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EUROPEAN MACROECONOMIC LANDSCAPE ON POPULISM, BREXIT, EURO AND MORE

UNEASY TIMES
FOUR DEFINING EVENTS
ON POPULISM

BREXIT – NOT SO SURPRISING AFTER ALL?
EURO – AND THE WINNER IS GERMANY
DOES THIS DECADE BELONG TO FRANCE?

TWO PROBLEMS OF COORDINATION
FISCAL POLICY IN VOGUE – AGAIN
INTEREST RATES AND EXCHANGE RATES

UNEASY TIMES

The Times They Are A-Changin', sang Bob Dylan in 1964.
And more so these days, don't you think?

- Brexit – how will it play out?
- Four years with Trump – what might happen?
- Greece on the brink?
- The end of euro is nigh?
- Merkel exits?
- Xi goes for a third term in 2022?

... and so on, add your own favorite events ...

FOUR DEFINING EVENTS

- January 1999 – Introduction of euro
- December 2001 – China becomes a member of WTO
- May 2004 – Eight new members of EU (and two more in January 2007)
- September 2008 – Lehman Brothers hits the wall

Euro – and macroeconomic stabilization policies are seriously contained

China – and factor price equalization theorem becomes relevant

Eight new members of EU – and labor moves freely across borders

Lehman goes belly up – and a global financial crisis follows

Serious consequences of these four events:

- Income and wealth more unevenly distributed
- Unemployment increases, and more so in countries that ill can afford it
- Means to handle the situation more limited

Når krybben er tom, bites hestene.

Paves the way for populism.

ON POPULISM

Francis Fukuyama: “Populism is the label that the political elites attach to policies supported by ordinary citizens that they don’t like.”

Brigitte Granville (Queen Mary University): “What they (populists) share is a zero-sum view of the world, which necessitates the *creation of scapegoats* who can be blamed for all problems ... Consider democracy a means to power, rather than a desirable end in itself.”

Frank Rossavik (Aftenposten, 10. februar): ”Innsettelsestalen tydet på at Trump tror han er valgt til diktator, ikke til president i et land der streng maktfordeling er et grunnleggende prinsipp.”

Michael Sandel (Harvard), "the upheavals of 2016 stemmed from the establishment's inability to address – or even adequately recognize – genuine grievances. ...these grievances are about *social esteem*, not only about wages and jobs..."

Andrés Velasco, former finance minister of Chile: "... a *willingness to suffer economic pain* in order to *avenge elite betrayals* ..."

Edmund Phelps (Columbia University) links populist voters' anger to their *loss of dignity* in the larger political economy.

Henrik Ibsen, mars 1888:

"Det er ikke lovprisninger eller tilslutning, jeg tørster efter. Men forståelse. Forståelse."

München, den 27. Marts 1888.

Herr redaktør Schibsted!

Tillad mig herved at bede Dem om i venlighed at modtage min bedste og forbindtligste tak for den opmærksomhed, De har havt den godhed at vise mig ved i Deres ærede blad for 20de dennes at optage en række af velvillige artikler i anledning af min 60de fødselsdag.

Jeg beder Dem være forvisset om at jeg altid vil føle mig erkendtlig for den glæde, De derved har beredt mig. Og denne glæde var så meget større, som den kom mig uventet.

Noget af det, der i mit literære forhold til hjemlandet har pint mig mest er den kendsgerning at jeg gennem en række af år, lige siden «De unges forbund» kom frem, stadig har været taget til indtægt af det ene eller det andet politiske parti. Jeg, der aldrig i mit liv har befattet mig med politik men kun med samfundsspørgsmål! Og så formentlige modstanderes ulyst til at ville forstå! Det er ikke lovprisninger eller tilslutning, jeg tørster efter. Men forståelse. Forståelse. – Den hånd, De i venlighed har rakt mig modtager jeg hjertelig gerne og tegner mig

Deres ærbødigst forbundne

Henrik Ibsen.

Not in the usual vocabulary of economists:

creation of scapegoats

social esteem

willingness to suffer economic pain

avenge elite betrayals ...”

loss of dignity

But relevant concepts if you want to grasp the current predicaments.

Brigitte Granville ends her article on a pessimistic note: “Efforts by the media to move the populist mind have proved counter-productive, and will likely continue to do so.”

BREXIT – NOT SO SURPRISING AFTER ALL?

New Labour with new leader, Tony Blair (1994)

Moves to the right to attract voters

White working class voters are neglected by both parties.

- ✓ Less social esteem and lose dignity.
- ✓ Feel betrayed by the politicians
- ✓ Left behind economically adds to the problem

More concerned with order and stability than freedom and diversity.

IMF: GDP in the UK in 2019 will be 5,5 per cent lower if leaving.
How does that fly with people fed up with the elite?

Mobilizing Leave?

23 June 2016 – Leave carries the day.

Brexit in two years' time

“Ever closer union” – how wise is that? Cameron got a waiver here
The legitimacy rests with the nation, not with EU

2004–2014: More than 2 million Poles to Germany and UK.

And close to 2 million Romanians to Italy and Spain.

