Global Economy

Europe prepares for an uncertain fall

El País (Spain)

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Economic data and news this summer in Europe are disappointing; not so much because of the expected moderation of growth but because of the signs of vulnerability of the more open economies following the slight fall in production in Germany and the fading expectations that the main risks, the trade war and Brexit would diminish in the second half of the year. This has contributed to confidence being further deteriorated and felled doubts on how long strong domestic demand (the main growth factor) will last.

Trade tensions between the US and China continue to escalate, with a threat to raise tariffs on all US imports and the ensuing risk that China could respond with a sharp depreciation of its currency, which, in turn, would be indirectly detrimental to European exports. In addition to being caught in this crossfire, Europe still faces the US' threat of higher tariffs on car imports from the US since November, which would worsen the situation mainly related to structural demand factors.

In Europe, Brexit negotiations remain blocked after the new government rejected the current deal and Europe maintains its firm position not to reopen it. This could lead to a no-deal Brexit at the end of October or at least ongoing uncertainty if the process were to end in elections or a new referendum.

The impact of both protectionism and Brexit is on supply (disruption of production chains and reallocation of resources), and more time will be needed to assess these and adopt long-term structural measures. All Europe would need to do is ensure its demand policies receive greater support in the coming months. The ECB paved the way in July, signaling further rate cuts as early as September; its commitment to keep these at low levels for longer; and relaunching the program for asset purchases. However, given the ECB's little leeway and the possible lower marginal effectiveness of monetary stimuli, it would seem inevitable to complement these with expansionary fiscal measures if uncertainty and risks continue to worsen. A coordinated response in Europe is unthinkable, particularly following the rise in political fragmentation. However, the most affected and marginalized countries — principally Germany — will have to overcome political reluctance to implement a fiscal impulse and prevent the worsening economy from spreading across the region. And they seem to be working on it.

That said, we are yet to see political decisions that no longer interfere with growth and counter the effect of these possible stimuli.

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