

# Global Economic Outlook

## Hope rests with policymakers

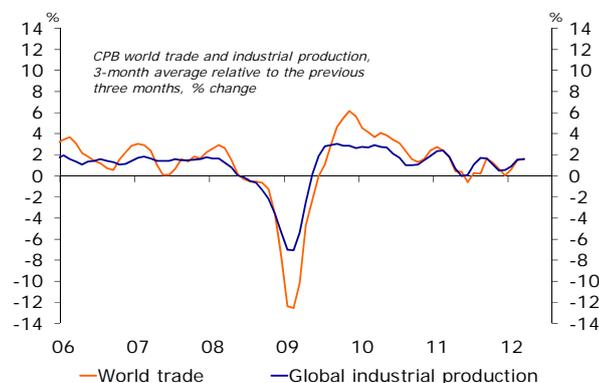
*The global economy started 2012 reasonably well. The growth of world trade and global industrial production was higher in the first quarter than in the previous quarter. However the available data for the second quarter point to less favourable economic conditions. We expect there to be a new mild upturn in growth in the second half of the year. But this depends very much on the efforts to deal with the crisis in Europe and economic policy elsewhere in the world.*

### Sometimes things go a bit better...

After a sharp slowdown in the last quarter of 2011, quarter-on-quarter growth in world trade and global industrial production picked up again in the first quarter (figure 1). The emerging Asian economies continue to play a very important role in global economic developments (figure 2).

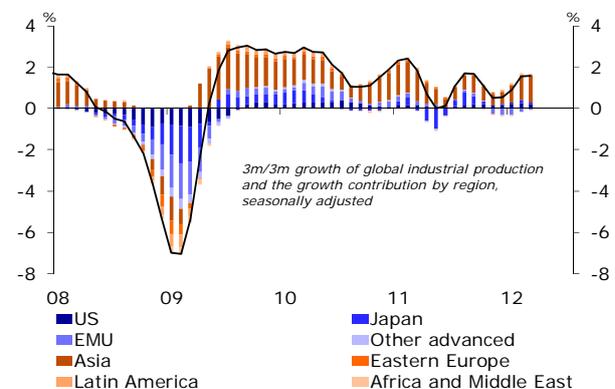
Apart from the higher global trade and production growth, growth in the volume of GDP was also stronger than expected in several regions in the first quarter of 2012. While US growth was weaker than in the last quarter of 2011, the slowdown was less severe than we had expected. In Japan, GDP growth was higher than we had expected. The continuation of the economic contraction that we had forecast for the eurozone did not occur, with the GDP volume remaining unchanged. Growth in the United Kingdom was disappointing, as we had not expected a second consecutive quarter of falling GDP volume there. The fall in growth in China was sharper than expected. On the other hand, other parts of Asia benefited from the extremely strong growth in Thailand, where the economy recovered from the damage done by the floods in the last quarter of 2011. All in all therefore, not a bad start to the year. However these relatively positive developments have not caused us to become more optimistic regarding progress in the year as a whole.

Figure 1: World economy picks up



Source: CPB

Figure 2: Asia still dominant



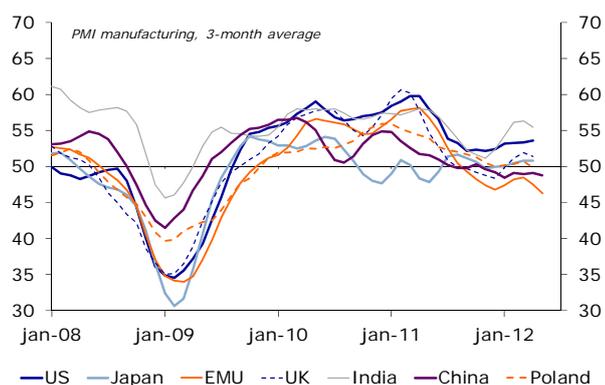
Source: CPB

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## ... only to get worse again later

Economic growth in Asia will slow again in the second quarter, since part of the strong growth in the region in the first quarter was due to a recovery in the

**Figure 3: Economic weakness continues**



Source: Reuters EcoWin

production chains that were disrupted by the floods in Thailand in October 2011. In China, industrial production growth fell sharply in April and the purchasing managers' index (PMI) for the manufacturing industry until the end of May remained at a relatively low level (figure 3). After the slowing of growth in the first quarter, it looks as though the Chinese economy will lose further momentum in the second quarter of 2012 as well. In the US, quarterly economic growth will continue at the relatively slow average rate seen last year for the rest of this year.

After a better-than-expected performance in the first quarter, Europe is still likely to undergo a fresh contraction. The lack of a contraction in the first quarter was a boost for the monetary union that is suffering from the debt crisis. Sentiment in the financial markets in the first months of the year was much better than towards the end of 2011. This period of relative calm in relation to the debt crisis also allowed consumer and producer confidence to strengthen. However the calm was short-lived. A new decline in the composite purchasing managers' index in April and May points to a contraction in eurozone GDP in the second quarter. In addition to a continuing recession in Southern Europe, Germany and France will probably not be able to avoid a contraction in economic activity. While the political debate over austerity versus stimulating economic growth in Europe seems to be moving more in the direction of growth, we do not expect any significant measures to support economic growth in the short term. In the United Kingdom as well, the government is still adhering to the same austerity strategy that retains the upper hand in the eurozone.

