

Economic state of the union, EuroMemo 2013

Engelbert Stockhammer
Kingston University

structure

- Economic developments
 - Background: export-led growth and debt-led growth
 - Growth, trade imbalances, ages and unemployment
 - House prices, household debt, banks
- Economic policy
 - More fiscal straightjacket
 - Cyprus
- Outlook: Europe's divided working class

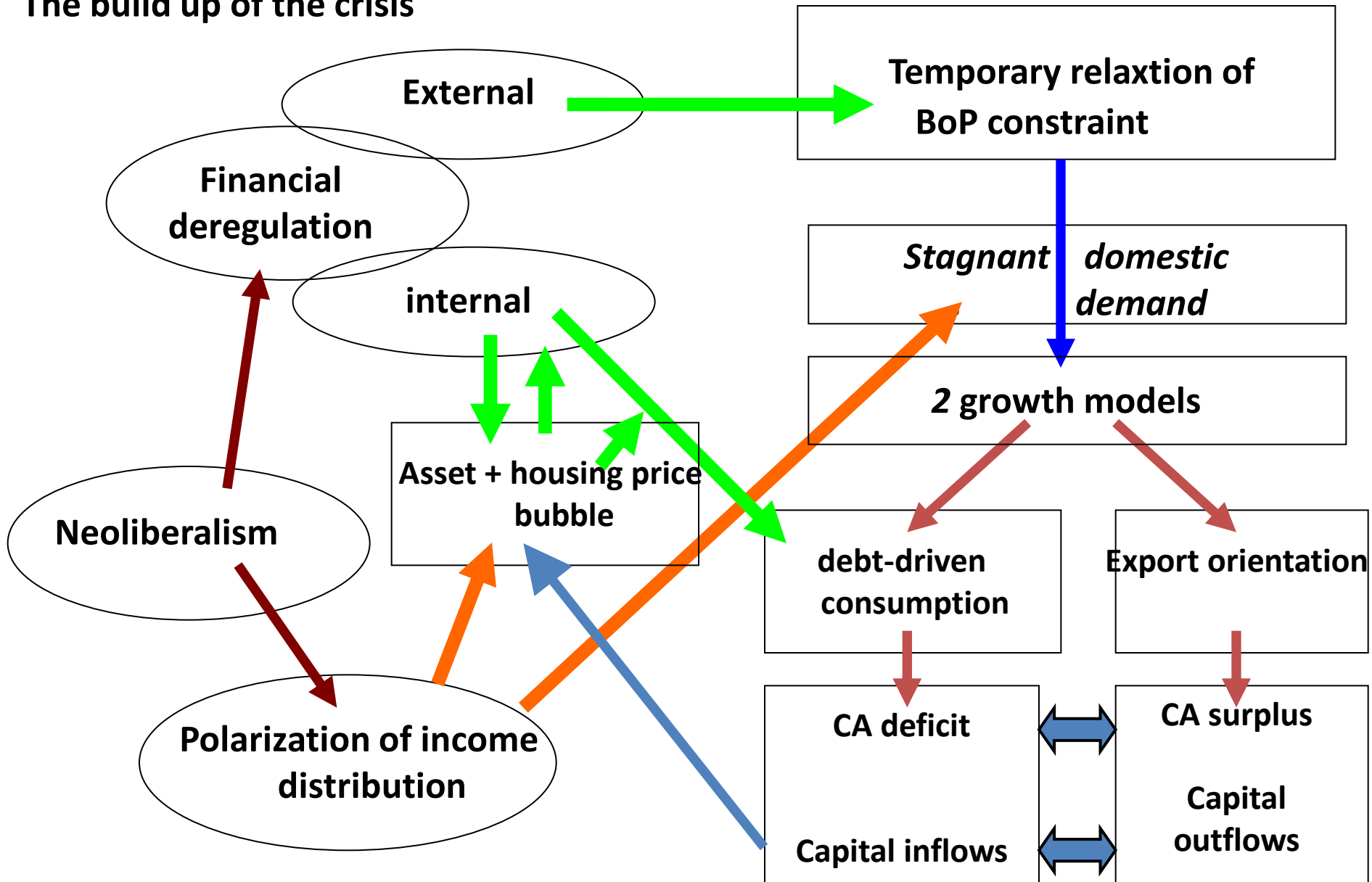
Background: neoliberal growth models

Neoliberal growth models & the crisis

- Rising inequality and fall in wage share → stagnation of domestic demand
- 2 growth models in response: debt-led and export-led growth → international imbalances
- In Europe: debt-led growth supported by EMU and FSAP

| | <i>debt-led</i> | <i>Export-led</i> |
|------------------|----------------------------------|-------------------------|
| <i>Center</i> | US, UK | Germany, Austria, Japan |
| <i>Periphery</i> | Greece, Ireland, Portugal, Spain | China |

The build up of the crisis



Increase in household debt (% of GDP)

| Increase in HH debt (in % GDP) 2000/08 | | | |
|---|-------|----------------|------|
| Germany | -11.3 | USA | 26 |
| | | United Kingdom | 28.1 |
| Netherlands | 32.8 | | |
| Austria | 7.9 | | |
| | | Ireland | 62.7 |
| | | Greece | 35.5 |
| France | 15.8 | Spain | 33.8 |
| | | Portugal | 27.4 |
| Source: Eurostat, except USA: FoF | | | |

International imbalances at the outset of the crisis

| current account (%GDP) 2007 | | | |
|-----------------------------|-----|----------------|-------|
| Germany | 7,9 | United Kingdom | -2,7 |
| Austria | 3,6 | United States | -5,2 |
| Netherlands | 8,7 | | |
| | | Greece | -14,5 |
| Japan | 4,8 | Ireland | -5,3 |
| China | 5,2 | Spain | -10 |
| | | Portugal | -9,4 |
| | | Italy | -2,4 |
| | | | |

building up of imbalances (in Europe: German wage suppression
+ financial bubbles in the South)

Crisis 2008-

Debt-led economies

Recession + stagnation due to
debt overhang

Export-led economies

Short sharp recession with
strong recovery

USA

Some counter-cyclical fiscal
policy
QE (for private sector as well as
for public sector) → interest
rates on govt bonds low

Europe

Fiscal straightjacket
Hesitant QE: ECB does not play
lender of last resort (LOLR) for
govts

