



IPE Berlin
Institute for International
Political Economy Berlin



Hochschule für
Wirtschaft und Recht Berlin
Berlin School of Economics and Law

The (so-called) crisis of the euro

Trevor Evans

Berlin School of Economics and Law

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

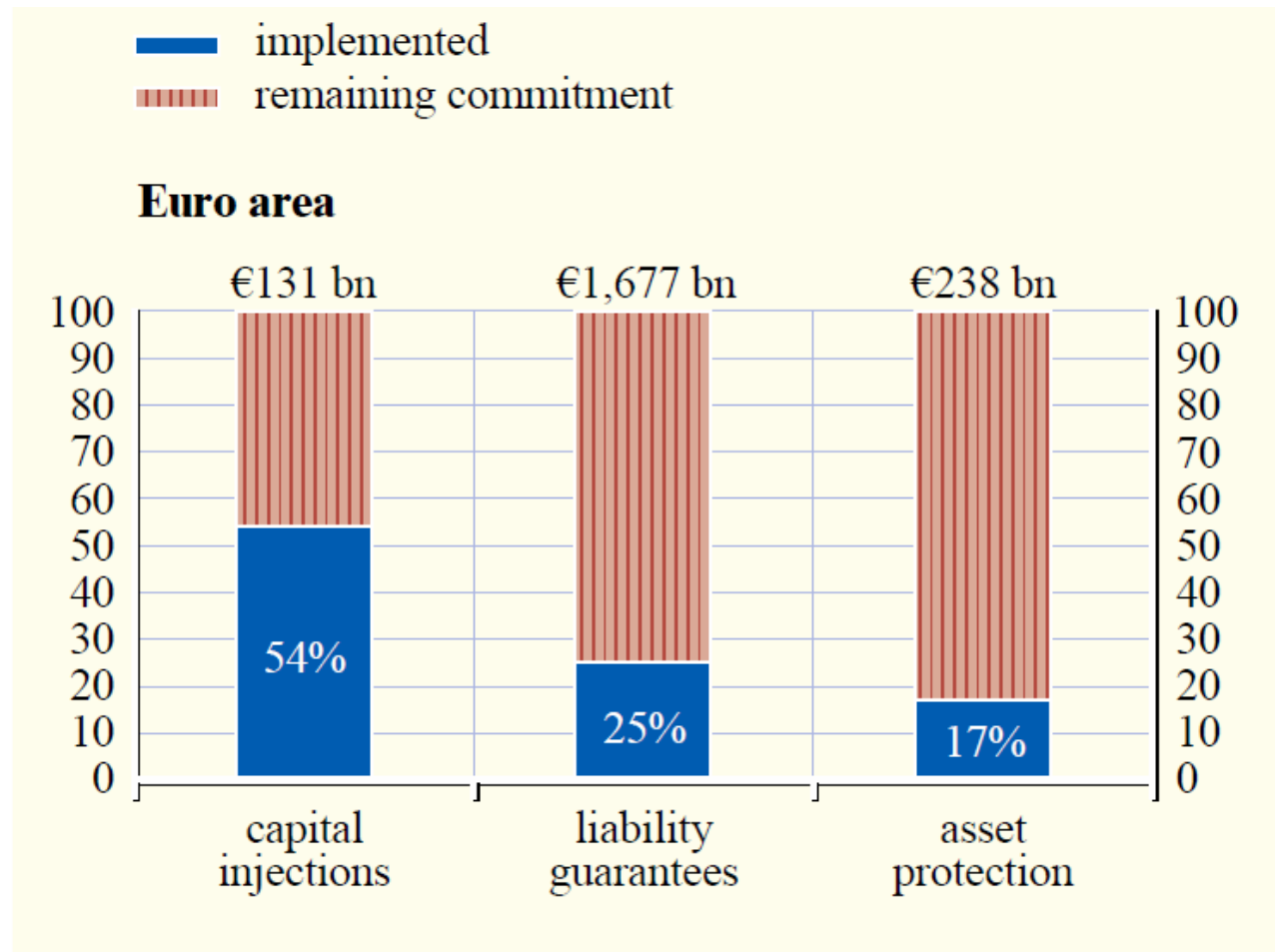
(\$ billions)

	Estimated holdings	Estimated write-offs
US	12,561	885
Britain	8,369	604
Euro area	22,901	814