## Hope rests with the policymakers ...

We expect to see a mild uplift in global economic growth in the second half of the year. Higher growth in the emerging Asian economies is of crucial importance for this scenario and growth here is expected to disappoint still in the second quarter. However the Chinese government has recently announced measures to support economic activity, and we believe these will succeed, so that the Chinese economy will regain strength in the second half of 2012. While the differences are great, governments and central banks in other emerging economies also have room to stimulate the economy.

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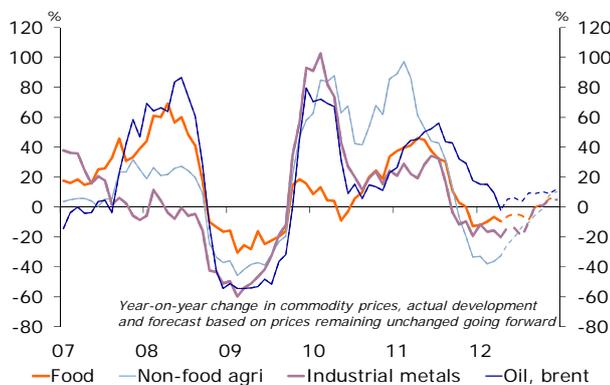
This potential for policy easing will increase further in the coming months, because the fall in commodity prices (figure 4) will lead to a reduction in global inflation. However we should not forget that as a result of the huge variances in growth in past years (figure 5) the emerging economies will relatively quickly reach their upper limits in terms of production, so that inflation driven by domestic wage pressure can accelerate relatively rapidly. There is thus a limit to what we can expect from this fast-growing part of the global economy.

The room for policy measures in the US and Japan is extremely limited. Both countries have high budget deficits and high levels of government debt. There is thus no room for a boost to the economy in the form of government spending. The policy rate in both countries is already more or less 0%. Both central banks will make further efforts to support the economy through alternative policy measures this year, although these cannot be expected to have any great effect. Economic growth will remain at a relatively modest rate in both countries, and will amount to around 2% for the whole of 2012. While this is weak, particularly for the US, growth will continue. Together with stronger growth in the emerging economies, this will keep global economic growth on track, which will in turn support export growth in the eurozone. For the southern member states, this will not be enough to compensate for the contraction in domestic spending, but it will be enough push the eurozone as a whole back to mild growth. This will also allow domestic spending in the stronger eurozone countries to increase further.

## ... but things can still go wrong

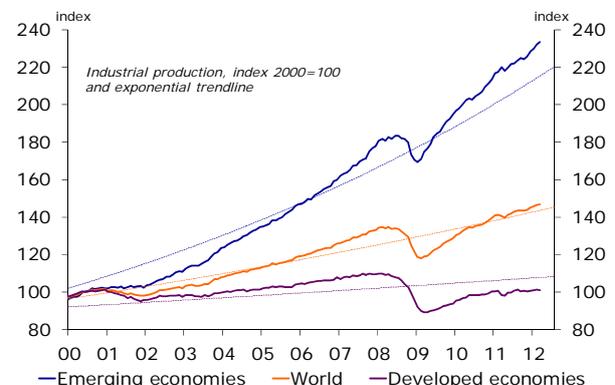
Our expectation that continuing economic growth in the rest of the world will support the eurozone economy is highly dependent on global political developments.

Figure 4: Decline in commodity prices



Source: Reuters EcoWin

Figure 5: Large differences in growth



Source: CPB, Rabobank

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The biggest risk is the European debt crisis. The turmoil in the financial markets will most likely continue until the new Greek elections to be held on 17 June. A bad result could lead to a further escalation of the problems, in which case the eurozone recession will last longer, and may also deepen. Furthermore, the possibility that Spain will have to appeal to the European bail-out fund has recently risen. This raises new doubts as to whether the support measures in place are sufficiently extensive and effective. If European policymakers fail to bring calm to the situation this could lead to a further escalation of the euro crisis in Europe, and also to lower economic growth in the rest of the world. This will immediately undermine the potential for export growth in the eurozone.

In addition to the obvious risks in Europe, the government finances in the US and Japan could also be problematic. There is currently little activity on reducing the budget deficit in the US as a result of the presidential elections in November. However if the new president fails to take action, under the current agreements there will be heavy automatic cuts in government spending. Things will also have to be put right in Japan at some time. Higher taxes on consumption or other measures to reduce the budget deficit that so far have been postponed could negatively affect growth here.

A final uncertainty concerns commodity prices that we mentioned earlier. These have fallen sharply since the beginning of the year, due to the moderate outlook for the global economy and the return of relative calm to a number of oil-producing countries. Renewed political tensions or poor harvests could generate sharp increases in the prices of oil and food very rapidly. If this were to happen, the room for policy measures apparently now available to central banks in emerging markets could become limited.

## **Weak or worse**

As a result of the limits to growth in the emerging world, the weak growth in the United States and Japan and the continuing problems in Europe, the global economy will perform slightly worse in 2012 than in 2011 and next year, even if the risks do not materialise, it will do only slightly better. With expected growth of global GDP of 4% or less, this year and the next the world will fall far short of the growth percentages of just below or even higher than 5% achieved in the years before the global financial crisis. And it should be clear that there is a significant possibility that growth will turn out to be even weaker.

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