NATIXIS

# FLASH ECONOMICS
ECONOMIC RESEARCH

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# Does the world have the economic policy weapons to combat a new global recession?

***It is not out of the question that the world is once again entering a global recession, due to:***

- ***the crisis in the euro zone and in the United Kingdom;***
- ***the marked slowdown in the US economy;***
- ***the continuing stagnation in Japan;***
- ***problems with the growth models of large emerging countries;***
- ***the spreading of the crisis to open economies via global trade.***

***In OECD countries, there is no room for manoeuvre either for fiscal policies or for monetary policies.***

***As for emerging countries, more expansionary fiscal and monetary policies are possible; but will they help the global economy:***

- ***if emerging countries' problems are structural;***
- ***if they lead to a sharp depreciation of the exchange rates of emerging countries?***

**ECONOMIC RESEARCH**
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**Another global recession?**

With good reason, the slowdown in global trade and prospects for production **(Chart 1) give rise to concern over the situation of the global economy.**

In fact, the global economy is **simultaneously hit** by:

- **the euro-zone crisis**, due to the decline in activity **(Chart 2A)** as a result of the restrictive fiscal policies, deleveraging in the private sector and falling wages **(Chart 2B)**;
- **the crisis in the United Kingdom (Chart 2A)**, due to the restrictive fiscal policy and falling real wages **(Chart 2B)**;
- **the slowdown in the US economy (Charts 3A** and **B)**, due to the ongoing household deleveraging, the fall in real wages and structural unemployment;
- **the continued stagnation in Japan (Chart 4)**, due to the excess corporate savings that are not being invested, weak household incomes and the loss of capacity as a result of the tsunami;