Source: IMF, *Global Financial Stability Report*, April 2010



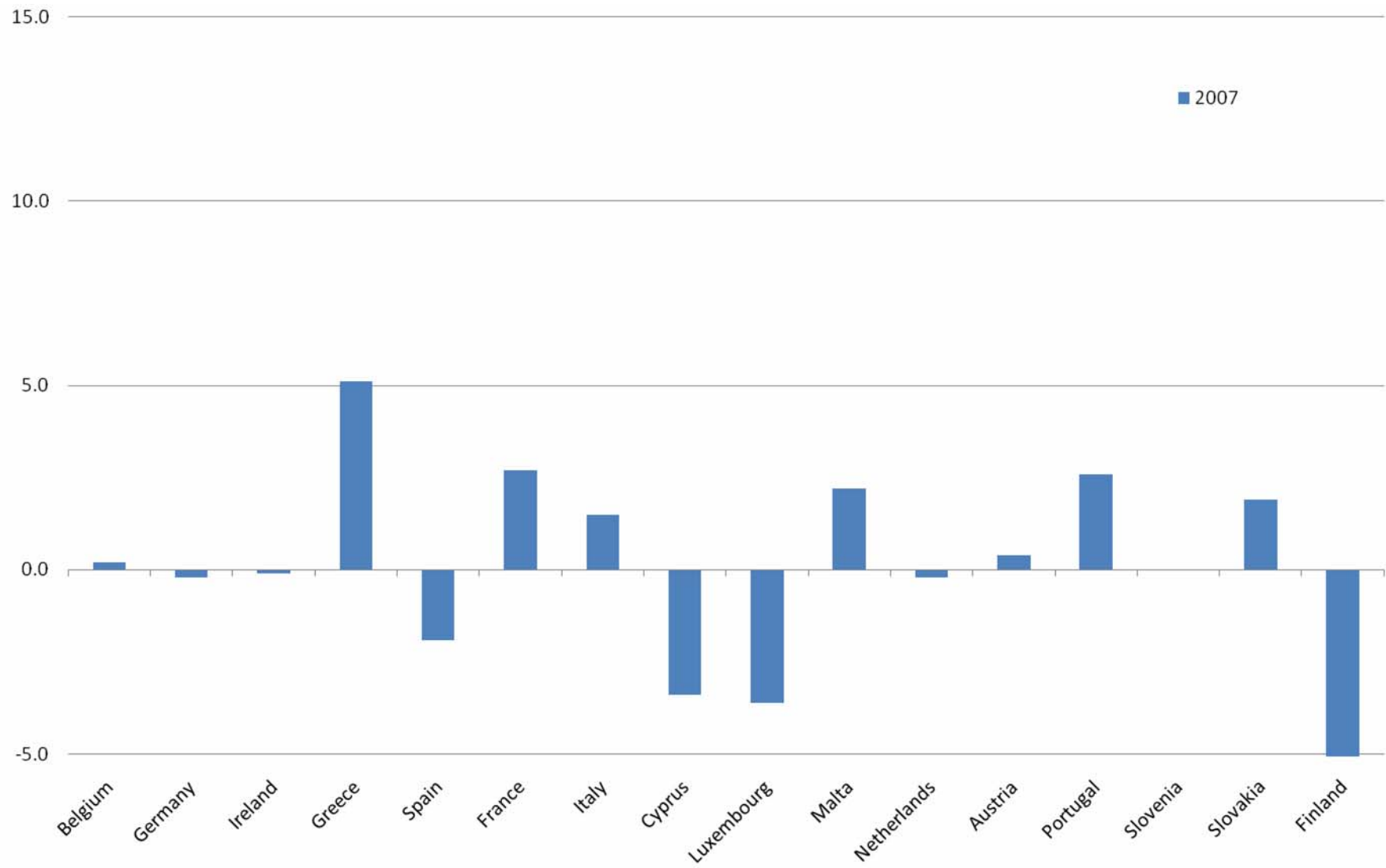
Government support for banks



Source: European Central Bank, *Monthly Bulletin*, April 2010, p. 80. Implemented as at February 2010.



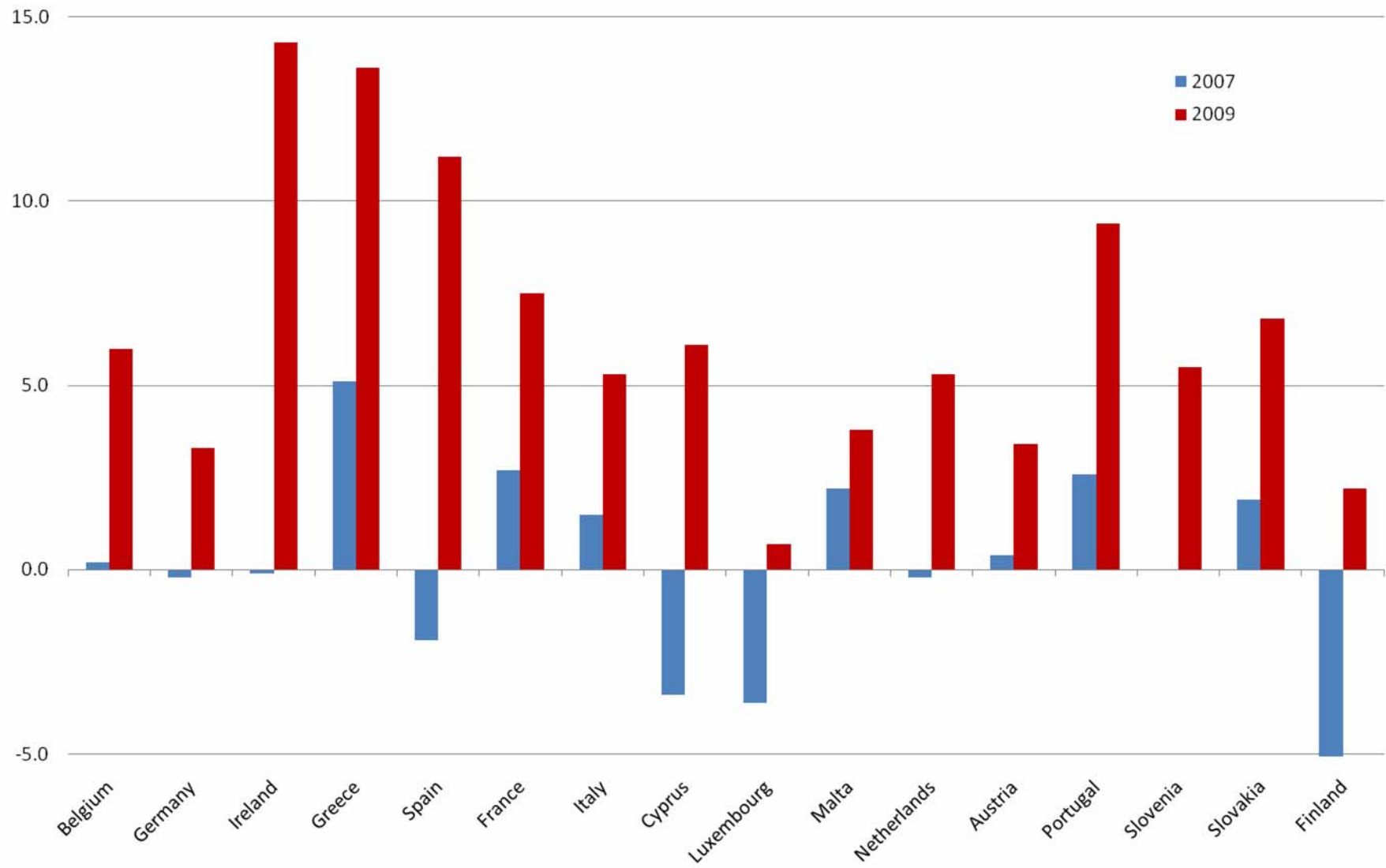
Euro area government deficits (% GDP)



