

How Germany Will Break the Eurozone

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Amazing what a bit of monetary policy can do to Germans.

Their stockmarket index *geknackt* 13,000, as they say in Germany. It's the same verb used when you're gleefully cracking nuts at Christmas. It implies a scrumptious morsel is inside.

It's not the stockmarket's performance that's impressive though – up three-fold since 2009. Nor the German export boom. Or extraordinary low levels of unemployment.

Ok, maybe they are impressive. But it's the level of self-delusion that's remarkable.

I'm mystified why the Germans don't realise they're the Greeks and Irish of 2005. Instead, they're supposedly the geniuses of property investment and masterminds of the Mittelstand.

But where would German monetary policy be under the deutschmark instead of the euro? According to the retiring German finance minister, the European Central Bank's (ECB) policy rate should be at 6.2%.

Yikes! It's at 0%!

A 6% policy rate would probably destroy the European economy overnight. And send governments broke. Again.

But where did the 6.2% come from? What does it mean?

Wolfgang Schäuble used something called the Taylor rule to come up with the number. And you're going to be hearing a heck of a lot about it soon.

The Taylor rule was developed by someone with the unsurprising surname of Taylor. John Taylor happens to be in the running for the top job at the Federal Reserve at the moment. So his theories are making a comeback.

Journalists claimed Donald Trump was immensely impressed with Taylor in a recent meeting, which saw his odds of becoming the next chairperson surge. At the expense of Kevin Warsh, who had criticised the way central bankers are beholden to the stockmarket. Not a good career move for a central banker in times like these...

There are many versions of the Taylor rule. The idea is that monetary policy should be set by an equation rather than discretion. Or that the rule should be the key factor before allowing for some discretion. Or that the rule should just be a reference. Or... you get the idea.

The updated versions of the Taylor rule have become so complex and full of assumptions that the concept is hardly a rule at all. It depends more on what assumptions central bankers make about "potential output" and "the NAIRU" (non-accelerating inflation rate of unemployment) than the real figures.

It's the idea behind the rule that's interesting. Should monetary policy be automated like everything else? Or should we keep economists employed at the central bank?

Sadly for them, central bankers are not getting any of the credit in Germany for engineering a new Wirtschaftswunder. It's the curse of being a central banker. No thanks you for creating free money.

But when the consequences of free money begin to bite, no doubt the Germans will be wailing the loudest.

Here's a contrarian prediction for you: the eurozone won't end because southern European states complain about restrictive monetary policy imposed on them while their recovery remains weak. It will end when Germany leaves because the ECB fails to reign in out-of-control inflation.

Europe's political nightmares are no dream

The Catalanian standoff continues. The breakaway region's president is desperately trying to ensure the Spanish prime minister makes the first move so he's seen as the aggressor. That strategy certainly worked so far.

But Spanish Prime Minister Mariano Rajoy has learned his lesson. Violence doesn't look so good on the news. And so he's shifted to the same strategy as that of the Catalanian president.

The deadline for Catalonia to make its intentions clear was simply shifted from Monday to Thursday when the Catalans didn't comply. The key thing all the news agencies and journalists focused on all week was the Monday deadline. And it was nonsense. Their attempt to assign credibility to Rajoy failed miserably.

But it's last Sunday that could prove more important than Catalonia's independence. Europe's election season continued with another shift in Austria.

The pollsters were worried because the polls had all agreed and hadn't budged over time. Any surprises and they'd be more embarrassed than ever.

But in the end, it was more of the same trend for the central European country. A shift to the anti-immigration right and a protest party taking a growing cut of the vote to come in second. It's all about coalitions now.

What makes Austria interesting is its similarities and differences to the Emmanuel Macron victory in France. The personality cult and youth of the new leader are very similar. But Sebastian Kurz is moderately anti-immigration and slightly eurosceptic.

Not that anyone can tell for sure what this means. Legal immigration, illegal immigration, the quotas for amounts of immigrants and the refugee crisis are all discussed without distinction. It's a politician's dream, providing plenty of opportunities to obfuscate and later deny the intended meanings.

In Austria, the right-wing protest vote came in second place, barely a of the social democratic left mainstream party. Formerly mainstream, anyway.

The right-wingers are anti-Muslim in a country which already banned the burka. They even fined a man in a shark animal suit to prove they're serious about it. They're also anti-EU. That's not so odd.

The key question, as everywhere else in Europe these days, is the direction of the coalition. Does Kurz go left or right? Either way, his majority remains slim.

To the left he has the previous coalition partner, the Social Democratic Party of Austria (SPO). Their breakup led to the election in the first place. And the SPO's electoral result is the worst since Hitler. On the right you have the politically incorrect right-wingers, the Freedom Party. Who would be the opposition if it's not kept quiet in a coalition. The leader already declared "we are the ones that dominate the political debate".

Having a right-wing party in government or opposition makes things far more interesting in Europe. The EU can begin to change or become unpopular at the government level. That's very different to being unpopular at the electoral level.

The Austrian election is a further confirmation of deadlock in Europe. Three major parties with between a third and a quarter of the vote generates no clear mandate to get anything done.

It's one of the ironies of democracy. If voters have had enough of the system, they only make it worse in the short run by voting for a secondary party. It prevents any single party from having enough power to pass laws. (In my opinion that's a good thing. But for some reason people like efficiency in government, even though it makes everything else inefficient.)

One thing's for sure. The Austrians know how to campaign politely. I'm in the Tyrol region and not a poster was seen.

Instead, the radio was full of political ads of a different kind. People were encouraged to send a selfie of themselves in the voting booth to the radio station for a chance to win a month's worth of an MP's salary. No mentioned expenses.

How democracy changes. We're yet to discover if the gimmick worked.

Next week, things get even more interesting for Europe. Czechia's version of Donald Trump makes his pitch and Slovenia votes too. If eastern Europe turns on the EU even more, it's under attack from all four sides.

By the way, you simply have to see MEP Daniel Hannan's speech on Brexit. At our conference he laid bare the stupidity about border disputes and immigration crackdowns. The concern over EU citizens entering the country illegally if we don't police the borders are comical for a painfully simple reason everyone else has missed.

You can get your hands on all the speeches and behind the scenes content [here](#).

Until next time,

Nick Hubble
Capital %26 Conflict

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