Immigration on top of the political agenda in UK around 2006, and stayed there ever since.
Which is remarkable. Rapid social changes that threaten traditional identities and values, i.e.
the cultural dimension behind Brexit.

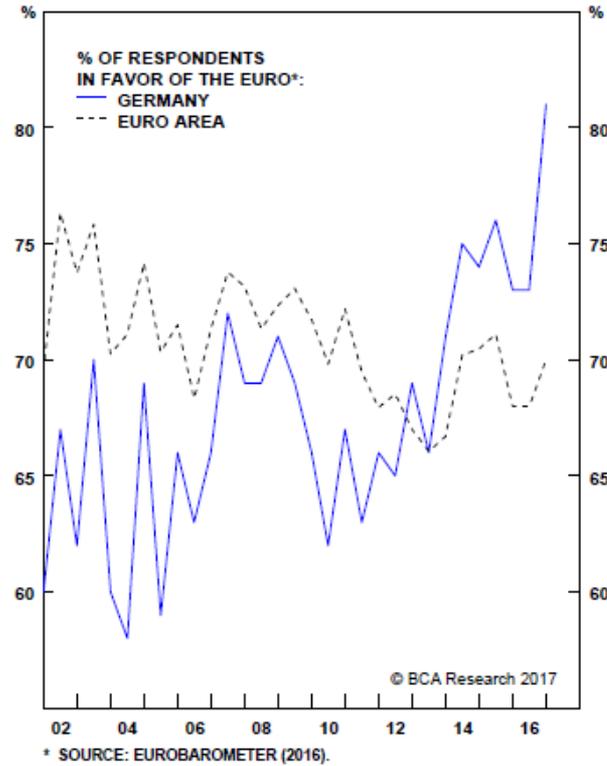
EURO – AND THE WINNER IS GERMANY

Change in GDP per head 2007-2016

Germany	+11%
France	0%
Spain	-8%
Italy	-11%

Chart 1

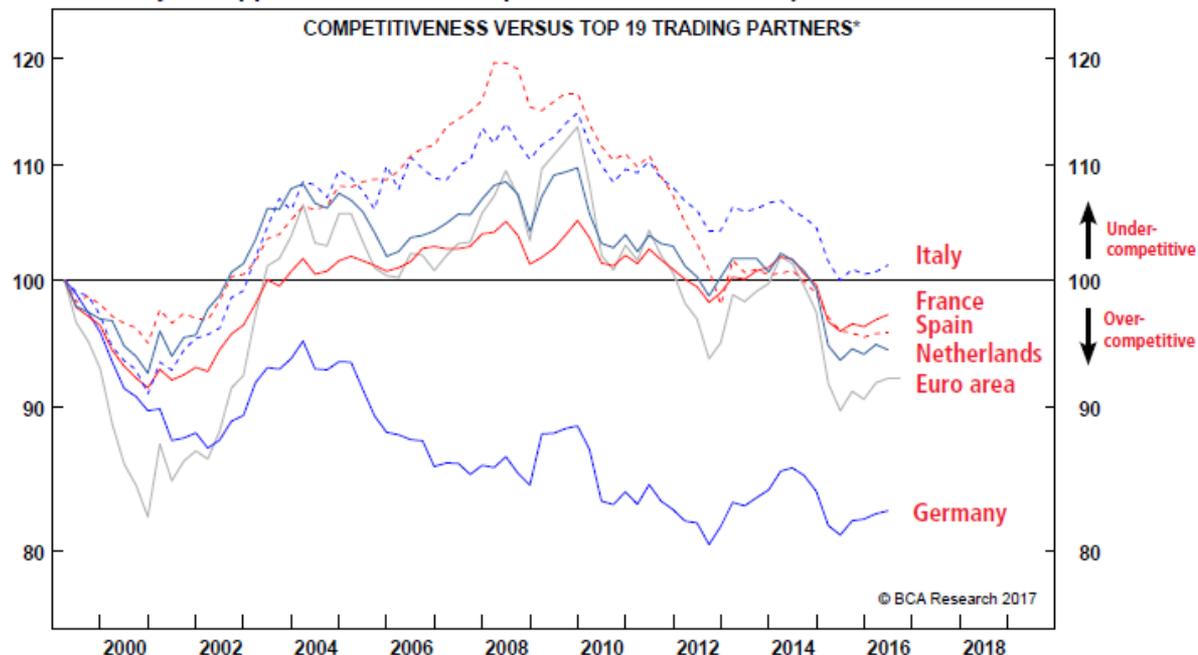
Germans See The Euro As A Great Deal



Germans have been comfortable with modest nominal wage increases
Improved competitiveness not eroded by an appreciating currency
Labor goes along with export-led economic growth