Source: Eurostat



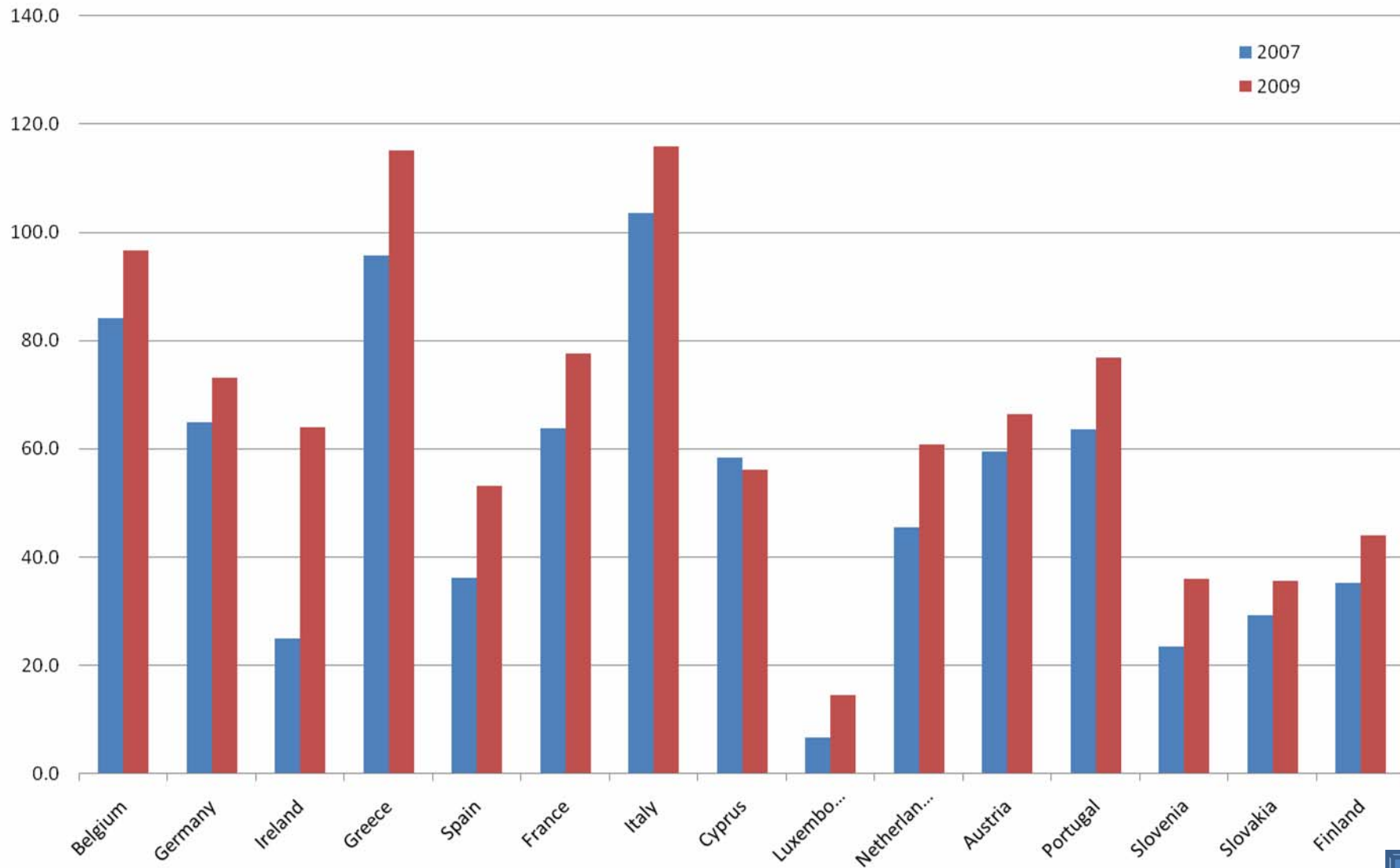
Euro area government deficits (% GDP)



