International Outlook for 2010

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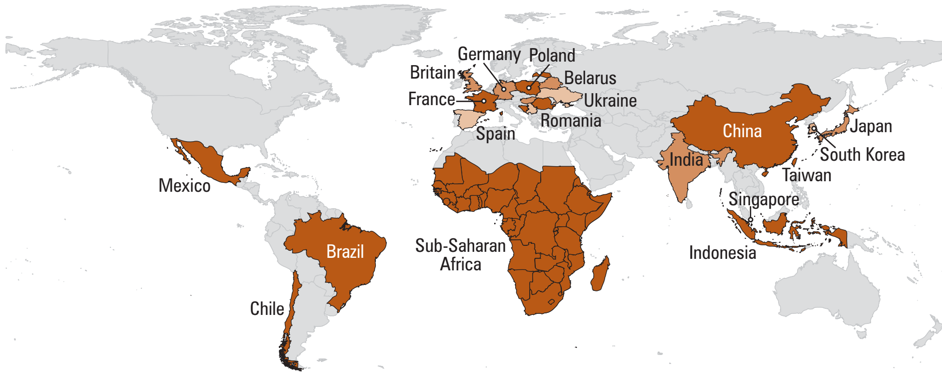

In 2010 the global economy is expected to make a slow recovery, expanding at a predicted rate of 3 percent, while employment and credit will remain strained. Furthermore, there are many downside risks and adverse scenarios that could materialize, such as an untimely unwinding of fiscal and monetary policies in rich nations.

Introduction

Our latest recession was born out of a synchronized financial crisis; much of the world happened to be in recession at the same time and this has made recovery more difficult. The good news is that we ended the free fall, but it would be a mistake to think that we are well on our way to a robust recovery. By definition, a recession is a business cycle contraction—a negative growth of gross domestic product (GDP). When the economy grows again, no matter how small, economists will say that we are over the recession; however, for ordinary people, the end of a recession is when they can get a job or feel secure in their current employment again.

How long are we going to have to wait before output grows fast enough to create jobs? A careful International Monetary Fund (IMF) report on eighty-eight banking crises in the last forty years was submitted to the leaders of the twenty most powerful countries at the annual G-20 meeting held in September 2009 in Pittsburgh, Pennsylvania. The conclusions were dismal as the report showed that the global financial crisis is likely going to hinder economic growth for quite a long time. The study showed that seven years after a financial crisis, output had declined relative to trend by 10 percent on average. In other words, seven years after the bust, a country's level of production was on average 10 percent below where it would have been without the crisis. The report said that lower employment, investment, and productivity are all contributing to sustained output losses.

Given the turbulent financial environment surrounding the global economy described above, I will now turn my attention to more detailed analysis of several economic regions around the globe, their most recent economic performance, and their outlook for 2010.

Advanced and Emerging Asia

The financial turmoil that originated in North America and Europe eventually hit Asia with great force. Among the major Asian economies, only China, India, and Indonesia did not experience contraction during the crisis. For the region as a whole, the economic contraction was sharp as GDP dropped an average 8.5 percent in the last quarter of 2008—with the economic activity in the newly industrializing economies (the four Asian Tigers: South Korea, Singapore, Hong Kong, and Taiwan) falling more than 15 percent. But just as the fall was quick and sharp, the rebound in the region has been rapid and strong. In fact, Asia is leading the global recovery, with China and India in the forefront. The Economist Intelligence Unit estimates a growth in GDP equal to 8.2 percent in China and 5.5 percent in India.

For the export-driven economies, such as South Korea, China, and Japan, the recovery is primarily the result of growth in domestic demand, supported by fiscal and monetary policies, rather than growth in demand from trading partners outside the region. More specifically, South Korea, China, and Japan's crisis-related fiscal measures were significantly greater (as a share of their GDP) than the advanced economy's average. Furthermore, as those countries came to the crisis with strong economic fundamentals (low inflation, favorable fiscal and current accounts) their policy actions were quite effective and have led to significant increase in the intra-regional trade. But even as these economies recover, they will remain under repair. For example, the expansion of China's government into health care and pensions will be a pertinent move to reduce households' precautionary motive for saving. It will result in an improvement of the national welfare and productivity and it will also contribute to a more balanced and sustainable economic growth that is less dependent on exports to Europe and the United States.

