Germany Is Hardly A Paragon Of Fiscal Virtue

The common perception is Germany is a hardworking, thrifty and fiscally prudent nation that is being dragged down by the lazier, spendthrift and fiscally irresponsible members. A superficial look at the government debt to GDP ratios appears to support this perception.

	2010 Government Debt to GDP Ratio (%)
Greece	143
Italy	119
Ireland	96
Portugal	93
Germany	83
France	82
UK	80
Spain	60
Source : Eurostats/Bloomberg	

However, statistical snapshots never tell one much about anything. It is the trends over time that have greater meaning. See the next table.

	Government Debt to GDP Ratio (%)		
	1991	**2000**	**2010**
Greece	79	102	143
Italy	97	109	119
Ireland	96	38	96
Portugal	60	48	93
Germany	40	60	83
France	35	57	82
UK	33	40	80
Spain	44	59	60
Source : Eurostats/Bloomberg			

Thus, we have a few shocking revelations.

- Over the past 20 years, Germany, France and UK have more than DOUBLED their government debt as a percentage of GDP. This pattern is far WORSE than that seen in Spain, Italy, Ireland or Portugal.
- Ireland, in the 1990s, brough their debt to GDP ratio down from 96% to 38%. Unfortunately, it is now back to 96%.
- Italy was the worst in 1991 and 2000 but the point is their ratio has only crept up slightly relative to Germany, France and UK.
- Spain's ratio is actually the most respectable and this number has hardly changed for a DECADE.
- Germany's ratio has deteriorated relentlessly throughout the last 20 years, a pattern also seen in France and UK.

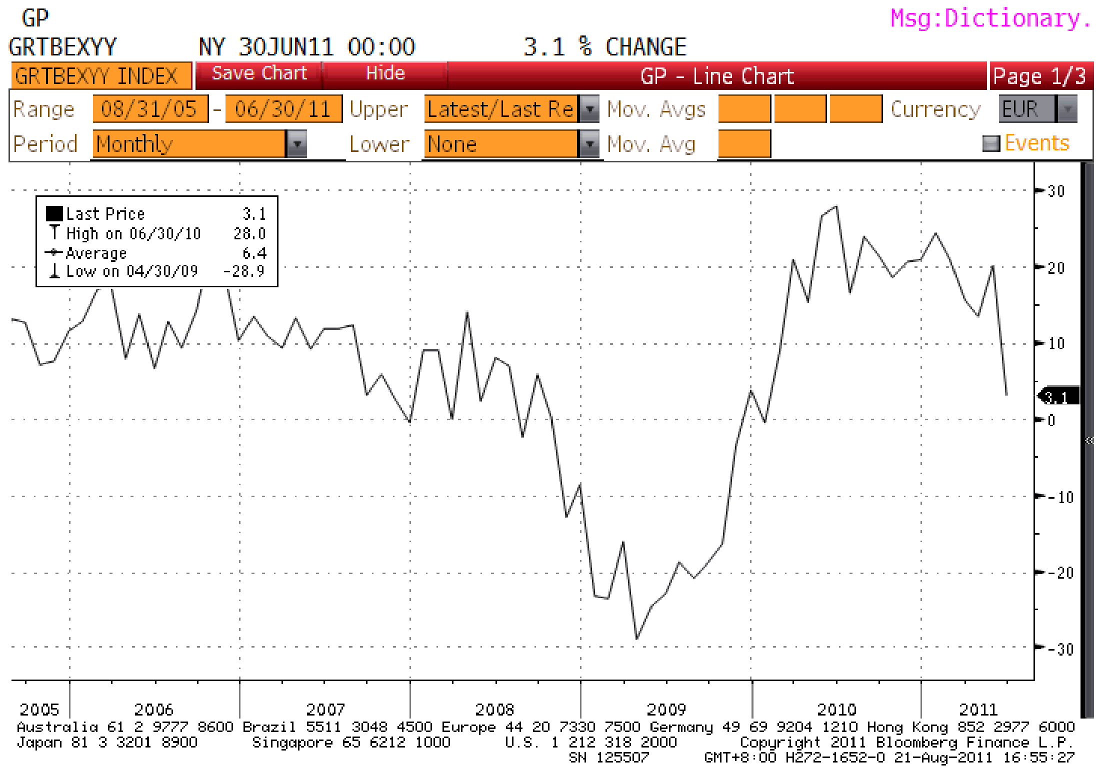
Yet, the Credit Default Swap rates are telling a different picture. Why? My belief is the CDS market is complete and utter nonsense. (I can tell you why, but my choice of words would be unprintable)

	1-Year CDS rates (bps)
Greece	3362.78
Italy	305.33
Ireland	285.31
Portugal	1136.92
Germany	42.7
France	96.95
UK	39.35
Spain	316.79
Source : Bloomberg	

Germany is a country with a great industrial base. Unfortunately, it is also a country that has one of the most bloated and overpaid public sectors in the developed world. In addition, the massive pool of savings and surpluses generated by its industrial base has been very poorly deployed by its large and very incompetent banking sector.

Now the rest of Europe is tipping over into recession. There is no fiscal means to cushion or halt the recession. Neither is there monetary means to do so, again because of the dogmatic, inflexible German lobby in the European Central Bank.

What this means is German exports will collapse in the coming months. You can see from the next chart that the collapse has already begun in June 2011. It should accelerate well into negative territory during H2, 2011.



This is why the German DAX Index has begun to UNDERPERFORM the rest of Europe.

Main Stock Market Index	**Change in the Past 1 Month (%)**
Greece	-25.21
Italy	-24.80
Ireland	-17.34
Portugal	-14.13
Germany	**-25.20**
France	-21.49
UK	-15.07
Spain	-19.06
Source : Bloomberg	

Germany's economy will enter a deep recession. It will find itself unable to use its fiscal lever because it has been abusing it already for 20 years! Meanwhile, there should be a lot of German banks and savings thrifts getting into trouble.

To give you an idea, here is a list of top international banks and their leverage, as measured by the ratio of their Total Assets to Shareholders Equity. You can easily see that by this measure, Deutsche Bank is the riskiest of these banks.

	Ratio of Total Assets to Shareholders Equity
Deutsche Bank	35.8
Credit Suisse	24.2
Barclays	24.1
UBS	24.0
BNP	22.2
RBS	18.6
HSBC	16.1
Goldman Sachs	12.7
Morgan Stanley	**12.6**
JP Morgan	12.3
Citibank	11.0
Bank of America	10.2
Source : Bloomberg	

The next table shows 3 smaller German banks to illustrate the vulnerability of the German banking system.

	Ratio of Total Assets to Shareholders Equity
Commerzbank	25.9
Deutsche Postbank	33.8
Landesbank Berlin	47.3
Source : Bloomberg	

Once the German banking system begins to get into trouble, all this nonsense about German thrift and prudence will stop. And the ECB will have to be given the power to print money to bail out Germany and with it, the rest of Europe!

When the Eurozone crisis first started, Germany should have shown leadership and accelerated the migration to full fiscal union. A united Europe in 2010 issuing Eurobonds would have stopped the rot and allowed the Euro exchange rate to begin acting as shock absorber for the region's economic and fiscal difficulties.

Instead Germany decided to preach to the rest of Europe from a high moral stool, a position that it does not deserve. The Euro stayed firm and the full brunt of the crisis was borne by the real economy and unemployment. As a result, the crisis has simply been moving from bad to worse. The prolonged period of non-solutions has damaged the entire region irreparably.

Dummkopf!