Σ stagnation/weak recovery

North

Weak recovery

South

Debt deflation
Sovereign debt
crisis

Recent economic developments

GDP and NX

| | real gdp | | | NX | | |
|---------------------------------|---------------|--------------|--|---------------------------------|-------------|-------------|
| Country | 2009-13 | 2013 | | Country | 2008-13 | 2013 |
| European Union (28 countries) | -1.3% | -0.1% | | European Union (28 countries) | 2.6 | 1.6 |
| Euro area (12 countries) | -2.1% | -0.4% | | Euro area (12 countries) | 3.1 | 2.5 |
| Germany | 2.9% | 0.4% | | Germany | 0.2 | 6.3 |
| Ireland | -2.9% | 1.1% | | Ireland | 8.8 | 3.1 |
| Greece | -23.3% | -4.2% | | Greece | 15.2 | -2.8 |
| Spain | -6.4% | -1.5% | | Spain | 11.2 | 1.6 |
| France | 0.0% | -0.1% | | France | 0.3 | -1.6 |
| Italy | -7.1% | -1.3% | | Italy | 3.8 | 1.0 |
| Czech Republic | -2.0% | -0.4% | | Czech Republic | 0.5 | -2.4 |
| Hungary | -5.4% | 0.2% | | Hungary | 9.4 | 2.5 |
| Poland | 13.6% | 1.1% | | Poland | 3.1 | -2.5 |
| Romania | -3.5% | 1.6% | | Romania | 7.5 | -3.9 |
| United Kingdom | -0.5% | 0.6% | | United Kingdom | -1.7 | -2.7 |

The costs of rebalancing

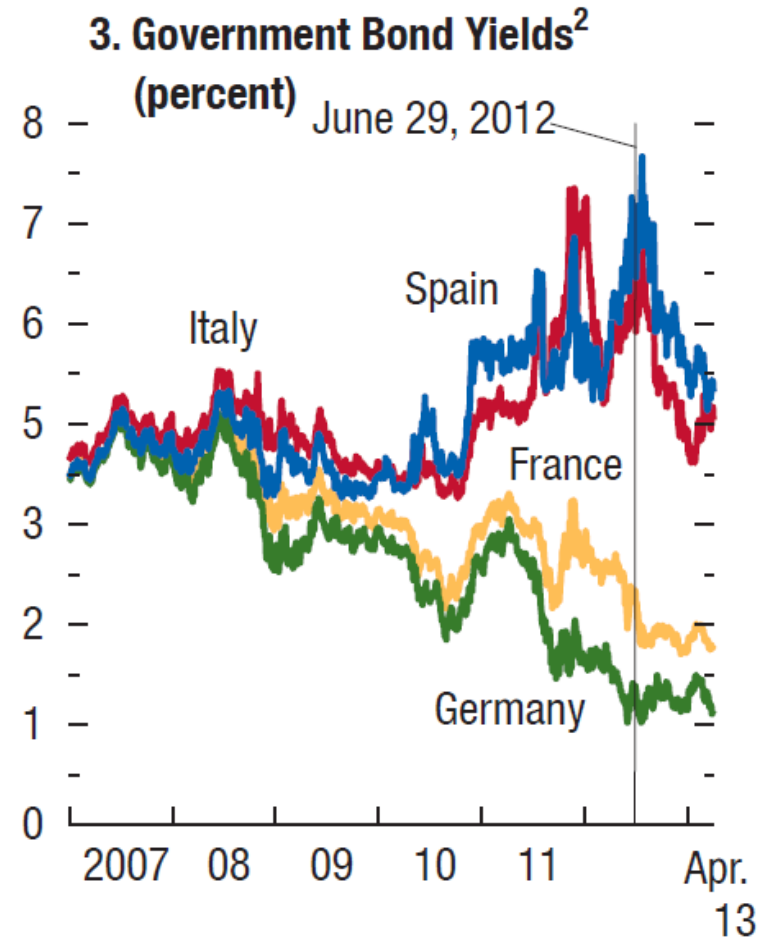
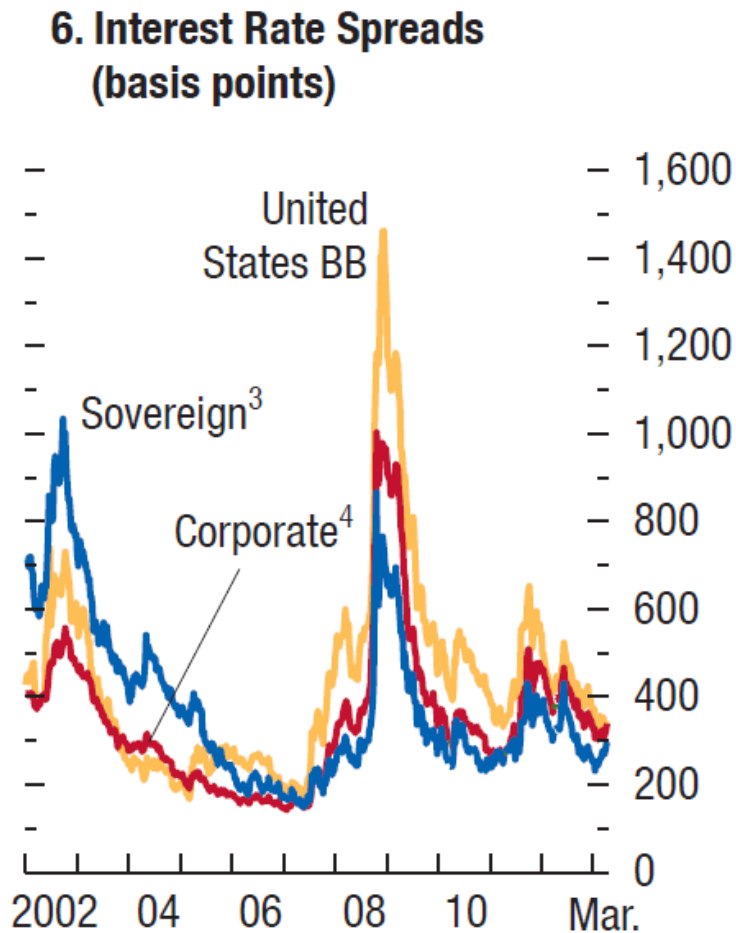
Stockhammer & Sotiropoulos (2012)

