Global Economic Outlook: Is the Global Economy Stalling?

*M**r Adrian Cooper**, Chief Economist and Managing Director of Oxford Economics Ltd, Singapore spoke on the topic 'Global Economic Outlook: Is the Global Economy Stalling?' on 20th October 2010. In an earlier visit, Mr Cooper had warned of signs of the softening of the global economy. This time he returned with more definite answers. The talk was chaired by Mr Steven Wong, Senior Director, ISIS Malaysia. ISIS Analyst **Zarina Zainuddin** reports.*

Adrian Cooper

Using a global economic model for forecasting that takes into account global interactions between economies, in an integrated and simultaneous way, making it easier to track how these economies evolve, Mr Adrian Cooper predicted an economic rebound, followed by a slow-down in the second half of 2010. The recovery in the first half, he said, was stronger than expected. Global trade which had spiralled downward had recovered to pre-recession levels.

The pertinent question now is what will happen to global recovery? Will it continue, will it be sustained, or will it begin to stall? The first point that Cooper emphasised was that the level of uncertainty about where the global economy was heading had actually increased since his last visit.

The second more critical point centred on the behaviour of the corporate sector. Its extreme reaction to the financial crisis drove the economy to free-fall in most countries. Their response to the current global scenario, given its cash-flush position, is what will ultimately decide whether global recovery will continue or stall.

The US Scenario

Cooper said concern over the stalling recovery is most prevalent in the US. Figures have shown that after strong economic growth since the last quarter of 2009, the second quarter of 2010 showed a significant weakening.

While US economic growth appears surprisingly weaker than that of some European countries, further examination has revealed that economic activities in Europe are significantly lower than pre-crisis levels, and that Europe has a long way to go before reaching sustained economic recovery.

Cooper attributed the weaker economic growth to a huge surge in imports combined with the fact that the boost from the turn of inventory cycle had started to fade. However it is important to note that domestic demand from increased corporate and household spending has actually continued to strengthen.

Two problems remain for the US: first, housing, which in Cooper's own words, 'is a mess.' However, he noted that prices have

UNITED STATES UNEMPLOYMENT RATE

The unemployment rate in the United States was last reported at 9 percent in January of 2011. From 1948 until 2010 the United States' Unemployment Rate averaged 5.70 percent reaching an historical high of 10.80 percent in November of 1982 and a record low of 2.50 percent in May of 1953. The labour force is defined as the number of people employed plus the number unemployed but seeking work. The nonlabour force includes those who are not looking for work, those who are institutionalised and those serving in the military. This page includes: United States Unemployment Rate chart, historical data and news.

Date Selection: January 2009 to February 2011

Country	Interest Rate	Growth Rate	Inflation Rate	Jobless Rate	Current Account	Exchange Rate
United States	0.25%	3.20%	1.50%	9.00%	-127	85.0400

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2011	9.00											
2010	9.70	9.70	9.70	9.90	9.70	9.50	9.50	9.60	9.60	9.60	9.80	9.40
2009	7.70	8.20	8.60	8.90	9.40	9.50	9.40	9.70	9.80	10.10	10.00	10.00

** Note: The table above displays the monthly average*

Source: TradingEconomics.com; Bureau of Labor Statistics

started to fall as measures, such as tax credit, that had helped prop up the housing market, have been eliminated.

The second problem which Cooper deemed as more serious is the job market, which remains very disappointing. Employment has remained weak throughout 2010.

The rise in domestic demand failed to translate into higher employment opportunities. This is especially disconcerting given the scale of job losses that occurred at the height of the economic crisis. To put what was happening into perspective, US companies were very aggressive in job cutting -- so aggressive that even as production was falling, productivity rose to record levels! Strong production figures are usually seen during periods of strong economic growth; to see rapid productivity growth during a recession points towards extremely sharp job cuts!

The sharp job cuts led to the assumption that once the economy began to recover companies would start to hire workers quickly. That however, did not happen. A number of theories have cropped up to explain the weak job market.

One was that as unemployment benefits have become more generous, people can afford to not seek employment actively for a longer period than they would have otherwise. Cooper dismissed this claim as being a minor influence on the labour market. Much more important is the lack of jobs on offer.

