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Whence the Euro? *Or, you think we've got politics?*

If anyone thought the excitement was over after the dismal third quarter and the spectacular October recovery, they got a rude awakening in November. And despite the predictable failure of the very unsuper super committee in Washington, the driver of our troubles continues to be the problem of the euro. And so we are going to take another trip, courtesy of *The Economist*, to the Euro Zone, a place where 17 countries are divided by a common culture, history and heritage, not to mention the other 10 members of the EU (European Union) waiting in the wings to join in the fun of sharing a common currency and little else, apparently.

Morning in Brussels?

At the end of this useful and very entertaining (did he really say that?) [article](#), the authors express their fervent hope that Europe might turn from its evil ways much as America did after the dismal 70s and pursue economic growth and success with renewed vigor and commitment. However, being *The Economist*, they concluded with a more realistic assessment, as wishful thinking is not considered analysis by this publication (which is one reason we like it so much). Muddling through seems the most likely outcome. No surprise there, but a better result than many fear, and perhaps reason for optimism about the global markets. We might well survive after all.

The background is pretty important

To understand how we got here, and what “here” means, we need to go back about half a century. I always loved European history; in many ways it seemed more colorful and varied than American history, and there was certainly more of it. You may not share my interest, but because the issues with the euro are driving the headlines which are driving the markets which are driving us all a little crazy, it is worth a look at this point in time. For any of you with the notion (as Smokey would say), this is an article well worth reading, only 14 pages.

In some respects we might finally be seeing the end of what is known as the “postwar period.” In Europe, in many ways the responses to the war and its aftermath play a major role in politics and economies to this day.

In 1957, the EEC (European Economic Community) was founded, headquartered in Brussels. It was trying to organize a Europe terrified by the threats of German revanchism (after two world wars) and a Communist takeover. The answer was a political organization based in Brussels that sought to take the passion of the people out of the equation to “transcend the nation state” if you will. And so here we are more than 50 years later with an EU organization that can be fairly characterized as “remote, impenetrable and elitist.” The solution has become a big part of the problem.¹

Beneath the Euro politics are the political structures and sentiments of the countries, many of which still sport large Socialist parties (France’s Socialists may well win next year’s election). Spain provides

¹ “Beyond the fringe”. Staring into the abyss (12 Nov 2011). *The Economist*. Special Report: Europe and its currency. Retrieved from <http://www.economist.com/node/21536873>

an instructive example, notching a rating of 133rd in the World Bank's ranking of how easy it is to start a business. *The Economist* cites the example of a little bookstore serving coffee and wine which took three years to get all the necessary approvals to open. Is it any wonder "roughly half of the under-30s [in Spain are] out of work"?²

Beyond the impossible bureaucracy, you also have the welfare state, which has become unaffordable. We can identify with this problem; as we face up to large pension obligations and a large public sector in the U.S., we feel the pain, and the political conflict is quite serious. Needless to say the situation is far worse in Europe in every respect.

So who are the Europeans? Can they pull together, and should they? As Germany resumes the mantle of leadership, France fades in its ambivalence and indecision, and the UK sails off into the Atlantic, will the EU move towards more centralized power, a ceding of sovereignty by the countries to Brussels, a common fiscal policy to go with the common currency? Or will they finesse the issue and seek a more coordinated set of fiscal policies without such centralization?

And will they embrace invigorating globalization or retreat once again into protectionism, managing their way to a "genteel decline"?³ I agree with *The Economist*; I am fervently hoping for the former while expecting the latter.

So what the heck happened in November?

Interestingly, the article specifically stated that "were a bank or a solvent economy suddenly to fall prey to a market panic, then governments and the ECB (European Central Bank) would surely step in."⁴ That is exactly what appears to have happened in November. It is not yet clear what, exactly, the threat was, but it is widely assumed that a major bank or two were in some difficulty in terms of liquidity, as markets panicked and banks stopped lending to each other. Yields on sovereign credits like Italy and Spain spiked to over 7%. And not only did the ECB jump in, they did so with some important support from the U.S. Federal Reserve Bank. Markets fell sharply and then rebounded sharply after the ECB stepped in.

Credibility is everything. Stay tuned.

Important Disclosure:

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² "Destructive creation". Staring into the abyss (12 Nov 2011). *The Economist*. Special Report: Europe and its currency. Retrieved from <http://www.economist.com/node/21536865>

³ "Making do". Staring into the abyss (12 Nov 2011). *The Economist*. Special Report: Europe and its currency. Retrieved from <http://www.economist.com/node/21536866>

⁴ "Making do". Staring into the abyss (12 Nov 2011). *The Economist*. Special Report: Europe and its currency. Retrieved from <http://www.economist.com/node/21536866>