

# Eurozone Economic Outlook: Struggles Create Opportunities

by Carsten Brzeski



**H**igher, faster, longer. With the Olympics and the European soccer championships this summer, Europe will once again celebrate these superlatives, enjoying the race for the gold medal. However, when looking at the eurozone, these superlatives remain limited to sports. The economic outlook is rather dire, and it will take a lot of time before these superlatives return to the economy.

The eurozone economy faces huge challenges. Countries in the south will have to continue to pay the bill for past parties, asking for a lot of stamina and political will. At the same time, even the economic strongholds are tumbling. Add

to this the negative impact on growth from an aging society, and a queasy feeling grows: the eurozone is heading toward a not-so-rosy future. But the future also offers opportunities, including opportunities to lead the industrialized countries with new growth sectors in a world in which commodities will become rarer.

## Fiscal Austerity Is Here to Stay

There is no quick fix for the eurozone sovereign debt crisis. Most eurozone peripheral countries have been surfing on a debt wave during the first 10 years of the monetary union. Sometimes it was a public-sector debt wave (Greece),

sometimes a private-sector debt wave (Spain and Ireland). Other countries did not even experience the pleasure of surfing at all but have been suffering from increased competition from emerging markets, thereby pushing the economies into sluggish growth (Portugal and Italy).

To some extent, the current situation is also the result of too often postponing painful measures into the distant future. Therefore, the only way forward is to reform economies, deleverage public and private finances, and put the economies on a more sustainable footing. Contrary to what some observers claim, there is no alternative to austerity measures. With aging societies and interest-rate payments often the second largest expenditures in national budgets, the pace of austerity can be discussed but not the principle necessity of austerity. A somewhat slower pace of budget cuts could soften, but would definitely not stop, the pain. As a consequence, fiscal austerity will have to be part of the economic game in the eurozone in the coming years.

## Can Core Eurozone Countries Alleviate the Pain?

Of course, austerity measures push the eurozone peripheral countries even further into a vicious circle of reforms, recession, and reduction of debt. Double-digit unemployment rates and youth unemployment close to 50 percent in countries including Spain and Greece is the best illustration of how painful the so-called economic adjustment will be. But is there an alternative?

It is often said that core eurozone countries should simply spend more, increase domestic demand, or even engage in direct transfers to help peripheral countries grow again. This is easier said than done. Currently, core eurozone countries are not very likely to be able to alleviate peripheral pain. Core eurozone countries including the Netherlands and France also have increasing debt levels and have to implement additional austerity measures to stop a debt spiral from gaining pace.

And core eurozone countries are also not free from other concerns. For example, the Netherlands still has to cope with a creeping process of deflating a real-estate bubble. France, the second largest economy of the eurozone, will have to implement structural reforms to regain international competitiveness. Even the strongholds are not as strong as they looked half a year ago.

Almost unnoticeably, eurozone's growth Superman, Germany, is flirting with at least a technical recession. Record low unemployment, a solid balance sheet in both the household and the corporate sector, and the right mix at the right time in terms of export products and export destinations should shield the German economy against the economic misery of many peripheral countries. However, the upside potential of the eurozone's biggest economy looks limited. With high energy prices, a cooling of the Chinese economy, austerity-driven slowdowns in all neighboring countries, and a still rather anemic U.S. recovery, there would have to be life on Mars for Germany to continue the export success story of the last years. Moreover, as Germany is an aging society, the hope for more domestic consumption and less savings could easily fall on deaf ears.

### More Bailouts Are Probable

Direct economic support or fiscal transfers are clearly not part of the

## European Debt Crisis Affecting International Investing

According to the FPA 2012 *Trends in Investing* study, 38 percent of financial advisers say their clients are less willing to invest in international securities as a result of global instabilities, such as the European debt crisis. As a result, 32 percent of advisers say they have decreased asset allocation to international securities.

### Select all of the following statements about the impact global instabilities, such as the European debt crisis, have had for you/your clients:

My clients are less willing to invest in international securities.	38%
My clients are more willing to invest in international securities.	7%
I have increased asset allocation to international securities.	15%
I have decreased asset allocation to international securities.	32%
None of the above.	34%

Source: FPA 2012 *Trends in Investing* study of 378 financial advisers, fielded in February. Results reported are statistically valid at a 95 percent confidence level with a +/- 5 percent margin of error and are representative of the FPA membership.

eurozone's crisis management in the near future. There is too little political support in the core eurozone countries for unconditional aid for the peripheral countries. Moreover, the track record of fiscal transfers within eurozone countries, in terms of economic convergence from richer to poorer regions, does not look very promising. Most of the time, fiscal transfers can stop economic divergence but do little to achieve convergence. As a consequence, the eurozone crisis management looks likely to continue along the current lines and principles: conditional financial support for eurozone countries if need be at the price of structural reforms and austerity. Debt restructurings will continue to be part of the toolbox. The main principle is that eurozone financial support can accompany the process of austerity and reforms to ensure against the worst happening.

The short-term prospects for the eurozone look anything but rosy. More bailouts look probable and more debt restructurings cannot be excluded. Growth will continue to disappoint, and Europe will have to reinvent its economic model, looking for new sources of growth.

The eurozone is at the beginning of an era of austerity and probably also at the beginning of an era of weaker growth. Nevertheless, despite the worries and problems, the road ahead also offers opportunities: to lead the industrialized countries on solid and sustainable public finances and with new growth sources and sectors in a world in which commodities will become rarer.

This year's big sporting events in Europe could be the last examples of superlatives and top performances for a long while. If the eurozone economy wants to compete again for a gold medal in the global race for economic top performance, it will require at least three qualities of Olympic athletes: stamina, willingness to overcome hardship, and a lot of patience.



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