Markets and investors need to understand the Greco-German poker game, with both sides playing to protect the single currency.

Jun 28 2012

Edward Price *argues that the recent Greek election results show that the Euro is more than a currency; it is an identity. The Germans are dealing with two opposing dilemmas: fighting to save the Euro and fighting against inflation. In the end however, he argues, we should bet on Germany fighting to save the Euro.*

June's election in Greece was a long-term bet on Europe, not austerity. This is important to understand, as it illustrates the political dynamic at the heart of the Eurozone crisis, something often lost in market commentary. That political dynamic to date has been communication between nations – principally Germany, France and Greece. Now it is changing to include communication between European electorates.

First things first, we should expect more protests in Athens. Discontent will continue, regardless of what small changes New Democracy's Antonis Samaras may achieve as prime minister on renegotiating the terms of Greek loans. That is bad news. Protests fuel uncertainty, which does nothing for the reputation of the Euro.

Second, however, is something curious. Europe's individual national electorates are showing some signs of thinking as one constituency. In other words, election results in France made a Greek bet on Europe possible, as French voters signalled to Greeks a high-level EU move away from pure austerity. This subsequently allowed Greeks to focus on the political risks of Eurozone exit, and vote in favour of the single currency.

Drawn-out uncertainty has made a bad crisis worse. This apparent electoral interaction in Europe is a good development. It will pressure European leaders for more coherence. Still disagreeing on many aspects of crisis response, European voters nonetheless seem to be offering at least some kind of agenda, broadly speaking a pro-Euro, pro-growth sketch.

The exception is Germany, where the public and various media share concerns with the Merkel government on bailouts and debt. A recent edition of the *Sueddeutsche Zeitung's* economics section made German feelings clear, describing as morphine the European Central Bank's potential future role in helping Greece. Anything that hides the pain of peripheral countries in need of real restructuring is not something that will appeal to the current German mood.

Markets, investors, commentators and credit rating agencies have however misinterpreted the German position throughout the crisis, seeing the largest and richest EU nation's rejection of shared European debt as an inflexible fiscal stance. Germany has done its best to present that line, yet, if listening closely, markets would remember Merkel's famous phrase: "If the Euro fails, then Europe fails".

Germany does not want the Euro to fail. Berlin's reluctance to act has been as much a political signal as it has an (arguably laudable) fiscal stance. Germans and Greeks have, in other words, been in a stand-off. The larger nation did not want the smaller to think Berlin would do anything for the Euro and by default for Athens too. That would have voided any Greek incentive to accept austerity. Markets have panicked at this obstinacy.

Likewise, the implied Greek threat of triggering a Eurozone meltdown was political, not something designed to spook markets directly, but to rile Germany via those markets. Greco-German relations have in fact been a very large, very dangerous game of dare – a vast game of high-stakes poker – whilst seemingly representative of each country's final fiscal stance. Markets looked at what they were given, and did not like what they saw. The game was played over a precipice.

With its election result, Greece has blinked first. Berlin will respond with a reward of sorts, and will ultimately compromise on shared European debt and perhaps another look at Greece bailout terms. Paris is a softening influence and together a conservative Greece and socialist France have given the Euro its best chance yet. Germany will feel a lot of pressure to return a high powered serve.

Nevertheless, markets will continue to worry about debt. The single currency weakened in anticipation of a European Council summit this week, largely because markets suspect the summit will see movement on the problematic issue of European banks and will include growth on the agenda. That sounds like “more debt” to markets, and Spain and Italy both issue just that – more debt – this week.

Markets might move in herds, but they are not stupid. Political developments aside, the economics of the Eurozone crisis remain. The conundrum is simple: some economies in Europe have unsustainable levels of accumulated debt, while those same economies will require debt, or stimulus, to end painful recessions. They cannot raise the money themselves and so must turn to Berlin for cash, yet Germany remains a very hard nut to crack.

A prediction: Germans will prove like the Greeks, more afraid of the political risks associated with a Eurozone failure than they are worried at the fiscal. The political risks are naturally huge, nothing less than the potential failure of Germany’s entire post-war identity. Likewise, fiscal risks are also vast, a post-*Bundesbank* era in which the European Central Bank loosens – and possibly loses – its mandate of price control in the Eurozone. The German mind is torn between two nightmares, fighting against inflation and fighting for the Euro.

The latter will eventually win out, a priority promoted by European voters in Greece and France who have made the big bet on Europe that Berlin has not yet made. Greece will stay in the Euro and Berlin will in time reply with a compromise on shared debt, most likely weakening the value of the Euro over time. Who will be happy thereafter – markets, electorates, and governments alike – remains to be seen. For now, this Greek vote shows the Euro is as much a political identity as it is a single currency. That is important information for anyone taking – or making – bets on how this crisis will end.

Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

Shortened URL for this post: **http://bit.ly/MDxSKA**

About the author

Edward Price
Edward Price has a background as a manager in the European Parliament. Currently writing about the global maritime market for Lloyd’s List from Paris and London. He offers analysis of international trade, energy markets and shipping finance, as well as the economics of the Eurozone crisis. Previously working for the European Commission’s Europe Direct, Edward is also a graduate of both the London School of Economics and University College London.

Related posts:

1. The Euro crisis threatens not only the common currency, but also the future of the European Central Bank (7.3)
2. With no political union in Europe, the Euro crisis may be a ‘never ending game’ for deep-rooted economic reasons (9.7)
3. Without a rise in German wages, 2012 may see the beginning of the breakup of the Eurozone (7)

This entry was posted in Edward Price, South Europe, The Euro, European economics, finance, business and regulation, West Europe and tagged Euro, Germany, Greece, inflation, markets. Bookmark the permalink.

Edit