Chart 2

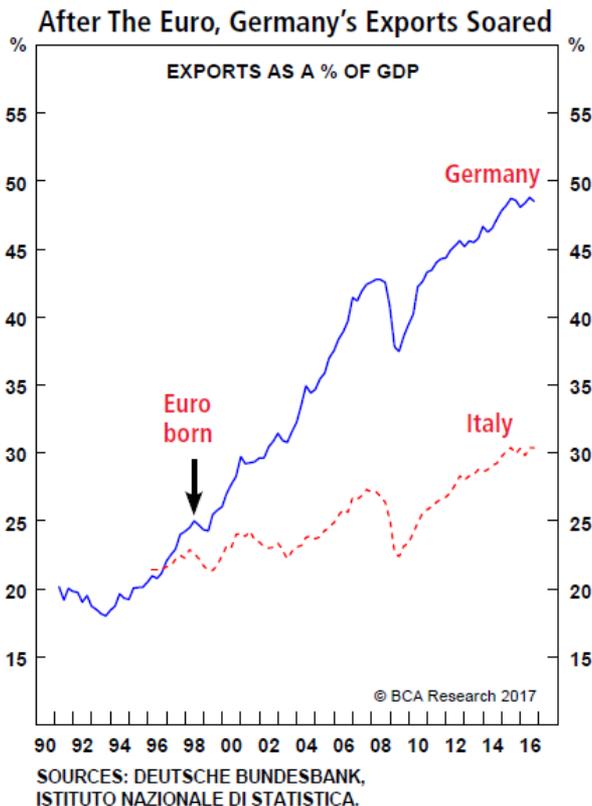
ECB Analysis Supports President Trump: The Euro Is Over-Competitive



*SOURCE: ECB HARMONISED COMPETITIVENESS INDICATORS BASED ON UNIT LABOUR COSTS
RELATIVE TO TOP 19 TRADING PARTNERS.

Source: BCA Research

Chart 3



Source: BCA Research

Chart 4

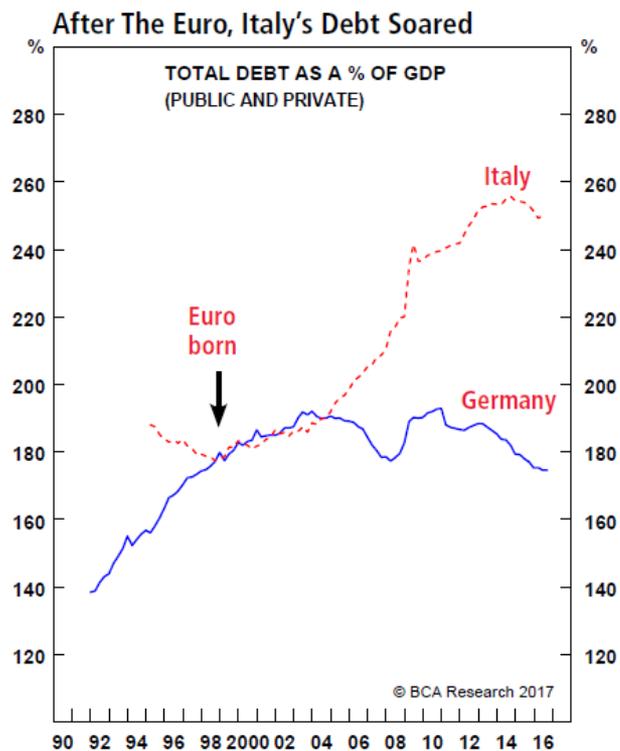
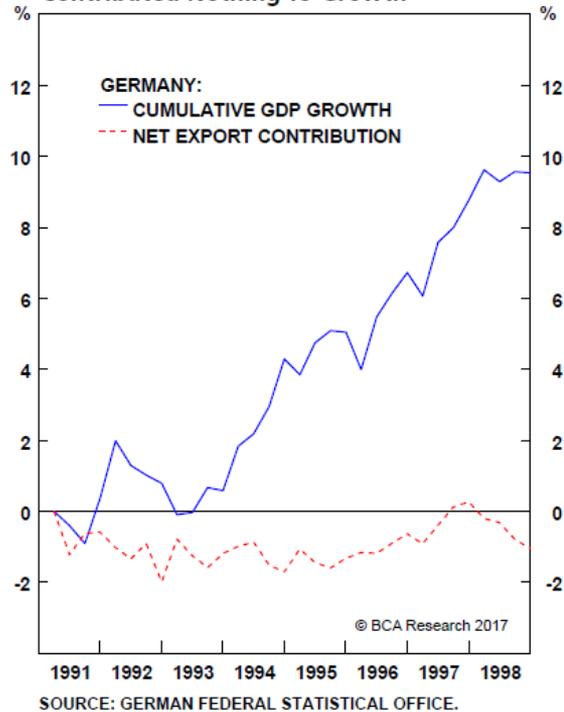