Source: Eurostat



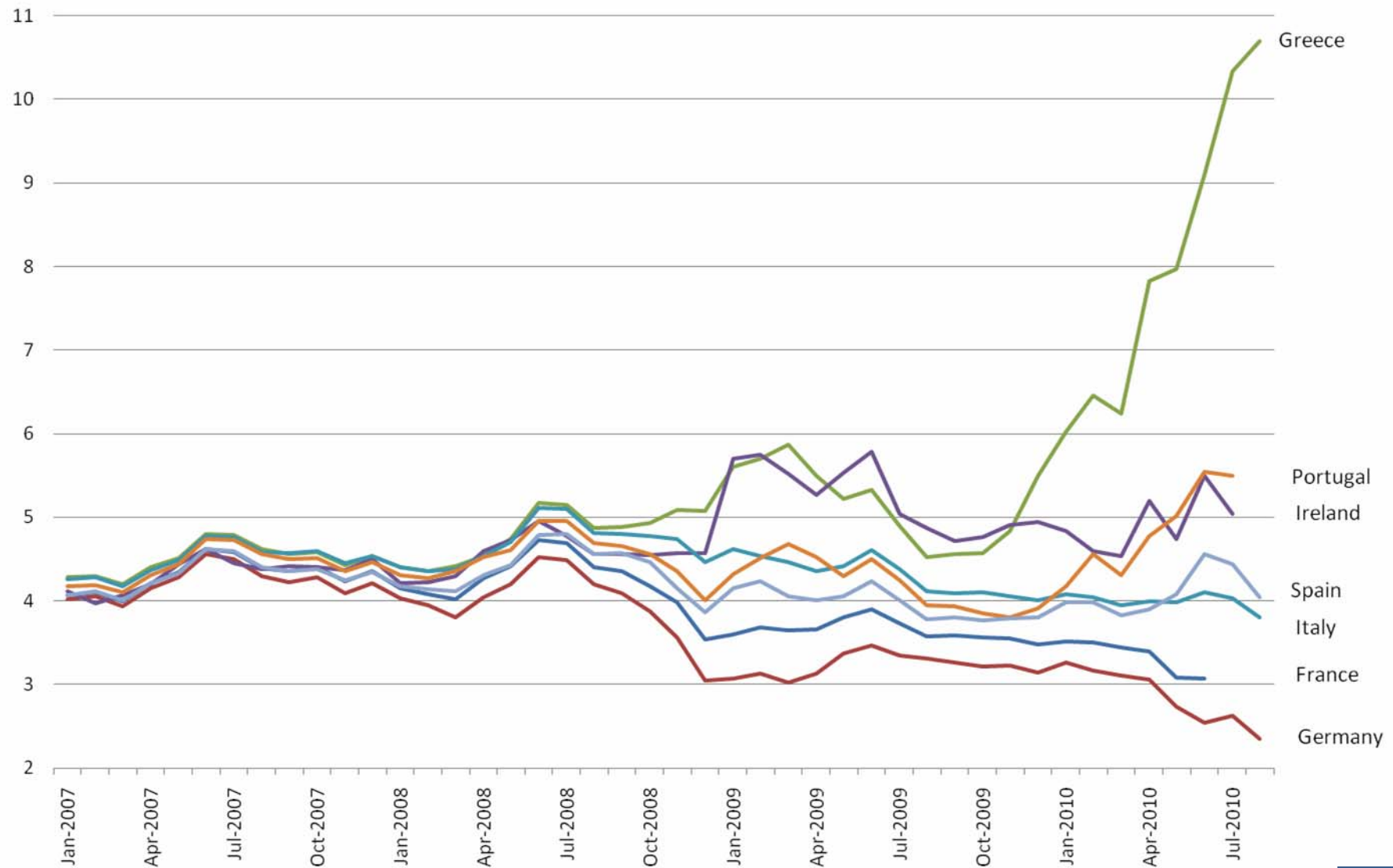
Euro area government debt (% GDP)



Source: Eurostat



10 year government bond yields (%)



Source: OECD



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



Source: OECD



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



Source: OECD



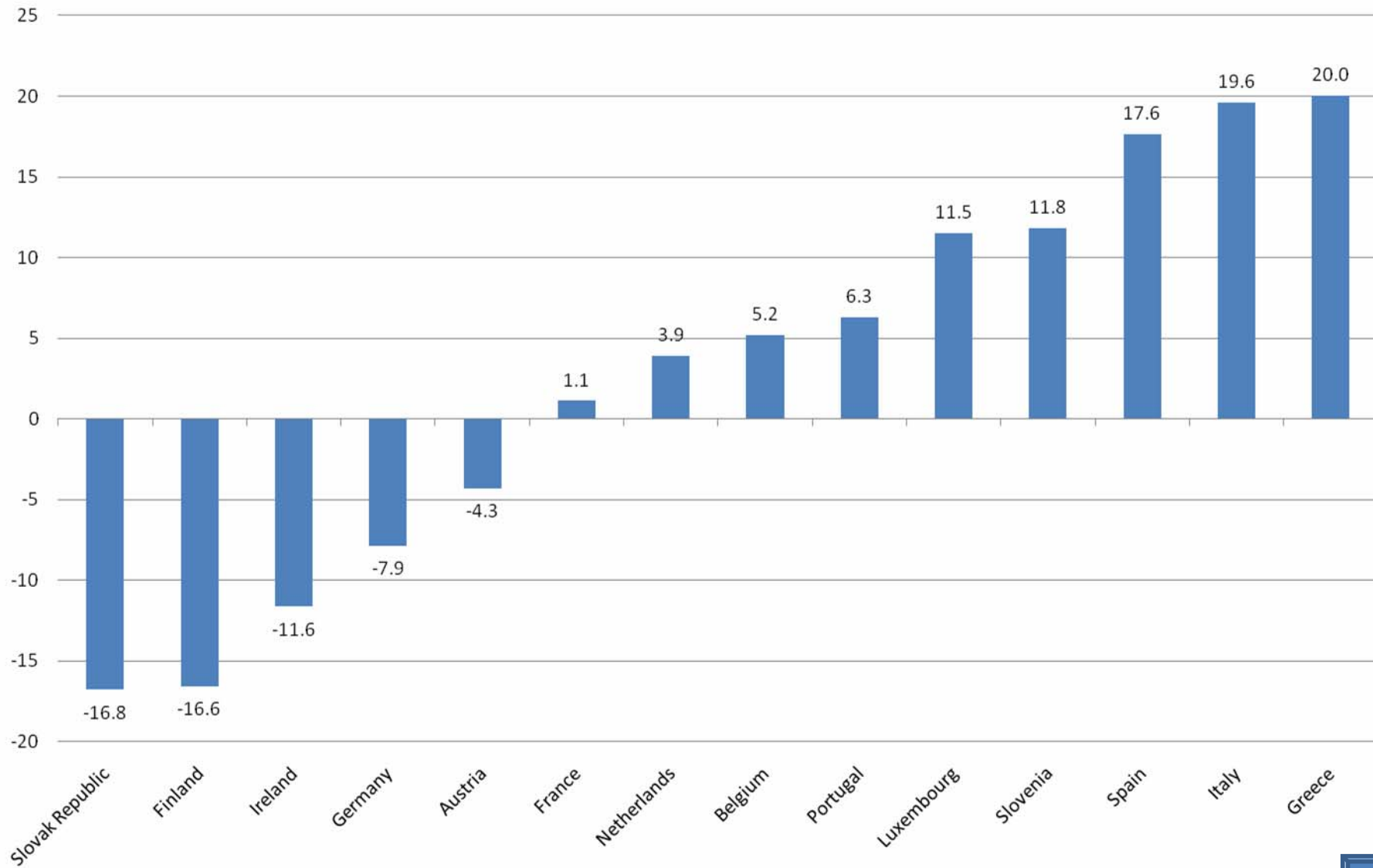
Germany: Labour productivity & real wages (1980 = 100)



