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# World economic outlook darkens

By Chris Giles



So acute are the risks that few economists are now willing to bet heavily against another global recession in 2012. By common consent, the world economic outlook is much darker today than it appeared in the early autumn.

The eurozone crisis has worsened with contagion spreading through Italy and Spain and now lapping at the door of France.

Recoveries remain feeble in other advanced economies. And emerging markets are beginning to feel the pressure.

Policymakers are worried. Christine Lagarde, managing director of the International Monetary Fund repeatedly warned in September that the world economy had entered a “dangerous phase”. By December, she said those threats were materialising. “The global economic outlook will be lower, and in certain parts much lower than what we had initially envisaged,” she told journalists this month in Brazil.

Deeper gloom has infected the Organisation for Economic Co-operation and Development, particularly with the response of advanced-economy politicians. Pier Carlo Padoan, its chief economist, said: “We are concerned that policymakers fail to see the urgency of taking decisive action to tackle the real and growing risks to the global economy.”

And that grim assessment is shared by economists in the private sector. As Goldman Sachs marked down its latest forecasts, Jan Hatzius, its chief US economist, said that growth was being held back in many developed economies by higher taxes and efforts to pay back household and corporate debt. “That combination is likely to see another two years of sub-par growth in the major advanced economies, extending into 2013,” he argued.

The verdict of Eswar Prasad, of the Brookings Institution, was even bleaker. “In early 2009, it was difficult to come up with a glimmer of hope. Here we are again. But what is different now is that the crisis of 2008 has created a huge debt burden, so constraints on policy are much tighter now.”

**Consensus forecasts for real GDP growth in 2012**



Source: Consensus Economics

But as the forecasters fret about 2012, not all of the world is yet suffering. Even in Europe, German employment hit another post-unification high in October, highlighting the disconnect between its current prosperity and the pain in the eurozone periphery.

Although forecasts are being revised down by the week, economists still generally expect the world economy to grow by a little more than 3 per cent in 2012 – down only 1 percentage point from 4 per cent in 2011, with a large majority of that expansion coming from emerging markets.

The centre of the current crisis is Europe, where economies both in and around the eurozone appear on the verge of recession. With the hopes dashed that a “bazooka” could prevent contagion spreading to Italy and Spain, governments, households and companies face high interest rates in much of

Europe even if official borrowing costs are again at historic lows.

Few expect the eurozone to recover quickly, with most forecasts now expecting contraction in the eurozone economy at the start of 2012 and near stagnation in countries, such as the UK, surrounding the single currency area.

The great concern is that an economic downturn will exacerbate the stresses in the sovereign debt and bank funding market, which are far from solved, creating a vicious downward spiral akin to 2008 and the potential collapse of the euro.

With the money supply contracting at the fastest rate since early 2009, Neville Hill, of Credit Suisse, observes, that “for institutions that set great store by monetary indicators – the European Central Bank and the Bundesbank, for example – that should be an alarming signal”.

Most observers still expect the euro to survive, but not because policymakers have solved the manifest problems. The most that many thought last week’s summit would change was to turn the crisis from what Gavyn Davies, of Fulcrum Asset Management, described as an acute crisis to a “chronic phase”.

In the US, the world's other huge advanced economic area, most economists still expect the country to enter election year in modest recovery mode. With unemployment falling and recent growth rates higher than in Europe on the back of higher consumer spending, recent survey data have pointed to continued growth at unexciting rates.

But a quiet year is far from guaranteed as election season approaches, political brinkmanship rises and the US is buffeted by the European storms. Willem Buiter, chief economist of Citi, argues that even with modest expansion, "we do not expect that US growth will be strong enough to pull unemployment materially lower in 2012-13".

So long as Europe staggers along, most important to the continuing outlook, says Julian Callow, of Barclays Capital, is that Congress extends the payroll tax cut, scheduled to expire at the end of 2011.

As the advanced world contemplates another year of disappointment, the engine of the global economy has moved ever more decisively to large emerging economies.

Gerard Lyons, of Standard Chartered, says the western fundamentals are poor and confidence is shot. "In contrast, across the emerging world, the fundamentals are good, the policy cupboard is almost full and confidence is likely to prove resilient."

But even these emerging economies are not problem-free. China, by far the most important, accounting for over 40 per cent of global growth in 2011, according to Nomura. "No wonder we are so concerned about the risks of a hard landing in China," says Paul Sheard, its chief economist.

It is feeling the slowdown in the rest of the world and the authorities are beginning to worry about their ability to sustain growth. At least, says Qu Hongbin, of HSBC, inflation is moderating increasing the scope for stimulatory policies. "The major macro risk in China is quickly shifting from inflation to disinflation, calling for more aggressive easing in policy going into next year," Mr Hongbin said.

Such policies worked in 2009 to increase infrastructure spending, investment by state-owned enterprises and housebuilding and are likely to work again, even if such capital spending does nothing for the longer-term aim of rebalancing the global economy.

Elsewhere in the emerging world, growth is continuing but also at slower rates. Eastern Europe, including Turkey, is particularly vulnerable to the eurozone crisis and its banks are seeking to pull funds home. Growth in Latin America is slowing rapidly as

the commodity boom levels off, while Africa, despite a hugely improved performance, is highly vulnerable to a global slowdown.

In all, the world remains a dangerous place with advanced economies a long way from recovering from the 2008-09 crisis and huge uncertainty over the scope of the emerging world to generate self-sustaining growth. Following robust recovery in 2010, this year has been a huge disappointment.

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