Chart 5

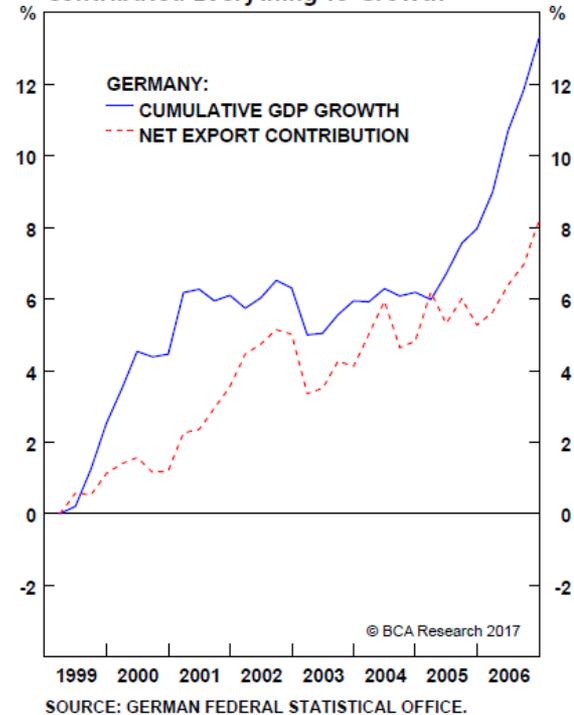
Germany Pre Euro: Net Exports Contributed Nothing To Growth



Source: BCA Research

Chart 6

Germany Post Euro: Net Exports Contributed Everything To Growth



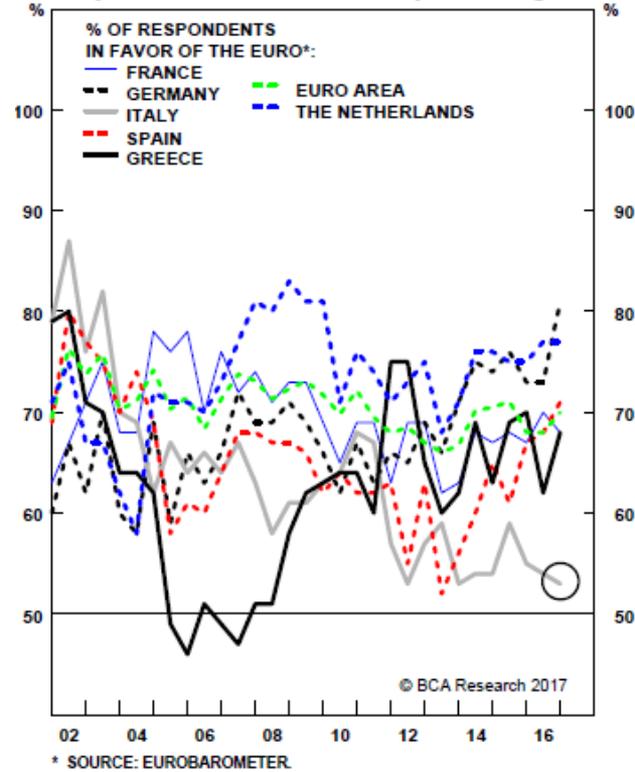
9 per cent of GDP is last year's German surplus on Current Account
Detrimental to the rest of the world – needs to have similar deficits

A transfer union within the euro area suggests itself

- ✓ Would help in handling the Greek crisis
- ✓ IMF in favor
- ✓ But politically impossible

Chart 7

Italy Poses Chief Risk To European Integration

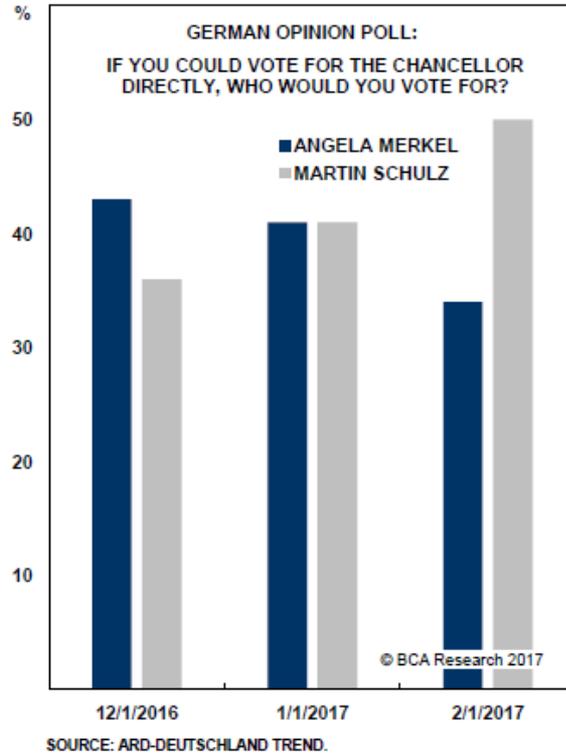


Source: BCA Research

- Election in Germany in September
- Time for SPD to take over?
- Martin Schulz, the new leader of the party, is ready.
- Would that be good for Germany?
- Twelve year with Merkel, is that enough?

