What More Cowbell Means for Europe's Economy

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Simonomics: A regular look at the global economy from a former staff columnist at The Wall Street Journal.

A decade and a half ago, *Saturday Night Live* viewers first heard the phrase "More cowbell!" from actor Christopher Walken playing fictional music producer "*the* Bruce Dickinson." Since then, the line has become an iconic quip — but one that's not limited to pop culture. Across the pond, investors have been calling for more financial cowbell from the European Central Bank, and earlier this month, they got it. Sort of.

The head of the ECB, Mario Draghi, did deliver more cowbell in the form of some stimulus and lowered interest rates, but not as much as had been expected. "Ultimately, and profoundly, the ECB disappointed, and this has rarely been seen in Draghi's tenure," states a recent report from the bank Brown Brothers Harriman. Some small commotion followed in the financial markets. Still, the question remains: Will the policy move ultimately achieve the desired goals of lifting inflation and spurring growth?

Much of what the ECB has done in terms of money printing — so-called quantitative easing — and cutting the cost of borrowing has been discounted by investors. That's what happens in financial markets and, in the case of raising inflation, it's good news. The ECB wants to raise inflation to avoid a deflationary spiral such as was seen in the Great Depression of the 1930s. In anticipation of the money printing and rate cut, investors have sold their euros, lowering its value more than 10 percent this year, which will likely help boost inflation. "There is an almost one-to-

one relationship between devaluation and inflation," says professor Steve Hanke of Johns Hopkins University and the Cato Institute.

But then there's the bad news. The fall in the value of the euro could have a harsh effect on Europe's beleaguered economy. If the dollar gets stronger versus the euro, for example, then all commodities get readjusted and their price increased in local currency, Hanke says. That's because commodities are priced in dollars, and those increased prices raise costs for eurozone manufacturers. Combined with the higher inflation, there will likely be lower demand from consumers. On top of that, a sizable portion of noncommodity imports are priced in dollars, adding yet more costs and lowering profits, Hanke says.

What's even more troubling is that investors in the U.S. tend to yank their dollars when currencies drop — motivating "capital to flee to seek use overseas," says R. David Ranson, president and research director at HCWE Worldwide Economics. Meanwhile, cash that stays at home will tend to flow toward businesses that produce for foreign markets, Ranson says, because that's where the relatively better returns will be. In this case, that means overall investment — one of the most variable parts of any economy, much more so than consumption — will be likely to fall in the eurozone, which wouldn't be good for eurozone growth, of course. That should matter to everyone because the combined countries of Europe's single currency constitute the second-biggest market in the world, smaller only than the GDP of the United States.