

International Outlook for 2012

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The significance of international trade to the U.S. economy, as well as the world economy, is undeniable. For decades, the U.S. has led the world in imports, while it has also remained one of the top three exporters. According to a recent paper from the National Bureau of Economic Research, the rise in U.S. exports since the end of the last recession contributed more than 50 percent to the growth of U.S. gross domestic product (GDP). Exports from the United States tend to respond to GDP growth in the rest of the world, as well as to the international value of the dollar.

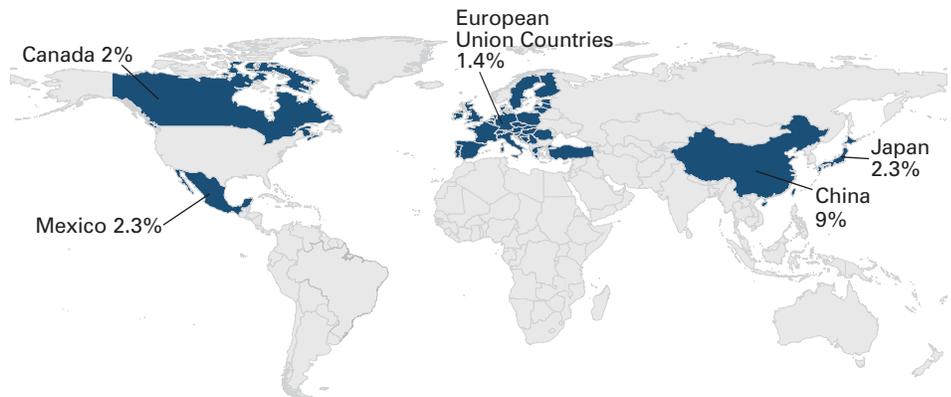
The main export partners of the U.S. are Canada, the European Union, Mexico, China and Japan. This article will provide a forecast of the global economy in 2012 with an emphasis on these trading partners since they are greatly affecting the U.S.'s path to a timid recovery. More than ever we are observing the inter-linkages of the world's economies.

The economic growth around the world looks to remain relatively stable in 2012. The International Monetary Fund projects the world's output to grow at 4 percent. This growth is powered by the emerging economies, while the developed world is lagging behind again this year.

China

China's outlook is positive but slightly slower than the previous two years. The world's second-largest economy is forecasted to grow at 9 percent. Due to its export-oriented economy, China is affected by an economic slowdown in its key trading partners—Europe and to some extent the United States. The slowdown in the Chinese growth is also partly policy driven, as the People's Bank of China is expected to

FIGURE 1: Projected GDP Growth, 2012



Source: International Monetary Fund

further tighten its monetary policy—particularly its foreign exchange rate policy to keep inflation under wrap. Other challenges for China include policies to disincentivize domestic savings (such as creating a welfare state) and further rely on domestic demand for growth. Finally, if the tightening regime continues it will help keep the dollar's value low and rebalance trade between the U.S. and China.

Canada

Canada is likely to outperform most of its peers with a growth forecast of about 2 percent in 2012. The fundamental drivers for growth—sound fiscal and economic management—are in place in the Canadian economy. Additionally, the abundance of natural resources that the world economy strongly demands has put Canada in a healthy trading position. Canada experiences a significant positive “wealth shock” when commodity prices rise and the macroeconomic resilience of the Canadian economy has prepared it to withstand negative price shocks. A decrease in commodity prices should not in itself trigger disruptive forces. However, external threats are great and potential spillovers

from the European debt crisis and fiscal hangover in the U.S. and Japan heighten the downside risks to the growth. These external threats have somewhat depressed Canadian businesses and consumers' confidence.

Mexico

After contracting 6.2 percent in 2009 and growing 5.4 percent in 2010, Mexico's GDP will expand 3.8 percent this year and 2.3 percent in 2012. Thanks to the North American Free Trade Agreement, Mexico's manufacturing industry is highly integrated into the U.S. industrial production chain, as 80 percent of Mexican exports are bought by U.S. households and businesses. Mexico's economic health is strongly tied to that of the United States. Therefore, Mexico's challenge is to be able to withstand a slowdown in their wealthy neighbor's economy by getting a bigger chunk of the American economy. The rising value of the yuan has contributed to lifting up Chinese wages and the high oil prices are making shipping costs from Mexico relatively more affordable. Those factors will contribute to Mexico regaining the biggest share of American imports.

However, the spike of violence in the north of the country may become a threat to the foreign direct investment that the country continues to rely on.

European Union

In the spring of 2011, the financial tensions in the European Union (EU) surged again, with significant tension in the periphery countries (Ireland, Greece, Portugal, Spain and Italy). Like the United States, the EU faces very substantial government and private-sector debt, much of which is now clearly not repayable. Some of those debts are held in the United States, but most of it is held by the European banks and the European Central Bank. The biggest threat is that the Greeks, the Portuguese and the Italians will default on their debts, in which case German and French lenders would be the biggest losers. But if Greece leaves the European Monetary Union, it may prompt the others to follow. This would be a legal and financial disaster for all parties concerned and would jeopardize the global economy as the EU's share in international trade is the most important in the world. Its financial sector is one of the world's largest, with significant banking exposures to other countries, and the euro is one of the major reserve currencies.

If Greece were to leave the European Monetary Union, capital would fly out of the country. In fear of a domino effect, deposits would run out of the periphery EU states; this unprecedented financial chaos would certainly trigger a deep recession. Germany, and to some extent France, would see an inflow of capital that will drive up the euro exchange rate and hurt the export-driven German economy for some time. The financial spillovers to other countries outside the EU would be limited, but the contagion through the trade channel would be

considerable around the world as a result of Europe being integrated in a larger trade zone.

Japan

Japan has suffered more than two decades of subpar economic growth and is set to experience a mild contraction in 2011. The country is struggling with high debt that has been further exacerbated by the devastating effects of the earthquake and tsunami of March 2011. However, Japan's distribution channels have been restored faster than expected, thereby limiting adverse spillovers to trade partners. At the moment, Japan is faced with a strong yen (mostly due to its current account surplus) and deteriorating overseas developments. Both issues are likely to dampen the growth forecast of 2.3 percent for 2012. Like virtually all the advanced economies, Japan has to balance its competing policy actions by 1) controlling the level of government debt and 2) spending to stimulate its slowing economic recovery.

Summary

Given the turbulent economic times in which we live, the downside risks for the global economy are greater than the upside opportunities. Politicians in Europe need to choose between a costly solution and a potentially ruinous one for the euro zone. Within the United States, partisan politics in the run-up to the election have taken precedence over enacting sound economic policy reforms.

Ultimately, the world's economy cannot count on the usual safeguard of growth from the emerging markets, as they are currently overheating and rightfully slowing after their rally from the most recent global recession. Globalization makes domestic economies vulnerable to costly backlashes, as we are currently

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experiencing, but increased trade has been transformative for all our economies. History has shown that when trade partners simultaneously devalue their currencies in an attempt to stimulate economic growth or enact protectionist trade barriers to aid their ailing domestic businesses, the efforts usually fail. Such policies rarely stimulate domestic economic growth and often serve to stunt global economic output. ■