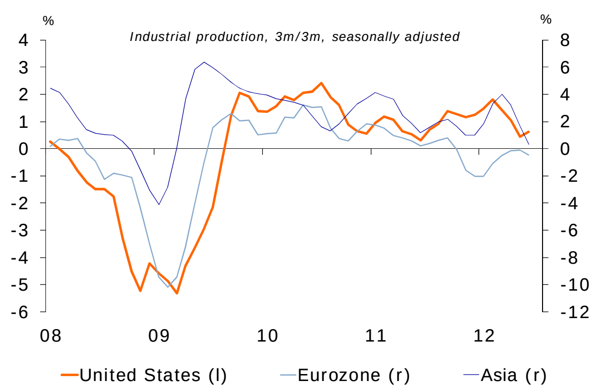
Growth differences remain intact

In many regions, real GDP growth slowed in the second quarter of 2012 compared to the first quarter. Sentiment indicators moreover as yet show no sign of an improvement. After expected growth in the global GDP volume of 3¼% in 2012, we are forecasting only a slight acceleration for next year to 3¾%. Once again, it will be the emerging economies that will achieve relatively rapid growth and moreover will have potential for economic stimulus. In the US, Japan and especially Europe, recovery from the recession in 2008/2009 will remain extremely slow.

Contagion from the European debt crisis is spreading

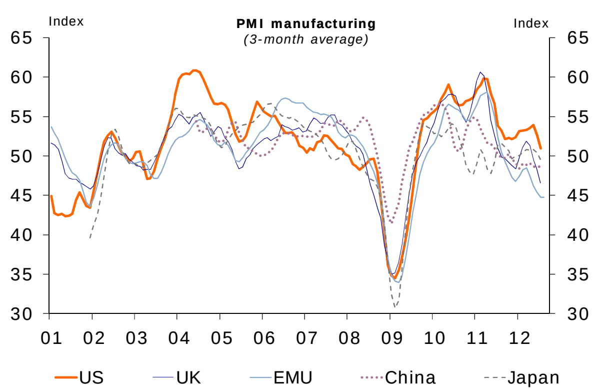
It became even clearer in the second quarter of the year that the effects of the European debt crisis are not restricted to the economy of the eurozone. In combination with a global slowdown in growth, the euro crisis has had a negative effect on the US stock market and on consumer and producer confidence. The lower growth of real Gross Domestic Product (GDP) in the United States in the second quarter shows that the recovery is losing momentum. There was also a deterioration in the United Kingdom in the second quarter, although the sharp contraction in GDP volume there can partly be attributed to temporary factors. Lower demand from Europe and the US also has implications for the export-driven Asian economies. Both Japan and China experienced slower growth in real GDP in the second quarter, due in part to lower export growth. Figure 1 shows that in the second quarter, industrial production was weak in the US and most of the Asian economies as well as in the eurozone. In Asia, industrial production came close to a contraction on a quarterly basis for the first time since early 2009. Slower growth in the US and Asia in turn affected the eurozone through lower growth in world trade. Quarter-on-quarter growth of world trade slowed from +0.8% in the first quarter to +0.3% in the second. While the contraction in real GDP in the second quarter in the eurozone was less severe than expected, it is clear that this region is also suffering from the global growth slowdown.

Figure 1: Global weakness in industry



Source: CPB World Trade Monitor

Figure 2: Widespread weakening of sentiment



Source: Reuters EcoWin

Global economic outlook

Sentiment indicators show that global economic growth cannot be expected to pick up in the short term. After the sharp deterioration in sentiment among purchasing managers (PMI) in the eurozone in April, this confidence indicator has stabilised in recent months. However sentiment in the manufacturing industry in the US and the UK has cooled significantly since then (figure 2). The worsening of the provisional Chinese PMI for the manufacturing industry in August also shows that the slowdown in growth in Asia could continue in the third quarter.

Europe still self-absorbed
Much attention will be focused on the European Central Bank (ECB) in the coming period, in the hope that it can deal with the European debt crisis. While the conditional commitment of ECB President Draghi – which implies that the ECB will purchase peripheral government bonds if a country receives financial support from the European bailout funds – has increased the likelihood of Spain receiving effective financial support, the extent to which this can restore calm to the financial markets remains uncertain. We do expect European policymakers to continue making gradual progress, whereby an exit from the crisis will finally come closer. A recovery in the serious deterioration in consumer and producer confidence is however not likely any time soon. For now, their cautiousness will indeed continue to be fed by factors including the uncertainty regarding financial support for Spain and Greece. Combined with the continuing climate of austerity, domestic spending in the eurozone is expected to contract further in the second half of 2012.

The total structural budgetary strains in the eurozone could ease slightly in 2013 compared to this year. Combined with the expected growth in Germany and the easing of the decline in GDP in many peripheral member states, this will probably lead to a return to GDP growth in real terms for the eurozone as a whole next year. A very moderate recovery with growth that is still well below potential is however the best that can be achieved. It has to be noted that the debt crisis continues to be the principal downside risk to our economic forecast.