- GIIPS had average NX of -8.4% (GDP) in 2007.
given standard macro relations, what is the output decline required to balance NX?
- Estimate panel of EU12 countries
- NX-equation: $NX = f(Y, ULC)$
- Phillips curve: $ULC = f(U, PM)$
- Okun's Law: $\Delta U = f(\Delta Y)$
- Finding: need -23% (recession sample) to -47% (full sample) GDP

Public debt

| budget deficit | | | public debt | | | |
|--------------------------|---------|-------|--------------------------|-----------|------|------|
| Country | 2009-13 | 2013 | Country | 2009-13 | 2008 | 2013 |
| Euro area (12 countries) | 0.34 | -2.86 | Euro area (12 countries) | 25 | 71 | 96 |
| Germany | 1.15 | -0.16 | Germany | 14 | 67 | 81 |
| Ireland | 0.22 | -7.14 | Ireland | 79 | 45 | 123 |
| Greece | 6.09 | -3.83 | Greece | 62 | 113 | 175 |
| Spain | -2.04 | -6.53 | Spain | 51 | 40 | 91 |
| France | 0.19 | -3.96 | France | 26 | 68 | 94 |
| Italy | 0.01 | -2.69 | Italy | 25 | 106 | 131 |
| Czech Republic | 0.30 | -2.86 | Czech Republic | 20 | 29 | 48 |
| Hungary | -0.15 | -3.14 | Hungary | 7 | 73 | 80 |
| Poland | 0.07 | -3.94 | Poland | 10 | 47 | 57 |
| Romania | 3.11 | -2.57 | Romania | 25 | 13 | 39 |
| United Kingdom | 0.36 | -6.85 | United Kingdom | 43 | 52 | 95 |

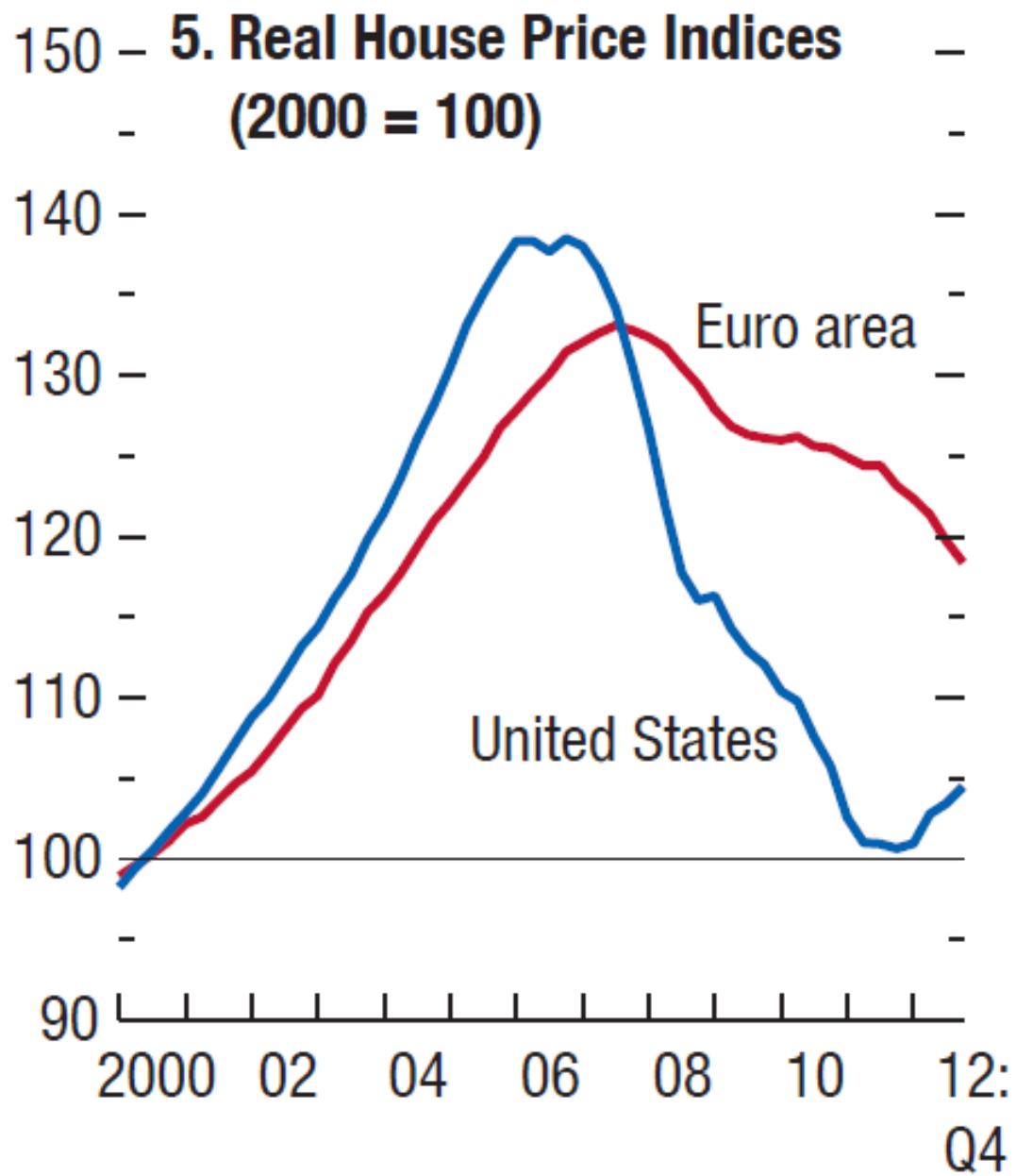
Sovereign yields remain high for South, but seem to be declining



