

Abstract

Macroeconomic adjustment in the Southern countries of the euro area after the financial crisis appears well under way as external imbalances in these countries have almost disappeared. However, in this paper, we argue the underlying structural problems persist and recovery is fragile. Both sovereign debt and external debt are approaching sustainability thresholds and indications of substantial structural reform are insufficient yet for the Southern countries. Prospects for higher growth in the near future are dim, due to lack of economic reforms, private and public debt overhang and imposed austerity programs. Moreover, the observed adjustment is strongly asymmetric and leads to more rather than less divergence. Overall, we feel the chosen approach will prove to be unsustainable and infeasible in the near future. To defend the euro and the euro area, a new approach is urgently needed.