Will Europe Drag Us All Down? U.S. Trade Deficit Widens

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Summary

- The European Commission lowers outlook for economic growth in the eurozone.
- This report is putting even more pressure on the European Central Bank to go establish a program of quantitative easing lowering even further the value of the Euro against dollar.
- The stronger dollar and slower economic growth in Europe already seem to be lowering our exports, hurting our outlook for economic growth.

The news out of Europe yesterday was not good. The European Commission released its latest estimates of what economic growth in the eurozone will look like next year. The estimates were substantially lower than what was reported earlier in the year.

The forecast for the euro currency area: the eurozone will only grow at a 1.1 percent rate next year. This is down from a prediction of 1.7 percent six months ago. Now, 2014 is only expected to increase by 1.3 percent over 2013.

And, the news is not good for the largest countries. The expected growth in Germany is now 1.1 percent, down from a 1.3 percent growth rate this year. France, the second largest country in Europe, is now expected to grow at a 0.7 percent rate, up slightly from a 0.3 percent growth in 2014. Italy is expected to show a 0.4 percent decline this year, but remain basically flat for next year.

In other words, the outlook is not that exciting.

Deflation is expected to stay away, but inflation is modest, at best, remaining below the 2.0 percent target rate for the currency union. Consumer prices are expected to rise at just 0.5 percent this year and 0.8 percent in 2015. In 2016, inflation is expected to jump up to 1.6 percent.

There are, I believe, three takeaways from these new figures.

First, as the Brussels-based organization states, the austerity programs of the members have not been the cause of the slower growth. Two countries that have gone through the "toughest reform programs," Ireland and Greece are showing strong signs of recovery. Ireland is expected to grow at 3.6 percent in 2015, the fastest rate of growth in the eurozone. Note that Ireland emerged from its bailout last year.

And, Greece is predicted to experience a 2.9 percent rate of growth next year. Greece has recently asked for an early exit to its bailout.

The European Commission still is emphasizing the budget and social reform that must take place before real, sustainable growth is achieved among its members. In other words, there is still the strong belief that unless each country in the community becomes competitive in the world, the currency-zone will not succeed.

This, of course, causes one to think of the situation of France and Italy, two countries that need to undergo massive reform programs. It also brings to mind the current battles going on between these two countries and the EU concerning current fiscal budgets that don't quite meet the guidelines that have been set up. This battle is not yet over.

Second, the projections of slower economic growth for the eurozone will put more pressure on the European Central Bank to "do something"…that something being the establishment of a policy of quantitative easing.

There it is, right in the headlines on the front page of my Financial Times this morning, "ECB Pressed to Act after Brussels Slashes 2015 Economic Forecasts," Maria Draghi, president of the ECB, and his colleagues, seemingly, must do something.

The specter hanging over the eurozone?

Martin Wolf brings to the fore what many other analysts have been saying: Don't make the same mistakes Japan did! Europe must do something…anything…to avoid a secular stagnation like Japan has experienced.

The organization that can move the fastest with the most fire power…regardless of whether it can succeed or not…is the central bank, the ECB. So the pressure will only grow.

But, what might a quantitative easing program for the ECB mean?

One thing it means is a lower value of the euro in order to spur on exports from the eurozone. This would also tend to lower imports coming into the continent.

As I have written about in the post just cited and several other posts, a decline in the value of the euro to $1.20 or less is not out of the picture. In fact, some economists argue that the decline in the value of the euro will not be really effective unless it does drop below $1.20.

But, what does it mean if the value of the euro drops below $1.20?

Well, and this gets me into my third point, exports from the United States will be impacted. This is noted in the Wall Street Journal: "Trade Deficit Grows Wider As Exports Hit Headwinds."

If Europeans lower their acquisition of imports…that is just the reverse side of the United States selling exports. In other words, the more the lower value of the euro helps the Europeans, the more it can hurt people in the United States.

Nick Timiraos, the author of the Wall Street Journal article, argues that the larger trade deficit can be attributed to lower US exports impacted by "a stronger dollar and slower growth overseas."

He goes on, "The report highlights questions over how the U. S. economy will fare if the dollar continues to strengthen against foreign currencies and if growth slumps in Europe and Asia."

One result of this report: "The figures prompted economists to trim their forecasts for growth in the third and fourth quarters." Not good!

The United States is not experiencing very strong growth anyway…even though it is a lot stronger than what is expected in the eurozone. But, we live in a global economy. The question seems to be, how much drag with the situation in Europe…and China…and Brazil…and so on and so forth…be on the economic growth of the United States?

Seems like forecasters are already starting to build this possibility into their projections.