Europe in recession – foreign trade as a way out?

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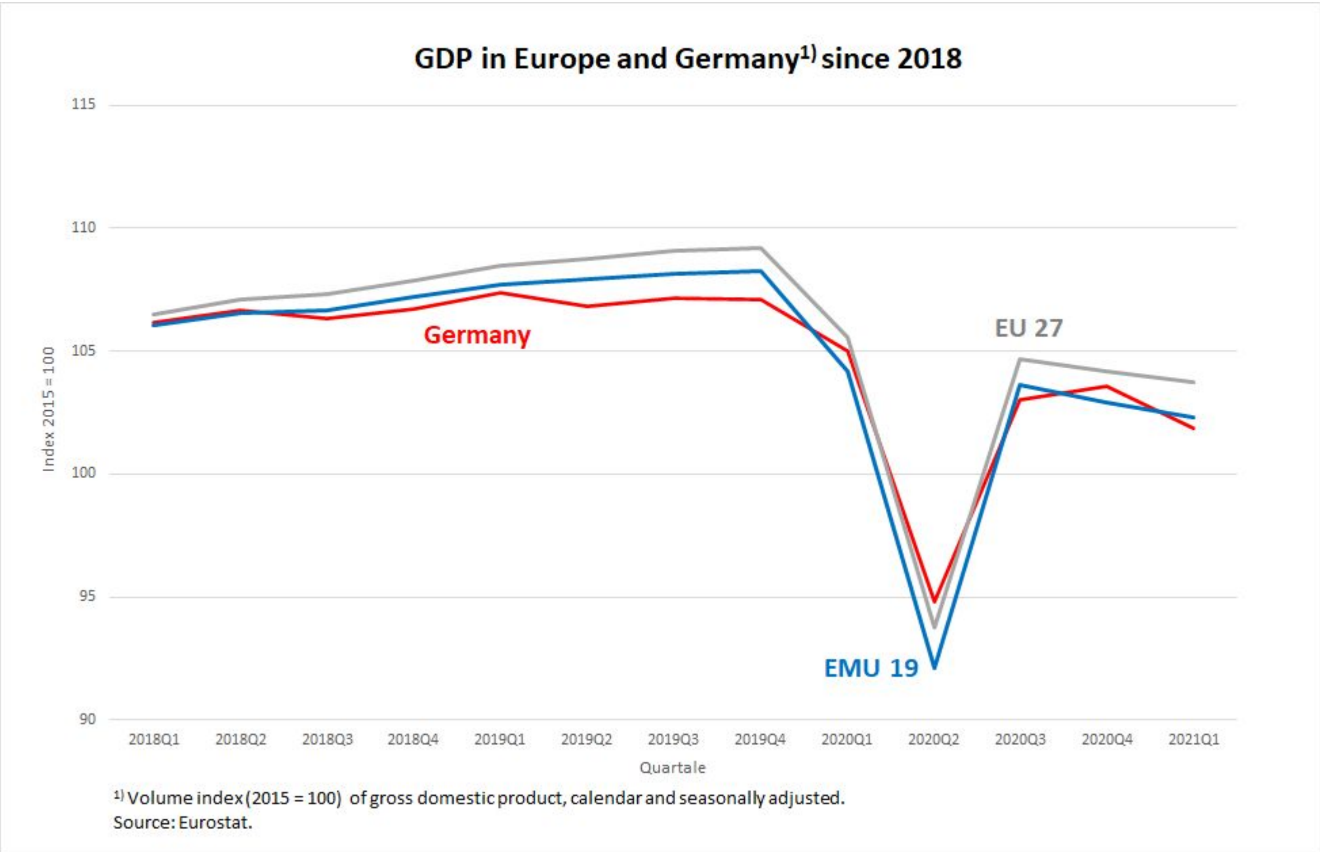
At the end of April, the European statistics agency Eurostat reported that the gross domestic product (GDP) in the European Monetary Union (EMU) had fallen by 0.6 percent in the first quarter of 2021 compared to the fourth quarter of 2020 and that GDP in the European Union (EU) had fallen by 0.4 percent. Both time series had already been in decline (-0.7 and -0.5 percent in the fourth quarter of 2020). Now, in mid-May, Eurostat has confirmed this first estimate: two quarters in a row with a negative growth rate, according to which Europe is in a recession (see Figure 1).