**Chart 1**
**World: Exports in value terms, manufacturing PMI and services PMI**

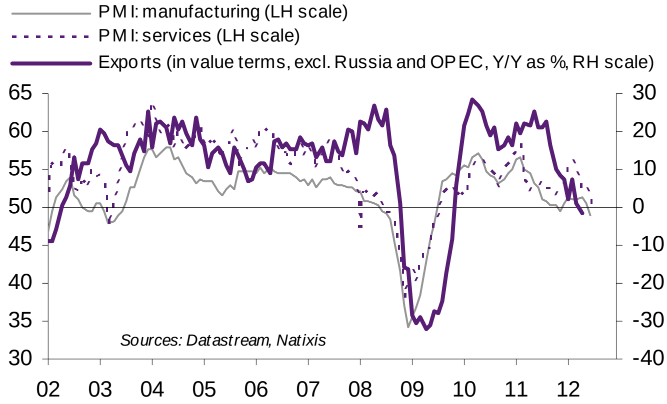



**Chart 2A**
**Real GDP growth (Y/Y as %)**

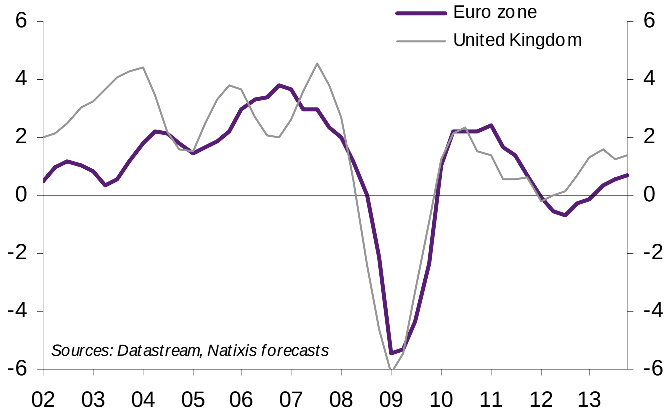



**Chart 2B**
**Real per capita wage (deflated by consumer price deflator, Y/Y as %)**

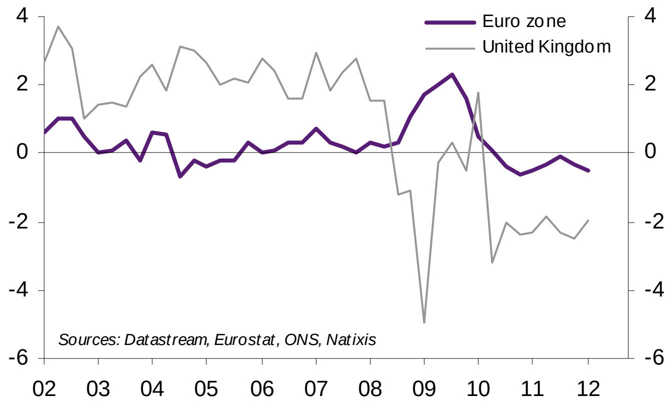



**Chart 3A**
**United States: Real GDP growth (Y/Y as %)**

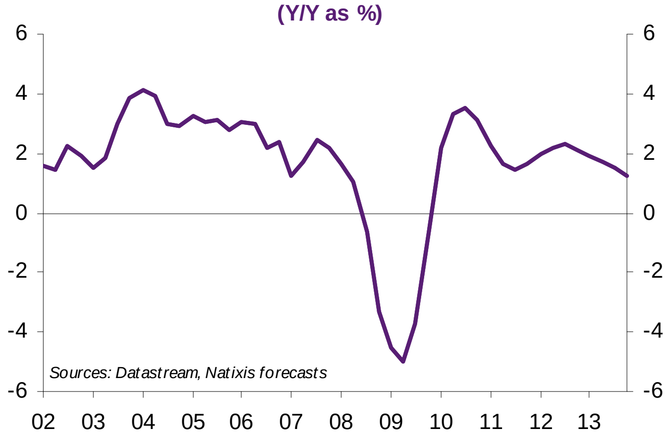


**Chart 3B**
**United States: ISM**

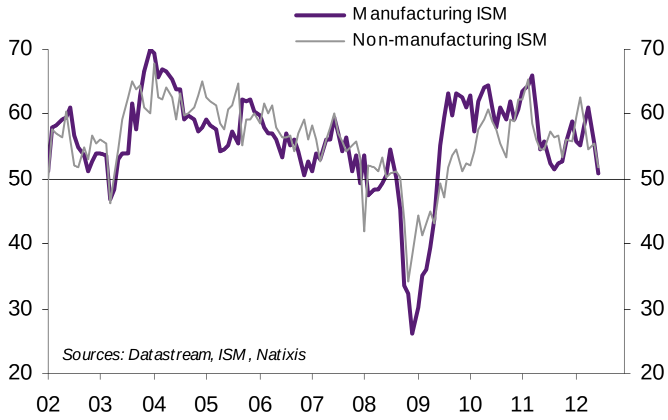
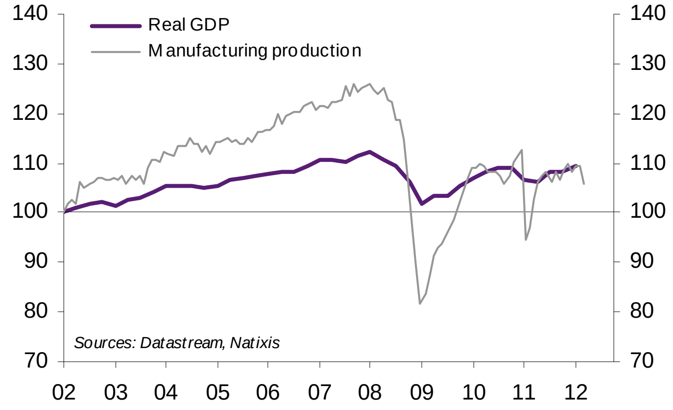



**Chart 4**
**Japan: Manufacturing production and real GDP (2002:1 = 100)**




- **the very marked slowdown in growth in large emerging countries since early 2010 (Charts 5A** and **B)**, due to problems in these countries' growth models:

  - loss of competitiveness and profitability in **China**, due to sharp wage increases since 2010;

  - stagnation in industrial production capacity in **India** due to hiring difficulties and problems with education and labour mobility;

  - real and lasting overvaluation of the exchange rate in **Brazil**, despite the recent depreciation, which has not gone far enough;

  - **the spreading of the crisis to open economies** (for example Singapore, Taiwan, South Korea, Sweden and Central European countries, **Charts 6A** and **B**) **via global trade**.