Another was that a lot of US job losses were in construction, and the problem is that it is difficult to redeploy affected construction workers into another field, such as IT or the retail sector -- basically there is a mismatch between the skills of the unemployed and the jobs that companies are seeking to fill. Again Cooper disagreed.

There are also claims of location mismatch: where the unemployed are and where the jobs being created are. But Cooper pointed out that not only are jobs not being created anywhere, where they are being created, the pace is slow.

The critical problem that US companies are facing right now, Cooper stressed, is uncertainty -- uncertainty about the economic

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outlook, compounded in the US by uncertainty about the political outlook, courtesy of the midterm congress election, and uncertainty about policies that would affect the business environment, such as future tax policies.

All these led to companies being very reluctant to make significant hires. The wait-and-see attitude has exacerbated the weakness in US recovery, which in turn heightened the sense of uncertainty.

Again Cooper stressed the important role that non-financial companies are playing in the economic cycle that the US is currently experiencing.

Role of the Corporate Sector

When the crisis first erupted in 2007-2008, many thought that it would lead to job cuts in financial services worldwide, as well as massive spending cut backs by the heavily indebted household sector, particularly in the US and Europe. However looking at the scale of cuts, it appeared as if these two did not account for the depth of the economic downturn Cooper said. In the US, consumer spending has fallen, but modestly, while in Germany, which experienced a deeper recession than the US, consumer spending did not fall at all.

Likewise, job cuts in the financial sector have been significant but not overwhelmingly so. In fact, said Cooper, job losses in other sectors have been more severe. The point is that while financial sector job losses and the drop in

Adrian Cooper addressing the participants at the forum

household demand may have been the initial stressors that led to the economic downturn, they were not the major drivers of the recession.

It was corporate behaviour that shaped the economic meltdown, said Cooper, in particular the scale of cutbacks in capital investments. These cutbacks, that occurred worldwide, were magnified by the trade linkages between economies, which in turn led to the vicious downward spiral around the world. It was a cycle driven by the corporate sector's anxiety over the availability of cash rather than one driven by correction in terms of the financial services sectors or indebted consumers.

Just as the economic downturn was driven by corporate behaviour, so will economic recovery, he said. In particular, having cut spending sharply, companies are enjoying healthy cash flows and substantial profits. The million-dollar question is, what are the companies going to do with the massive cash surplus? Will they start to spend that money?

The answer to this question is absolutely critical because there is very little support coming from developed countries. These governments had run massive deficits and can now no longer afford to support recovery efforts. Where previously they were cutting taxes and raising public spending, they are now at a point where they are raising taxes and cutting public spending.

The constraints on government are particularly true for southern European countries where concern over sovereign debt dominates. In Greece, a significant tax increase and public spending cuts were announced and in Spain and Portugal, a significant tightening of fiscal policies. Even healthy economies such as Germany, which could afford public spending, have announced tight fiscal policy for 2011. Cooper said there is a danger of more austerity measures, especially from countries at the periphery of the EU; some of these economies have slipped back into recession. The economic outlook for Europe in the next year or so remains weak.

Households represent another constraint on the economy. Part of the reason is existing

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high consumer debt -- the lack of progress on the part of the household sector in tackling their debt issues. The prevailing weak labour market exacerbates the matter as households are reluctant to spend due to the uncertainty in the job market.

Inflation is being pushed up by increases in commodity prices, and indirect taxes have resulted in a squeeze on real wages in developed countries. A combination of these factors means that households are not likely to be the engine of growth in driving the economic recovery. So if recovery is to come at all, it will depend on whether companies are going to spend their cash, since neither households nor the government are in the position to do so.

Past behaviour suggests that there will be a time lag of six to nine months before companies which have accumulated cash begin to spend it. According to Cooper, signs of spending are beginning to appear in the US, and are likely to be replicated in other developed countries like the UK and Germany.

Mergers and Acquisition (M&A) spending showed signs of picking up although it is still lower than the pre-crisis level. There is enough evidence to suggest that corporate spending will pick up in 2011, albeit at a slow pace.

