

Is it too late for Germany to turn its back on Europe?

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To quote the head of Germany's central bank Jens Weidmann "monetary firepower is not unlimited, especially not in a monetary union". The Germans are aware that they are being dragged deeper into this crisis every time the ECB acts, as one vote among many the Germans cannot unilaterally impose their will, however they have acted to limit activity primarily through the protests of German sitting members at the ECB and their insistence around the fiscal pact. The question now is how to deal with a rising tide of growth now and pain later across the union. Make no mistake LTRO 3 and LTRO 4 will commit Germany to Europe whether they want to be or not. Judging by the noises out of the Bundesbank they don't seem to be totally convinced.

The finite nature of bailout funds can perhaps best be illustrated by focussing in on Germany. Statistics on this need to be cobbled together from a number of sources, however Germany's ECB liability stands around 18% of 4 trillion Euro LTRO, or 720 billion Euro, add to that a 250 billion Euro pledge towards European stabilization mechanisms (there are other balances such as bank guarantees and Target 2 balances however for the benefit of simplicity we will not make assumptions on those figures, they might approximate another 700 billion Euro), add this trillion or so to the existing 2.6 trillion in government debt and you now have a figure that is above Germany's 3.2 trillion Euro GDP.

All of this makes the current political environment in the Netherlands and France particularly interesting, all of a sudden, the German's could find themselves outflanked by the Keynesians and become Europe's odd man out. Ultimately as we have stated previously it brings the date that something has to happen closer. The statistics of mutual cross collateralization through European mechanisms does make it clear just how difficult (if not impossible) it would be for Germany to extract itself. Ultimately it might be the Germans who have a choice to make (this would need to be made sooner rather than later), the real danger for them is that they could lose the numbers and support for maintaining their much loved fiscal pact here on the back of the French election which will almost certainly lead to a call to loosen a number of accords that have previously been put up as non-negotiable. Thus, the risk is now political as a rising tide of anti-austerity, pro-growth rises it simultaneously delays the reforms that the Germans believe are fundamental pre-cursors to fiscal and political union. The push pull here is that it has now moved on to Germany to make ideological concessions to the rest of Europe.

At the heart of the German conundrum is the lesson of the Weimar republic. They are loathed to engage in actions that will almost certainly have an inflationary impact. The action of growth now, pain later to deal with debt essentially utilizes inflation for the purpose of reducing the size of the liability in real terms, for this to be maintained it is necessary for accommodative monetary policy to be applied over an extended period of time. This approach is not consistent with the views of the Bundesbank and Merkel; however, the question is whether Europe is at a cross roads where the decision will be made for them through circumstance.

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