# International Outlook for 2013

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Because of weak growth, 2012 is not going to be remembered as the year where the major advanced economies rebuilt confidence in their medium-term prospects. With deficient confidence in the advanced economies, uncertainty will once again dampen our global growth forecast in 2013. As a result of the cautious growth expected out of the emerging economies and the uncertainty in the advanced economies, the global economy is expected to grow at just 3.6 percent this coming year.

This article looks at what some economists are preemptively calling the perfect storm of 2013 and will shed light on the threats for the global economy.

Our economic environment in the second decade of the 2000s is perceived differently from the first one. First, what the subprime financial crisis made apparent to all of us is that we, as American citizens, are living beyond our means. By exposing the extent of our global interdependence, the crisis highlighted the weaknesses of the banking system and demonstrated how the interdependence compounds the systemic risk prevalent in a weak financial market. This weakness obviously threatens not only the financial institutions of Europe, but global institutions as well. Secondly, the U.S. policy response to the subprime crisis, followed by the European sovereign crisis, revealed that many developed countries' governments are also living beyond their means. Finally, the frequency and intensity of the turmoil in the Middle East, and in particular the instability brought on by Iranian politics in the region, is creating volatility as leading economies, like the United States, the European Union (EU), China, India and Japan, are net importers of oil.

**Table 1: Projections for Advanced and Emerging Economies, 2010 to 2013**

| Geography | Actual | | Projections | |
|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 |
| **World Output** | **5.1%** | **3.8%** | **3.3%** | **3.6%** |
| **Advanced Economies** | **3.0%** | **1.6%** | **1.3%** | **1.5%** |
| United States | 2.4% | 1.8% | 2.2% | 2.1% |
| Euro Area | 2.0% | 1.4% | -0.4% | 0.2% |
| Germany | 4.0% | 3.1% | 0.9% | 0.9% |
| France | 1.7% | 1.7% | 0.1% | 0.4% |
| Italy | 1.8% | 0.4% | -2.3% | -0.7% |
| Spain | -0.3% | 0.4% | -1.5% | -1.3% |
| Japan | 4.5% | -0.8% | 2.2% | 1.2% |
| **Emerging and Developing Economies** | **7.4%** | **6.2%** | **5.3%** | **5.6%** |
| China | 10.4% | 9.2% | 7.8% | 8.2% |
| India | 10.1% | 6.8% | 4.9% | 6.0% |
| Brazil | 7.5% | 2.7% | 1.5% | 4.0% |

Source: International Monetary Fund, *World Economic Outlook*, October 2012

## Uncertainty Created by Higher National Debt in the Advanced Economies

Large public debts almost always lead to higher long-term interest rates, higher future taxation, higher inflation, greater uncertainty and, therefore, greater vulnerability to crises. With these threats in mind, the large public debt in the advanced economies is likely to have an adverse effect on investment, productivity and economic growth.

In the United States, the inability of Congress to plan a way to change the path of our public debt will hurt us in the long run, but in the very near future it forces us to face a "fiscal cliff." The fiscal cliff refers to the expiration of Bush-era tax cuts (threatening consumer's disposable income) and the launch of automatic annual spending cuts spread over the next decade (threatening the government's ability to pull the economy to growth), which will lead to a recession in the first two quarters of 2013.

The situation in Europe is also very concerning. On one side, the southern economies (such as Greece and Spain) are displaying austerity fatigue; on the other side, the northern economies (such as Finland and Germany) are displaying bailout fatigue. This could very well result in an exit of the eurozone by either Greece (debtor) or Finland (creditor). Given the history of Europe, the big two (France and Germany) need to avoid a disorderly breakup of the eurozone. Meanwhile, the periodically resurfacing fear and panic of a disorderly European breakup raises the borrowing costs for the most fragile economies and threatens to push those countries into insolvency, which would create further problems for Europe's economy. This is why Europe's growth forecast is very guarded even at 0.2 percent.

Japan's debt, by virtually any measure, is the highest in the world. Complicating the matter, the country's aging population and the cashing of their pensions is putting further strain on Japan's ability to maintain a sustainable trajectory of their public debt. This growing strain will continue to decrease business sentiment and has diminished the growth prospects of Japan, which is forecasted to grow at 1.2 percent in 2013.

## Uncertainty Created by the Banking System in the Advanced Economies

Every financial crisis shows the same vicious spirals: when the banks are in trouble, credit rationing follows, growth weakens and the government steps in to prevent a bigger liquidity crisis. Then, the intervention of the government affects the sovereign debt level, and this in turn further weakens the banks. When the banks are weak, they lend less—which hurts consumption and business investment—and then the government gets stretched more, which grows government debt held by the weak banks.

In the United States, we seem to have cleaned up the excesses where they existed and are in the process of creating a buffer such as the Dodd-Frank Act, which is a regulation intended to promote the financial stability of the U.S. by improving accountability and transparency in the financial system and ending abuses of the financial system under the "too-big-to-fail" clause. But in mid-2012, JP Morgan's significant risks and losses clearly revealed that despite the Dodd-Frank Act, "too-big-to-fail" and the financial risks that come with it continue to represent a threat for the taxpayers despite increased regulation of the financial industry.

In Europe, the weak banking problem is apparent and imminent, so it is time to clean up banks' excesses. Any solution to reducing the excesses is going to be costly to the creditor countries (their taxpayers) and dangerous in terms of added moral hazard. Europe needs a stronger central supervision and the mutualization of some liabilities in the banking sector. Mutual liabilities can be created through a joint European fund, which would mimic the FDIC's role in the U.S., and then be used to re-capitalize the failing banks. This solution may prove too costly to implement, and thus Europe may search indefinitely for an answer to keep the eurozone intact.

## Uncertainty Created by Weakened Growth in the Emerging World

China is expected to be the driver of global growth as it has been in the past decade. Despite global pessimism, China is forecasted to grow 8.2 percent in 2013. The downside risks of China's two major trading partners, the U.S. and the EU, threaten China's ability to hit its forecasted growth rate. Furthermore, China has been a growth model plagued with distortions, including the influence of the state in controlling key prices such as interest rates, the exchange rate and natural resource pricing. In addition, distortions occur since the state has a majority stake in enterprise ownership and tends to politicize investment decisions, artificially spur export-led growth and favor manufacturing over services.

After strong growth peaking in 2010, Brazil has been slowing ever since and is forecasted to grow at 4 percent in 2013. Much has to do with external factors brought in from the global economic slowdown; nevertheless, the internal economic woes of this country continue to stem from the "Brazil cost" (specifically, the high cost of doing business in Brazil is brought on by its mix of high taxes, high labor costs, infrastructure bottlenecks that strangle businesses facing stiff competition abroad, as well as high interest rates).

## Conclusion

Our forecasted global growth of 3.6 percent is assuming that the major global economic threats are kept in check: namely that the U.S. finds a solution to its deficit problems and that the eurozone maintains a somewhat stable economic climate. If not, as Nouriel Roubini predicted, it will create a perfect storm and lead to another global contraction.