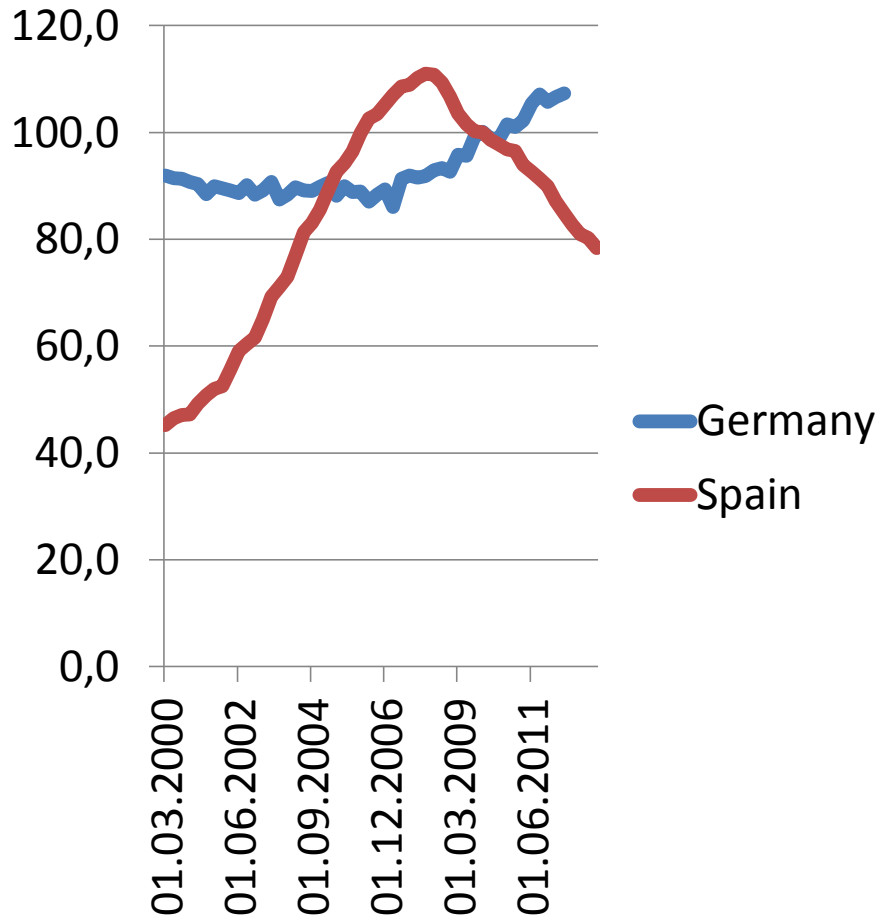
Unemployment and wage

| unemployment rate | | | real wages | | |
|-------------------------------|---------|------|-------------------------------|---------|-------|
| Country | 2008-13 | 2013 | Country | 2009-13 | 2013 |
| European Union (27 countries) | 0.6 | 11.1 | European Union (27 countries) | -0.6% | 0.3% |
| Euro area (12) | 4.6 | 12.2 | | | |
| Germany | -2.1 | 5.4 | Germany | 2.9% | 0.8% |
| Ireland | 7.8 | 14.2 | Ireland | -3.5% | -1.0% |
| Greece | 19.3 | 27 | Greece | -22.1% | -6.2% |
| Spain | 15.7 | 27 | Spain | -6.9% | -0.3% |
| France | 2.8 | 10.6 | France | 2.0% | -0.3% |
| Italy | 5.1 | 11.8 | Italy | -2.4% | -0.4% |
| Czech Republic | 3.1 | 7.5 | Czech Republic | 4.7% | -0.4% |
| Hungary | 3.6 | 11.4 | Hungary | -8.7% | -3.1% |
| Poland | 3.8 | 10.9 | Poland | 2.0% | 1.2% |
| Romania | 1.1 | 6.9 | Romania | -6.8% | 1.7% |
| United Kingdom | 2.4 | 8 | United Kingdom | -3.2% | 0.6% |

