THE EURO

DISILLUSIONMENT SETS IN

No international infatuation with the currency of the 11 Member States

The disadvantages for continental Europe of the policy adopted

over the last decade are now permanent fixtures.

Officially, we were promised wonders. Amongst other things, the new currency was meant to be a formidable challenge to the dollar and we were advised to make sure its value did not climb too high on the international markets against an inevitably doomed opponent. Yet, a strong Euro would be good for European economies; it would implement the necessary conditions for long awaited prosperity and a drop in the unemployment undermining our Continent. Thanks to the independence of the Central Bank in Frankfurt, there would be a rush towards the European financial markets with abundant finance on favorable terms for Euroland companies – allowing a further reduction in intervention interest rates – already "the lowest in the world", a distortion of reality regularly set forth by Euro officials.

Well known consequences

In the light of this onslaught of claims – which did little credit to their authors and insulted the intelligence of their readers – some voices objected in vain that the impact of the official changeover to the single currency would not really change very much at all. In effect, we have already been living with the Euro system for some ten years, since French monetary and exchange policy committed to maintaining a fixed parity with the German Mark, as its prime objective.

It follows that apart from lingering doubts as to the durability of this fixed exchange regime, Euro effects on the economy have had plenty of time to appear over the last few years and are familiar to us all today. A restrictive monetary and budgetary policy on a French economy with under-exploited production potential has generated high cyclical unemployment and accelerated a drop in inflation, recently turned into deflation (the consumer price index fell 0.3% in January, whereas industrial prices have been dropping for several months).

So nothing new on this front since the official launch of the single currency of the Eleven. The previous policy was simply continued - along with its effects on the economic climate. Doubtless the French economy did enjoy a substantial recovery in 1998, but this was due primarily to the drop of the Deutsche Mark (and hence of the Franc) against the US dollar in 1996 and 1997, which gave our firms a burst of fresh air.

It should also be stressed that despite the official crowing, GNP growth in 1998 compared with 1997 (the famous 3.2%) occurred essentially during the last quarter of 1997 and the first 6 months of 1998. In fact, the economy began to show signs of slowing down in the second half of '98. This is confirmed by the evolution of industrial production which has been losing momentum for several months, heralding a further drop in GNP growth.

Growth in 1998 - best illustrated by "instantaneous" growth rates, calculated by comparing evolution of the quarterly results against those of the previous quarter - shows a drop in annual rate from 2.7 to 2.6%. Nothing to write home about.

Most forecasters were aware of this and are now busy revising their projections for 1999 on a monthly basis. At present, growth stands at 1.4% at best for Germany and Italy, whereas in France, despite official efforts to scramble information, everything points to below 2%, unless of course a significant change occurs - always possible - within the international environment, exchange rates and monetary policy.

So nothing has changed. The scenario is unfolding as predicted. Deflation warnings are confirmed both in France and Germany, growth is slackening, unemployment will rise and the European Bank interest rates will remain nominally unchanged, which means that they will increase in real terms, on account of falling prices.

But what has become of the Euro effect which was supposed to turn the tables on this discouraging picture? It has not happened - and that too was anticipated. In fact, currency user habits are slow to evolve in international trade. It took almost a century for the Dollar to replace the Pound Sterling in international transactions - long after the financial might of America far outstripped that of England.

On the contrary, European growth prospects look doubtful because of the general climate of uncertainty weighing down on monetary and fiscal policy. There is no evidence of additional demand for the Euro beyond that of the Mark, the Franc and the Lira. On the contrary, the Dollar has become stronger for various reasons independent of the launch of the single currency. The Euro is therefore rather weak - all the better for the European economy which is entering a phase where production falls below potential. All the same, we will inevitably feel the consequences of the Euro's recovery against the dollar between mid-97 and the end of 98, albeit with a few months' gap.

In fact, the weak Euro led the Governor of the Central Bank, Mr Duisenberg, to refuse to reduce official interest rates, to avoid further weakening of the single currency. His mistake, however, is to underestimate the impact of gestating deflation on the slackening of Euroland economies.

Economic setbacks

Though denied by the French government, all this explains the French and German Finance Ministers' attempts to pressurize the Frankfurt Bank into agreeing to a kinder interest rate policy. It also explains why the old ideas of major European public sector work programs have been dusted down and brought out of the cupboard to increase the public debt and in the long term, fiscal pressure. In the end, to avoid openly countering the provisions made by the stability pact, it has been decided that a loan will be given at European level rather than national. A poor subterfuge.

The point is that, only weeks in, the Maastricht system, the monetary constitution of the Euro and the stability pact look every bit like a cumbersome straightjacket, leading to unfortunate macro-economic policies. National leaders are obviously aware of this and groping for a way out, which is proving particularly difficult to find. Warnings dispensed by various Euro critics were once again confirmed in the very first weeks.

What single monetary policy could possibly be adopted when Ireland was enjoying strong growth and Germany effectively going into recession during the third quarter of 1998 (an absolute fall in GNP) whereas Italy had its growth amputated and France was clearly entering a period of deflation ? It is like trying to put a square in a round hole, with Mr Duisberg facing an impossible task.

So it is understandable that under such conditions, Euro disillusion has replaced Euro euphoria. Firms, which fell for the official propaganda or underestimated the impact of monetary and exchange policy on growth and the purchasing power of their customers, will likely soon be changing their tune.

Unfortunately, Euro-land employees and future unemployed will ultimately be called upon to foot the bill for the conceptual errors committed by the hot air bureaucrats. Blunders involving the Opéra Bastille or the Très Grande Bibliothèque or even those of Crédit Lyonnais are much easier to understand. But at the end of the day, the economic setbacks associated with the Très Grande Monnaie will most likely cost us all much more.