**Chart 5A**
**Real GDP growth (Y/Y as %)**

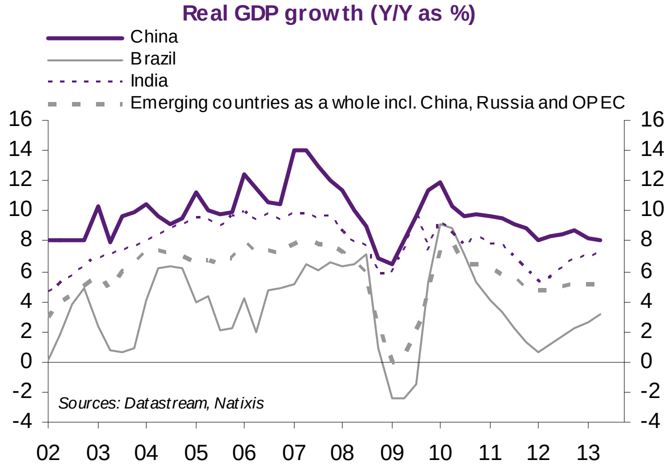



**Chart 5B**
**Manufacturing production (Y/Y as %)**

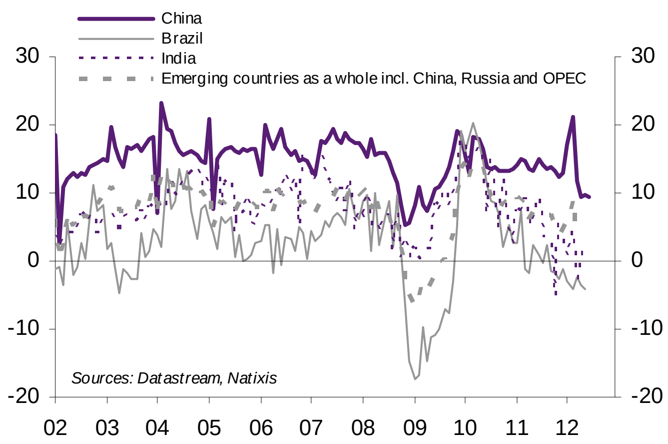


Chart 6A
Real GDP growth (Y/Y as %)

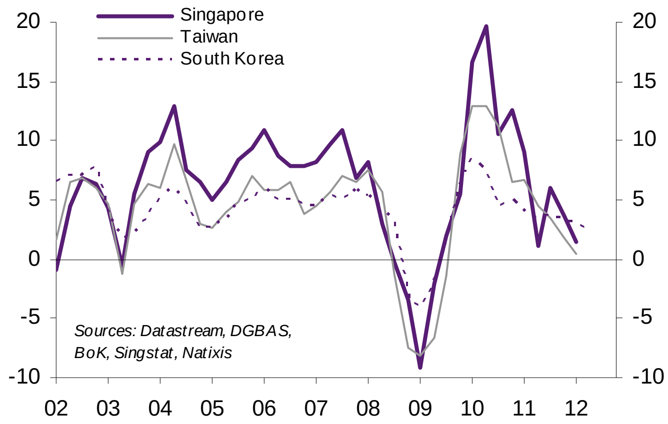
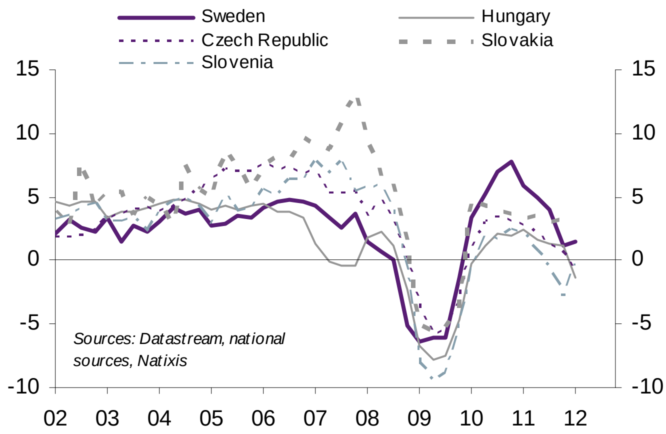



Chart 6B
Real GDP growth (Y/Y as %)




**All in all, the fact that practically all regions are affected means that global growth is seriously threatened.**

**Fundamentally, the problem boils down to:**

- **the need for the public and private sectors to continue to deleverage in OECD countries (Charts 7A** and **B);**

Chart 7A
Private sector* debt load (as % of GDP)