Europe

The financial fiasco that began in 2008 was economically devastating in Europe where GDP was contracting at a rate of 4.8 percent in the second quarter of 2009. Nevertheless, with positive last quarter results, Germany and France are currently pulling the area to a timid growth expected in 2010. The 2010 forecast is positive for most European countries. But some economists believe the recent crunch may have firmly established unemployment in the region, including Britain where the latest data show 7.9 percent unemployment. In Spain, the unemployment rate is currently around a staggering 18.9 percent, with a gloomy forecast in the months to come.

The housing bubble burst adversely affected countries with huge investment in the construction industry, such as Spain and Great Britain. The sharp decline in global demand affected export-driven countries, such as Germany, and the financial system debacle drove the IMF to bail out Iceland that was incapable of repaying its debt. The IMF had to respond to the crisis with a record lending commitment to small, export-oriented countries that are highly dependent on foreign capital inflows, such as Belarus, Bosnia-Herzegovina, Hungary, Latvia, Poland, Romania, Serbia, and Ukraine. Ultimately, the monetary actions taken by the European countries' central banks, the support that the banks received from the governments' financial bailouts/stimulus plans, as well as the major fiscal stimulus programs from the European governments to their citizens, have contributed to reduce uncertainty and increase confidence. This has led to a visible, but fragile, improvement in economic conditions.

Latin America

This is the first time Latin American economies have performed better than other economic regions in the face of strong global financial turbulence. The policy reforms adopted in recent years have prepared the region to resist external shocks better than they have in the past. Moreover, the resilience of the region can be explained by the change in the economic linkages between Latin America and the rest of the world. The top economy in the region, Brazil, is leading the economic recovery with a predicted 2010 growth of 3.8 percent. This is due in part to its large domestic market and Brazil's increased partnership with China, who is now Brazil's number one trading partner. Similarly, Chile, who signed a free trade agreement with China in 2005, is seeing new opportunity for recovery as China's demand for copper and other commodities is growing again.

The one major blemish on the Latin American economic region has been the performance of the Mexican economy. Thanks to the North American Free Trade Agreement, Mexico's economic health is strongly tied to that of the United States, as 80 percent of Mexican exports are bought by U.S. households and businesses. The Mexican economy was the hardest hit in the region, and it is projected to see an output contraction of 7.1 percent in 2009. The H1N1 virus further reduced revenue from the tourism sector in Mexico starting in the spring of 2009, and a drop in remittances from the United States is driving a significant amount of Mexicans to fall below the poverty line. Nevertheless, the Mexican economy is expected to recover in the last quarter of 2009 and the Economist Intelligence Unit predicts a growth in gross output of 3 percent in 2010.

Sub-Saharan Africa

Despite the more positive global outlook, it is certainly unclear whether or not Africa has seen its worst days. As the world's largest and second most-populous continent after Asia, Africa still represents the largest proportion of the world's poor. The sharp decrease in foreign direct investment and credit flows in Africa will have lasting consequences on its capacity to develop in the years to come. Africa needs and should continue to receive international support through the IMF and the World Bank. However, without its own institutions taking personal responsibility and accepting the many challenges to promote economic growth, Africa will continue to be marginalized economically. The sub-Saharan African economies have the potential to benefit from global economic growth when it materializes, with high-scale global events such as the 2010 FIFA World Cup hosted in South Africa. Unfortunately, if the domestic political institutions do not improve, the potential will not be reached.

Conclusion

We have observed with the current financial crisis that the emerging economies are growing faster than the high-income countries because the emerging economies have developed an ability to generate growth internally. However, it is very unlikely that a robust global recovery could happen without a robust recovery in the high-income countries. Overall, we are in a very fragile state of recovery as the unemployment rates around the globe are still going up and the expected unwinding of the monetary and fiscal policies leaves us uncertain whether the private sector will be able to pick up the slack. Furthermore, as political and economic leaders around the world question the viability of the dollar as the international reserve currency, the turmoil over the dollar may soon become a public policy issue in the United States.