Figure 1



These figures have had little echo in the German media. The question of whether a federal minister did not make citations sufficiently recognizable in her doctoral thesis and therefore resigned, preoccupied the reporters more. At first sight, that makes sense: In Germany – unlike in Europe – there is no recession because the German economy has not yet contracted for two consecutive quarters.

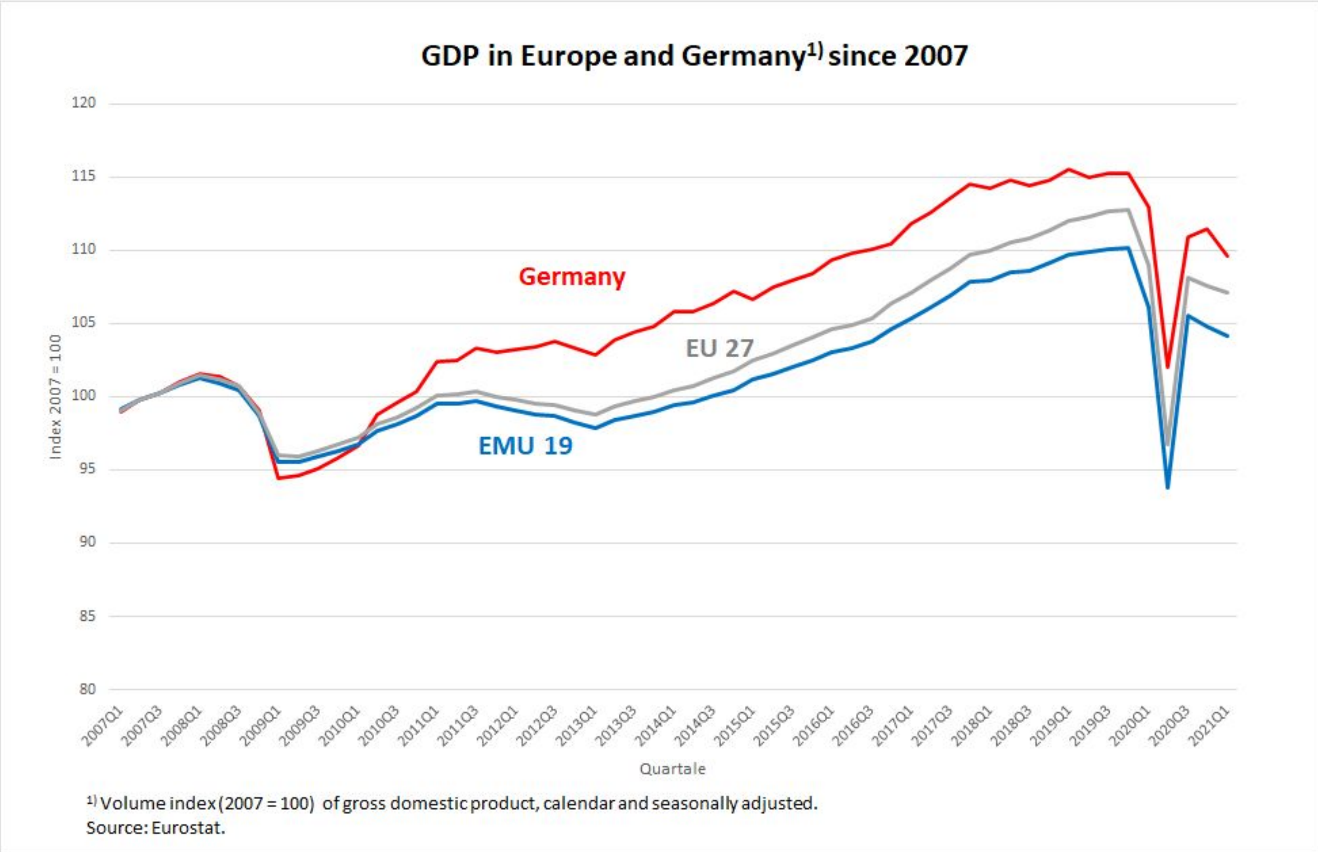
According to the German Central Bank (Deutsche Bundesbank), this is not to be expected in the near future either: In their latest monthly report (p. 9), the monetary authorities forecast: „German economic output should increase significantly again in the second quarter of 2021. … With rapid progress in the vaccination campaign, there is a chance that containment measures could be eased considerably in the coming months. Then GDP could increase sharply in the third quarter and exceed its pre-crisis level again in autumn.“ (all translations of texts from Deutsche Bundesbank are mine)

