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Enering a new slowdown

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The European crisis is pulling the rest of the global economy into a new slowdown. The numbers indicate that the eurozone may have already entered into recession during the last quarter of 2011. The simultaneous fiscal austerity programs across Europe and new banking regulations are strangling demand growth, and therefore economic growth. Consumers and investors are understandably jittery and unwilling to play their role in the economy. Public and private indebtedness has not come down significantly.

The World Bank predicts a global growth rate of between 2.5 and 3.1 percent for 2012 and 2013. Global trade is forecast to grow by 4.7 percent at most, one of the slowest rates of the last few years. The impact on exporting economies could be massive. International investment flows could also shrink, especially originating from Europe. The IMF is right in asking Europe to prioritize its policies, focusing on new measures to enable the economy to grow, a financial firewall to prevent public debt contagion, and more fiscal integration. Little has been done on policies to stimulate the economy, and governments continue to hesitate when it comes to making the European Financial Stability Facility work.

Asian economies navigated the turbulent waters of the last five years rather well, but they are also being affected by the recent European troubles. They are not immune to a European meltdown or to a prolonged recession in the eurozone, which is one of its main trading partners, and a source of capital. It might be in the best interest of the major Asian economies to help Europe overcome its problems by importing more goods and services. After all, if your customer runs out of money to spend, you are bound to suffer a similar fate in this interconnected global economy.

Europe faces tough choices. Short-run fiscal austerity coupled with a persistent credit crunch is bringing the economy to its knees. Rather than prioritizing deficit reduction, European countries ought to relax financial restrictions on both the public and the private sector to let the economy grow, issuing at the same time a firm and verifiable commitment to fiscal balance in the medium run. One cannot possibly grow and reduce the deficit within one single year. One must prioritize. Without economic growth, European governments will find it very difficult to meet their fiscal austerity targets.

Asian countries, and emerging economies in general, have a lot at stake in the European crisis. Their economic model relies heavily on exports, and their growing financial surpluses need to be invested wisely so that the foundations for future growth regionally and globally are in place.

The European crisis represents an opportunity for the major Asian economies to begin adjusting to the new global economy of the 21st century. Emerging economies must play a more important role in international capital markets and in international multilateral agencies given that they already represent half of global GDP and about 75 percent of global foreign exchange reserves.

Most importantly, growth in Asia, Latin America, Africa, and the Middle East cannot continue to be primarily based on exports.
Domestic demand must become a more important engine of growth. The stability and dynamism of the global economy in decades to come will mostly depend on this important transformation in emerging economies.

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