{ EURONZONE }

JEREMY WARNER

Angela Merkel is a brilliant politician, but her understanding of basic economics is flawed

There is at least one group of people for whom the US federal government shutdown last month must have been something of a relief – European policymakers. Once more, America was at the epicentre of crisis, not Europe. After more than two years of European turmoil, this was quite a turnaround.

Unfortunately, paralysis in Washington is unlikely to provide any more than temporary cover. Brussels and Berlin should enjoy their moment in the shadows while they can, for we are still a million miles away from the political leadership necessary to produce a sustainable and lasting monetary union.

Some sort of a crisis will be back before they know it. Or worse, the upheavals of recent years will simply harden into a slow, lingering death, with large parts of the continent condemned to depression.

But first, the positive news. Thanks to the actions of the European Central Bank (ECB), the immediate banking and sovereign debt crisis has abated and the eurozone as a whole is out of recession, even if for some countries the story is merely one of reduced rates of economic contraction, rather than a return to growth. Angela Merkel has also won a third term as German chancellor, which, if nothing else, provides a rare example of stability and apparently dependable continuity for this beleaguered continent.

In a recent article for the *Financial Times*, her finance minister, Wolfgang Schaeuble, invited us to "rejoice at the positive economic signals the eurozone is sending almost continuously these days". Cool-headed, crisis management had prevailed; "We live in the real world, not in a parallel universe where well-established economic principles no longer apply," Schaeuble said. "Systems adapt, downturns bottom out, trends turn. In other words, what is broken can be repaired. Europe today is the proof."

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Would that it were so. Merkel is a formidable and, in many respects, brilliant politician, but she seems to have a flawed understanding of basic economics, or a stubborn determination to ignore them.

She's not about to upset the political consensus in Germany by attempting to bulldoze through the sort of initiatives that might underpin monetary union and heave Europe out of its economic funk. She's a little steps politician, not a revolutionary leader.

Full-scale banking union and any notion of sovereign debt mutualisation are matters that are not open to discussion. Never mind the wrath of her own electorate and the German Constitutional Court were she to put them on the table, Merkel is also unwilling to contemplate the European treaty change necessary to push them through. Far too difficult, she calculates, no doubt correctly.

Besides, she genuinely seems to think they are unnecessary. Berlin's perspective on the crisis runs something like this: the decision to restructure Greek debt without first putting in place a safety net for larger eurozone economies such as Italy and Spain shattered financial, business and consumer confidence in the region, resulting in a deep recession. Markets naturally feared a domino effect, and sold larger sovereigns accordingly, further exaggerating the underlying banking crisis.

But then the ECB rode to the rescue, first with the promise of unlimited liquidity to the eurozone banking system, and eventually the same for sovereign nations. These 'lender of last resort' facilities have succeeded in halting the contagion, so that confidence is on an improving trend again.

In the meantime, the crisis has galvanised much-needed structural change in the eurozone periphery, allowing Europe to emerge, phoenix-like, from the ashes – strengthened, not weakened.

Few would deny the need for structural change in Europe. But of itself, it is not going to cure the eurozone of its underlying difficulty – a fixed exchange rate regime between nations of widely divergent competitiveness and economic needs is always going to create imbalances that end in crisis.

As I say, some symptoms of Europe's debt crisis have been successfully treated, but its underlying causes remain almost wholly unaddressed.

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