Germany good, all good? At least the Deutsche Bundesbank does not pay much attention to the recession in Europe in its monthly report – the R-word does not even appear. Instead, it simply says: „In the euro area, economic output fell slightly again in the first quarter of 2021 under the impact of the pandemic and the measures to contain it.“ (p. 19) The outlook is positive, similar to that for Germany: „In the course of spring the economic situation in the euro area should improve noticeably.“(p. 24) So why worry about Europe?

A comparison of the current development in Europe with that of the previous major crisis, the 2008/2009 financial crisis, shows the explosiveness of the current situation (see Figure 2, which goes back further than Figure 1 and in which the index is set for 2007 = 100, which shows the above-average German development since the financial crisis): The economic slump in Europe since the first quarter of 2020 is now greater than during the financial crisis, despite the recovery in production in the third quarter of 2020. There was no continuous upward trend as from the second half of 2009. Of course, this has to do with the resurgence of the pandemic: hopes for a sustainable recovery of the economy were premature.

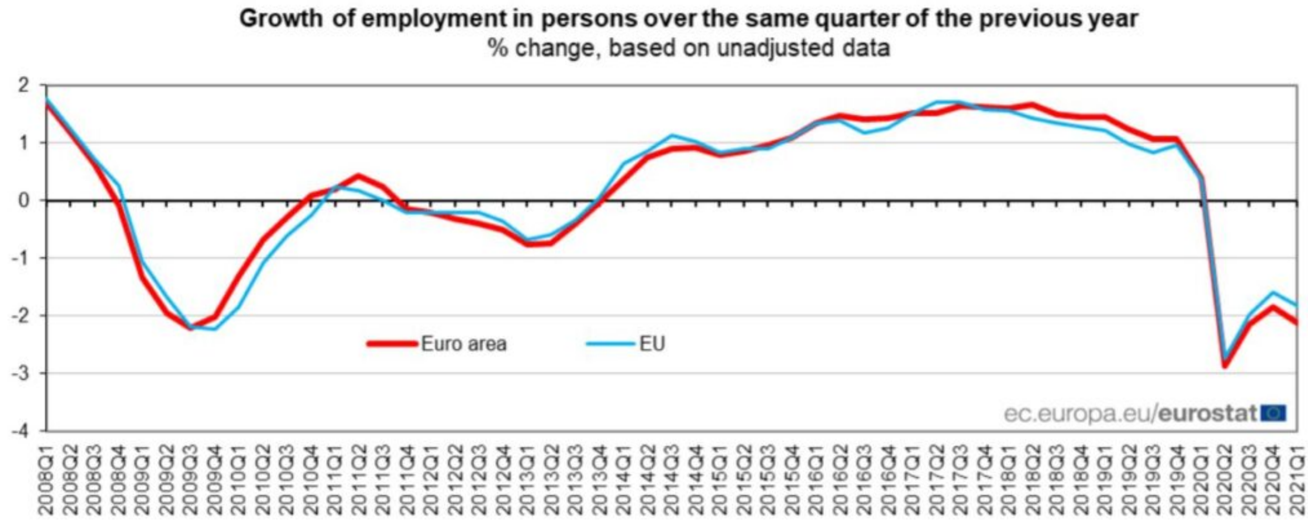
The longer the dry spell, however, the more difficult it becomes to avoid solidifying its traces, especially on the European labour markets. And that is exactly what European and, last but not least, German economic policy must take care of if it wants to prevent the economic and social rifts between the EU countries and within the individual states from deepening and the resulting strengthening of radical political fringes.