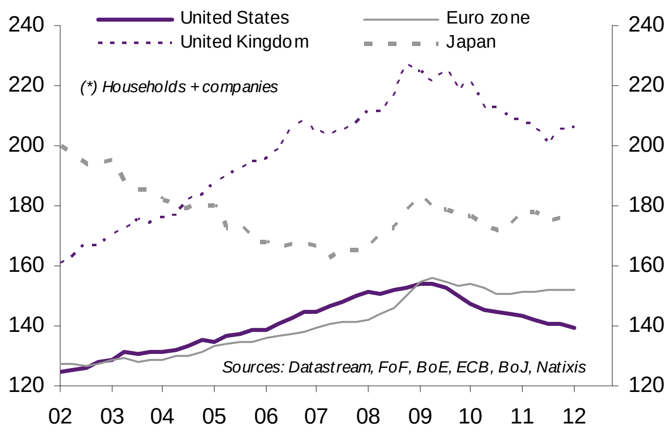
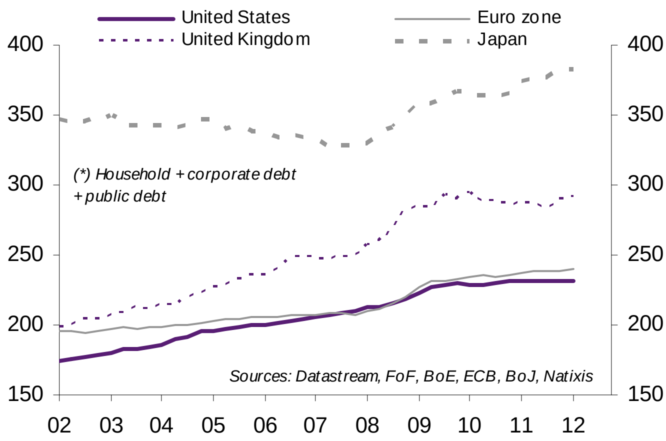



Chart 7B
Total debt* (as % of nominal GDP)




- **the end of the growth model driven by low-end production, exports and migration in China;**
- **the stalled growth in industry in Brazil and India.**

**Faced with this risk of recession, does the world have the capacity to react with its economic policies?**

**(1) In OECD countries, there is no longer any room for manoeuvre in monetary policies** (interest rates are already very low, **Chart 8A**, and liquidity already extremely abundant, **Chart 8B**) **or fiscal policies** (very high fiscal deficits and public debt, **Charts 9A** and **B**).