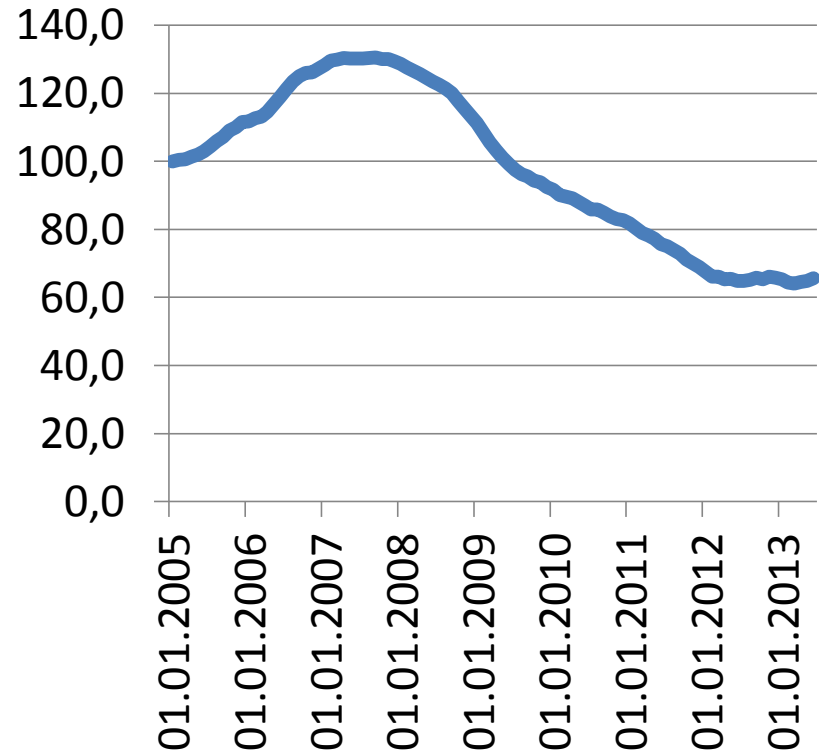
Housing, credit, banks



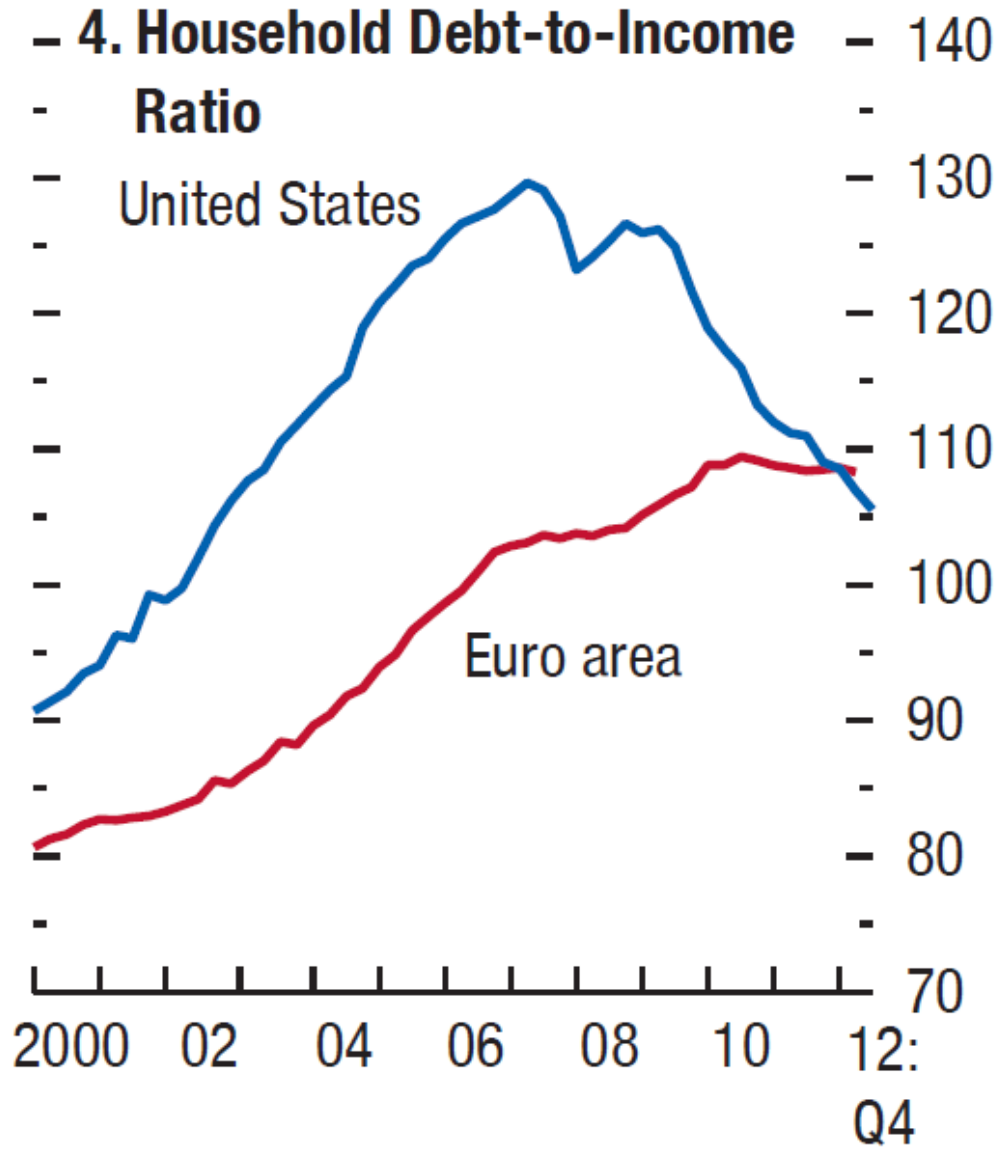
Property prices: Spain (-30%), Germany, Ireland (-50%)



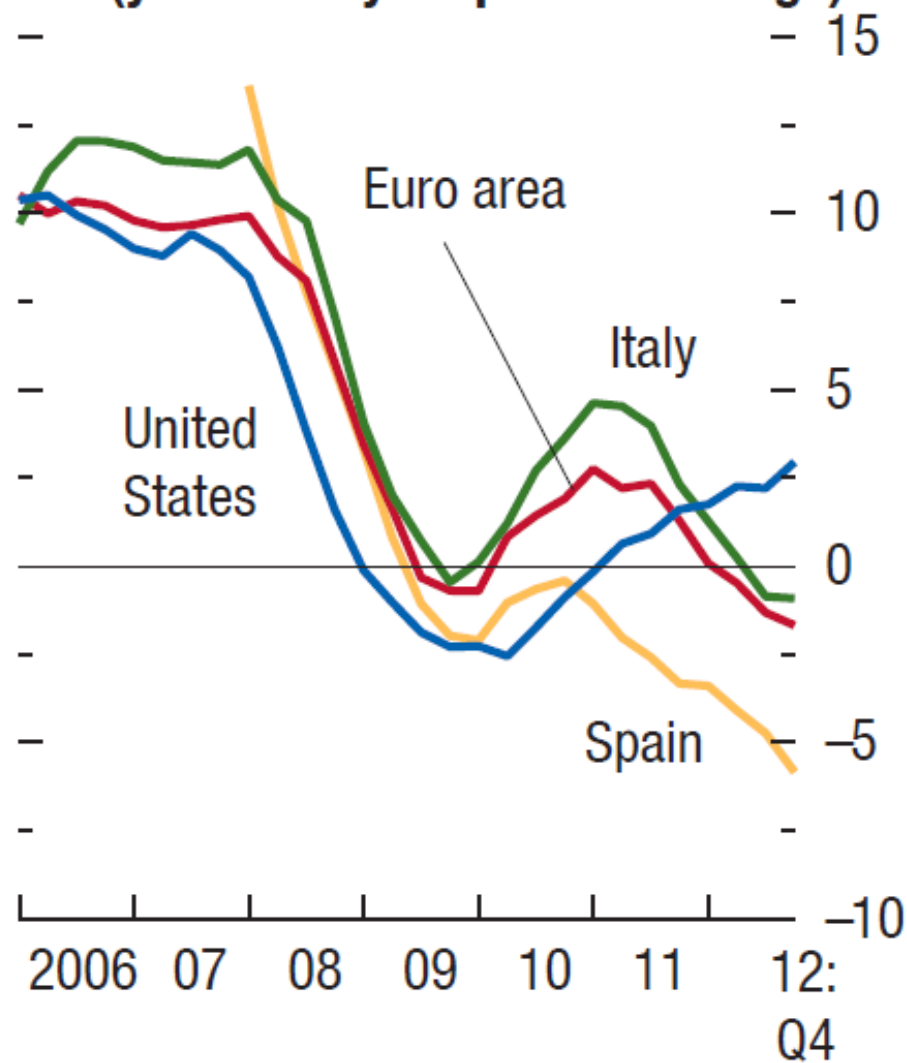
**Ireland: property prices
(-50% since 2007)**



4. Household Debt-to-Income Ratio



2. Nonfinancial Firm and Household Credit Growth² (year-over-year percent change)



Fragile banks

- RAC typically 4-12%
- what does this mean for equity/ total assets?
- Banks are extremely leveraged
 - That boost profits in boom
 - And losses in crises

| Deutsche Bank, consolidated group, 2013Q1, bn € | |
|--|-------------|
| Assets | 2033 |
| RAC | 325 |
| Total Shareholder Equity | 56 |
| capital ratio (RAC) | 17% |
| capital ratio (total assets) | 3% |