Source: OECD



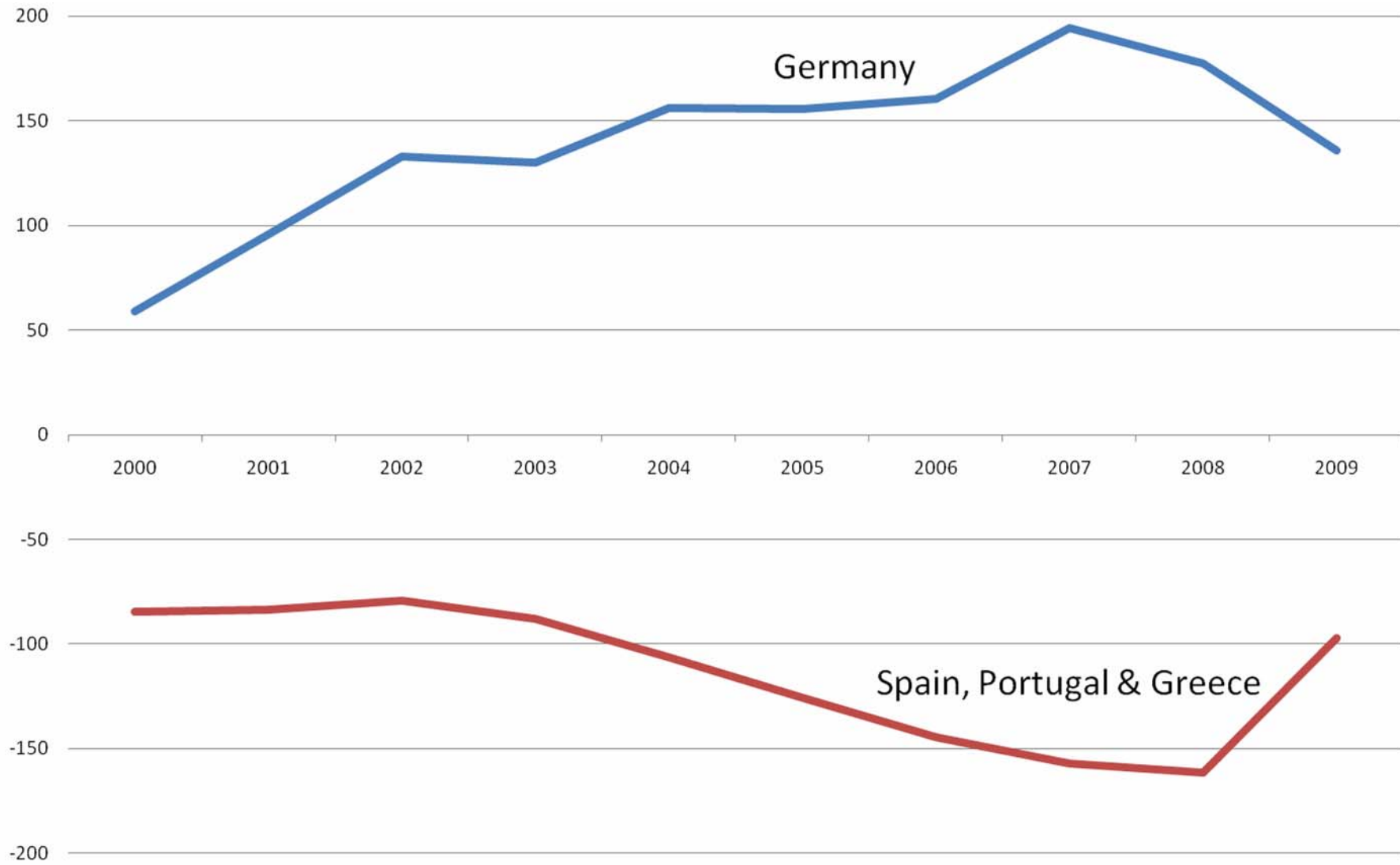
Change in unit labour costs, 2000-2007 (%)



