

A DIVERGING EUROPE ON THE EDGE

This is the third independent Annual Growth Survey (iAGS), each a response to the European Commission's AGS, and we have to take note sadly of the continuation of the crisis. Response to the euro sovereign debt crisis has been substantial, but we analyse that it was not sufficient to give a strong enough momentum to the euro area economy in order lastingly to exit the recession it entered 6 years ago.

Failing to exit the crisis brings many poisons, economic, social, and political. Unemployment is at high levels, inequality is rising, and convergence between European regions that was once the rule is no longer occurring. Pressure on wages and the need to restore internal balances between countries fuels deflation. Debt deleveraging, private or public, is far from accomplished and the prospect of falling prices may be the mechanism by which stagnation is perpetuated. The European project of a prosperous and inclusive society is going to sink if we fail to rebound.

Monetary policy alone can't solve the problem. Fiscal policy coordination still does not work well and its bias toward front loading has to be corrected. In the opinion of the authors, what is needed is to circumvent the rules of the fiscal compact. The Juncker plan is one attempt to do so, by proposing to exclude Member State's contribution from national deficit and debt rules. That is far from sufficient, but it opens the way to find ways to achieve fiscal stimulus while continuing to exert pressure on national public finance. Structural reforms cannot be used as a substitute for a stimulus and the possible short term impact on prices or activity should be considered with extreme care.

The report is organized in 5 chapters, one introduction and a bibliography at the end. Table of content precedes. Chapter 1 analyses the macroeconomic situation, presents our forecast. The debt deflation dynamic is a present concern and the nominal adjustment needed as well as fiscal rules increase this risk. Chapter 2 deals with inequality development in the European Union. End of regional convergence, absolute poverty increases, long term unemployment draw a picture of divergence that goes beyond a sluggish macro outlook. Chapter 3 deals with monetary policy in a fragmented financial system. Monetary policy alone will not change the course of the events, but quantitative easing is to be pushed forward. More can be done, with a monetary financing of public investment. Chapter 4 discuss the necessity of "greening" an investment plan and propose a "carbon fiscal shock" to drive the European economy out of the crisis and toward low carbon pathway. Chapter 5 evaluates the magnitude

of the nominal adjustment inside the euro area. Adjusting only countries in deficit could increase the pressure toward deflation and ask for a balanced adjustment, involving surplus countries.

We hope you find the iAGS 2015 report a stimulating read, on behalf of the iAGS team.

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