QE

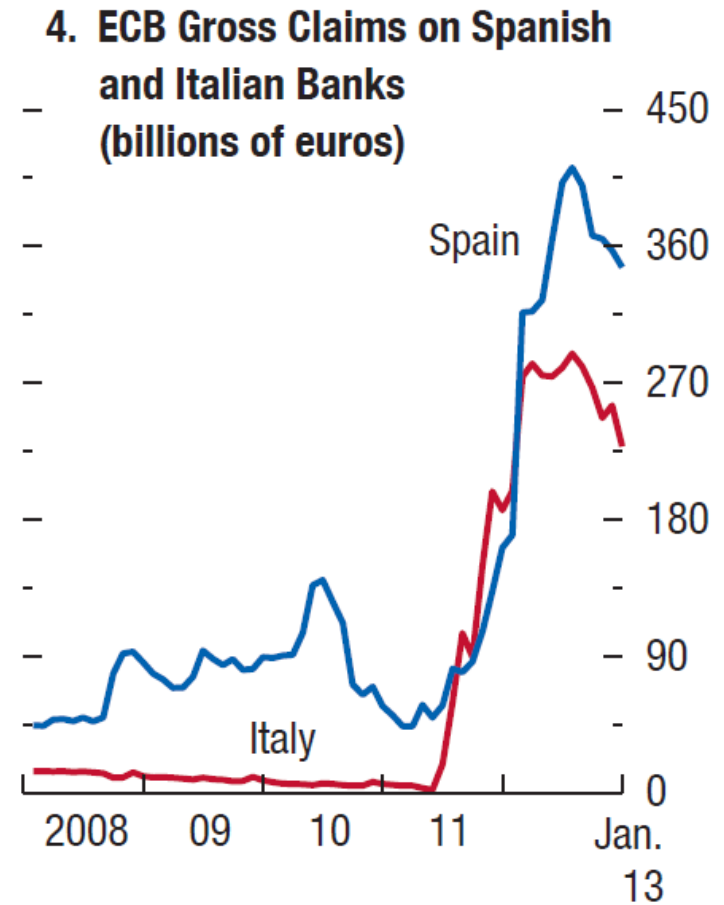
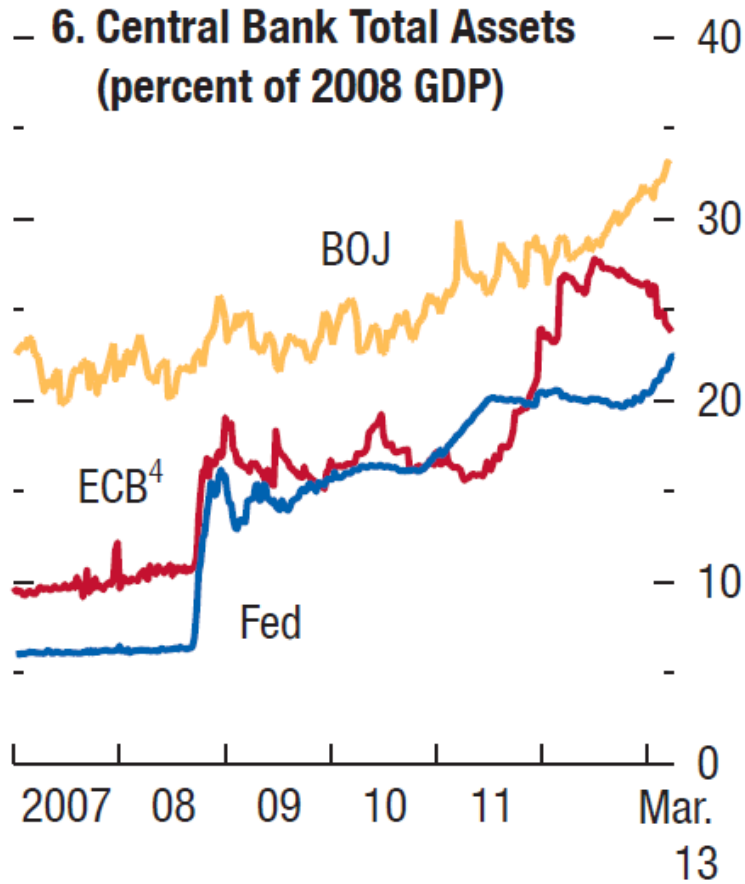
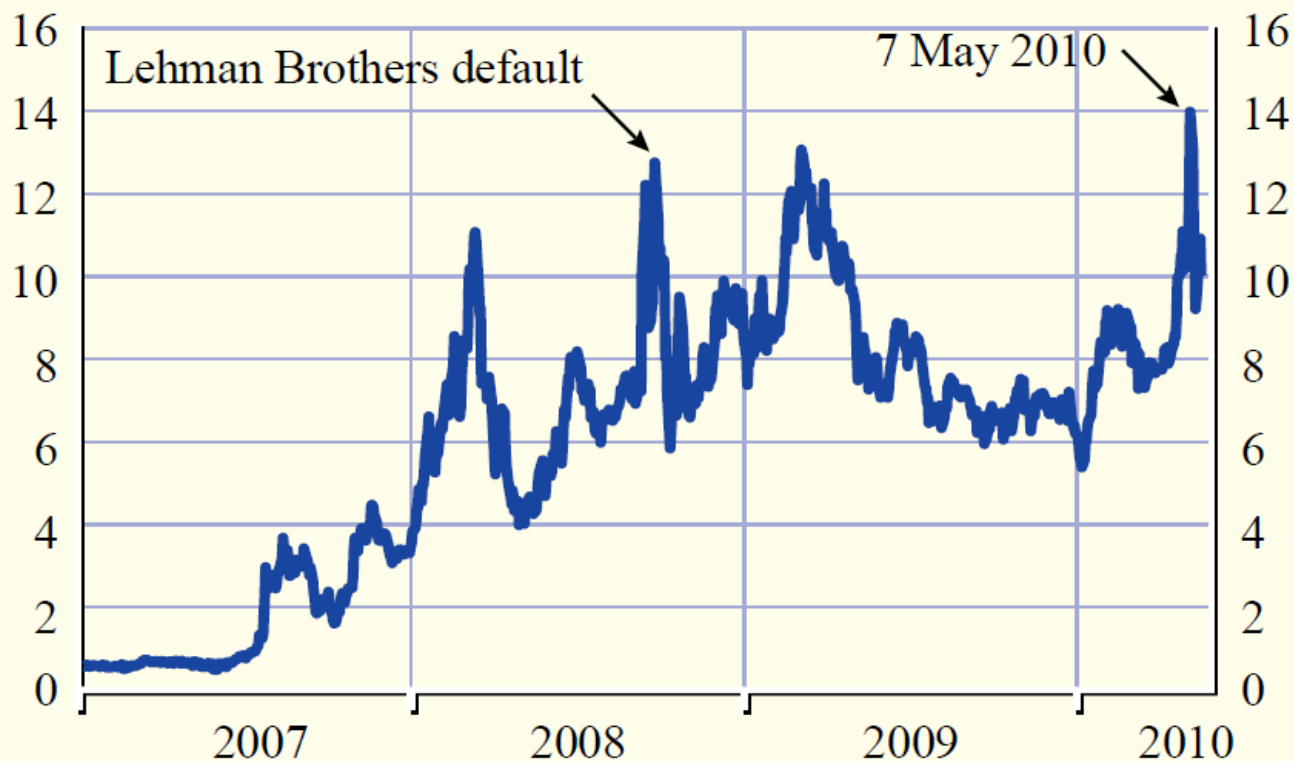


