italy and other Europe countries are," said Mr. Piga. "Expansion should not be conditional on reform, reform should be conditional on expansion. Then we have the resources we need to do the reforms we like."



Others are skeptical that Berlin can change gears.

"Germany will become like Japan because Merkel is a non-reformer, investments are down, innovation is limited, demographics are a risk, and there is a limit to the strategy that you become cheap to sell outside the country," said Theodore Pelagidis, an economics professor of the University of Piraeus, Greece.

For many in Spain, which avoided an official bailout but received a €100 billion aid package from the euro zone to bail out its banks in 2012, the German data is also alarming. If everyone tightens their belt in Europe, then it is unclear where growth can come from, argues Jordi Bacarai, director of the Barcelona Centre for International Affairs.

"It's impossible to have the same symmetry of austerity in Europe," he argued, saying countries like Spain, Greece and Italy need the "positive impact" of growth in Germany.

Portugal is also unhappy with Berlin's approach. "The general feeling is that the persistent idea of fiscal consolidation defended by Germany is a disaster for economic growth and social cohesion, in Portugal and other euro zone countries," said Mr. Faria.

Critics in these countries don't just want Germany to boost its economy but to make a bigger effort to stimulate growth in the euro zone as a whole.

But Berlin has already rejected the idea of using the existing €450 billion bailout fund, the European Stability Mechanism, to stimulate growth, a

suggestion from incoming European Commission president, Jean-Claude Juncker.

This is anathema to Germany's view of countries living within one's means. To Berlin, Europe's profligacy is what got it into the mess in the first place.

Mr. Schäuble is resisting the mounting pressure, saying last week more growth will not be "achieved by writing checks." Berlin instead wants to see Italy and France, the leading nations opposing austerity, implement structural reforms.

Yet, even countries that have been forced to swallow the austerity pill are now hoping for a change in policy in Berlin.

For Ireland, the poster boy of European austerity, there is a sense that the pain is finally ending. After years of punishing austerity, dictated by the troika of the European Union, ECB and IMF as a condition of the 2010 bailout, Ireland is finally seeing its economy grow again and is expected to reach its budget deficit target of under 3 percent.

As such, there is little interest among Ireland's policymakers in joining with the other countries such as Italy and France, which have resisted large scale reforms, in some kind of anti-austerity drive. "There is a sense that we swallowed our medicine, and now we are coming out the other side," said Ben Tonra, professor of international relations at University College Dublin.

Nevertheless, Ireland wants to see change, he said. "There is an overwhelming sense among policy and business elites here that a growth strategy, not austerity, has to be front and center."

Siobhán Dowling is an editor at Handelsblatt Global Edition in Berlin and covers politics and economics. Lára Hilmarsdóttir covers business and economics from Berlin. To contact the authors: dowling@handelsblatt.com, l.hilmarsdottir@vhb.de.

BACK TO TABLE OF CONTENTS