Source: OECD

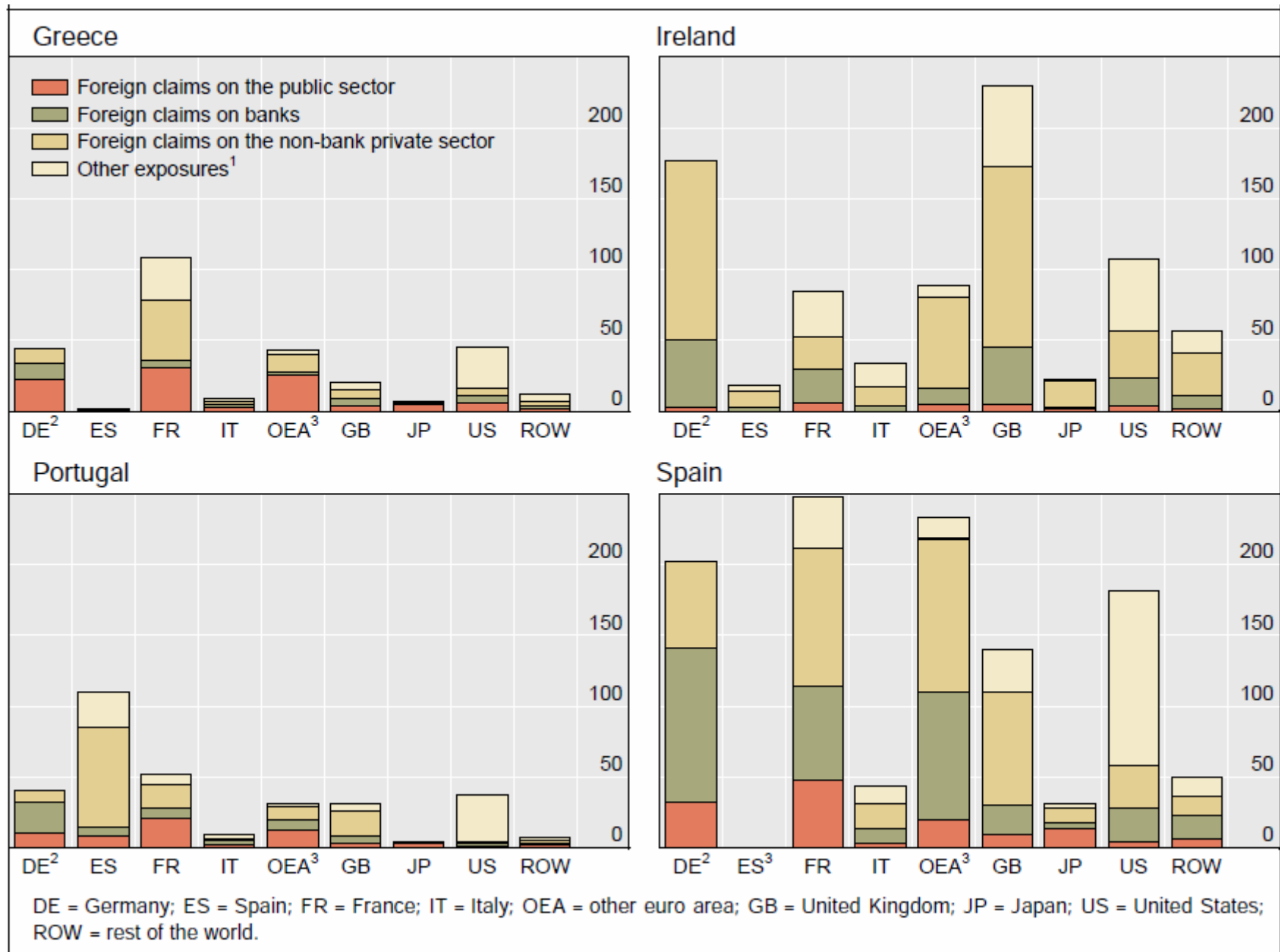


Trade balances, 2000-2007 (€ billion)