Chart E Systemic risk indicator

(percentages; Jan. 2007 – May 2010, probability of default)



Sources: Bloomberg, ECB calculations.

Europe's Lehmann moment

- “on 6-7 May tensions in the sovereign debt markets of some euro area countries spread to other segments of the financial markets. Volatility in the financial markets increased sharply and liquidity conditions deteriorated significantly not only in sovereign bond markets, but also and to a critical degree in the money markets. Transactions within the interbank market declined rapidly and uncertainty among banks about counterparties' creditworthiness increased.” (ECB Monthly Bulletin June 2010, 41)
- **“heightened concerns about the probability of default of some European financial institutions. Indeed, the probability of a simultaneous default of two or more euro area large and complex banking groups, (...) rose sharply on 7 May, reaching values higher than in the aftermath of the collapse of Lehman Brothers.”** ECB Monthly Bulletin June 2010, 38-39
- *Sovereign debt crisis = (private) banking crisis*

Gov't debt, money and banks

- CBs (LOLR) are contested between private (financial) interests and gov'ts
- ECB is reluctantly playing LOLR for private sector
- ... and even more reluctantly for public sector
 - EMU has removed LOLR from nation states
 - Turned what would have been an exchange rate crisis into a sovereign debt crisis (similar to 'debt in foreign currency')
- Crisis has illustrated how closely linked the state and the (national) financial sectors are
- A sovereign debt crisis is also a crisis of private banking sector
 - Role of gov't bonds in banks' balance sheet
- A banking crisis → public debt
- European neoliberalism wants to strangulate the nation states, but hasn't built a European one.

Wrapping up & policy

Is the worst over, or is the next crisis around the corner?

- On the surface it looks like stabilisation, but with divergence across Europe
 - No disaster (yet)
 - Mild recession in North
 - Positive growth in Ireland, no collapse in Spain, growth in Baltics
 - Some countries left to rot (Greece, Cyprus)
 - Financial market pressures have eased
 - Rebalancing is taking place (trade imbalances, house prices; but not household debt)
- In the 'South' a social roll back: falling wages and high unemployment, attack on welfare state
- Possible sources of instability
 - Fragile banks
 - Fragile sovereign debt in Spain, Italy
 - High levels of household debt

Economic policy

- 6pack, 2pack, TSCG, Eu Semester: more austerity (for South) & constitutional
- ESM
- Banking union: not quite
 - Supervision
 - Rescue fund
- Cyprus – ordo-liberalism (when it's about someone else's money)
 - Bail in and 'tax' on deposits >10k
 - Cyprus had a huge (8.5 x GDP) financial sector

Thinking about rebalancing strategies in the Euro area

| | | <i>How to deal with cost differentials</i> | |
|------------------------------|-------------------------|--|--|
| | | Adjustment in trade deficit countries: deflationary | Adjustment in trade surplus countries: Inflationary |
| <i>How to deal with debt</i> | Bankruptcy | | |
| | Restructuring / Bail in | | |
| | Bail out | | |
| | Bail out + QE | | |

Europe's divided workers

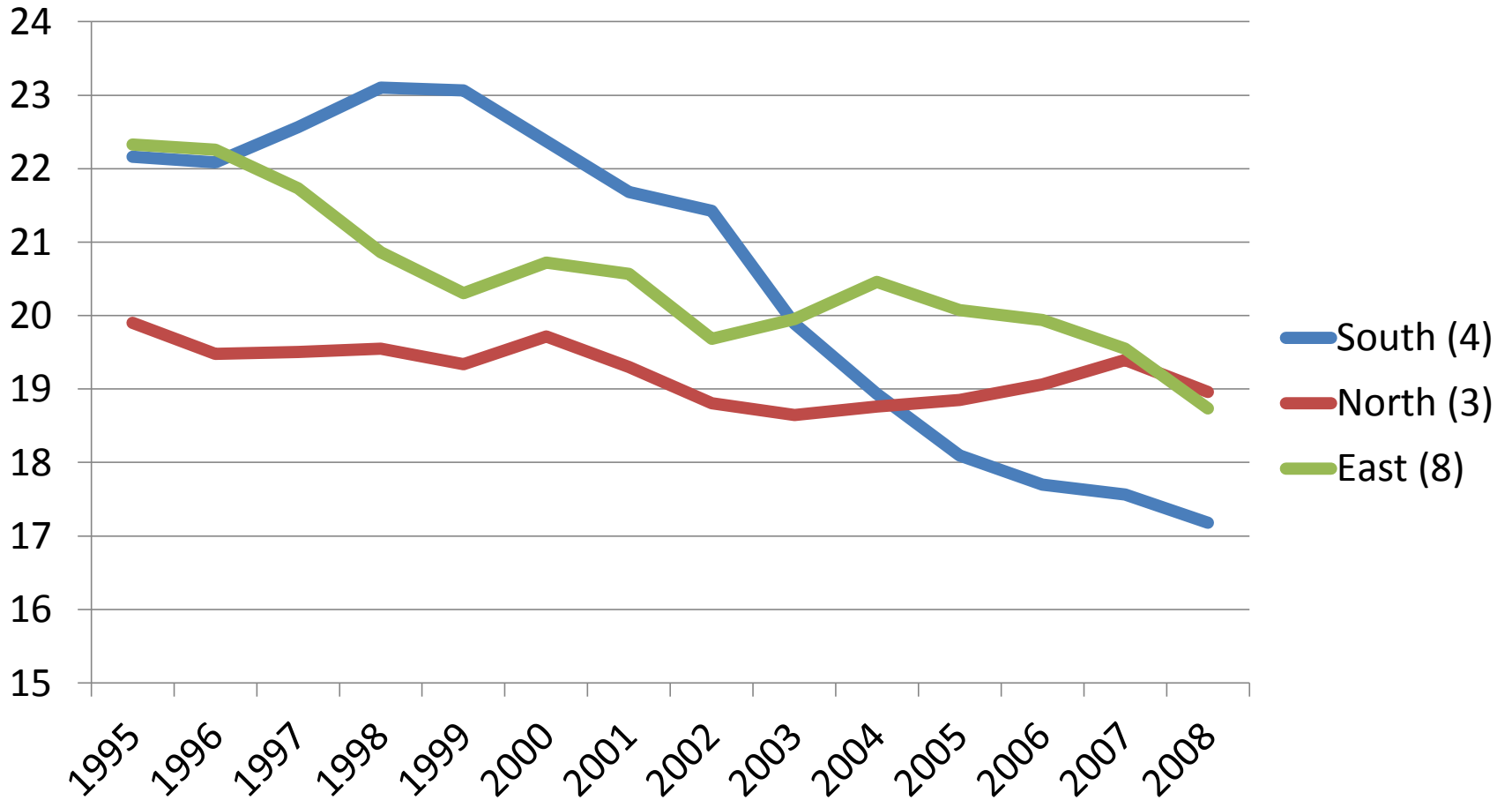
- North: export-led growth (stable industry); before crisis: erosion of welfare state + rising inequality; recovery after recession
- South: debt-led growth: bubble + deindustrialisation; before crisis: consolidation of welfare state; crisis -> depression + attack on welfare state
- East: dependent catching up (subordination to German production networks) with some debt-led elements (rising household debt from low levels), moderate de-industrialisation with upgrading (productivity and wage growth); crisis: varied experience

