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All eyes on European summit

ECONOMIC STAKES ARE HIGH: Malaysia should 'expect the best, but prepare for the worst'

By Steven CM Wong

CURRENT signs are pointing to a world economy that is slowing to a standstill and that will probably enter reverse gear in the near term.

This conclusion may seem prematurely pessimistic, especially with all eyes on the European Union summit on Thursday and a slew of economic data yet to be released this week. But this is precisely what markets are flashing and what the world's most thoughtful brains are saying in no uncertain terms.

A securities firm's electronic stock board in Tokyo yesterday. Asian stocks mostly drifted lower as investors grew cautious ahead of a European Union summit on Thursday. AP pic

Europe may have dodged a bullet with fears of a Greek exit from the euro subsiding for now. Any hope for a resolution, however, is still up in the air with Greece's new government appearing to play political mind games with the troika made up of the European Union, the European Central Bank and the International Monetary Fund.

Latest indications are that the Greek prime minister and finance minister will not be attending the summit and will send representatives instead. The IMF has also indicated that its representative will not be attending.

Even before the Greece problem is close to being resolved, Spain is expected to officially request for financial assistance for its banks this week. Germany, the major bank-roller for the region's bailouts, is expected to make some minor concessions but remain resolute, given its internal difficulties. Its lower house will vote on the European Stability Mechanism and Fiscal Pact on Friday.

All in all, Thursday's summit is looking to be a major disappointment even though the stakes are high.

Last week, data showed the Euro area manufacturing contracting at the fastest rate in three years, while purchasing managers indexes and key business surveys indicated a sharp slowdown, most notably in Germany.

This week will see figures for United States' new and pending home sales, the Conference Board's consumer confidence index, unemployment claims and gross domestic product growth, with few of these expected to lift spirits or expectations.

It should be noted that if the world economy does enter into recession, all the numbers can change drastically.

Depending on how severe it is, it can be more akin to falling off a cliff rather than a slow slide down a slope.

The Bank of International Settlements has come out to say that central banks are at the limits of what they can do to alleviate the financial situation. So long as they respond by increasing liquidity -- in effect creating more debt to paper over existing debt -- risks continue to rise, while governments are given an excuse to cut their spending.

Pimco's Mohamed El-Erian characterises the current situation as one of stable disequilibrium, one that is reflected by the huge global imbalances. The little improvement we have seen to date, he argues, is due more to the global economic slowdown than any effort on the part of governments.

Indeed, news that the four largest developing economies, Brazil, Russia, India and China, have seen their currencies post their biggest declines since 1998 have not helped. The real, ruble and rupee have all weakened the most among developing countries, while the yuan has depreciated the most since 1994.

In short, the writing is on the wall. Hopes continue to be held out for a comprehensive solution to the world economy's woes, including a comprehensive banking and fiscal fix in Europe, but indications so far is that this is all they will be -- hopes.

In view of the nail-biting events, what tack should Malaysia take, if any? The fact that there is still plenty of domestic liquidity has been reinforced constantly. The country has the means to finance economic growth without recourse to external borrowing.

Also repeatedly emphasised is that we have the Economic Transformation Programme and the 10th Malaysia Plan that will ensure that there is the need for it. These will, in all probability, help rather than hurt the country's prospects over the long term.

But whether they are sufficient to effectively fight off the recessive forces that are swirling around the globe is another matter. The magnitude of the latter could well be larger than what a small economy like Malaysia may be able to withstand.

The time could well be ripe to employ the old adage of "expecting the best but preparing for the worst".

This might be the right time to think long and hard about the "what-ifs".