Economy & Rates

Eclipse of confidence, growth slowdown*

** For more details, see the* Economy Report *of the same title*

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Summary
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- **As we enter 2012, it is clear that the world economy is more fragile than at any time since 2008. World growth has fallen below 3% and the eurozone is in recession. A break-up of EMU cannot be ruled out. This depends far more on political leaders than on financial markets. No officials at the ECB or in government have anything to gain from a break-up. As such, this is an avoidable scenario. On this assumption, the debt crisis will ease in intensity and the European recession could give way to subdued growth in 2013. In short, the worst is not certain.**
- **High hopes followed by a huge disappointment – that is a reasonable summary of 2011 on the economic front. The least that can be said is that nobody is guilty of over-optimism at the start of 2012, be they investors, consumers or governments. Some are wondering if the financial world can be stabilised until a solution is found for the European debt crisis and its various ramifications (for institutions and banks). Others are experiencing a squeeze on their disposable income, either because of high unemployment or fiscal austerity. In Europe, these two constraints are set to tighten further in 2012. Lastly, many policymakers have their eyes set on forthcoming elections. They will go into these with poor economic records (in the US and France) and will need to convince electors that their opponents would be worst. To sum up, there is little reason for joy!**
- **The list of possible catastrophes is clearly established. It includes failures of states or big banks, a dissolution of the eurozone, a disorderly bursting of the investment bubble in China or a disruption of oil supplies, any of which could trigger a global recession. The probability of each of these events is certainly not zero. But some are perfectly avoidable, especially those linked to problems in Europe.**
- **A good part of Europe's current problems are a form of self-punishment. In the space of two years, political leaders have exhausted their capital of confidence with a series of belated and ill-conceived measures, or "grand plans" that have never been implemented. To restore their credibility, they are now imposing austerity plans on one country after another. This is accentuating the recession, which in turn makes it harder to reduce deficits. An approach that does not sacrifice the short-term to laudable medium-term targets is needed. The same remark holds true for banks: they cannot be asked at the same time to finance the private sector, to buy government debt and to respect regulations that have been tightened in the midst of a recession. On the flip side, the ECB has opened the liquidity taps wide and eased its monetary policy. Other actions (quantitative easing or aid from the IMF) may be necessary, especially since the Greek problem is still not resolved and neither Portugal, Spain nor Italy are considered fully solvent.**
- **In the US, there are encouraging signs of a stabilisation in the housing market and a gradual reduction in unemployment. But the economy is still in convalescence. Since the end of the cycle of unbridled credit expansion, it has not yet seen a return of normal growth conditions that would make it possible to avoid an ultra-stimulative policy mix without falling back into recession. The conditions for a fiscal accident are in place (high public debt and political paralysis); one was narrowly avoided in 2011, but the risk is no lower in 2012 and 2013.**