Figure 2



In addition, Eurostat reports (see Figure 3, original of the press release mentioned) that the number of people in employment in the euro zone fell by 2.1 percent in the first three months of this year compared to the same period of the previous year (in the EU by 1.8 percent). Over the course of the year, this corresponds to a decrease of 0.3 percent compared to the previous quarter – that is 3.1 million people in the euro zone and 3.7 million people in the EU. In the third and fourth quarters of 2020, there were still increases, which, however, by no means made up for the pandemic-induced slump in the labour market in the first half of 2020. Compared to the time before the outbreak of the pandemic (i.e. the fourth quarter of 2019), around 5 million fewer people in EMU are now on wages (-3.4 percent), in the EU it is almost 6 million fewer (-3.4 percent).

Figure 3



And that could just be the beginning of the misery on the European labour market. As the credit reporting agency Creditreform currently reports , due to government aid measures and insolvency regulations adapted to the pandemic situation , the extent of corporate insolvencies – as intended – has so far been kept within limits, namely so much that the number of corporate bankruptcies in most European countries in 2020 was below the annual average for the past ten years. In Germany, for example, the number of filings for bankruptcy in February 2021 compared to the same month last year went down by a fifth according to the Federal Statistical Office. Creditreform fears that „[in] connection with the expiry of government aid measures … the circumstance [that more than one in five companies in Western Europe is not making a profit with its business model] will lead to increasing bankruptcies." The development should then be reflected in the labour market data. Thanks to short-time working allowance (cf. also the EU's SURE program), things currently look less dramatic than they would if they corresponded to the drop in production.

How does the Deutsche Bundesbank perceive the development? "The situation on the [European] labour market remained comparatively calm. … When interpreting the labour market figures, however, it must be taken into account that extensive state support measures continue to benefit the labour market. … [In the] sectors that have been particularly badly affected by the pandemic and containment measures until recently, it remains to be seen how quickly and to what extent companies can find their way back to profitable business models and secure employment on their own" (p. 23).

But how long should one wait? Until the decline in employment is no longer classified as "comparatively quiet" and the desperation of unemployed and underemployed Europeans cannot be overheard anymore? And under what conditions should one wait: if the bankruptcy regulations tighten again, if claims to short-time work and unemployment benefits expire, if wages fall and energy and food prices rise? After all, in Germany too, as the Bundesbank writes referring to the Federal Employment Service, „meanwhile … unemployed people are increasingly switching from the insurance system to the basic security system, as their claims from unemployment insurance expire“ (p. 57). And in the euro area the official number of unemployed falls parallel to the number of employed persons (p. 23), which is presumably related to the fact that they no longer care to register as unemployed due to a lack of entitlement and thus fall out of the statistics. Waiting means not offering these people a concrete positive perspective and leaving them alone with their problems and justified fears.

Isn’t this view of the future all too gloomy? Can’t Germany point to export successes that have brought the local industry with its large capital stock unexpectedly high profits again? And isn’t it the stated goal of Brussels politics to „strengthen“ Europe, i.e. to lead it out of the crisis more competitively, so that what Germany seems to be able to accomplish again should also succeed in the rest of Europe? With positive consequences for all industries and all job seekers?

After all, foreign trade with EU countries outside the euro area (apart from the United Kingdom) and with non-European countries has been booming since the beginning of this year – with regard to excess demand in favour of the euro area: the balance of the current account in the first quarter was (not seasonally adjusted) 51 billion euros, the trade balance 49.5 billion euros. Seasonally adjusted, the latter was a good 64 billion euros and is likely to have reached around 3% of the eurozone’s GDP again. But what is behind these numbers?

