

DON'T LET PERFECT BE THE ENEMY OF GOOD

The eurozone has not done all that it could have done, but it has probably done enough to ensure growth, says Rob Wood

“My wings are like a shield of steel”, was the catchphrase of Batfink in a popular 1960s cartoon spoof of Batman. They got him through all manner of scrapes. Mario Draghi’s words seem to be doing a similar job for him. Ever since the head of the European Central Bank (ECB) said he would do “whatever it takes” to hold the eurozone together, its economy has navigated its way through some mini-crises and ended its 18-month-long recession.

Draghi’s mechanism for containing contagion – his words backed up by the threat of massive government bond purchases – treated the symptoms of the crisis. Meanwhile, governments needed to fix the underlying disease of a periphery much less competitive than the core of the eurozone. And although the reforms have not been perfect, we should not let that cloud the reality. Real progress has been made and the eurozone is well placed for the economic recovery to gain momentum.

Despite governments being busy, progress has not been as fast or as thorough as we all would have liked. But life is rarely perfect, and it does not need to be for the eurozone to recover. The economy grew in the second quarter of 2013 and it is gaining momentum. The ECB’s cautious forecast of 1% growth next year will probably prove to be too cautious.

The pain of the past few years has given euro-periphery countries the incentives to make their economies more flexible and competitive. Austerity has been too harsh in some cases, making a bad situation worse. But the political will to stick to the course has been strong, a factor that was underestimated by those forecasting the imminent demise of the currency zone. Officials have learnt from their mistakes and eased the austerity conditions. There is still much to do, but the drag from austerity is now fading across much of the eurozone.

Two different recoveries are happening at the same time. The German motor is firing. But it is a new type of motor,

more hybrid than the old combustion engine. Rather than exports and investment surging, domestic demand is growing as the shackles of wage restraint are thrown aside.

In something of a role reversal, the periphery is exporting more, emulating previous German success. Germany is sucking in more imports, so the trade surplus with the rest of Europe has fallen. But the improved competitiveness of the periphery is also helping exports to other regions. Spain is the most advanced in terms of structural reforms and it shows, with its business optimism reaching the highest of the major eurozone economies outside Germany in August.

The eurozone has not done all that it could have done, but what it has done should be enough to ensure continued growth. Yes, it would have been better if a banking union had been quickly implemented, or if we had not had to wait until the 11th hour before the ECB agreed to do what all other central banks in the world do by providing a backstop to their own currency. But the disappearance of Armageddon headlines tells another tale. The eurozone could well be a positive surprise over the next year or two.

Serious risks remain. The German constitutional court could render Draghi’s rescue shield ineffective later this year. Political problems in Italy could flare up if the centre left votes to strip convicted tax fraudster Silvio Berlusconi of his Senate seat. The eurozone is just starting on a long journey of recovery that could easily be knocked off course for a time. But real improvements have been made, so any further waves of crisis should be less vicious and a robust recovery should take hold. ♡

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