Chart 8

Schulz Now Leads Merkel For Chancellor



Source: BCA Research

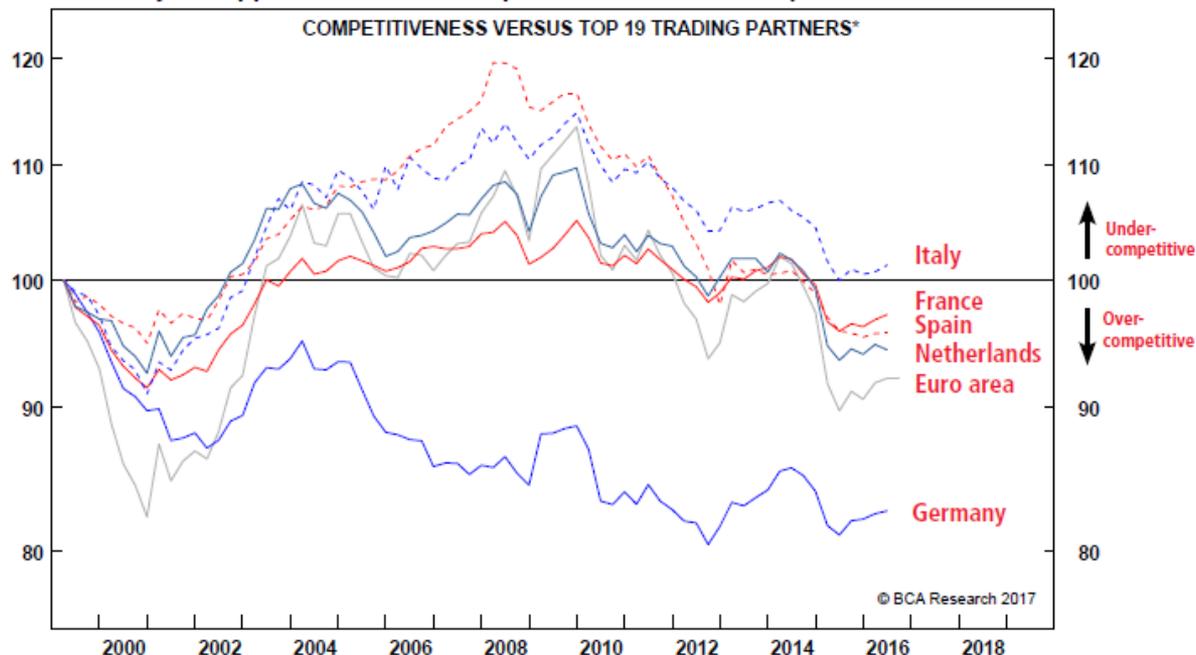
BCA-analysis concludes:

The key question for 2017 is the same as it has been since 2010: what will Germany do? A Germany more willing to shoulder the cost of economic rebalancing via higher inflation and debt relief would be a game changer for markets.

Germany should allow wages and prices to increase more rapidly than in other eurozone countries. And also stimulate real investments.

Chart 2

ECB Analysis Supports President Trump: The Euro Is Over-Competitive



*SOURCE: ECB HARMONISED COMPETITIVENESS INDICATORS BASED ON UNIT LABOUR COSTS RELATIVE TO TOP 19 TRADING PARTNERS.

Source: BCA Research

UK leaves EU – making Germany too powerful.
Also, militarily the Brits are needed within the EU.

Frank-Walter Steinmeier, Foreign Minister in Germany:

“But as the United States and the EU have stumbled, Germany has held its ground and emerged as a major power, largely by default.”

DOES THIS DECADE BELONG TO FRANCE?

BCA-analysis one month ago thinks so. Three challenges

- The state is too large
- The cost of financing the large state falls on the corporate sector
- The labor market is inflexible

If Emmanuel Macron wins the election, he would have a mandate to pursue growth-friendly policies, i.e. address the three issues above

Chart 9

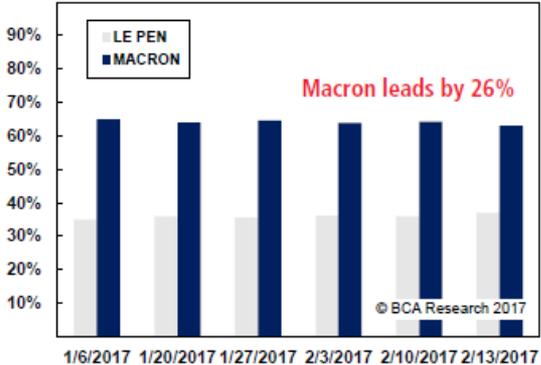
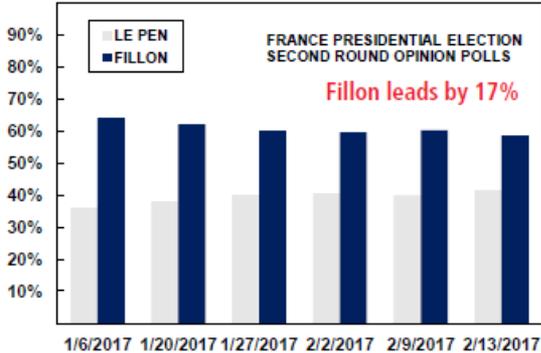
If Marine Le Pen carries the day – well, what can one say?

Will Marine Le Pen try to take France out of EMU (do away with the euro)? What will happen to EU?

Martin Wolf: “The political and economic impact of breaking up the eurozone is so great that the single currency may well soldier on forever”.