**Chart 8A**
**Key intervention rates (as %)**

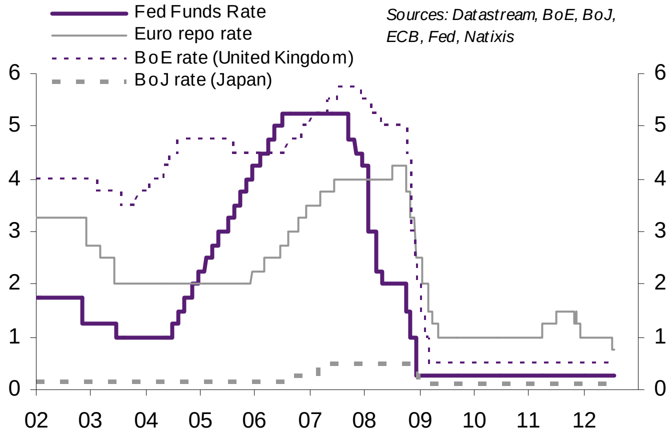



**Chart 8B**
**Monetary bases (as % of nominal GDP)**

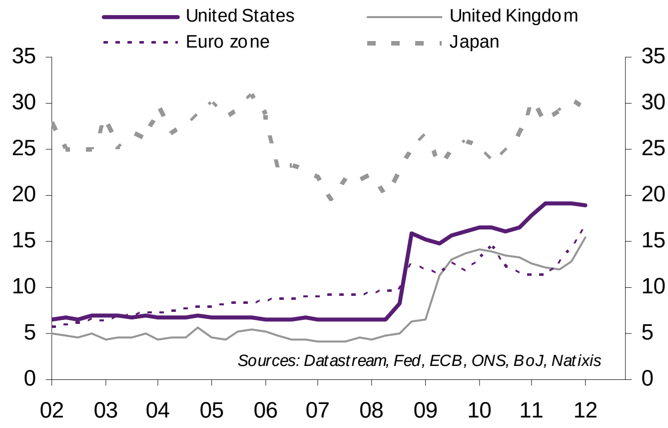



**Chart 9A**
**Fiscal deficit (as % of GDP)**

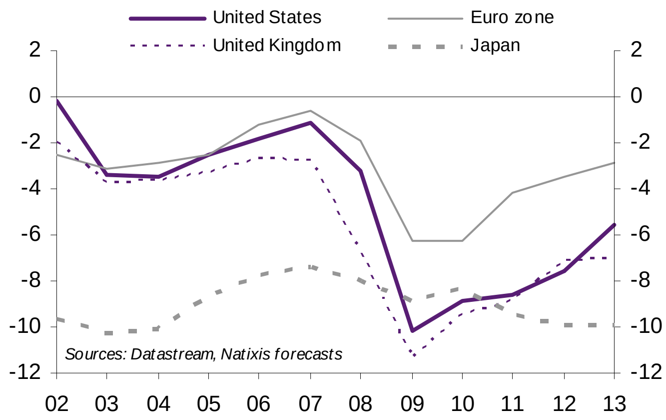
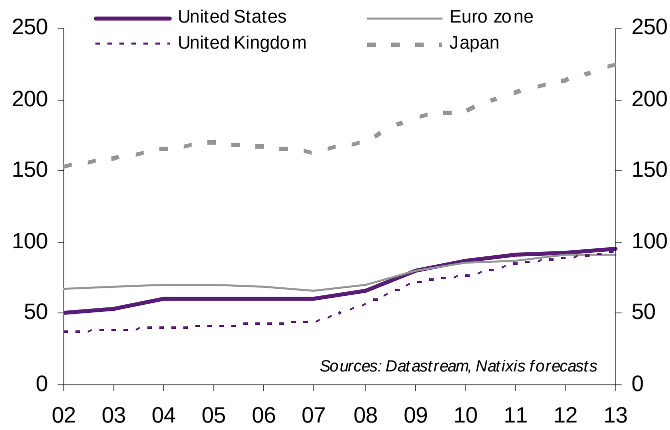



**Chart 9B**
**Public debt (as % of GDP)**




Of course, a QE3 in the United States, further VLTROs or asset purchase policies in the euro zone, another extension to the Gilt purchase programme in the United Kingdom and liquidity creation in Japan are all conceivable, but all these even more expansionary monetary policies would have very little effect on the economy.

**(2) In emerging countries, interest rates can be lowered (Chart 10A)** and, as the debt ratio is much lower than in OECD countries **(Chart 10B)**, monetary policy ought to be more efficient than in these countries.

Chart 10A
Central bank key intervention rates (as %)

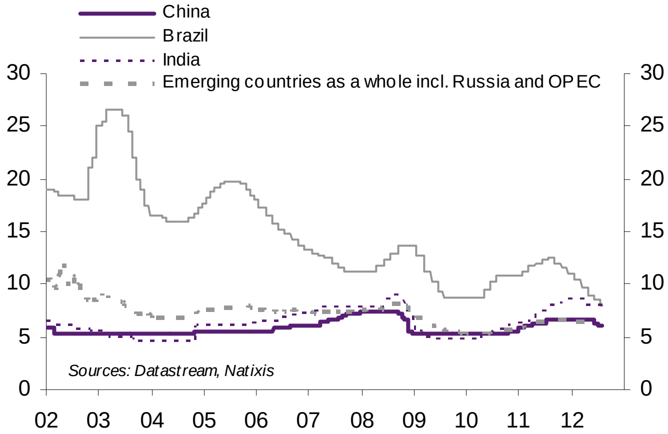
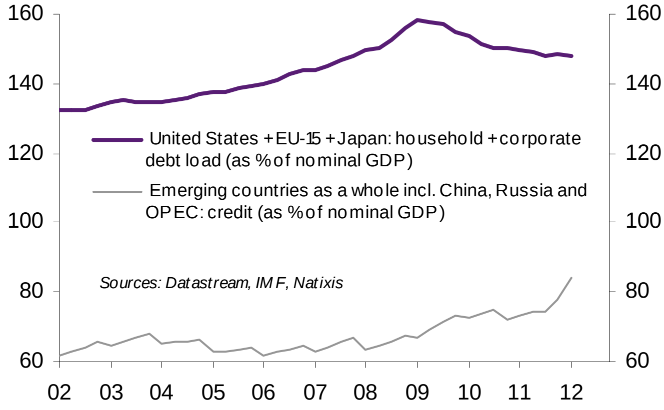



Chart 10B
Private debt load* (as % of nominal GDP)




**Fiscal deficits and public debts are also much lower in emerging countries than in OECD countries (Charts 11A** and **B)**, and emerging countries could conduct more expansionary monetary policies.

