German Central Banker Says Euro Economy Gradually Recovering

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The sluggish economic recovery across Europe is not likely to gain much steam this year, said Andreas Dombret, a member of the executive board of Germany's central bank, during a visit to the Federal Reserve Bank of Atlanta on April 11.

Dombret is responsible for banking supervision and risk control at the Deutsche Bundesbank and oversees its representative offices abroad. At a lunch cosponsored by the Atlanta Fed and the American Council on Germany, he discussed the outlook for the euro area's economy and monetary union.

The euro area consists of 19 countries that share a currency, the euro. But those individual national economies range from Germany's robust $4 trillion economy, the world's fourth largest, to tiny Malta.

Gradual recovery continues

Taken together, the euro area continues to experience a "gradual recovery," Dombret said. He noted that the European Central Bank (ECB)—which serves the euro area—predicts gross domestic product growth of 1.4 percent this year and 1.7 percent in 2017 for the euro area. The March forecast is lower than the ECB's December growth projections of 1.7 and 1.9 percent, respectively.

Andreas Dombret

Restraints on the euro area economy include two interrelated forces: weakness in global trade and low commodity prices, Dombret said. Lower crude oil prices, it turns out, generally don't stimulate economic activity as much as higher oil prices hurt it, he explained. Cheaper oil and other commodities can help consumers, for instance through lower gas prices.

However, commodity-producing countries suffer as their exports fetch lower prices on world markets. In turn those nations, many of them emerging markets, earn less money and so import fewer goods from Germany and other European countries, Dombret observed.

Loose monetary policy poses risks

To boost the euro area's slow recovery, the ECB has loosened monetary policy. But the more monetary policy is loosened, the bigger the possible negative side effects, Dombret noted.

The ECB in 2015 began buying European government bonds in large quantities, similar to the Fed's asset purchase program, or quantitative easing. Bond purchases have been large enough to make the ECB the single biggest creditor of each of the 19 member states, Dombret said. The problem: this supply of capital from the ECB could erode the discipline financial markets typically exert on fiscal policymakers, Dombret said, and thus delay budgetary reforms some euro countries need. The most serious danger in this, he said, is that fiscally troubled member states can still jeopardize the stability of the entire euro area.

One way to remedy this problem would be a "fiscal union" to accompany the monetary union. But huge political and practical hurdles make it hardly realistic to expect a single unified fiscal policy for all 19 euro area countries, Dombret said.

In the absence of an overarching fiscal union, each nation should be held to account if it violates the fiscal parameters laid out in the treaty that established the euro area, he added. So far, countries that consistently break the fiscal rules have generally escaped serious penalties.

A final point Dombret made: it is critical that American and euro area officials work together. He noted that while economic power in the euro area remains fragmented, the combined entity represents an enormous economy.

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