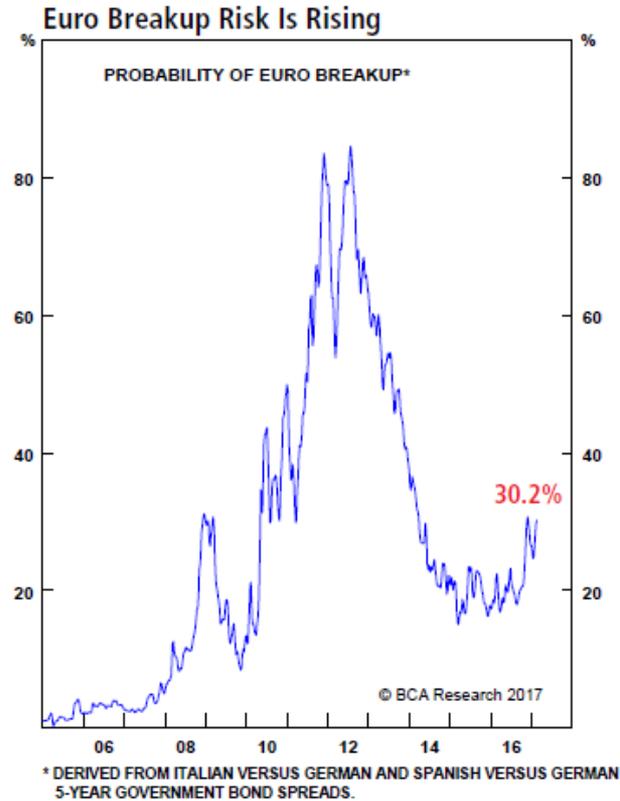
Source: BCA Research

Le Pen Lags By ~20% In Key Second-Round Polls



SOURCE: IFOP, BVA, OXADA, HARRIS INTERACTIVE, IPSOS, KANTAR SOFRES, AND ELABE.

Chart 10



Source: BCA Research

TWO PROBLEMS OF COORDINATION

Coordination problem 1:

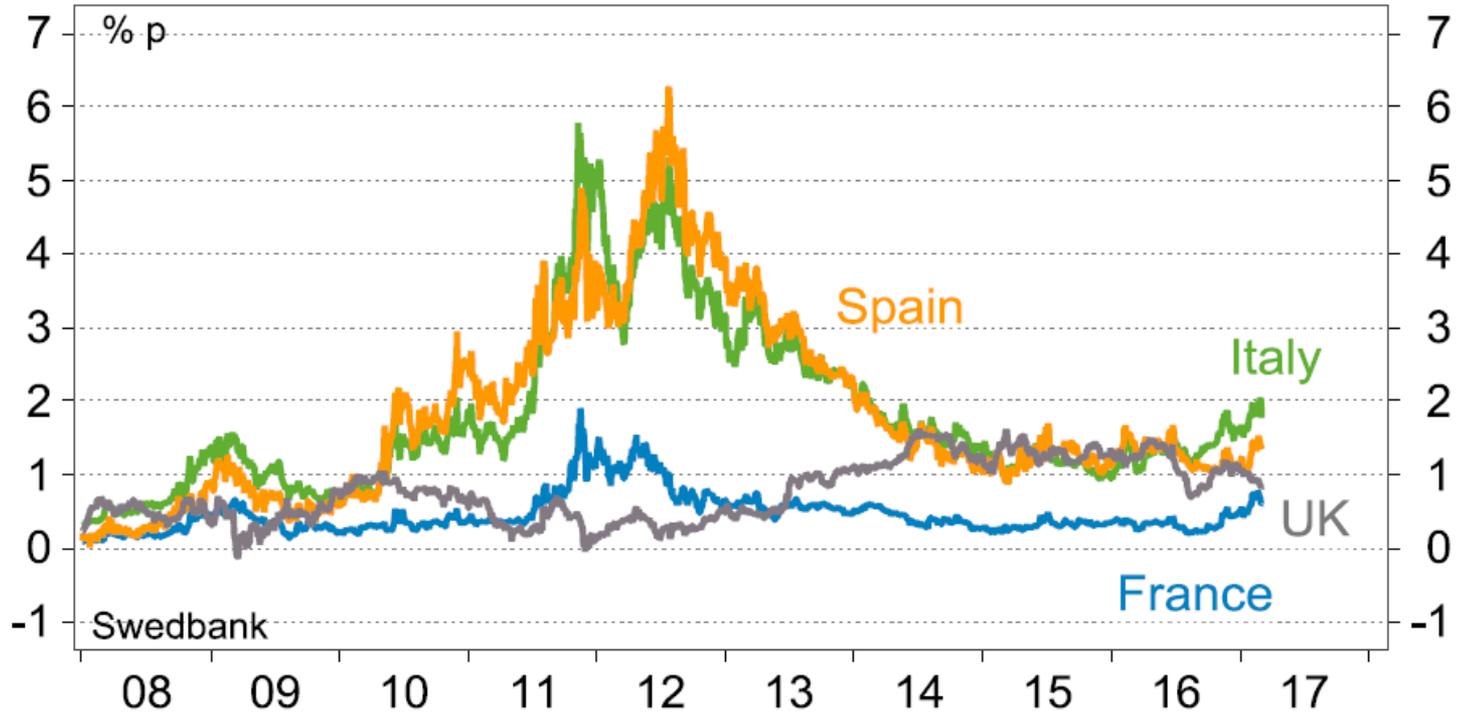
For a country that needs to improve her competitiveness
a reduction in real wages is called for.

