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Why Germany and the UK must become close allies

ALLISTER HEATH

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Theresa May and Angela Merkel at the G20 Summit in Hangzhou, China CREDIT: TASS / BARCROFT IMAGES

It is often argued that Germany was the great winner from the launch of the euro. The argument is simple: the single currency is relatively weak, while the deutschmark was very strong. So by joining the euro, Germany locked in a much lower exchange rate, making it permanently more competitive and helping it export a lot more.

Had Germany retained the mark, it could well have ended up as a safe haven refuge currency, rocketing like the Swiss franc and choking German manufacturers.

The euro's positive effect for Germany may have been at its strongest when selling goods to the rest of the eurozone: that exchange rate has been fixed since 1 January 1999.

Under the old system of separate national currencies, it is generally assumed that Germany would have pursued a "sound money" policy while the likes of Spain and Italy would have been looser and tolerated more inflation; the result would have been to push up the mark relative to the now defunct peso and lira.

Exchanging marks for euros in 2001 CREDIT: EPA

The reality, needless to say, is a lot more complex. A low currency is good for exporters; it is bad for imports. Deflation in parts of the eurozone has pushed prices down and improved competitiveness, which in terms of competitiveness is the equivalent of a devaluation.

Crucially, by destroying the economies of countries such as Italy – which has barely grown at all in GDP terms since the abolition of the lira – or Greece, the euro has depressed demand in most of the eurozone and thus reduced the appetite for German goods.

It is hard, therefore, to determine for sure whether the euro has helped or hindered Germany's exporters – that said, on balance, it is likely that mainstream opinion has proved correct in this case. German exporters are probably better off today than they would otherwise have been.

They certainly export a lot to the UK, and no wonder. Our economy has grown faster than the eurozone since the launch of the single currency – and strong growth in our total demand for goods and services has unsurprisingly meant sucking in a lot of German products.

The fact that German exporters price themselves in euros rather than marks would also have helped, though of course the recent slump in the value of sterling will have hit German exporters, forcing them to accept a drop in the euro-denominated value of their exports or to push prices up.

There is nothing wrong with the fact that British consumers and manufacturers purchase so many German products and inputs: imports are a good thing. It is great that more Brits are able to enjoy BMWs and other high-quality goods; protectionism is the most basic of all errors in economics.

CREDIT: REUTERS

We export goods and increasingly services to be able to buy imports. That is the whole and only point. The old mercantilist view that we should seek to minimise imports is an intellectually bankrupt concept that has been demolished by all serious economic thinkers of the past few hundred years.

Britain and Germany have developed a symbiotic economic relationship: without the City, Frankfurt's own financial centre and German industry would be weaker; without our import-hungry consumers, German manufacturers would be plunged in crisis.

The scale of Germany GmbH's dependence on UK consumers is laid bare in a fascinating report from Barclays; Olga Tschekassin and Tomasz Wieladek, two analysts at the bank, have dived deep into the numbers. Their key revelation is that Germany's current account surplus with the UK is now worth a massive 1.7pc of German GDP and 20.4pc of its total surplus.

We matter immensely to German exporters, something which will matter hugely in the forthcoming Brexit negotiations. The vast bulk of this current account surplus is made up of a trade surplus; this has been in a 0.5pc-2pc of GDP range for the past 20 years but has been trending up recently. It is clear that Britain has become a permanently more important market for German companies in recent years.

The UK is now Germany’s third largest export partner, the Barclays analysts report, with €90bn (£76bn) worth of sales last year. The country’s nominal exports to the UK increased by 50pc between 2010 and 2015. No less than 7.5pc of all German goods exports were sold to Britain in 2015, a large number given that we don’t purchase many machine tools or other heavy products of the sort Germany also specialises in, unlike emerging economies. Tschekassin and Wieladek point out that cars and other vehicles sales were worth €25bn, or half of Germany’s trade in goods surplus with the UK.

Angela Merkel CREDIT: BLOOMBERG

In the past, recessions in Britain have therefore unsurprisingly been bad for Germany: they led to a prompt reduction in demand for German goods. Any “punitive” post-Brexit attack on Britain that was sufficiently vindictive and destructive to hurt our economy would therefore also hurt German companies, causing immediate job losses and a political fallout in Berlin.

One simulation run by Barclays which assumed zero domestic demand growth in Britain for an extended period would see the trade deficit more than halving after eight quarters, cutting German GDP by 0.7pc. Such numbers are entirely hypothetical and depend on many factors, not least exchange rate fluctuations; but they illustrate the fact that it is self-evidently in Germany’s interests for the UK to do well.

It is vital, therefore, that Germany and Britain work closely together to help maintain UK-EU trade relations that are as free as possible after Brexit. The two countries are natural allies: they share broadly the same values when it comes to trade and economic integration.