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GREEK DEBATE

Germany is unfit for the euro

By: Joerg Bibow
21.04.10

Portents of the Greek Rescue

By: Barry Eichengreen
15.04.10

Finally a deal, but I am still sceptical

By: Wolfgang Münchau
13.04.10

Why Greece will default

By: Wolfgang Münchau
07.04.10

Why an IMF solution is most likely

By: Laurence Boone
24.03.10

The Greek crisis and the future of the Eurozone

By: Paul De Grauwe
11.03.10

Greek Competitiveness Is Not the Issue, Fiscal Discipline Is

By: Erik Jones
04.03.10

Europe in Dire Straits – don't be Brothers in Arms.

By: Henrik Enderlein
02.03.10

How should the Eurozone handle

17.06.2008

WELCOME TO THE BRAVE NEW WORLD OF STABILITY-ORIENTED STAGNATION

By: Jörg Bibow



In "Time to decouple from the Fed" (10 June 2008)

Wolfgang Munchau offers some very receptive views on what he sees as monetary policy decoupling, depicting a world that is "in the middle of a shift from a unipolar to a bipolar world" with the euro as the challenger of US dollar hegemony. Arguably, what is behind all this is a global clash of two opposing economic policy philosophies: call it the Anglo-Saxon versus the German way; the latter having been transformed into a continental European one through the euro. Anglo-Saxon policymakers view the world through a model that includes both supply and demand, with a clear role for macroeconomic policies to stabilize the economy. By contrast, German policymakers deny any such role for demand management. It is useful to

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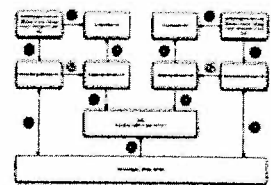
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EUROINTELLIGENCE BRIEFING NOTE



The Flaws of the Central Counter Party Idea

16.03.2011

By: Satyajit Das

This paper takes a detailed and critical look at the CCP - the basic idea behind, its design, risks and effects on the market.

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MUNCHAU'S COLUMNS

Muddling through is

Greece?By: Daniela Schwarzer
and Sebastian Dullien

01.03.10

**The Euro Area's
political constraints**

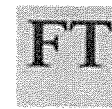
By: Wolfgang Münchau

16.02.10

consider some history in this context.

The origin of the above clash goes back to at least the late 1970s when attempts at international policy coordination included a role for Europe as a new "locomotive" in supporting the world economy's recovery from OPEC I. As inflation increased further in subsequent years, the perceived failure of such "fine tuning" led to a lasting U-turn in German policymaking, coming into effect in Germany in 1982 and with little delay in France too with the "franc fort" policy. Ever since has Germany refrained from trying to stimulate aggregate demand when confronting domestic demand stagnation, a peculiar "supply-side-only" policy philosophy that has spread throughout continental Europe first through the hardening of the Exchange Rate Mechanism of the European Monetary System and then through the process that led up to the introduction of the euro (although remnants of competing view are still present in continental Europe, for instance in France).

The consequences of this clash of policy philosophies first appeared in the form of the US "twin deficits" of the 1980s, as Europe became solely reliant on the US

no optionFINANCIAL
TIMES

16.03.2011

By: Wolfgang
Munchau

There are only two ways to resolve a debt crisis: through bail-out or through default.

**GLOBAL ECONOMIC
SYMPOSIUM****A repository of
solutions to global
problems**

25.06.2010

For two years now, leading policy makers, academics and businessmen have been meeting for discussions in the Global Economic Symposium to provide concrete solutions for the most pressing global governance issues the world will be facing this century. Here is the result of these discussions: a repository of concrete policy proposals.

locomotive to pull it out of the doldrums. Another interesting symptom then occurred in 1987 when the Bundesbank embarked on tightening policy as soon as growth finally started to pick up in Germany, with the associated transatlantic tensions turning into the stock market crash of October 1987. Just before the crash US Treasury Secretary Baker was ready to proclaim that "we will not sit back in this country and watch surplus countries jack up their interest rates and squeeze growth world wide on the expectation that the US somehow will follow by raising its interest rates." That was then.

