November 6, 2013

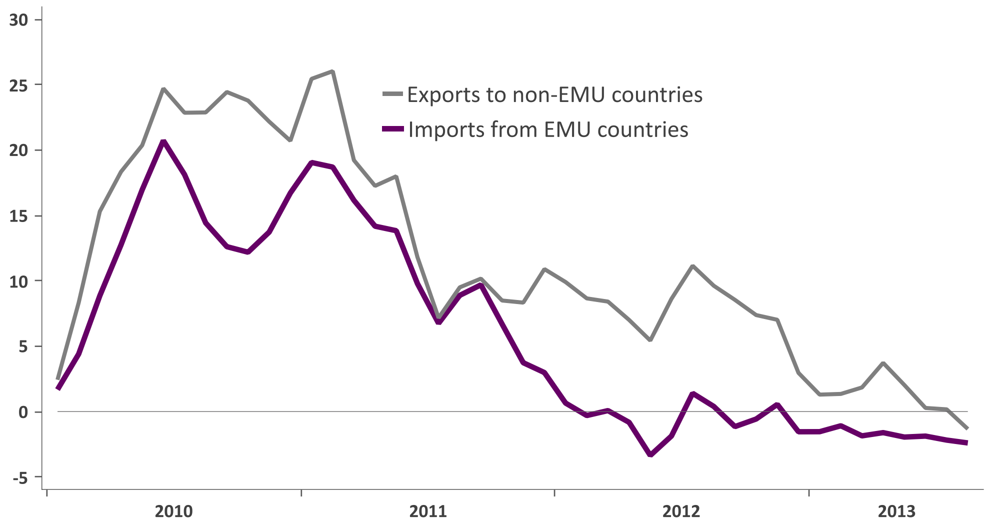
GLOBAL MACRO

Too Little Power form the German Powerhouse

There are quite a few encouraging signs in the Eurozone economy today. Sentiment has picked up in an increasing number of sectors and countries, the industrial outlook shows improvement, and the European Commission's Business Climate Indicator suggests that GDP growth should resume before the year is out. One key ingredient is missing here, however: better trade performance. Not only are exports to the rest of the world marking time, but trade within the currency bloc has contracted further—an unusual occurrence in a recovery phase. This makes it hard to take an overly upbeat view of the period to come. Unless its export numbers improve, the euro area's future could prove to be less rosy than hoped. In fact, the E.M.U. may well be in for lastingly sluggish trade figures.

Intra- and Extra-Euro Area Trade in the E.M.U.

YoY in %, 2MMA



Sources: RichesFlores Research, Macrobond

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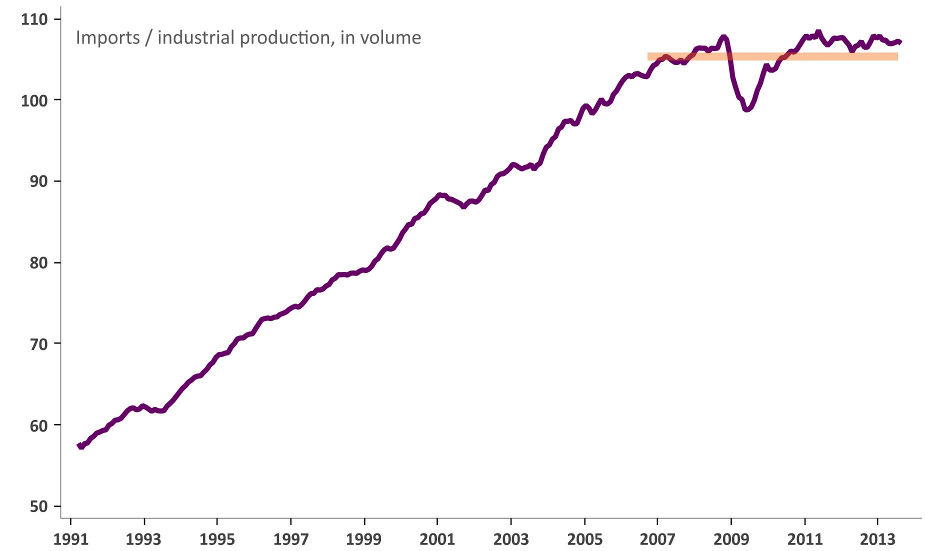
The Dwindling Import Content of Global Growth—Bad News for Germany, and by Extension for its Eurozone Peers