Chart 11A
Fiscal deficit (as % of GDP)

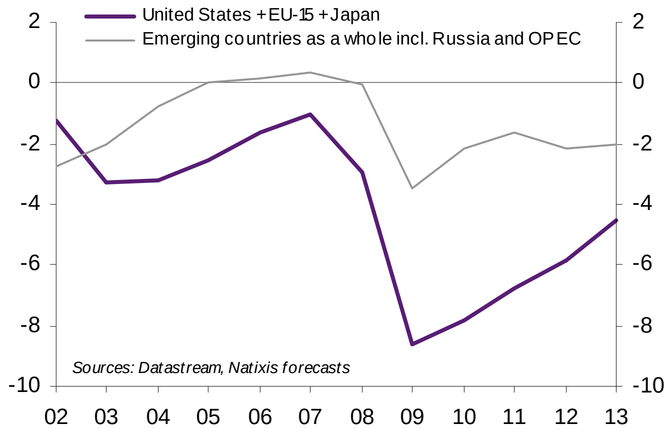
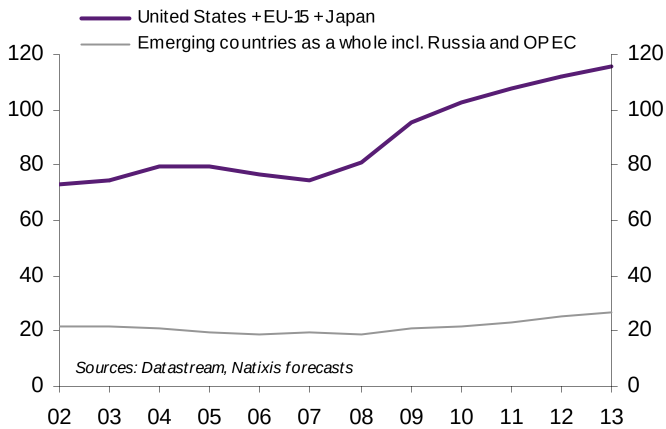



Chart 11B
Public debt (as % of GDP




**(3) The issue is therefore not whether emerging countries are able to conduct more expansionary economic policies, but whether these policies could restore global growth:**

**(a) If emerging countries have structural economic problems, counter-cyclical policies will not resolve them**. Boosting credit and investment in construction by state-owned companies in China **(Chart 12A)** would improve neither the sophistication of the product range nor cost-competitiveness.

Running fiscal deficits or lowering interest rates in India and Brazil would not resolve the problems in education (India) or in real overvaluation and falling investment and employment in industry (Brazil, **Chart 12B**).

**Chart 12A**
**China: Credit and investment in construction (Y/Y as %)**

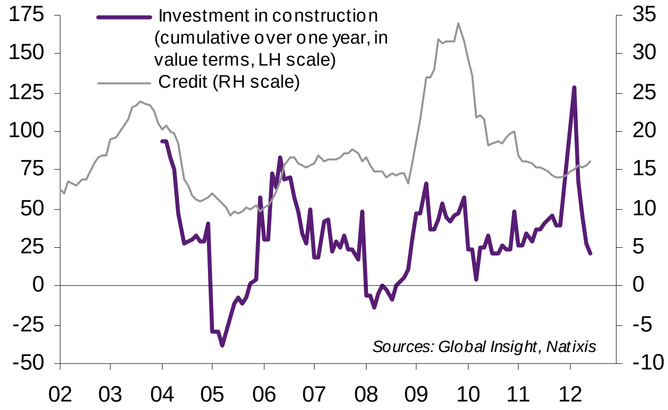
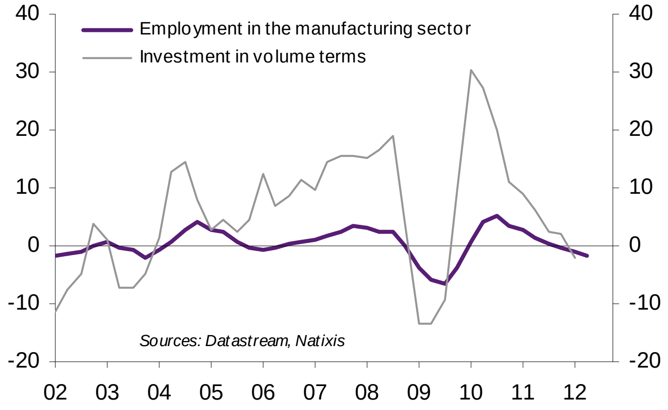



