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Europe's Malaise: The New Normal?

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Russia and Ukraine continue to confront each other along their border. Iraq has splintered, leading to unabated internal warfare. And the situation in Gaza remains dire. These events should be enough to constitute the sum total of our global crises, but they're not. On top of everything, the German economy contracted by 0.2 percent last quarter. Though many will dismiss this contraction outright, the fact that the world's fourth-largest economy (and Europe's largest) has shrunk, even by this small amount, is a matter of global significance.

Europe has been mired in an economic crisis for half a decade now. Germany is the economic engine of Europe, and it is expected that it will at some point pull Europe out of its crisis. There have been constant predictions that Europe may finally be turning an economic corner, but if Germany's economy is contracting (Berlin claims it will rebound this year), it is difficult to believe that any corner is being turned. It is becoming increasingly reasonable to believe that rather than an interlude in European prosperity, what we now see is actually the new normal. The key point is not that Germany's economy has contracted by a trivial amount. The point is that it has come time to raise the possibility that it could be a very long time before Europe returns to its pre-2008 prosperity and to consider what this means.

Europe's Economic Crisis Timeline

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Faltering Europe

The German economy contracted despite indications that there would be zero economic growth. But the rest of Europe is faltering, too. France had zero growth. Italy declined by 0.2 percent. The only large European economy that grew was the United Kingdom, the country most skeptical of the value of EU membership. Excluding Ireland, which grew at a now-robust rate of 2.5 percent, no EU economy grew more than 1 percent. Together, the European Union scarcely grew at all.

Obviously, growth rate is not the full measure of an economy, and statistics don't always paint the full picture. Growth doesn't measure social reality, and therefore it is important to look at unemployment. And though Europe is fairly stagnant, the unemployment situation is truly disturbing. Spain and Greece both have around 25 percent unemployment, the level the United States reached during the Great Depression. While that's stunning, 15 of the 28 EU members have unemployment rates of more than 10 percent; most have maintained that high rate now for several years. More alarming, these rates are not falling.

Half of all EU residents live in four countries: Germany, France, the United Kingdom and Italy. The average growth rate for these countries is about 1.25 percent. Excluding the United Kingdom, their economies contracted by 0.1 percent. The unemployment rate in the four countries averages 8.5 percent. But if we drop the United Kingdom, the average is 9.2 percent. Removing Britain from the equation is not arbitrary: It is the only one of the four that is not part of the eurozone, and it is the country most likely to drop out of the European Union. The others aren't going anywhere. Perhaps the United Kingdom isn't either, but that remains to be seen. Germany, France and Italy, by population if nothing else, are the core of the European Union. They are not growing, and unemployment is high. Therefore, Europe as a whole is not growing at all, and unemployment is high.

Five to six years after the global financial crisis, persistent and widespread numbers like this can no longer be considered cyclical, particularly because Germany is running out of gas. It is interesting to consider how Germany has arrived at this point. Exports continue to grow, including exports to the rest of Europe. (That is one reason it has been so difficult for the rest of Europe to recover: Having lost the ability to control access to their markets, other European countries are unable to compete with German exports. It may be free trade, it may even be fair trade, but it is also a trade pattern that fixes failure in place.) Employment remains strong. The German financial system is viable. Yet consumer and corporate confidence is declining. As we look at the

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situation Germany is facing, confidence should be decreasing. And that in turn becomes a self-fulfilling prophecy: German employment has been supported by exports, but there is a limited appetite for Germany's exports amid Europe's long-term weakness and a world doing better but still not well enough to float the German economy.

One of the things that should concern Germans is the banking system. It has been the obsession of the European financial elite, at the cost of massive unemployment, and there is the belief, validated by stress tests, that the financial system is sound. For me, there has been an ongoing mystery about Europe: How could it have such high unemployment rates and not suffer a consumer debt crisis? The climbing rate of unemployment should be hitting banks with defaulted mortgages and unpaid credit card debt. Given the fragility of the European financial system in the past, it seems reasonable that there would be heavy pressure caused by consumer debt.

The known nonperforming debt situation is sufficiently concerning. Four countries have nonperforming loan rates surpassing 20 percent. Six have rates between 10 and 20 percent, including Italy's, which stands at 15.1 percent. The overall EU rate is 7.3 percent. Obviously, the situation in Italy is the most dangerous, but there is the question of whether these numbers capture the entire problem. Spain, with 24 percent unemployment, is reporting only an 8.2 percent nonperforming loan rate. Portugal, with lower unemployment rates, has an 11 percent nonperforming loan rate. France (with more than 10 percent unemployment) is reporting only a 4.3 percent nonperforming loan rate. The devil is in the details, and there may be an explanation for these anomalies. But the definition for a nonperforming loan has been flexible in Europe and other places before, and the simple question remains: How can such long-term high unemployment rates not produce significant problems in consumer debt?

It is simply unclear how Europe untangles this Gordian knot. Considering the length of Europe's economic malaise, a strong argument would be required to say this is a passing phase. Given Europe's unemployment, Germany's need to export to the rest of Europe, and persistent weak growth rates now spreading to Germany, it is simply not obvious what force will reverse this process. Inertia is pointing to a continuation of the current pattern. It is hard to see anything that will help Europe recover its vibrancy.

A Political Question

The question that follows is political. If the economic premise of the European Union -- prosperity -- is cast into doubt, then what holds Europe together? This is particularly relevant as the fault line between


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Russia and the European Peninsula comes alive and as Europe is measuredly asserting itself in Ukraine. Poland's and Romania's interest in Ukraine is clear. Spain's interest is less obvious. The idea of pursuing common goals to preserve EU prosperity doesn't work when the bloc is economically crippled and when signs of divergence are already evident. These include British threats to withdraw from the European Union and the loss of common interests that united the countries when prosperous.

One of the most important signs of divergence is the emergence of anti-establishment and Euroskeptical parties, which did remarkably well in recent European Parliament elections. This political shift has been dismissed by many as merely the result of a protest vote rather than a harbinger of the future. In my view, protest votes of this breadth and magnitude are significant in and of themselves. They remind us that the most dangerous source of social unrest is not the young and unemployed but rather middle-aged men and women who have suffered unemployment and lost their investments. They live in a world of shattered hopes, convinced that others engineered their misfortune. The young throw rocks and then go home. The middle-aged and middle class, having lost their dreams with no hope of recovery, are at the heart of fascism and are the real threat posed by the new European reality.

Russia is important, and so is radical Islam. But the fate of Europe is a vital force that will shape the world. Russian power grows as Europe fragments. Europe has its own internal confrontation with Islam. With long-term sclerosis of the economy and persistent unemployment, how do the Europeans deal with the immigrants among them? How does the Continent accept open borders? The implications are profound, and it is time to consider that a Europe without growth, with high unemployment and with no way out might be the reality for a much longer time than anyone expected.

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