A repeat of contrasting policies and diverging economic trends was seen in the 1990s. As Europe - following Bundesbank wisdom - struggled to meet the Maastricht criteria and was getting stuck in protracted domestic demand stagnation, the US "new economy" boom provided the external lifeline that allowed European countries to meet the 3 percent budget deficit hurdle and the euro to get off the ground. The re-emergence of a US current account deficit in the 1990s was not all that surprising since the industrialized world was once again relying on one engine only: the US. This situation was then further magnified when, following the Asian

crises of late 1990s, the developing world at large found new wisdom in mercantilist development strategies. Another interesting policy event occurred at that time: While the US Federal Reserve eased policy stance in the context of the emerging market and LTCM crisis, thereby also accommodating crisis countries' urge to export, the Bundesbank declined to follow suit. As one consequence of this monetary policy decoupling, the euro was launched at a level that became quickly judged as too high by the markets in view of the stronger growth performance across the Atlantic, and especially when considering the aggressive ECB policy tightening in 2000.

Yet another repeat of contrasting policies and diverging trends was seen in this decade. While the US Federal Reserve eased policy very aggressively in 2001-2 and maintained its easy policy stance until strong domestic demand growth seemed firmly secured, the ECB eased policy much more slowly, preferring to "cautiously" watch as "between 2001 and 2005, the eurozone was the sick giant in the world economy" (as Martin Wolf's put it succinctly, FT 27 March 2007). Even before any clear signs emerged that the eurozone might finally

overcome persistent domestic demand stagnation, the ECB then embarked on tightening policy in late 2005. The world's most independent central bank grudgingly interrupted its tightening cycle last summer when financial market turmoil hit.

We may now assess today's developments in the light of this brief historical review. Following months of both public and behind the scenes laboring by Bundesbank head Axel Weber, the ECB decided at its last council meeting to recommence its tightening cycle, supposedly as a pre-emptive strike at the perceived risk of second-round effects. Or are other motives at play too? These latest events are surely happening at a particularly interesting point in time. Only days before did US Treasury Secretary Paulsen and Fed Chairman Bernanke launch fresh verbal interventions in support of the US dollar. Presumably the ECB welcomed the new emphasis on dollar policy among US officials. Since the ECB had previously tried to persuade financial markets in that very direction too. As Munchau points out, the ECB's preannounced hike has "not only domestic but global implications [since] it limits the Fed's own room for manoeuvre". So if US Treasury Secretary Baker dreaded this kind of situation some twenty years ago, is the

current US Treasury Secretary going to like it any more? We are all holding our breath in awaiting the outcome of the upcoming G8 meeting.

It may well be the case that monetary policy decoupling has reached a new level today, but Wolfgang Munchau's analysis is begging one rather important question, namely: Who is going to be the new engine of the global economy? Who is going to "mind the store" and keep world demand alive if the US apparently can't do it anymore?

Munchau does not believe in any real decoupling of the developing world. And the ECB has made it very clear that it does not consider itself responsible for supporting domestic demand growth in Euroland. In fact, the pre-announced hike occurring at a time of slowing domestic demand growth is only the latest piece of evidence for that. In all this the ECB is following Bundesbank traditions. Studying Germany's economic history since 1982 is thus of some interest. Except for the unification boom, an historical "accident" which even the Bundesbank could not prevent, Germany has become ever more reliant on exports to support its growth. In the present decade Germany's economy has turned into a truly

schizophrenic creature: world export champion is one of its faces, mindless fiscal consolidation at any price, relentless wage deflation and persistently contracting consumer spending the other.

I referred to two contrasting economic policy traditions above. It is all too clear that the German tradition of relying on exports as its sole growth sponsor is notoriously freeloading on the Anglo-Saxon one. Essentially, the German way is to leave the difficult task of steering the economy to others while focusing on the fool's job of maintaining price stability in an economy that is stagnating most of the time anyway. This strategy surely has worked well for the Bundesbank. In essence it says: Never take any risk in "artificially" stimulating demand, while there is of course nothing at all artificial about choking demand whenever perceived inflation threats might appear anywhere on the radar screen. It is also all too clear what this kind of asymmetry does to the real economy.

So note that if the German policy philosophy guiding the ECB today is really going to constrain US policy from here on, the world economy will have to find a way of looking after its growth by exporting to some other planet. Otherwise it may be time, then, to send out a warm

welcome to the brave new world of "stability-oriented" stagnation.

The clash of economic policy philosophies and Euroland's role in the world economy is analyzed in more depth in a recently published book by Palgrave-Macmillan, titled 'Euroland and the World Economy – Global Player or Global Drag?' (co-edited and co-authored by Joerg Bibow and Andrea Terzi).

See also: "Time for the euro area to become part of the solution", Eurointelligence, 6 February 2008 (with Andrea Terzi).

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