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Continued growth belies hysteria over global depression

by Daniel Ben-Ami

Given the pervasive sense of doom about the global economy at present it is worth taking a step back to work out what is really happening. In all the hysteria about plunging stockmarkets and failing financial institutions it is easy to lose a sense of perspective.

In broad terms there are several ways in which the impact of the market turmoil can be assessed. There are quantitative measures - the hard numbers so beloved of economists - and more qualitative ones. The latter involve asking what is the precise character of the problems.

It is also important to distinguish between what has already happened and what could happen. This may seem obvious but they are often muddled together in the anxious discussion.

In terms of economic indicators the striking thing is that, so far at least, the impact of the financial turmoil has been muted. Although the credit crunch started back in August 2007 the main developed economies are still - just about - growing.

The only significant developed country in technical recession - defined as two consecutive quarters of falling output - is Ireland. Denmark was in recession but has recently started to grow again.

This is not to say that the textbook definition of a recession is perfect or that things cannot get worse. It is likely that both the eurozone and Japan will soon be in recession.

But what is happening is that growth in many of the developed countries has fallen to about zero rather than there being a sharp drop in output. America is doing relatively well with GDP growth at an annual rate of 2.8% in the second quarter of 2008, although it did suffer a 0.2% fall in the final quarter of 2007.

In contrast, it is worth remembering that America's GDP fell by 30% and industrial output fell by 47% during the Great Depression of the 1930s. Even in the recession of 1981-2 America's output fell by 2%.

Nor are the forecasts for global growth in the coming period that bad. The official International Monetary Fund (IMF) forecasts for the world economy are not out till this week. But last week Michael Mussa, a former IMF chief economist, published economic forecasts last week on behalf of the highly respected Peterson Institute for International Economics in Washington DC (see table).

Overall he forecasts 1.2% growth for the industrial countries in 2009 compared with 1.5% in 2008 and 2.5% in 2007. This is hardly rapid growth but it is a long way from a severe downturn.

The outlook for emerging economies, which today account for almost half of the world economy, is much better although they are expected to slow. Overall emerging economies are forecast to expand by 5.7% in 2009 compared with 6.4% this year and 7.4% in 2007.

Of course the forecasts for future growth could be wrong. To get a better idea of what is going on it is necessary to look more closely at the character of the slowdown. Often conventional economists rely too much on the numbers and appreciate too little the peculiar character of the economic situation. In this respect there are several factors to consider.

- This is a consumption-led downturn. What is happening is that people's disposable income is being squeezed by rising energy and food prices while credit is becoming more expensive as a result of the financial turmoil. This is the reverse of a "classic" recession in which problems tend to start in the industrial sector and then spread to the rest of the economy.

In this context it is worth remembering how the Great Depression of the 1930s developed. The initial decline in America's economic output was already apparent in the summer of 1929 - that is before the stockmarket crash. The crash itself started in October 1929 while banking panics did not begin for another year, in the autumn of 1930.

In contrast the banking crisis this time around started about a year ago, stocks have suffered more recently and a fall in output is still not certain. Not only is the magnitude of the downturn not comparable but the character of the crisis was entirely different.

- A risk-based financial system. The financial system has been reforged as more of a mechanism for transferring risk than a channel for capital flows. Under the old model if a mortgage lender suffered bad debt problems it could go under.

Under the new model of finance the mortgage lender will have most likely repackaged its debt and passed it on to other institutions. This means the lender is less exposed to risk but there is a greater chance of "contagion" when things go wrong. Such developments as the rise of derivatives and securitisation help to diversify risk but they can also mean problems can spread more easily.

- Lack of political leadership. A chronic lack of leadership on both sides of the Atlantic has exacerbated the crisis. In Britain it was most apparent with Alistair Darling, the chancellor, saying the economy was facing its worst crisis for 60 years then backtracking.

In America it was even more glaring with the House of Representatives voting against the first attempt to pass the bail-out plan.

- Strong emerging economies. On the positive side, the strong growth of the developing countries gives added resilience to the global economy.

Even though their growth looks set to slow it is still moving forwards at a reasonable pace. Developing economies are also less dependent on the industrial world than in previous slowdowns.

Overall the world economy looks set for a slow, painful squeeze rather than a violent downturn. Financial markets are likely to continue to be volatile but, unless the credit markets seize up in panic, the real economy should continue to move forward, if at a slow pace. Developing countries should outperform the advanced economies by a wide margin.

GDP GROWTH FORECASTS

Country/region	Weight	2007	2008	2009
Ind countries	52.5	2.5	1.5	1.2
America	21.5	2.2	1.5	1.3
Japan	6.7	2.0	1.0	1.0
Eurozone	16.0	2.6	1.4	1.1
Britain	3.3	3.0	1.3	1.2
Emerging mkts	47.5	7.4	6.4	5.7
China	10.5	11.9	10.0	9.0
India	4.5	8.7	7.7	7.0
Russia	3.2	7.5	7.2	6.0
World (at PPP exchange rates)	100	4.9	3.8	3.4

Shows real GDP growth projections as of September 26, 2008. Percentage change, year over year.

Source: Peterson Institute

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