Acrimonious autumn

European and trans-Atlantic divisions

by David Marsh in Washington

Tue 23 Sep 2014

Dial D for divergence in the policy dialogue between the US and Europe. Jack Lew is the latest US Treasury secretary to argue, probably without much effect, for Europe to take short-term measures to boost growth. The trans-Atlantic divide, accentuated by a tightening of US credit at a time when Europe is considering further easing, portends fresh acrimony when policy-makers gather in Washington for the annual meetings of the International Monetary Fund and World Bank next month.

Lew referred at the weekend G20 finance ministers' meeting in Cairns, Australia, to 'philosophical differences with our friends in Europe'. This was a delicate way of urging countries with current account surpluses, led by Germany, to agree to boost short-term demand to stimulate growth.

Lew's actions mirror the frustration over Europe felt by his predecessor Tim Geithner, who eventually abandoned any attempt to browbeat the Europeans because he realised his entreaties were counterproductive. Underlining the force behind the US campaign, the Organisation for Economic Co-operation and Development has significantly downgraded major countries' growth forecasts. Last week it reduced its prediction for US GDP growth this year to 2.1% from 2.6% in its previous forecast in May, for the euro area to 0.8% from 1.2%, and for Japan to 0.9% from 1.2%. For the UK and Canada, the downgrades were much smaller: to 3.1% from 3.2%, and to 2.3% from 2.5%, respectively.

The OECD called recovery in the euro area 'disappointing, notably in the largest countries: Germany, France and Italy'. It said 'confidence is again weakening' and demand was 'anaemic', calling on the European Central Bank to take 'more vigorous monetary stimulus'.

Underlining the lack of demand in Europe's biggest economy, German domestic forecasters say Germany is on track for a current account surplus of around €200bn this year, the highest ever, more than 7% of GDP. According to the European Commission, current account surpluses of above 6% of GDP are sources of regional and international economic imbalance, yet Germany has registered surpluses of this size for eight of the nine years since 2006, the sole exception being 2009, when the surplus was 5.9%.

German officials have hinted that, if growth continues to disappoint, some form of override to next year's goal of a balanced budget may be in store. A combination of lower taxes and higher discretionary spending in areas like infrastructure could be Berlin's response to growth prospects badly dented by sanctions on Russian trade, moribund euro area activity and a significant slowdown among the large emerging market economies.

Yet, as always, Berlin will be dragged into stimulus only with great reluctance – with the result that any German action almost inevitably will be too little and too late to do much good. The outlook for significant ECB quantitative easing meanwhile remains bedevilled by deep-seated legal and ideological differences with Germany.

Reducing Europe's policy leeway, German Chancellor Angela Merkel, French President François Hollande and UK Prime Minister David Cameron all face a multi-fronted fight against myriad political adversaries.

Ms Merkel has to confront a constant undertone of complaints about economic stewardship from her Social Democrat coalition partners. She also has to worry about the new German anti-euro party, Alternative for Germany, lately commanding the support of 7% to 8% of the electorate in opinion polls.

Hollande, his popularity rating at new lows, is being similarly squeezed. The president is under attack both from the left of his Socialist party and from mainstream conservative parties and the far right Front National. The latter is calling on France to re-establish national economic policies and leave the euro.

In Britain, Cameron won a temporary respite with the No vote to Scottish independence in Thursday's referendum. But he is in the crossfire of Scottish nationalists calling on him to fulfil promises of more money and power north of the border, and many Southerners demanding similar devolution for England.

Given these cacophonous forces besetting Europe's leaders, the chances of united policy action from the Old Continent are scant indeed.