**Chart 12B**
**Brazil: Employment in the manufacturing sector and investment in volume terms (Y/Y as %)**




**(b) If more expansionary monetary policies in emerging countries lead to a depreciation of their currencies, which is starting to be the case (Chart 13A), the situation would improve in emerging countries but deteriorate in OECD countries; viewed as a whole, there would be no improvement in the situation of the global economy.**

It is striking to see that even the Chinese RMB has depreciated against the dollar **(Chart 13B)**; the Brazilian *real* and the Indian rupee have depreciated sharply since 2011.

**Chart 13A**
**Exchange rates against the dollar (2002:1 = 100)**

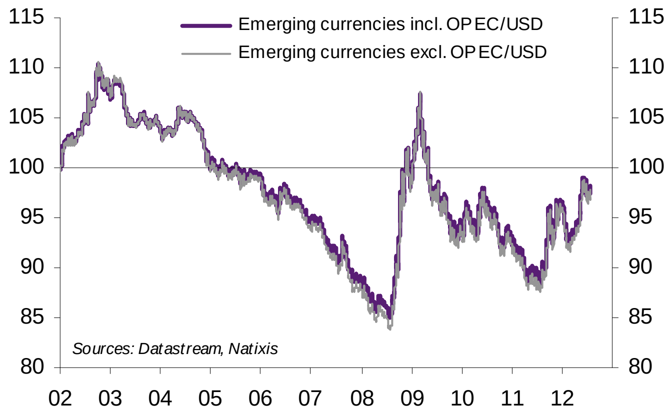
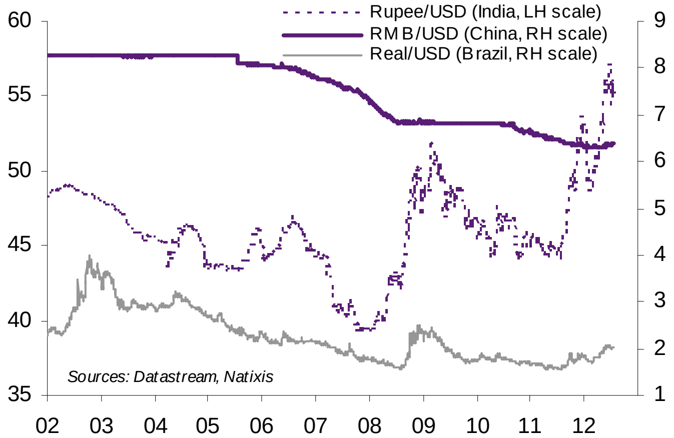



**Chart 13B**
**Exchange rates against the dollar**



**Conclusion: Global growth in 2012-2013 should cause more concern**

Current forecasts **(Table 1)** continue to point to a recovery in global growth between 2012 and 2013 and then in 2014.

We believe **there is cause to be more concerned**:

- the slowdown in growth affects all regions and has structural causes;
- OECD countries no longer have the room for manoeuvre to conduct counter-cyclical economic policies;
- emerging countries still have room for manoeuvre to conduct such policies, but they could prove ineffective.

**Table 1**
**World: Real GDP growth (as % per year)**

| | IMF | Consensus Forecast | OECD |
|---|---|---|---|
| **2010** | 5.3 | 4.3 | 5.1 |
| **2011** | 3.9 | 2.9 | 3.6 |
| **2012** | 3.5 | 2.5 | 3.4 |
| **2013** | 3.9 | 2.9 | 4.2 |
| **2014** | 4.4 | - | - |

Sources: IMF, Economic Outlook No. 91 OECD Consensus Forecast, Natixis

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