Source: Eurostat





Source: *BIS Quarterly Review, June 2010*

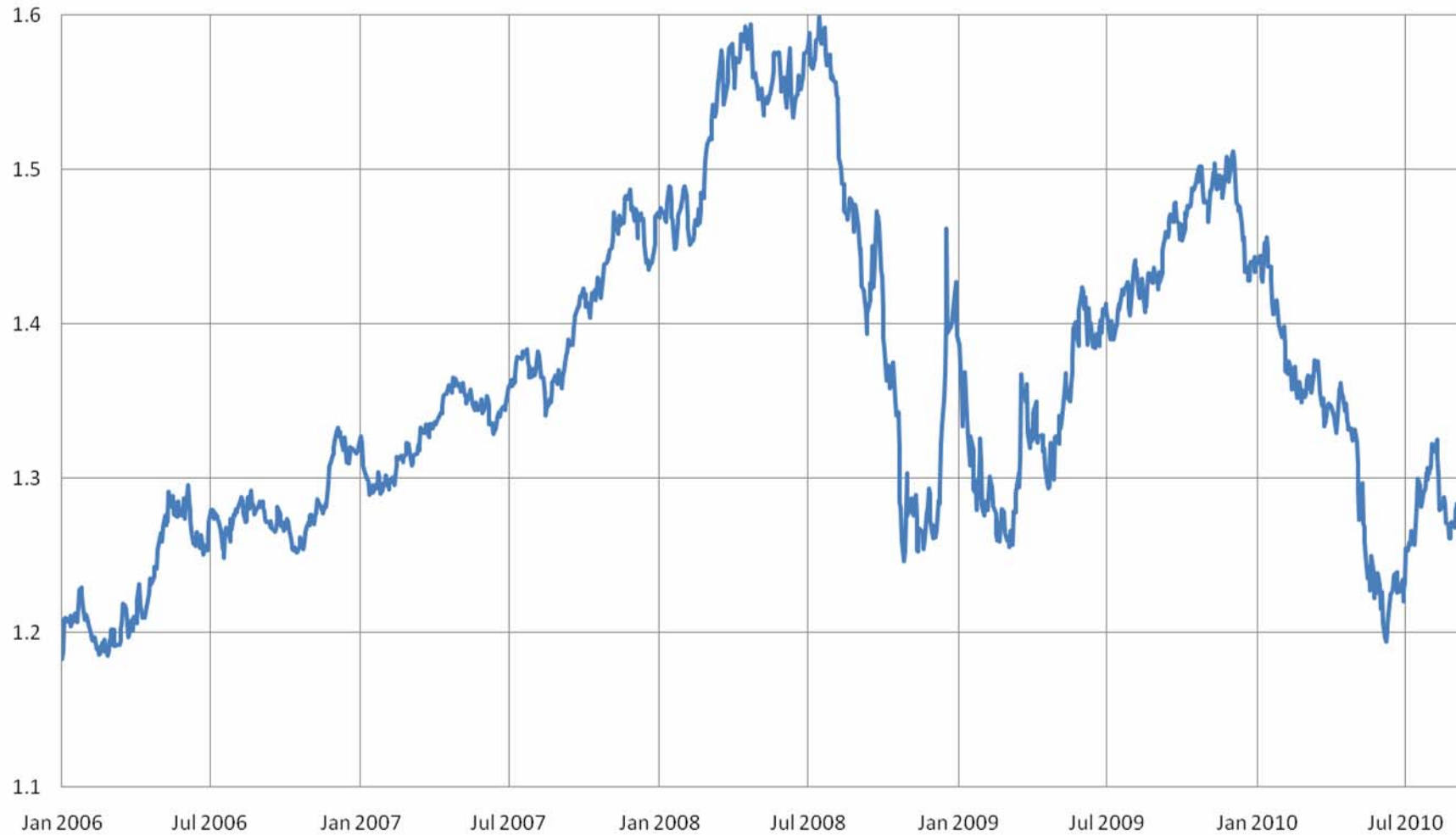
Bank exposure to Greece, Ireland, Portugal & Spain (End Q1 2010, \$ billion)

		Bank nationality									
		DE	ES	FR	IT	OEA	GB	JP	US	ROW	Total
Greece	Public sector	23.1	0.9	27.0	3.3	22.9	3.6	4.3	5.4	2.0	92.5
	Total	51.0	1.6	111.6	8.8	47.9	16.5	5.9	41.2	12.7	297.2
Ireland	Public sector	3.4	0.2	8.7	0.9	3.8	7.3	1.8	1.9	1.8	29.7
	Total	205.8	16.2	85.7	28.6	92.5	222.4	22.9	113.9	55.8	843.8
Portugal	Public sector	9.9	10.6	20.4	2.2	11.5	2.6	2.3	1.6	1.7	62.9
	Total	46.6	108.0	49.7	9.4	29.1	32.4	4.0	37.3	6.0	322.4
Spain	Public sector	30.0		46.9	2.3	19.1	7.6	12.5	4.9	4.4	127.6
	Total	217.9		244.2	42.5	200.6	141.7	30.0	186.4	39.3	1,102.6
Total	Public sector	66.4	11.7	103.0	8.7	57.3	21.1	20.9	13.8	9.9	312.7
	Total	521.3	125.8	491.2	89.3	370.1	413.0	62.8	378.8	113.8	2,566.0

