German Recovery Hinges on Euro Zone

Company Investment Will Resume if Bloc Is Stable, Economy Minister Rösler Says, as Cyprus Aid Question Looms

By WILLIAM BOSTON and SUSANN KREUTZMANN

BERLIN—German Economy Minister Philipp Rösler warned that the return to strong growth in Europe's largest economy later this year depends on stabilization of the euro zone, even as the undecided outcome of Sunday's vote in Cyprus suggests the current calm is still tenuous.

Despite a marked deterioration of the euro-zone economy in the final months of last year, Mr. Rösler, in an interview with The Wall Street Journal, expressed guarded optimism that European policy makers are getting the upper hand in the euro zone's three-year-old sovereign-debt crisis.

Associated Press

Philipp Rösler, shown at the wheel, in Palo Alto, Calif., last week, says Germany's recovery depends on euro-zone stability.

He said Germany's economy, which shrank 0.6% in the fourth quarter from the previous quarter, was hit by uncertainty about the currency bloc's economy, causing companies to hold back investment. That investment could resume flowing later this year, he said, if the crisis continues to abate.

"It is not the end of the crisis, but the beginning of the end of the crisis," Mr. Rösler said. "We are expecting strong growth during the course of the year and growth of 1.6% in 2014. The precondition for that is that the euro zone continues to stabilize."

It is far from certain that the current calm can be sustained. The next potential flashpoint could be Cyprus, which is seeking nearly €18 billion ($24 billion) in international aid to prop up its banks, which were hit hard by last year's restructuring of Greek sovereign debt.

European officials and analysts have warned that any false moves on the Cyprus situation could reignite the crisis.

But Mr. Rösler, when asked if he would back aid for the embattled island nation, remained noncommittal. He advised European leaders not to rush to judgment, but to wait to see if the next government is willing to discuss structural economic reforms, such as a restructuring of the
country's banking industry, and allow European leaders to determine what impact a default in Cyprus could have on banks outside the country, especially in Greece.

"The [Cypriot] government must lay the numbers and facts on the table so that we can determine what the real financial need is," he said. "We need to know, for example, what the financial links are or what impact there could be on Greek banks."

Mr. Rösler's pro-business Free Democrat party is junior partner in Chancellor Angela Merkel's ruling coalition government, and therefore will have a strong say on granting aid to Cyprus. There is a group of euro rebels in the FDP who reject any euro zone bailout.

And many German lawmakers—across party lines—aren't convinced that Cyprus poses an existential threat to the euro zone, a requirement for any aid from the European Stability Mechanism, the euro-zone bailout fund.

Mr. Rösler's remedy for the euro zone is continued fiscal reform and free trade to boost growth.

But the latest data on the bloc's economy cast doubt on assurances by some European policymakers that fiscal austerity will cure the region's ills.

The euro zone's economy shrank in the fourth quarter at the fastest pace since the peak of the world recession in early 2009, the latest data show, suggesting that the euro zone crisis is far from over.

Yet Mr. Rösler admonished policymakers not to ease up on fiscal reforms or seek solace in temporary measures that would likely be ineffective, such as currency devaluation.

"I am deeply convinced that it is better to strengthen competitiveness than to weaken the currency," he said.

He acknowledged that Germany's relative strength is partly the fruit of the country's massive stimulus program in 2008. But he said economic stimulus for weak euro-zone countries wouldn't have a similar stabilizing impact if it weren't preceded by structural economic reforms.

"If a strong economic framework already exists then certain temporary measures could be fruitful in individual circumstances," he said. "But that's a different case if the [economic] structures are inefficient or do not even exist."

Growth will come from trade, Mr. Rösler emphasized, and he welcomed U.S. President Barack Obama’s invitation to the European Union to open comprehensive talks with Europe on a trans-Atlantic free trade agreement. The issue has long been the dream of Europeans, and Mr. Obama has given the idea momentum, despite obvious obstacles such as differences over regulation of everything from food to financial markets.

Mr. Rösler, who will lead the German negotiating team, said the U.S. and the EU should put all issues on the table to prevent any taboos from derailing talks.

"We have different ways of going about things in the U.S. and in the EU—whether in banking regulation or the financial-transaction tax, for example," he said."

Nevertheless, I am deeply convinced that if there is good will, everything is possible."

Write to William Boston at william.boston@dowjones.com and Susann Kreutzmann at susann.kreutzmann@dowjones.com