Devalue or depreciate your own currency

Don't have one? Reduce nominal wages across the board.

Tremendously difficult – just ask the Greeks.

Chart 11 (as of 3 March) 10 y bond yields, spread to Germany



Source: Swedbank – Macrobond

Coordination problem 2:

Fukuyama points to the need of “... trading a little aggregate national income for greater domestic inequality”. Hard to make happen even if business is in favor. Why? Because of problems of coordination.

Countervailing powers in the form of trade unions, to offset business's excessive advantages, e.g. the Scandinavian model, to stabilize the economy.

Fukuyama notes: “German business elites never sought to undermine the power of their trade unions.”

FISCAL POLICY IN VOGUE – AGAIN

OECD and IMF and The Commission in EU all seem to be increasingly in favor of more expansionary fiscal policies, to the tune of ½ per cent of GDP.

Why? Not much ammunition left for monetary policies.

Some other arguments:

- ✓ Crowding IN, i.e. fiscal expansion and demand does increase, making firms step up real investments to meet increased demand
- ✓ (Government debt / GDP) may decline if GDP grows faster than debt
- ✓ Hysteresis effects – hard to reduce unemployment once it has increased
- ✓ Low interest rates and can carry higher G-debt
- ✓ Coordination of expansionary fiscal policies across countries to minimize import leakages

Challenge to use added money wisely.

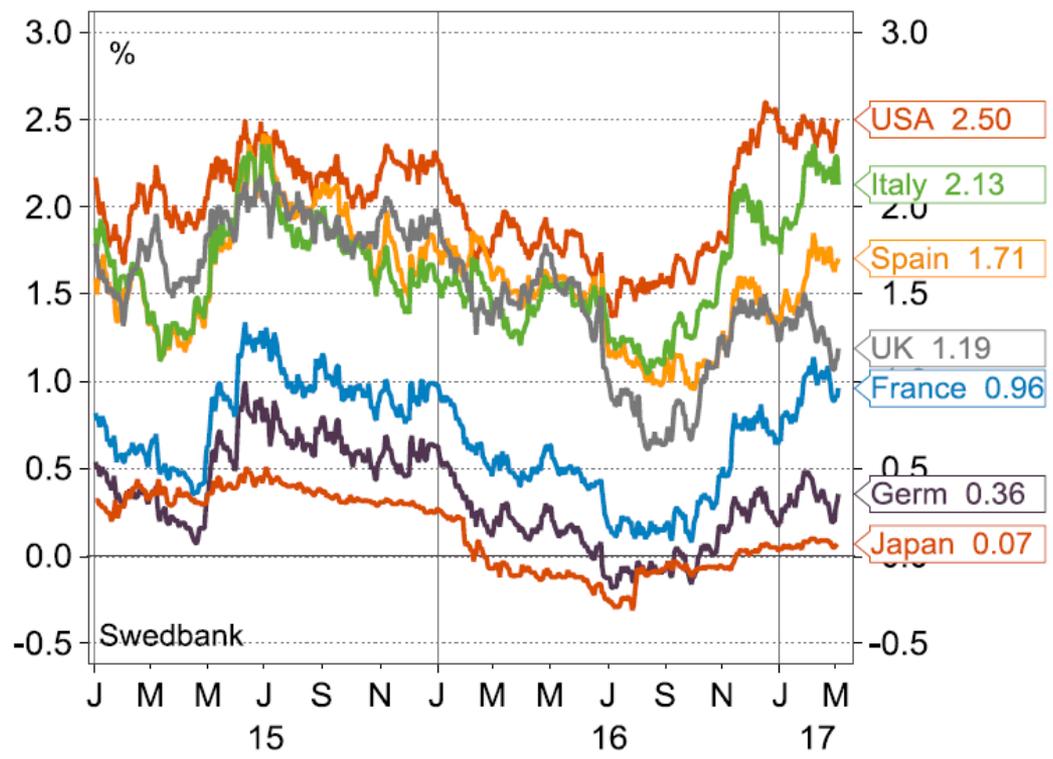
Matter of urgency? HAS to do something to keep EU together?

INTEREST RATES AND EXCHANGE RATES

Yields on government bonds are increasing, and yield curves are sloping upwards.

