The Euro-Crisis: Past, Present and Future

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Past

How are asymmetric shocks handled within a single country?

1) Wage flexibility
2) Labour migration
3) Fiscal adjustment
4) Banking adjustment

All were somewhat lower in euro-zone than in other large federal countries.

Maastricht only concerned with public sector deficits, Stability and Growth Pact.

In fact worst distortions were via a boom in private sector debt, via local banks. Ireland, Spain, Portugal. Also competitiveness and current account. Sudden stop (Calvo).

Tragedy that Greece came first. Played into German views that answer was austerity. It was not. Three problems:

Sectoral Balance Sheets

Germany (N)			Club Med (S)	
Pre 2008				
				[Greece]
O'seas Sector	--		++	++
Private Sector	++		--	0
Public Sector	0		0	--
2008-2012				
O'seas Sector	-		+	
Private Sector	+		+	
Public Sector	0		--	
2012 →				
O'seas Sector	-	<u>Inconsistency</u>	-	
Private Sector	+		+	
Public Sector	0		0	

Debt Sustainability

Δ Debt/GDP = Debt/GDP$_{t-1}$*(Ave interest rate – GDP growth)/(1 + GDP growth) – Primary Balance/GDP

Critical issue is relativity of g-i, not level of i alone.

Not recognised.

Present

Interactions national governments, banks and economics

Housing collapse → banks → governments → banks → economy → banks → governments.

This has now been recognised and partially met. Euro-summit, end June.

Otherwise responses have been to inject liquidity to stave off insolvency. Does not meet balance sheet, competitiveness, or g-i problems.

Minimum kicking can down the road.

Ireland, Latvia improving; rest getting worse.

Future

How long can ever more sticking plasters last?

Greece/Cyprus will go by end 2012 probably.

End games?

1) Move to a more federal union? But timetable/disagreement.
2) Contagious break-up?
3) Muddle through. But social/political tensions.

N.B. (1) and (2) not mutually exclusive.