Stark Signal for the Euro

By THOROLD BARKER

What is the future of the euro if old hands from Germany’s Bundesbank have lost faith in the institution charged with overseeing the currency?

Jürgen Stark, chief economist of the European Central Bank and a member of the executive committee, resigned Friday after apparently disagreeing with the ECB’s recent decision to buy Italian and Spanish sovereign bonds. That comes only months after another Bundesbank heavyweight, Axel Weber, decided to rule himself out as successor to ECB President Jean-Claude Trichet and leave the governing council.

Short term, Mr. Stark’s departure removes a key policy hawk, both when it comes to fighting inflation and opposition to more bond buying. But the more important impact is on the ECB’s credibility. The central bank’s leadership is already heavily weighted toward the fiscally challenged countries of southern Europe, rather than northern counterparts such as Germany, which is the currency zone’s economic powerhouse and anchor member. On the six-strong executive board, the vice president is Portuguese and the new president will be an Italian, Mario Draghi.

Mr. Stark will be succeeded by another German. But disagreements on ECB policy will do nothing to reassure fractious financial markets. And given the Bundesbank still is revered in Germany, skepticism over the euro’s direction hardly will boost political support for yet more intervention to keep the euro together in the face of extreme pressures.

With peripheral European countries still far from solving their debt problems, euro-zone economic growth slowing, a split ECB, and political wrangling over bailouts, it is little surprise that the euro finally has stopped defying gravity. Its 3.8% fall against the dollar this week was overdue. And the correction is likely to go further, given that the next move in interest rates is likely to be downward.

Investors should be prepared for a long, hard grind, with all eyes on whether Germany will move toward something akin to a euro-zone bond. That is probably the only thing that would draw a line under the crisis, by effectively pooling the debts and tax-raising capabilities of the currency zone. Taken in aggregate, the euro zone’s fiscal deficit was 6% in 2010, versus more than 10% in the U.S.

But getting there is a political minefield. Not only would Germany and other more prosperous countries have to accept ultimate responsibility for the debts of weaker southern European countries. Those countries, in turn, would effectively have to accept Berlin as ultimate arbiter of fiscal policy. It is one thing for the market to force budget cuts on a country. It is quite another to take orders from foreign officials.

Given the vagaries of politics—even Europe’s Lisbon treaty only just squeaked through—and the inability of European institutions to move fast at the best of times, further flare-ups are almost certain. Even when compared with weak currencies like the dollar, the euro’s future as a store of value looks bleak.

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