Policy implications

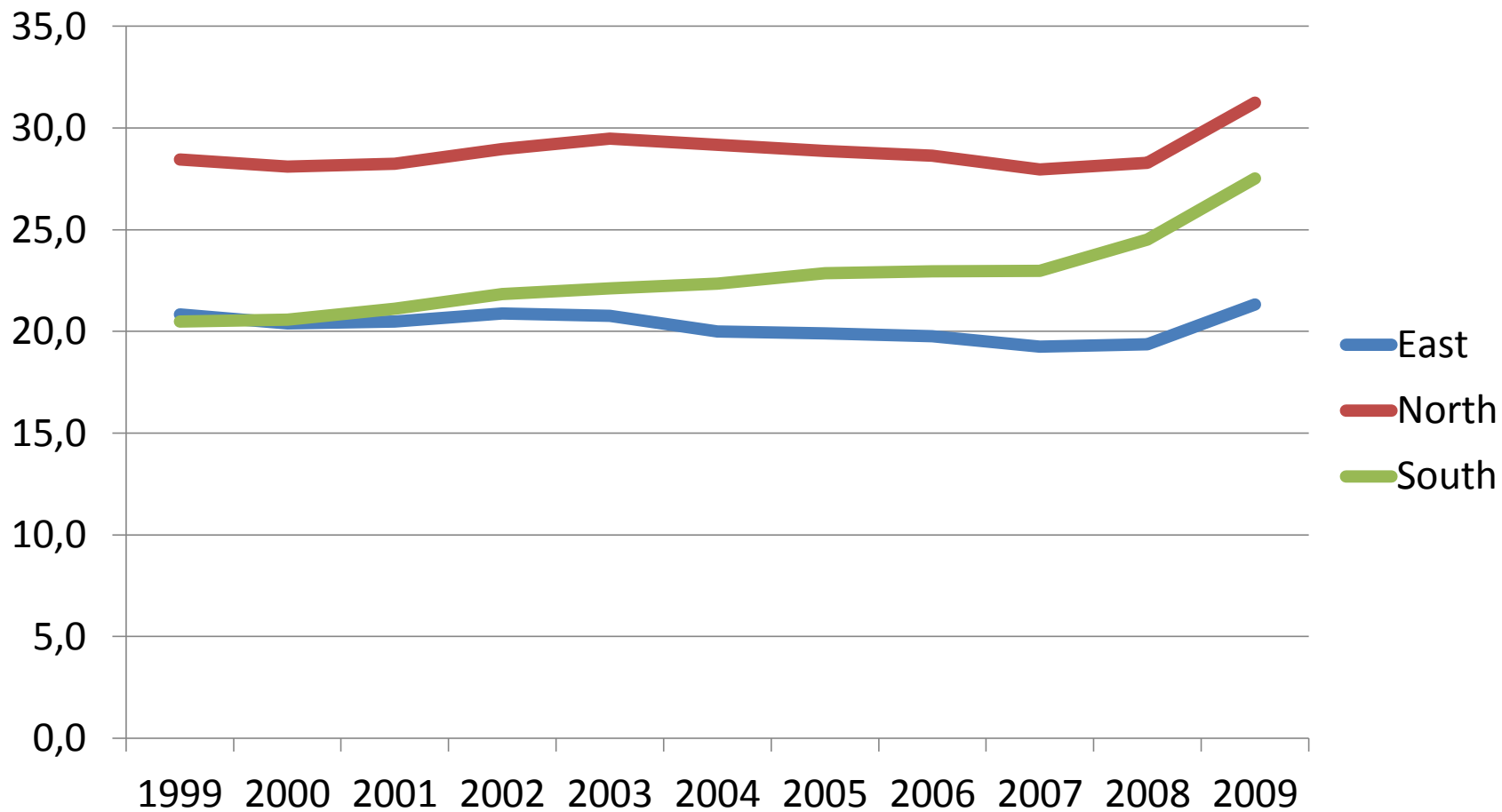
- So what does this mean for progressive political strategies in Europe?
- Recognition: national working classes face different economic circumstances
- Either unity *has to be create politically* or develop *national progressive strategies*
- Demands to could create political unity ('Proletarians of Europe, unite!')
 - European system of minimum wages
 - Inflationary adjustment in reaction to debt and to cost imbalances. (High wage growth in surplus countries
 - Wealth taxes

appendix

Manufacturing as % of value added



Social expenditures as % GDP



Wage dispersion in Germany and Spain

