Signs of US recovery while Ukrainian crisis puts pressure on Europe’s economy

The financial crisis of 2008 led to a ‘Great Recession’ and a sovereign debt crisis in Europe, the consequences of which continue to be felt thanks, also, to the geopolitical fallout from Ukraine, Gaza and the Middle East – not to mention the tensions in East Asia between China and most of its neighbors. The West and NATO are pondering the adoption of tougher sanctions against Russia amid plans to run intensive military exercises that have clearly been announced with President Putin in mind. Most EU countries would rather avoid enforcing sanctions against Russia, which supplies much of the Union’s energy along with several billion dollars of capital to its banks while serving as a key market for western luxury, agriculture and technology goods. As the summer of 2014 comes to a close, the European economy has yet to find respite while the United States, China and Japan have shown signs of health. Tensions abound and they come from all directions, generating a fog that makes it difficult to understand exactly what role the various individual factors, whether structural, political, economic, financial or military are having on the much awaited and often prematurely announced recovery.

The American economy improved in the second quarter, with GDP rising up 4.2% according to the Department of Commerce. The growth contrasts with the slowdown in the first quarter when the economy had contracted by 2.1%. The growth rate in the second quarter may temporarily lift fears of a slowdown or a recession in the American economy after the slowdown of the first quarter, which was such that the average growth rate for the first half of the year is actually lackluster at 1.05%. The confidence of European, and other, observers cannot be very high, considering look that the United States is still the biggest economy in the world and – despite the fact that China is catching up quickly – still the beacon that sets the direction of the international cycle. The USA is still the largest market in the world, absorbing exports from all over the world. There is also a psychological factor such that the world looks to 'America' for hope or perhaps at least some comfort that 'things will improve'. Indeed, this faith in America is not all misplaced.

The United States was surely hit by a hard recession sparked by debt and unscrupulous banking practices. The solution was to cut debt by promoting more savings, leading to lower consumption, which had the effect of slowing down the economy, given that the 'austerity' measures were practiced on a wide scale. Now, economists have suggested that American household budgets have improved and that their debt levels are more manageable even as housing values are recovering. In other words all the elements exist to warrant a healthy growth rate fueled by increased consumption and confidence. If the growth rate average for 2014 fails to inspire, despite some bursts of enthusiasm such as has occurred for the second quarter, it is because the improvements so far have mainly been registered at the individual family level. The extent of the 2008 crisis was such that it forced the State to intervene more directly in the American economy; public sector spending for the past six years has been unprecedented to compensate for the vastly reduced private sector spending. The public sector's coffers were stretched to the limit, hampering its continued ability to compensate for the absentee private sector.

Now, there is actual room for optimism. Household accounts, including public accounts in the United States have improved and even the federal deficit stands at 2.9% of gross domestic product while it had been as high as 10.8 percent at the peak of the crisis in 2009. So, the United States continue to be alive, and all the more so because technical progress never left; innovation at all levels of industry continued and even capital at the corporate level flowed much more freely than in many parts of Europe. This is the kind of optimism reflected by the record highs of the NY stock exchange, which have kept commodities low, even managing to absorb the heavy geopolitical risk that was supposed to have driven gold prices to new records. Indeed, China, whose slowdown from an average GDP growth rate of around 10% to one closer to 7% was supposed to have had dire consequences, has failed to materialize into a crisis. China certainly has some risks, but these are far more related to the population's rising demand for civil liberties, of which the right to a cleaner environment is essential. Then, there is Japan, whose economic situation is similar to that in much of the European Union, the much acclaimed 'abenomics' (a package of fiscal reforms and stimulus measures) reforms launched by Prime Minister Shinzo Abe to promote growth have started to choke after an initial sense of success in 2013.

The Tokyo stock exchange has been growing as has GDP but the improvements have come largely as the result of monetary policies favoring inflation (printing more money) and cash stimulus. Structural reform remains an elusive target. Only structural reform can achieve the desired effect of long term growth. Europe continues to loiter in recessionary territory, albeit there is great discrepancy among individual members. The explanation is more geopolitical than economic as any indicators of confidence are waning even in the economic powerhouse of Germany, which stands to lose or gain the most from its proximity to Ukraine. If Germany sneezes, the rest of Europe catches a cold and its economy is suffering the repercussions of tensions even though the actual growth factors remain intact. The policy of military encirclement against Russia, backed by Washington and blindly accepted – if not convincingly absorbed – by European governments, have led to a crisis of trade relations with Moscow, for which Europe's productive apparatus has paid a great price, especially Germany, which is in turn the EU's economic locomotive. NATO is planning to increase the effectiveness and visibility of its forces in Eastern Europe in a Cold War like scenario to scare Moscow into reducing its involvement in the Ukrainian civil war.

This does not mean that The United States, Germany and other allies, have plans to increase the number of its troops in the region, which would vastly increase tensions with Moscow. They merely intend to show “unity and readiness” to respond to events in Ukraine. For now, NATO merely wants to make it clear to Moscow that it is ready to send more troops in its bases in Eastern Europe if necessary through a “rapid deployment force”, through the enhancement of existing bases, logistics, supplies and infrastructure. It is doubtful that President Putin will feel any urge to reverse his strategy in Ukraine. However, Britain and six other states have announced they intention to create a multilateral force with at least 10,000 troops to respond to Russia in Ukraine according to the Financial Times. The official announcement is expected to be issued later this week at the NATO summit. The countries currently involved in the force, which will include naval units and ground troops, are Denmark, Latvia, Estonia, Lithuania, Norway and the Netherlands. Meanwhile, the Kremlin continues to deny any involvement, even though rumors abound that Russian speaking separatists in Ukraine are preparing to attack two key areas of Maryupol and Volnovakha in order to open a corridor between Donetsk until the Crimea. Should this be the case, NATO has stacked the deck too high in order to back down from taking more significant punitive actions with Moscow. This will only raise tensions in Europe, putting pressure on growth.