The importance of non-euro Europe

Why heterogeneity in the single currency bloc is a fact of life

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The reality of the euro area is that each member – including Greece – is an adherent for specific, partly opportunistic reasons which often vary from country. The differentiated, condominium-like structure of the euro explains why interest rate 'spreads' between government bonds in the single currency bloc are likely to persist during and after the European Central Bank's €60bn a month bond purchase programme aimed at restoring 2% inflation.

Euro area heterogeneity provides an underlying reason, too, why achieving consensus in thorny issues like reform in Greece as a quid pro quo for debt relief is so difficult.

Euro countries need to invest time and resources to work together as a team to influence ECB monetary policies – and, indeed, policies in other areas too – towards a much more equitable distribution of the benefits and drawbacks of the single currency. The necessary changes include modifying the ECB's rules of engagement, in quantitative easing and elsewhere, to give it a more active role in influencing the business cycle. They extend to the more complex political process of revising the European treaties to adapt the framework of monetary union to members' aspirations. Such adjustments form the only way to allow sceptical countries outside the euro eventually to join and also, more pressingly, to keep the present membership intact.

Heterogeneity outside the euro bloc places additional pressure on members of the single currency. The 10 non-euro EU states share much of Brussels legislation and have strong commercial and financial links with euro countries. Several, such as the UK, Poland, Sweden and the Czech Republic, have been faring better than euro members partly because they took advantage of post-2009 dislocation to carry out necessary devaluations.

Sterling fell by around 25% in the recession induced by the financial crisis. Sweden, Poland, the Czech Republic and Hungary registered depreciations of more than 10%. By 2010 GDP growth in these countries was recovering. In 2012 it was back to pre-crisis levels, while the larger euro countries were still struggling. Lower exchange rates fed through to higher inflation, which was a useful accompaniment to renewed growth and (in contrast to what happened in euro members) helped diminish the real value of public debt.

To understand the euro we recognise that different countries desire different outcomes. To protect its exports, Germany doesn't want to return to a strong D-mark. Greece is chained to the euro – or rather the euro is chained to Greece – since its public debt is 90% in the hand of euro area taxpayers and it is de facto denominated in a foreign currency.

For large economies such as France, Italy and Spain, the euro is the route towards necessary reforms. This is one good reason for persistent interest rate spreads in these countries compared with German government bonds.

It's too early to say whether the ECB's QE is achieving the goal of increasing inflation and of rekindling euro area growth. But one thing is clear: different countries feel the effects in different ways and at different speeds. We have seen a small 0.3% price increase in May against a 0.6% contraction in January. A modest economic recovery is under way, with the EU's real GDP increasing 0.4% in the first quarter against from 0.3% in the last quarter of 2014. On the negative side, loans to the non-financial sector have been stagnating after a three-year decline, while government yields have rebounded to 2014 levels after bottoming out at the beginning of the QE programme. The euro's significant devaluation against the main international currencies has not yet triggered an across-the-board rise in EU exports.

The ECB measures will not achieve the same result across all euro area countries. Peripheral banking systems will find it difficult to transmit liquidity to the real economy. A muted recovery across the euro area is the most likely to outcome, but at different speeds. This is a clear signal that, even if the euro area weathers the outcome of the Greek debt stand-off without undue perturbation, heterogeneity unfortunately will remain a fact of life.

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