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Expert Commentary

Karim Abadir, Professor at Imperial College London, on Eurozone's economy

My comment is that actions taken by governments will take 6 months to a year before their impact is felt, hence do not expect any change of policy taking place now to have an effect any time soon.

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Presently, Germany is a leader exporter in the EU and one of the largest in the world. The country, which appears to be over competitive, faces large current account surplus, which causes concerns among policymakers, because other Eurozone countries face major CA deficit. Is Germany, to your mind, a driver or a burden for the Eurozone in respect to the union's total trade balance? Do you worry about Germany becoming too dominant?

Germany is not a burden at all when it comes to a current account surplus. Actually, much of the surplus is coming from outside of the Eurozone, thus this is definitely a beneficial inflow into Europe. Germany's strict approach to monetary policy may be a burden, but their CA surplus is not.

The recent economic data from France pointed out the enormous and tough task the government facing, which believes that it is able to meet the pledges to revive growth and the public finances. Does it mean that the contagion is spreading to the core European countries?

In my earlier predictions of the effect of austerity, I warned that this would push Europe into a triple-dip recession, with only export-driven economies as a possible exception. I stand by my forecast and, as can be verified, all the predictions I have made publicly (which I have started doing since early 2007) have been correct and the sequence is listed on my webpage. My comment is that actions taken by governments will take 6 months to a year before their impact is felt, hence do not expect any change of policy taking place now to have an effect any time soon.

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There is an opinion that currently the Euro is too strong taking into consideration a weak economy in the Euro area. In fact, the Euro skyrocketed from 90 U.S. cents at its launch towards the peak of $1.59 in July 2008.
What, to your mind, is a sustainable level for the Euro, bearing in mind different economic situation in the member countries? Should the Eurozone pursue an alternative of the Euro depreciation in order to boost economic recovery? If so, how it could be implemented in order not to cause another wave of "currency war" talks?

The Euro is indeed too strong, and I have advocated a level closer to 1.20 (or even 1.10 temporarily) than the current 1.30. This will happen because of the pace of recovery being different between the US and Europe (including the UK), with the US being ahead in the recovery curve, and hence its interest rates should rise sooner than Europe's. Currencies cannot be manipulated by authorities for long. This is the level that the currencies will settle at, not because of the will of the policymakers, but because of the forecasted state of the economies. This is at the heart of my predictions for the earlier questions as well, and the currency rates are simply a corollary to the main prediction of the macroeconomies.

Bernd Lucke, a German economist and politician, proposes that the Southern European countries should introduce parallel currencies, by bringing back the Drachma, the Peseta, the Escudo and the Lira and tie them to the Euro at fixed rates. He argues that this would allow them to devalue their currencies, thus, reducing costs of their goods in overseas markets. To your mind, is it a viable alternative for the debt-stricken countries?

These countries should not have been in the Eurozone in the first place, because their economies are not well integrated with the rest. But now that they are in, and I do not see this separation happening, realistically, because this is now a political and symbolic question, not an economic one. I believe a more constructive approach would be to work on restructuring these economies to have closer integration with the core Eurozone.

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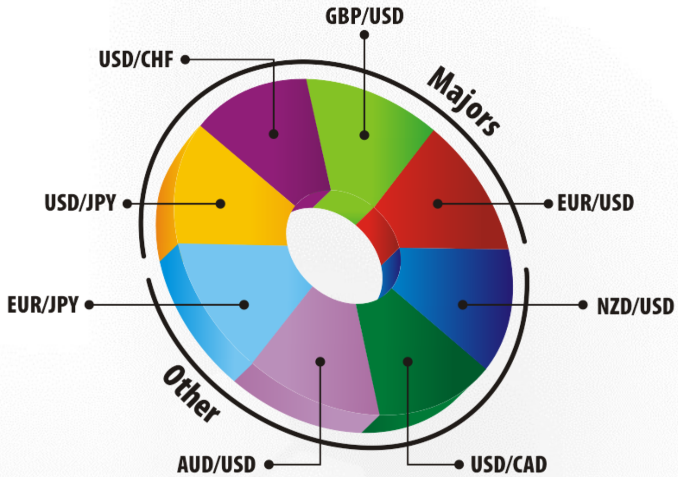

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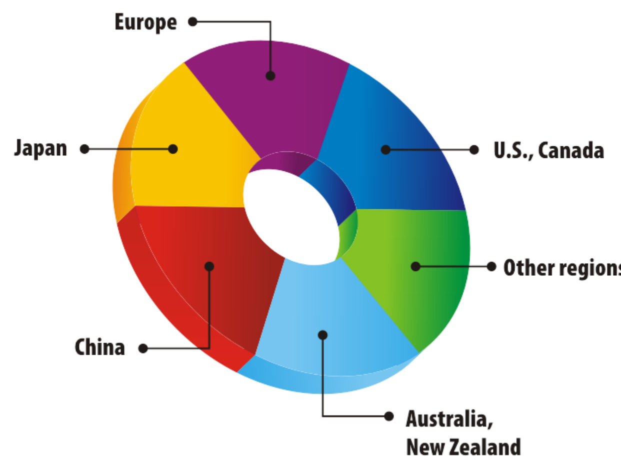

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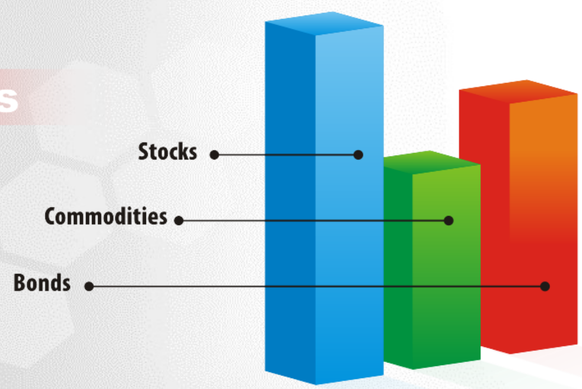

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