Cooper listed factors that would inhibit higher spending. These include the unusual uncertainty, accumulated excess capacity, higher than previously, and the high level of debts, particularly in Europe. He predicted that initially, companies would be likely to spend excess cash in order to lower their debt obligations and speculated that since the debt problem is less severe in the US, companies there are more likely to start spending on investments compared to Europe.

The credit crunch still prevails in major economies due to problems in the banking sector, which means lending to the non-financial sector is still at a low level. Adding up all the factors, Cooper forecast a significant slowdown of the major economies up to the early part of 2011.

While he hoped there would be enough spending by the corporate sector to offset the cuts in government and household spending so as to generate some growth, he cautioned that the pace of spending will be slow, and so will be the recovery. The situation was disappointing as normally, in the second year of recovery, economic growth increases at a faster rate but he thinks this is not likely. Instead, Cooper said, there is likely to be a permanent loss of GDP -- the cost of the financial crisis so to speak.

The outlook for the interest rate will remain very weak and we can expect monetary policy to become even looser in major economies, particularly the US. Major economies are turning to easy monetary policies in order to support recovery and to compensate for the existing constraints such as the accumulated huge budget deficit.

Outlook for Emerging Markets

The scenario is much brighter for the emerging markets said Cooper. Growth has slowed down somewhat compared to early 2010, which is to be expected given the rapid growth rate registered in earlier quarters, the rebound in world trade and the turn of inventory cycles.

Though growth rates across emerging markets have slowed somewhat, the figures are still healthy, said Cooper. Within the emerging markets, particularly in Asia, there is buoyant domestic demand, growing to a critical mass, that will help sustain growth in these countries.

The strength of domestic demand in China has helped to support economic growth in Asia. Strong import growth in China translates into strong production input growth in some Asian countries which has helped to sustain and increase consumer spending growth across Asia.

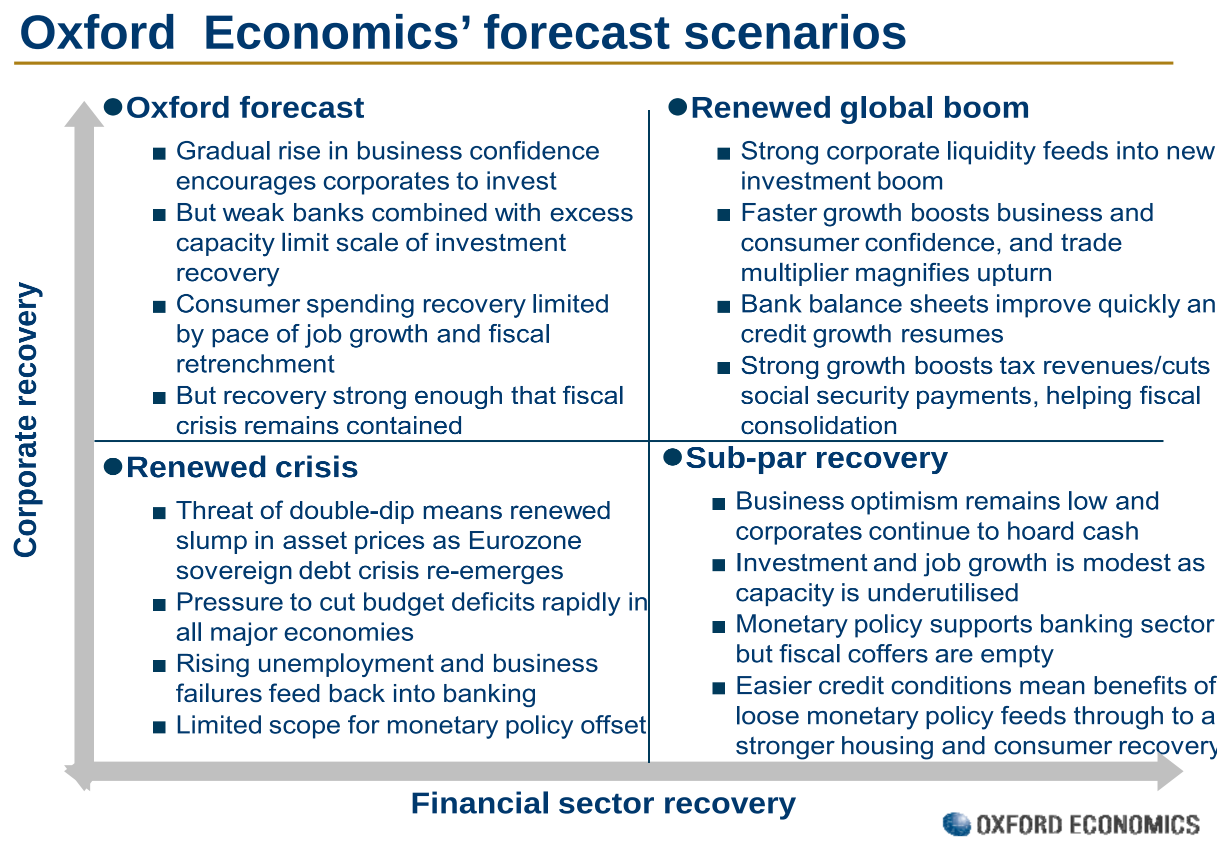
The good news for the emerging market said Cooper, is that in the face of the slowing of developed economies, many emerging economies still have ammunition that their governments can deploy to support recovery, if needed. In particular the fiscal positions of most emerging market economies are much healthier, and the level of government debts or the level of budget deficits much lower. There is also the ability to boost money supply effectively as demonstrated by China during the crisis.

