Eurozone: The closing window of opportunity

Latest reports from Germany show that the so-called window of opportunity to further Eurozone reform is closing quickly. Maybe it's already closed, even before it was really open

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It's almost a year since Emmanuel Macron won the presidential elections in France. What followed was a wave of 'europhoria,' kick-starting pro-European sentiment and hopes that the EU and the Eurozone could enter the next stage of integration.

Since then, there have been numerous new and old reform proposals but every single idea had been put on hold due to the political impasse in Berlin. When CDU, CSU and SPD finally signed a coalition agreement with a clear pro-European tone, hopes that the reform work could finally begin re-emerged. Unjustified, it currently seems.

Cold showers from Berlin

The latest reports and public statements from Germany suggest that the new and old German government won't be too unhappy about the letter sent earlier by the governments of Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands and Sweden, basically demanding small and cautious steps forward towards further integration.

> *Media reports say Merkel has less and less support for new Eurozone reforms, as every new reform would mean shared liabilities or transfers. A concept similar to Voldemort for most conservatives in Germany*

New German finance minister Olaf Scholz was today quoted saying that a European Deposit Insurance Scheme was a good idea eventually. But not now. The same message was echoed by Bundesbank President Jens Weidmann last night. Weidmann also added that any macroeconomic stabilisation facility should not go beyond a rainy day fund.

As the new co-chairwoman of the German Green Pary, Annalena Baerbock, put it: “Since Martin Schulz is gone, one has the sense that the Eurozone chapter of the coalition agreement has been closed, unread”. Last but not least, there have been media reports that Angela Merkel has less and less support for new Eurozone reforms, as every single new reform would mean shared liabilities or transfers.

The Germans have to show their Eurozone reform hand in June

It is not surprising to us, but all of this means that Macron supporters and all those investors who had hoped for a new reform push are currently getting many cold showers from Berlin. Being pro-European is clearly not the same as being in favour of new Eurozone reforms. At the next European Summit in June, Berlin will have to show its hand.

The risk is high that 'europhoria' will get another setback as the only three reforms surviving Berlin’s scissors will probably be:

i) making the ESM a financial backstop for the Bank Resolution Fund;
ii) giving the principal green light to reform the ESM into an EMF without going into details
iii) reserving an undefined portion of the next EU budget for the Eurozone.

Closing window of opportunity will unfortunately keep break-up phantasies alive

All of this is not necessarily bad news. The Eurozone has become much more resilient than it was ten years ago and it can absorb shocks much better than in the past. Also, it is doubtful whether a Eurozone finance minister or a permanent Eurozone budget would really completely rule out the existential risk of the monetary union.

In the end, the destiny of the monetary union will always be in the hands of national voters. If Europe now instead manages to agree on common immigration rules, border controls and a Defense Union, this would not make up for the missed opportunity to further reform the Eurozone but could at least strengthen the overall framework. It would probably also help more to regain people’s support for Europe than technical improvements of the monetary union.

Also, this probably means that when the next recession hits the Eurozone, the ECB will again have to be counted upon to keep the Eurozone intact with unconventional policy measures, which is neither very popular in Germany nor will another "bailout for reforms" policy increase pro-euro sentiment in Southern European countries.

Unfortunately, this closing window of opportunity will keep break-up phantasies alive, at least for now.

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