Now for the next euro crisis

Oliver Hartwich | The New Zealand Initiative | 23 July 2015

Now that the Greek banks have re-opened, the third bailout package is on the way and something vaguely resembling normalcy is returning to Greece, we can finally deal with other things again – the euro crisis, for example.

You may object that what kept us so excited, frightened and busy over the past few months WAS the euro crisis. I would not be so sure about that.

Greece is a special case. Its structural economic problems are huge but its economic significance for Europe, let alone the rest of the world, is limited. Greece's GDP is only a little larger than Queensland's, although Greece has more than twice Queensland's population.

As we have just witnessed, it took an enormous effort to keep Greece in the eurozone and Greece's banks afloat. In the end, Europe could deal with these problems (which, by the way, is not the same as solving them). As long as there is political will in the remaining 18 euro member states, they will always be able to carry Greece through its travails.

For other members of the eurozone, such propping up will not always be possible. Some countries may be too big to fail. Beyond that, they are too big to be saved. We should therefore be concerned about those larger countries in the eurozone whose economic circumstances are not reassuring. The Greek crisis distracted us from their problems but in the long run, what happens next in France, Spain and Italy may well turn out to be more worrying than anything we have seen around Athens so far.

As the eurozone's second-largest economy, France is certainly not Greece. Its debt-to-GDP ratio is high at 96.4% but it is a long way away from Greek levels of around 180%. What is worrying, however, is France's budget deficit and its sluggish growth performance. For the past couple of years, France's economy grew at a rate of 0.3% and 0.4% respectively. This poor economic development was reflected in budget deficits of 4.1% and 4.0% of GDP.

The French government has issued a growth target of 1% this year. This is undoubtedly unambitious by international standards but at least it means that the French have a chance of meeting it. In its spring forecast, the European Commission even predicted a 1.7% growth rate next year, which for the French must feel like some sort of boom.

Given that the French government occupies well over half the economy, it is unlikely that we are going to see economic growth rates beyond these levels. This also means that budget deficits will remain stubbornly high. Even at the optimistic growth rate for next year, France would still run a 3.5% budget deficit.

Italy's story is similar to France, except that the Italian figures are even worse on the growth and debt fronts. Italy's economy shrank in 2013 and 2014 (-1.7% and -0.4% year-on-year). Its budget deficits are a little smaller than France's but its current debt level of 133% of GDP is a real concern.

Italy only has a chance to stabilise and shrink its debt burden if it manages to revive its economy. Though the outlook has improved somewhat, it remains to be seen if 0.7% growth for this year and 1.5% in 2016, as just forecast by the Bank of Italy, will be enough to achieve that.

When talking about potential euro crisis candidates, we have to talk about Spain. It is true that Spain has made progress in the implementation of economic reforms in recent years. Unfortunately, its economic data show that the country is by no means out of the woods yet.

The Spanish budget deficit may have been reduced from 6.8% in 2013 to 4.5% this year. Another positive is Spain's economic growth rate which this year may reach almost 3%. But despite these positive developments, debt levels are still increasing and currently stand at 100% of GDP. And unemployment, though also falling, is still at a scandalously high level of over 22%.

In these three major eurozone countries, there is no shortage of economic problems. France, Italy and Spain are not currently in crisis but no one would call them in good shape. On the contrary, they are just a few steps away from becoming the heart of the next eurozone crisis. All it takes is a trigger.

In Spain's case, such a trigger could be its forthcoming parliamentary elections. In recent opinion polls, the Podemos protest movement may have lost some ground as a result of the eurozone's tough stance against Podemos' friends in the Greek Syriza party. It is still possible though that by the time of the election, the anti-reform and anti-austerity forces will upset Spain's political system.

The stabilisation of eurozone debt levels, which the European Commission hopes for, also depends on growth picking up across the continent. This does not allow much of a margin for error, and any kind of external shock would derail the attempts at debt stabilisation. A slowdown of the global economy would thus see European debt and deficit data take off. Since they are already high where they are now, it would not take long before panic sets in.

Of course, it could also play out well. We might indeed see a broad recovery across the eurozone with years of better growth figures than the ones we have seen since 2008. Eurozone countries would then have a chance to get their houses in order. But is this really the most likely scenario? I wouldn't bet on it.

For the time being, even though the Greek problem has not been solved, let's at least enjoy the fact that we might not hear so much about Greece over the coming months. Instead, let's pay a bit more attention to some other European economies.

When the next euro crisis begins, there is a good chance that it will not be about Greece.

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