However it would be wrong to say that the emerging markets are without problems. Claims about economic decoupling, said Cooper, are 'exaggerated and it would be wrong to exaggerate the degree of decoupling that emerging economies could achieve.'

The pressure on currencies illustrate this point. The current loose monetary policy, particularly in the United States, generates excess liquidity, and in efforts to seek better returns, attention will focus, naturally, on investing in healthy economies, which in turn puts an upward pressure on the currencies of these economies, especially in Asia.

Cooper also pointed out that while export dependency on OECD countries has declined

Table 1



Note: Four different scenarios and the prevailing economic conditions of each scenario

Source: Oxford Economics, 2010

Table 2

Oxford Economics' forecast scenarios

Alternative GDP growth forecasts	2009	2010	2011	2012
Oxford Forecast (45%)				
US	-2.6	2.6	2.5	3.5
Eurozone	-4.0	1.5	1.3	1.7
China	9.1	9.7	9.0	9.2
World	-0.7	4.5	4.2	4.9
Renewed boom (15%)				
US	-2.6	2.8	3.7	4.2
Eurozone	-4.0	1.7	2.4	2.8
China	9.1	10.4	10.7	10.4
World	-0.7	4.8	5.5	5.9
Sub-par recovery (30%)				
US	-2.6	2.4	1.8	2.2
Eurozone	-4.0	1.2	0.8	0.9
China	9.1	8.8	7.2	7.5
World	-0.7	4.1	3.3	3.7
Renewed crisis (10%)				
US	-2.6	2.2	-0.6	1.0
Eurozone	-4.0	1.0	-1.3	-0.2
China	9.1	8.0	4.9	5.5
World	-0.7	3.7	1.0	2.3

OXFORD ECONOMICS

Note: Economic forecasts of the US, the Euro zone, China and the World for each economic scenario as well as the probability of such scenarios happening

Source: Oxford Economics, 2010

somewhat, the exports are still at about 15 per cent of Asian economies' GDP which means any slowdown in OECD would to some degree affect economic growth in Asia and other emerging economies.

Cooper confessed that his is not an easy outlook. It is an uncertain outlook. He gave examples of several alternative scenarios.

He believes that the probability of the Central Forecast (Oxford) is at 45 per cent — lower than forecasted earlier in the year. This reflects the belief that the uncertainties surrounding the global outlook have actually intensified.

The probability of the 'down side risks scenario' (30 per cent) is twice as big as the probability of the 'upside risks scenario' (15 per cent). The probability of a double-dip recession in the US and Europe in 2011 is at 10 per cent, which is quite high, said Cooper, given that these economies had just experienced a recovery period.

In conclusion, Cooper reiterated his earlier point -- what happens to the global economy will hinge on how the corporate sectors behave with their excess cash. He pointed out that the prevailing uncertainties would probably make the corporate sector behave more cautiously, which is why Cooper favours the down side risks scenario.