With easy money now a thing of the past, a lot of countries can no longer afford to live beyond their means. This has driven down their trade deficits—certainly a heartening change. But the downside is that world trade as a whole has been losing momentum. After rising virtually without interruption since 1990, the import content of growth has gone into reverse in many countries. For example, U.S. and British imports have yet to recover to their pre-crisis levels, while Spain's are still fully one fifth lower than in 2007. The current-account rebalancing under way was masked for a time by booming demand in emerging markets. At present, it is hard to overlook. Since the 2008 crisis, the import content of global industrial production has remained flat. This has thrown the entire international growth process out of kilter, creating a genuine structural change that will be increasingly detrimental—particularly to major export nations like China and Germany.

Import Content of World Industrial Production



Sources: RichesFlores Research, Macrobond

German export growth has slid steadily over the last two years, so much so that it now stands in negative territory. As a consequence, imports have also fallen, which means additional trouble for the country's top trading partners (France, Italy, and the Netherlands) given that Germany remains their number-one export destination. There are serious grounds for concern here. Now that the euro area can no longer reap the benefits of buoyant intraregional trade, the structurally deficient domestic demand that has come to characterize the region is likely to undermine economic recovery sooner rather than later.

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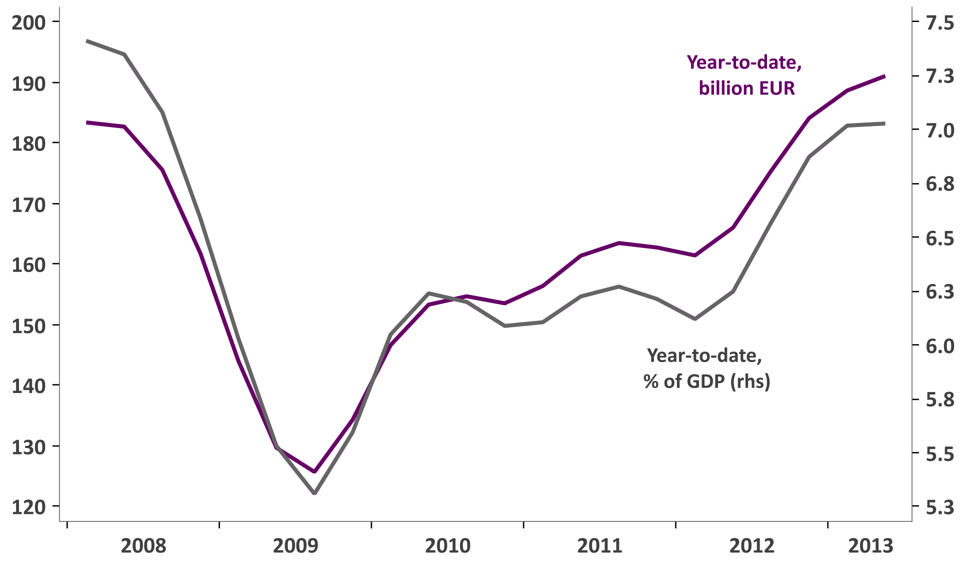
Germany's Ballooning Current Account Surplus—the Latest Manifestation of Eurozone Imbalances

Germany is supposed to be the euro area's powerhouse, but it clearly isn't providing much power today. For one thing, the country's falling exports have led to lower German demand for goods from its trading partners. For another, weak domestic consumer spending is an obstacle to the much hoped-for rebalancing. Household consumption in Q2 grew by just 0.8 percent on an annualized basis, suggesting that Germany's low jobless rate hasn't been such a boon after all. The country's current-account surplus—primarily a reflection of low imports—has mounted steadily in the past few quarters to a whopping 7 percent of GDP today. No doubt about it: this trend is creating imbalances—along with a rise in the euro that only makes matters worse.

Unless the E.M.U. countries do a better job of sharing the burden of adjustment, the current recovery will fail to bring about long-term improvement in the regional economy. And because the E.C.B. lacks the means to solve the problem on its own, the ball is entirely in Germany's court.

Germany's Current Account



Sources: RichesFlores Research, Macrobond

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