Source: BIS Quarterly Review, September 2010



Euro – US dollar exchange rate

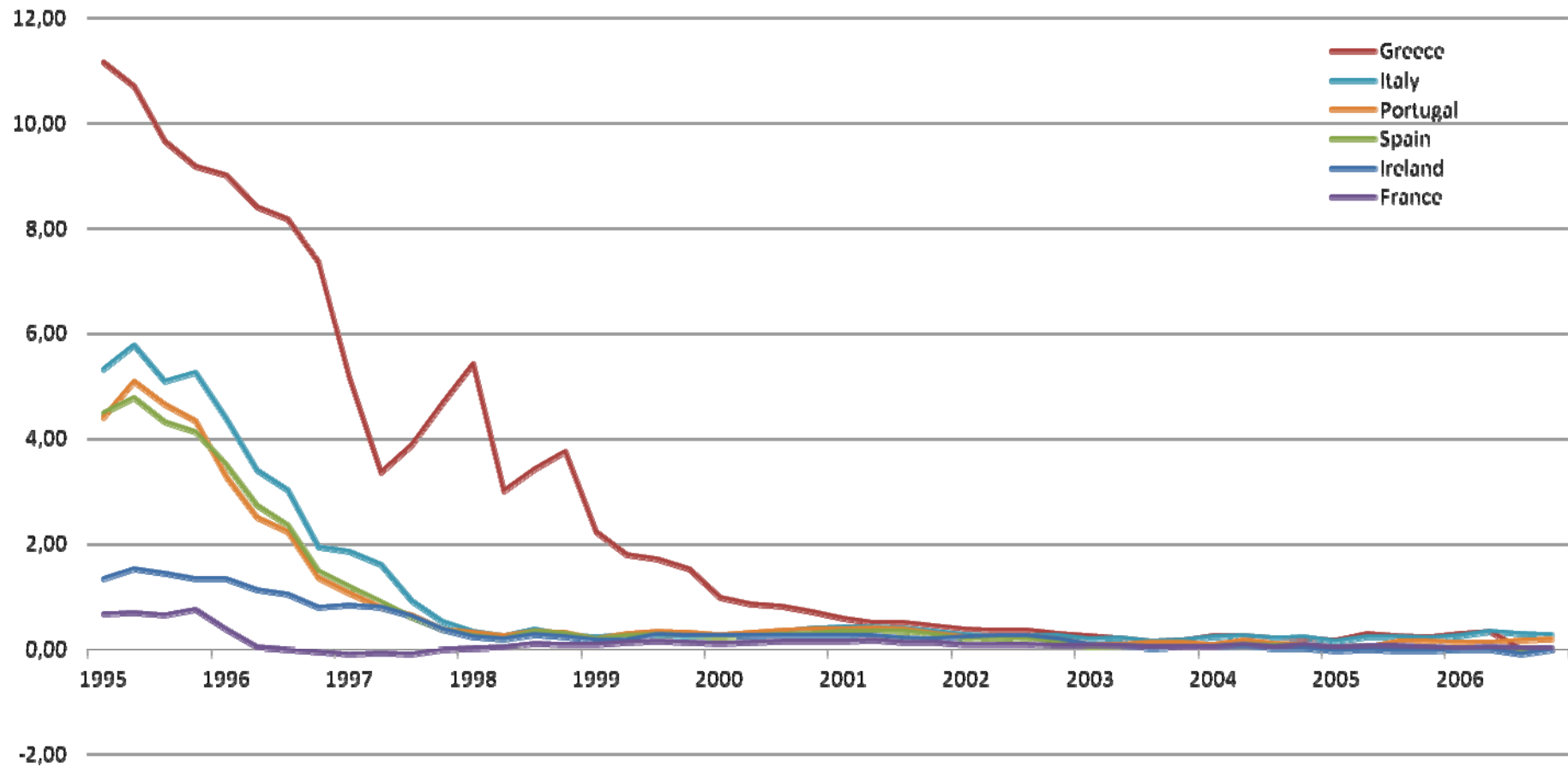


Source: European Central Bank



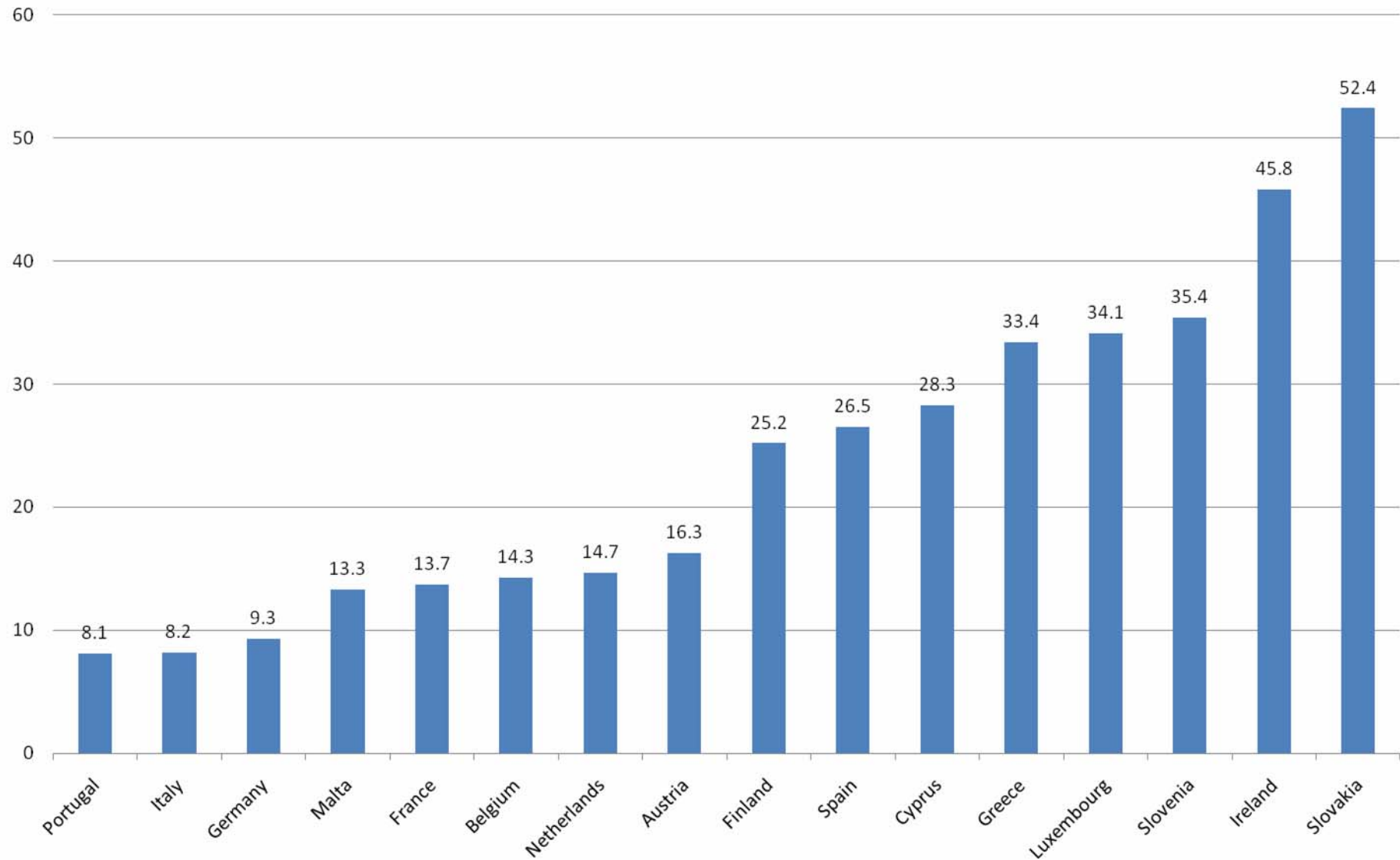
Long-term interest rates

(10 year government bonds spread over Germany, %)



Source: Eurostat

GDP growth 2000-2007 (%)



Source: Eurostat