Germany’s share of this trade surplus is by far the largest of all EMU countries. Seasonally adjusted, it amounts to almost 53 billion euros, followed by Italy with just under 17 billion euros and Ireland with just under 12 billion euros, while France recorded a loss of almost 7 billion euros. So Germany benefits like no other EMU member country from the excess demand from outside the EMU.

The hope of export-driven profits for German industry was probably an important reason why manufacturing companies were excluded from hard lockdown measures, unlike schools, day-care centers, many retail outlets, restaurants, hotels, the travel industry, the event industry and the cultural sector. The distribution of the crisis burden in Germany has been correspondingly lopsided so far. The German trade balance, exports minus imports, i.e. the excess demand of the rest of the world in favour of Germany, is 54 billion euros (unadjusted figures) in the first quarter of 2021, which corresponds to 6.4 percent of GDP, and has thus increased compared to the fourth quarter of 2020.

It will take a little longer before the data on income and hours worked are available. Then it can also be examined in more detail how the price competitiveness of the German economy, the main driver of the export surpluses, has developed. What wage dynamics will arise in the future? The Deutsche Bundesbank writes about this in its monthly report: "In the current collective bargaining round, the social partners have so far agreed on fairly moderate wage agreements and, in return, on regulations for maintaining jobs. … At the beginning of the contractual term there are often a number of months without wage increases. Only later do permanent increases take place. In addition, this year there are one-time Corona premiums and significant new special payments, the latter can be converted into additional days off. … In several industries, companies in economic hardship are given the opportunity to postpone regular wage increases or new special payments to a later point in time" (p. 58). To sum up, this creates good conditions for German exporters to continue to gain shares on international markets. However, these wage agreements do not bode well for domestic demand.

In this way, Germany is once again setting the pace for Europe in terms of competitiveness: wage agreements are struck to strengthen export surpluses, even if they result in weaker domestic demand and thus primarily at the expense of demand in those sectors that are suffering the most from the measures to combat the pandemic. The labour market situation in these branches is therefore unlikely to improve to such an extent that the level from before the Corona crisis is reached again. (The managing director of the German Association of Towns and Municipalities , for example, expressed himself in this direction, fearing a loss of up to half a million jobs in German retail alone.)

In other words: A strategy based on wage moderation across Europe, if it is not to result in rising long-term unemployment, requires a massive structural change – in *addition* to the structural change that the EU Commission is already committed to with the Green New Deal. No one knows how this is to be managed – especially under the sword of Damocles of the European fiscal pact, the German debt brake and the criticism of the monetary policy of the ECB. On top of that, this strategy requires a *non*-increasing exchange rate of the euro and the willingness of non-European countries to absorb European surpluses. Neither the US nor China will be willing to do this indefinitely.

In contrast, the Deutsche Bundesbank apparently believes that this can succeed. She justifies her optimism for economic development in the Eurozone as follows: “The upward trend in the global economy also has a supportive effect” (p. 24). The German Central Bank does not feel the slightest need to discuss that Germany could and should contribute to this fundamental trend primarily through stronger wage growth. Instead Germany seems keen to let a global tendency of growth pull itself out of the economic trough via exports.

Why don’t the latest reports from Eurostat lead to a livelier debate in Germany on how to improve the European economy? Wouldn’t that be a key campaign issue for the general elections in Germany coming up on 26 September 2021? Relying on the European Corona Relief Fund is not enough. The billions from this aid package will not be given out quickly and, above all, not in a wide range of industries, but primarily for building purposes and in the IT sector. This is already indicated in the price development in these areas. The people who have become unemployed since the beginning of the Corona crisis and those who will become unemployed in the next few months largely do not work for these economic sectors. They have no real chance of finding a job again quickly if the economic policy sticks to a wait-and-see attitude.