Policymakers in the industrial countries have used all their ammunition
Given the expected very moderate recovery in the eurozone, stimulation of the global economy will depend for now on policymakers in the rest of the world. Figure 3 shows that there is a large difference in the potential for monetary policy easing between the industrialised countries and the emerging economies. Since most of the large industrialised countries have little budgetary flexibility, in recent years they have tried to stimulate their economies through unconventional monetary policy. In the United Kingdom, a third round of quantitative easing has recently

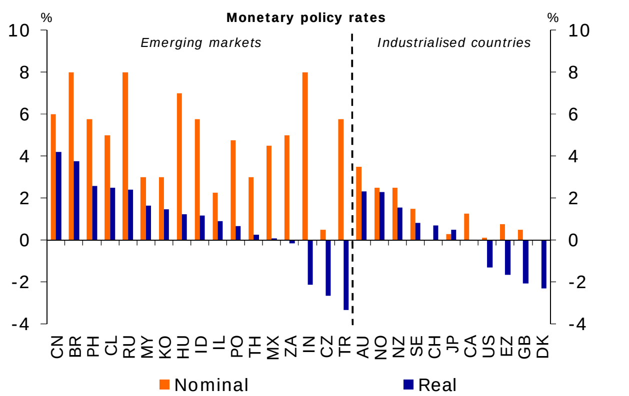
been announced in combination with an extensive funding programme for banks, and the Japanese central bank also appears to intend to continue its accommodative stance for the time being. Policymakers in the United States face an additional challenge in the form of the negative effect on the economy of the so-called fiscal cliff, which consists of declining tax breaks and automatic spending cuts and could cause an economic contraction in the first quarter of 2013. While we expect the fiscal cliff to be partially avoided, and also smoothed through further unconventional monetary policy, it is clear that the US has no potential for budgetary stimulus at the moment. We are generally sceptical with regard to the possibilities available to policymakers in the above-mentioned industrialised countries to significantly improve their growth prospects for next year.

Can the emerging markets turn the tide?

While the potential for conventional monetary policy in most of the industrialised countries was already exhausted after the crisis in 2008/2009, many central bankers in other parts of the world thankfully took advantage of the monetary flexibility available to them last year. Half of the 28 central banks around the world have reduced their official interest rates since mid 2011 (figure 4). Besides a number of smaller Western economies, the emerging markets played an important role. A limited number of governments in emerging economies moreover chose to implement budgetary stimulus.

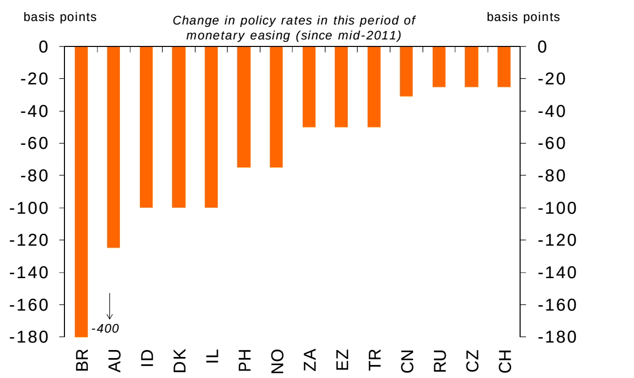
As mentioned earlier, the growth figures for the second quarter and the most recent leading indicators however show that the effect of this stimulus has been limited. This is partly because such measures only affect economic activity with a time lag. Secondly, it appears the extent of the stimulus has until now been limited. While we expect policymakers to continue to further stimulate growth in the near term, this will probably not be sufficient to significantly support growth in the industrialised countries.

Figure 3: Where is the monetary policy flexibility?



Source: Reuters EcoWin

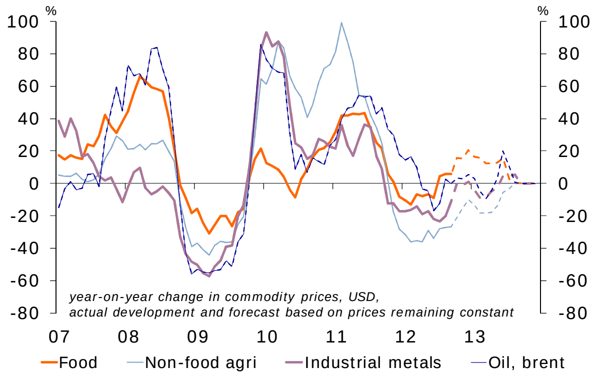
Figure 4: Interest-rate cuts since mid-2011



Source: Reuters EcoWin

The emerging world is expected to take a cautious attitude with regard to stimulating growth. Despite the weaker growth in recent months, many economies in these regions are still running relatively strongly and close to the limits of their production capacity. There will thus be no absolute increase in growth comparable to that seen after the crisis in 2008/2009. With the overheating that resulted from the policy accommodation in response to that crisis still fresh in people's minds, stimulus will be only applied gradually. Although inflation has recently declined in many countries, the recent rapid increase in food and energy prices is an additional source of concern (figure 5). Food indeed accounts for a relatively high proportion of total household spending in many emerging markets. Furthermore, paradoxically enough, the European debt crisis could be a reason for countries to remain cautious as regards stimulation. Should the crisis escalate further, policy flexibility will act as a useful insurance. As stated in the section on emerging markets elsewhere in this Quarterly Report, the limited effectiveness of transmission mechanisms will mean that cautious monetary accommodation will at best have only a delayed effect on the real economy.

Figure 5: Price development of commodities



Source: Reuters EcoWin

In conclusion, one can say that a number of emerging markets will achieve slightly higher growth next year compared to this year due to the expected stimulus. Since this will lead to only limited support for growth in world trade, the weak growth in domestic demand in most industrialised countries will not receive much assistance from net export growth. In the industrialised world, only the eurozone can be expected to be in a position to achieve higher growth next year compared to this year. On balance therefore, the still meagre growth of the global economy will only be able to accelerate very slightly next year. Furthermore, the scenario of relatively high growth in the emerging world and continuing weakness in the industrialised world will continue to be a reality for the foreseeable future.

Michiel Verduijn
M.P.Verduijn@rn.rabobank.nl