Bloomberg

Lew to Push Growth Amid Contagion Concerns in Europe Visit

By Ian Katz and Kasia Klimasinska - Apr 5, 2013

Jacob J. Lew pivots to Europe, a region fraught with risks to the world economy, after making China his first overseas destination as Treasury secretary last month in a nod to the strongest engine of global growth.

Lew arrives April 8 for a two-day visit to meet with European Central Bank President Mario Draghi in Frankfurt, German Finance Minister Wolfgang Schaeuble in Berlin, French Finance Minister Pierre Moscovici in Paris and European Union officials in Brussels. He returns to Washington the evening before President Barack Obama sends his overdue fiscal 2014 budget to Congress on April 10.

As the American economy accelerates and Europe's recession drags on, Lew may prod officials in the region to boost growth and limit financial-market contagion, said Eswar Prasad, a professor at Cornell University in Ithaca, New York. He may also press them to unify Europe's banking system and fiscal policies to safeguard the economy and the common currency and express U.S. objections to a proposed financial-transactions tax.

"Lew's trip to Europe comes at a critical juncture for the U.S. economy," said Prasad, a former International Monetary Fund official. "A flare-up of the euro zone debt crisis could create turmoil in global financial markets and set back the fragile U.S. recovery."

Instability Risk

Financial instability in Europe remains a risk to the U.S. economy, a Treasury official said today during a telephone briefing with reporters. The official, who asked not to be identified as a condition of the briefing, said Lew will want to hear from European officials about their plans to increase growth.

Euro-area leaders are struggling to stabilize the region after a month in which they fumbled a bailout of Cyprus and the euro fell to its lowest level of the year against the dollar. The IMF said April 3 it will contribute about 1 billion euros ($1.29 billion) as part of a 10 billion-euro rescue package for Cyprus.

The first attempt to bail out Cyprus last month sent bank shares tumbling across the euro area and rattled confidence in policy makers' ability to tame the sovereign-debt crisis. Europe is entering its second year of recession, and fragmented financial markets are preventing the ECB's record-low borrowing costs from reaching companies in countries including Spain and Italy.

'Shaky' Union

"The priority for U.S. policy makers is that the euro zone becomes much more integrated and this shaky monetary union is shored up through a real economic and political one," said Nicholas Spiro, managing director of Spiro Sovereign Strategy Ltd. in London.

Lew, in response to questions from senators for his confirmation in February, said the U.S. recovery from the worst recession since the Great Depression has been "affected by headwinds from the euro area." The currency bloc accounted for 18 percent of U.S. exports last year.

3M Co. (MMM), the St. Paul, Minnesota-based maker of products ranging from Scotch tape to dental braces, is among companies forecasting weakness in Europe.

"We're operating pretty steady in the U.S. and Latin America," David Meline, chief financial officer, said at a March 21 conference. In Asia prospects are "more mixed" while Western Europe "continues to have a number of challenges," he said.

EU Meetings

In Brussels, Lew, 57, will meet with EU President Herman Van Rompuy, European Commission President Jose Manuel Barroso, EU Economic and Monetary Affairs Commissioner Olli Rehn, and EU financial services chief Michel Barnier.

Erik Jones, director of European studies at Johns Hopkins University's School of Advanced International Studies in Washington, said Lew will "no doubt" talk with Barnier about plans by Germany, France and nine other EU nations to impose a tax on financial transactions.

The Obama administration has opposed the EU proposal. Lael Brainard, the Treasury's undersecretary for international affairs, met with EU Tax Commissioner Algirdas Semeta in February and raised concerns over whether the tax would harm American investors at home and overseas.

The proposal calls for a 0.1 percent levy on stock and bond trades and 0.01 percent on derivatives trades with ties to participating countries. The measure exempts primary offerings of government bonds. The EU estimates the move could raise as much as 35 billion euros a year.

Trade Partnership

Lew will discuss expanding trade with the EU as part of the Transatlantic Trade and Investment Partnership, which Obama highlighted in his State of the Union address in February, the U.S. Treasury official said.

Lew, Obama's former chief of staff and budget director, also is trying to forge relationships with European leaders. Most of them had known Lew's predecessor, Timothy F. Geithner, from his previous jobs as Treasury's top international official, at the Federal Reserve Bank of New York and the IMF.

"He seems perceived, rightly or wrongly, as a budget expert, and I think it's important for him to get out and show U.S. leadership and show U.S. engagement," said Tim Adams, who held Brainard's position during the George W. Bush administration and is now managing director of the Washington- based Institute of International Finance, which represents the world's largest financial companies.

IMF Gathering

Lew's trip will also allow him to meet his European counterparts less than two weeks before IMF and World Bank meetings starting April 19 in Washington.

U.S. Treasury officials at a meeting the Group of 20 finance ministers in Moscow in February emphasized the need for stronger demand growth to help Europe emerge from its crisis.

"The big worry is: How does Europe get out of this, how does Europe generate growth?" said Nariman Behravesh, chief economist at IHS Inc. (IHS) in Lexington, Massachusetts.

Yesterday Draghi tried to quell such concerns, saying the ECB stands ready to cut interest rates if the economy deteriorates further, and officials are considering additional measures to boost growth.

France's 10-year yield dropped 11 basis points, or 0.11 percentage point today, to 1.76 percent at 4:51 p.m. London time after falling to 1.716 percent, the lowest level since Bloomberg began compiling the data in 1990. Spain's 10-year yield dropped 16 basis points to 4.75 percent, extending their decline this week to 31 basis points. Rates on similar-maturity Italian securities fell as much as 19 basis points to 4.37 percent, the lowest level since Feb. 25.

The crisis-containment approach to Europe contrasts with Lew's visit to China last month, when Lew pressed the country's new leaders on cybersecurity, North Korea and the value of the yuan. He told reporters that the "dominant economic theme was what can be done to generate more domestic demand and more growth."

“Europe is where the downside lies for the U.S,” said Domenico Lombardi, a senior fellow specializing in global economics at the Brookings Institution in Washington. “China is where the upside is.”

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