The euro crisis
- it’s all about monetary policy failure

Lars Christensen
New York, October 15 2015
Columbia University
The Standard View: Debt Crisis
Public Debt/GDP in the Eurozone

Note: Gray lines are all the other countries.
Source: Eurostat, Author’s Calculations
Private Credit/GDP in the Eurozone

Source: Bank for International Settlements (BIS) Credit Database Eurostat, Author’s Calculations
The Eurozone Crisis

Note: Gray bars = GDP recession. Core = Austria, Belgium, Finland, France, Germany, Netherlands; Periphery = Greece, Ireland, Italy, Portugal, Spain.
Source: Eurostat, Author’s Calculations
Monetary Conditions and Public Debt

The Eurozone Crisis and Public Debt

% Deviation from Trend
-20.0  -17.5  -15.0 -12.5  -10.0  -7.5  -5.0  -2.5  0.0

Total Money Spending Deviation from Pre-Crisis Trend
Public Debt to GDP

Debt/GDP
65  70  75  80  85  90  95

Note: Total money spending is measured using nominal GDP.
Source: Eurostat, Author’s Calculations
Monetary strangulation: Peggers and Floaters

Real GDP %-change 2007-2015

Europe

Source: IMF, 2015 is IMF forecast
The Scandi story: Peggers and Floaters
Peggers and Floaters

GDP/capita (US dollars)
log-scale, Index 2001 = 100

2001:
Turkey: Floats the lira and introduces Inflation Targeting
Greece: Joins the euro and leave monetary policy to Frankfurt
Fiscal strangulation:
Same policy

![Graph showing fiscal stance (%-point, change, +=easing, -=tightening) from 2001 to 2014. The graph compares Euro and peggers vs. floaters. Source: IMF.](image-url)
...but different outcome

Public debt (% of GDP), Index, 2007 = zero

- Floaters
- Euro countries and peggers

Source: IMF
Monetary Crisis: Falling NGDP

Gross Public debt - change 2007-2014 (%-point)

Euro countries and euro piggeries

European floaters

Source: IMF

Markets & Money Advisory / Alhambravej 8, 1 / DK-1826 Frederiksberg / Denmark
Mail: lacsen@gmail.com / Mobile: +45 52 50 25 06 / www.marketonetarist.com
Monetary Crisis: Falling NGDP

Gross Publ. Debt, % point change, 2007-14

Nom. GDP, % change, 2007-14

\[ y = 0.0085x^2 - 1.2807x + 44.245 \]
\[ R^2 = 0.45094 \]

Source: IMF
Peggers and Floaters
Current Account Balance and Economic Growth

(In 29 European Countries)

Real GDP Growth (% Change 2010-2014) vs. Average Current Account Balance 2003-2008

R² = 0.95%
Peggers and Floaters
Current Account Balance and Economic Growth
Monetary Strangulation leads to Political Instability

Number of Prime Ministers, Finance Ministers, Central Bank governors since January 1 2009
The latest – a key risk: Inflation expectations drop again
But will the Bundesbank accept more QE?
It ain’t over till the fat lady sings

Main conclusions:

• The ECB’s decision to do Quantitative Easing has been right – but it is too little and maybe too late
• The euro is NOT an Optimal Currency Area
• So crisis likely to re-ignite – particularly if the ECB allows inflation expectations to continue to drop
• More Quantitative Easing is need
• …but not for Germany!
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