CONFRONTATIONS EUROPE N°101 July 2015 Interface

The raise of inequalities at a global level

The raise of inequalities at the global level worries more and more our international bodies. Deflationary pressures and the concomitant fall in interest rates have meant wealth holders have benefited most from the recent situation.

After the OECD, the IMF[1] is now voicing its concern, since inequalities are one of the major causes of the global stagnation of the economy. According to the study, increasing the income of the richest 1% by 1 GDP point decreases global growth by 0.08 points, whereas the same increase for the poorest 20% increases growth by 0.38 points. Almost half of the population (the "poor" and the "middle classes") is now struggling to educate its children.

If the fruits of prosperity cease to be shared, we can imagine the societal tensions – which are nurturing a risk aversion climate. Hence the necessity to raise awareness of an increased need for essential general-interest investments, notably improving access to training and education.

C.U.

[1] Cause and Consequences of Income Inequlities: A Global Perspective, June 2015, IMF

After Greece, where is the next crisis hiding?

While European leaders are busy dealing with the Greek tragedy, fears of Grexit and contagion looming again. Reinforcing the Economic and Monetary Union is undeniably a key work for the coming months; Confrontations Europe will come back on this. But already other alarming signals are beginning to make themselves felt, pointing to the emergence of new threats to growth. Where are the sources of tension? Where is the next crisis hiding?

A first point concerns the international situation. Professor Aglietta raises the issue of the explosion in **global debt in the non-financial sectors,** which continued to rise after 2007 especially the public debt, which is depriving states of their capacity for action. This is particularly true of emerging countries, where debt is quantified in dollars. It is therefore possible to imagine a pessimistic relapse scenario linked with a new dollar cycle, in other words with misalignments in exchange rates and with the global balance of payment imbalances this creates. We are currently seeing a deterioration in US company profits and a resurgence of the US deficit. Is the US economy strong enough to withstand such an extreme appreciation of the dollar?

A second series of questions concerns the **sustainability of current monetary policies (quantitative easing) and the effects of the financial regulation**: are we not responsible for nourishing unwanted effects, as suggested by a recent SwissRe report[1]? This new upsurge in risks is obscured by the massive outpouring of issued liquidity. And the financial markets are facing a paradoxical situation, as economist Nouriel Roubini points out[2], since macroeconomic liquidity has never been more abundant and yet **liquidity** on sovereign debt, exchange and even the credit and equity markets has diminished. Prices no longer reflect the market exactly, but rather the impact that measures taken by central bankers have on expectations. Jamie Dimon of JP Morgan warns against the growth **volatility** of the exchange and public debt markets; the US Treasury Bill and German Bund markets are buffeted by heavy turbulence in just a few hours. Yet central banks are buying government debt on a massive scale, so investors could find themselves short of safe havens for their portfolio, which they are required to have under the regulation. These upheavals cause flash crashes, made more severe by lack of liquidity. The second failing? The huge amounts of injected liquidity are not being invested in the real economy, they are inflating valuations on the financial markets, thus creating a **bubble phenomenon**. All the indices bear witness to this overheating phenomenon, notably in the housing and equity markets. Companies are not investing and prefer to distribute dividends. Larry Fink, Chairman and CEO of BlackRock, points out the risk of excessive levels of dividends and share redemption. By wanting to revive the economy through credit, the central banks have ultimately caused an artificial swelling of asset prices.

The third concern is over the **increase in inequalities at the global level** (see column).

One last point I would like to raise here is the idea that **a lack of global demand hampers recovery.** In other words, too much money is not being invested for want of solutions. Now, more than ever, we need to invest, especially in **infrastructure** generating a high social return. Yet **such investments are not massively happening**. Why? **Poor budgetary governance** (how can we invest when the debt-to-GDP ratio stands at 95%?) and **poor institutional and political governance** (would we know how to spend 50 billion euros effectively even if we had them?) are two factors thought to explain these blocks.

For the sake of completeness, we should finish with the thorny issue of the decline in productivity gains, and we will come back to this later. **Four failures are potential breeding grounds for future crises:** tensions around balances of payments worldwide, financial failures, to share wealth and lack of projects. All of which we would like to see our leaders addressing as a matter of urgency…and the same goes for immigration and the democracy crisis…

Carole Ulmer, Director of Studies, Confrontations Europe

[1] Financial repression: The unintended consequences, 2015 Swiss Re
[2] The Liquidity Time Bomb, Nouriel Roubini, Project Syndicate, 31 May 2015