Chart12 (as of 3 March)

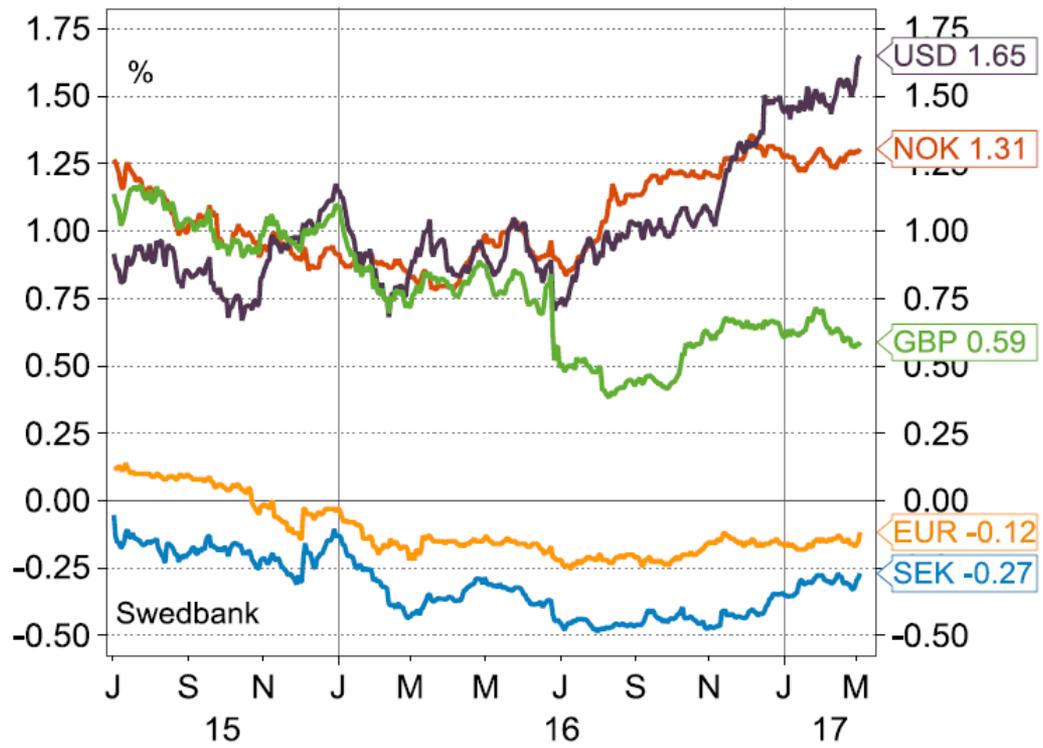
Yields on 10y gov.bonds



Source: Swedbank – Macrobond

Chart 13 (as of 3 March)

2 year swap



Source: Swedbank – Macrobond

Exchange rates is a thorny issue.

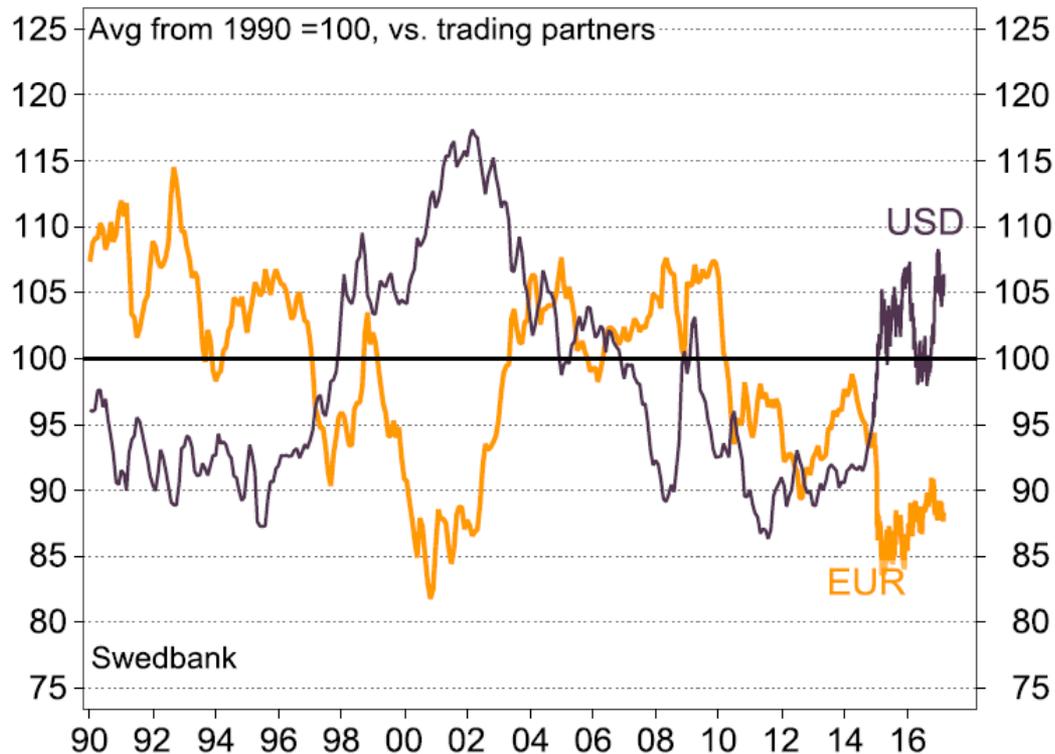
Mr Trump thinks the dollar is overvalued.

With Ms Yellen raising rates this month, the dollar could keep appreciating.

Case for Donald to urge Angela to pursue a more expansionary fiscal policy

Chart 14 (as of 3 March)

Real exchange rates



Source: Swedbank – Macrobond

World Bank's forecast – economic growth in the euro area

Chart 15

World Bank (WB) Forecast

Real GDP (at 2010 Prices) Growth (% Change), EA



Source: Knoema G20 Economic Forecast