World economy set for another major downturn

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The World Bank has issued a grim forecast on the outlook for the world economy, with the potential for a crisis worse than that which followed the collapse of Lehman Brothers in September 2008. The warning was contained in the Bank's Global Economic Prospects report, issued yesterday.

These predictions were backed by a United Nations report. It said the world economy was "teetering on the brink of another major downturn," with output growth slowing "considerably" in 2011 and only "anaemic growth" expected in 2012 and 2013.

The World Bank pointed to a significant worsening of economic prospects, beginning in August 2011 as the euro zone financial crisis started to deepen. This was having a major impact on so-called emerging markets where rates on credit default swaps (CDS)—an indication of fears of a debt default—had been rising.

However, this was by no means the only sign. "For developing countries, the contagion has been broadly based," the report stated. "Developing-country markets have lost 8.5 percent of their value since July-end. This, combined with the 4.2 percent drop in high-income stock-market valuations, has translated into $6.5 trillion, or 9.5 percent of global GDP, in wealth losses."

Even more significant was the sharp decline in capital flows to developing countries as investors withdrew money in the second half of last year. "Overall, gross capital flows to developing countries plunged to $170 billion in the second half of 2011, only 55 percent of the $309 billion received during the like period of 2010."

According to the report, "the world economy has entered a dangerous period" as the financial turmoil in Europe spread to developing and other high-income countries that had previously been unaffected.

The World Bank's forecasts of world economic growth had been "significantly downgraded" from its previous assessment six months ago. It now expected the global economy to expand by only 2.5 percent and 3.1 percent in 2012 and 2013, compared to the previous prediction of 3.6 percent for both years. Any rate below 3 percent is generally considered to be a recession for the world economy as a whole. Europe was now in a recession and growth in high-income countries was expected to be only 1.4 percent.

Even these weak results may not be achieved. "The downturn in Europe and the slow growth in developing countries could reinforce one another more than is anticipated," resulting in even worse results and "further complicating efforts to restore market confidence." At the same time, "the medium-term challenge represented by high debts and slow trend growth in other high-income countries has not been resolved and could trigger sudden adverse shocks."

The consequences would be even greater than those of the breakdown of the global financial system after September 2008.

"While contained for the moment, the risk of a much broader freezing up of capital markets and a global crisis similar in magnitude to the Lehman crisis remains. In particular, the willingness of markets to finance the deficits and maturing debt of high-income countries cannot be assured. Should more countries find themselves denied such financing, a much wider financial crisis that could engulf private banks and other financial institutions on both sides of the Atlantic cannot be ruled out."

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In other words, despite the trillions of dollars handed out to the banks and financial institutions over the past three years by governments around the world, nothing has been resolved. The global economy could be plunged into a disaster at any time. This underscores the fact that the crisis of 2008 was not a conjunctural downturn, from which there would be a recovery, but the start of an ongoing breakdown in the world capitalist economy, threatening the jobs and livelihoods of billions of people.

The report stated: "In the event of a major crisis, the downturn may well be longer than in 2008/09 because high-income countries do not have the fiscal or monetary resources to bail out the banking system or stimulate demand to the same extent as in 2008/09. Although developing countries have some maneuverability on the monetary side, they could be forced to … cut spending—especially if financing for fiscal deficits dries up."

The impact of the financial turmoil in Europe is expressed in world trade—always an indicator of the state of the global economy. The report noted that trade volumes had declined at an annualised pace of 8 percent during the three months ending in October 2011 "mainly reflecting a 17 percent annualised decline in European imports."

Exports from so-called developing countries fell at an annualised rate of 1.7 percent in the third quarter of last year and continued to fall in November. The countries of South Asia were among the hardest hit, with sharp contractions, following rapid export growth in the first half of the year. Exports from East Asia were falling at double-digit annualised rates. While some of this decline was due to the impact of the floods in Thailand, it also expressed the contraction of markets in Europe and other high-income regions.

World Bank chief economist Justin Lifu Lin said China still remained a bright spot. Its growth rate, although down to a forecast of 8.4 percent for this year, compared to 9.1 percent last year, remained relatively high. "If China can maintain its growth, it's good for the world, providing support for commodities markets and growth in other countries." He warned that while China's exports would be adversely affected by the worldwide downturn, the Chinese government was one of the least indebted in the world and had "relatively large room for manoeuvre to stimulate the economy."

In view of recent reports from Beijing on the state of the Chinese economy and the mounting problems faced by government and monetary authorities, such comments can be likened to whistling past the graveyard.

This week, the Chinese government announced that the growth rate for the last quarter of 2011 was an annualised 8.9 percent, the lowest for 10 quarters. Overall growth for 2011 was 9.2 percent, the weakest since 2009 when China experienced the impact of the Lehman collapse.

A National Bureau of Statistics spokesman said 2012 would be a year of "complexity and challenges." The *Financial Times* reported that his remarks were "laced with words such as 'gloomy', 'complicated' and 'severe'."

Huang Yiping, the chief economist at Barclays Bank, which has just completed a study of China's real estate bubble, told the *Financial Times* that the probability of a big stimulus package was much lower now because the government was still dealing with the effects of the last one. "China has very heavily indebted local governments and has seen an extraordinary credit expansion that contributed to large asset bubbles, particularly in housing, over the last few years. Over-investment is also a major concern and these are all problems that have contributed to collapse in other developing economies in the past," he said.

A severe economic crisis in China will have major social and political consequences, with the government calculating that it needs at least 8 percent growth to maintain social stability and prevent a challenge to its rule. There will also be significant consequences for commodity exporting countries such as Canada, Australia and Brazil that have, to some extent, been insulated from the full impact of financial turbulence by high prices and volumes for their commodity exports to China.

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