

SUNDAY, 10 FEBRUARY 2013

## Sunday Start

### What Next in the Global Economy

Happy Chinese New Year and welcome to the **Year of the Snake!** According to my colleague Helen Qiao, ancient Chinese wisdom advises a snake in the house because it protects the family from starving. I told my wife, but she says she'd rather have us starving. Also, *Feng Shui* masters advise people to take precautions against the snake's traditionally **destructive powers**. In fact, previous years of the snake have had more than their fair share of catastrophic events: **2001** (9/11), **1989** (Tiananmen Square), **1941** (Pearl Harbor) and **1929** (Wall Street crash). Luckily, I'm not superstitious and I continue to believe that this year, snake or no snake, will be a relatively **good** one in several respects.

As regards the economic cycle, the beginning of the Year of the Snake probably marks the lower **turning point for global growth**, driven by the meaningful recovery in global trade that I've been highlighting here for several months now. **China** and **India's** slowdown ended in 3Q12, **Japan's** in 4Q, the **US's** and **Germany's** will likely end this quarter and the **euro area's** hopefully in 2Q. Following the slight contraction in US GDP in 4Q, our team now sees US 1Q GDP tracking at +1.9% saar (up from +1.6% last week) on the back of the strong December trade report. In the US and globally, it's still a hesitant and uneven (or bumpy, below-par and brittle) recovery. Yet, the growth momentum is no longer down but up. If – and that's a big if, of course – policy mistakes in Washington, Berlin, Paris, Rome, Madrid and elsewhere can be avoided, there is a good chance that the global economy will emerge **from the twilight into the daylight** later this year and into 2014, as our baseline forecast anticipates. So here's my advice for this coming week: just ignore the probably still bad but backward-looking 4Q GDP releases from the euro area and Japan next Thursday.

What you shouldn't ignore, however, is the ongoing **rebalancing** within and between the main economies – my second reason to believe that the snakes won't rear their ugly heads this year. The **US**, helped by a competitive currency, relatively stagnant labour costs and cheap energy, is on its way to regaining its erstwhile export and **manufacturing prowess**. Across the Pacific, **China**, helped by rising incomes and a gradual implementation of social security reforms, is on a long march towards a **consumer-led economy**. Within the euro area, **Germany**, helped by super-low interest rates, rising wages and inflating property prices, will see **domestic demand improving** and its external competitiveness deteriorating. And **Spain**, where unit labour costs are falling due to recession and reforms and where exports performance is strong, is on its way to become the euro area's **next Germany**. I've been telling the Spain-becomes-Germany-and-Germany-becomes-Spain story for quite some time now, but on my visit to **Madrid** this past week I felt it resonated for the first time with our Spanish clients. True, the talk and the headlines in Madrid have been dominated by the corruption allegations against the government last week. However, hardly anybody I met believes that this has the potential to bring down the government or reverse the policy course. Moreover, several of my contacts who were among the most bearish over the last couple of years now think that the worst for the Spanish economy may soon be behind us. I think they are right.

Third but not least, **central banks** should continue to be **supportive** this year, despite a gradual improvement in economic growth. Fears of an early end of ZIRP, QE and OMT are likely to prove unfounded. However, **here is the twist**: many central banks will likely ease much more grudgingly and reluctantly in the Year of the Snake than last year. The reason is that many of them will be forced into doing more to stem excessive exchange rate appreciation resulting from the unfolding **regime change in Japan**, where the government and the Bank of Japan will likely aim at finally ending deflation. In my view, there is nothing wrong with this: further downward pressure on the yen will merely be the side-effect of the BoJ trying to achieve its new 2% inflation target – the same target most other major central banks have. And to make sure that they don't miss their own inflation targets due to currency appreciation, other central banks will simply have to ease policy further, too. The end result? **An even easier global monetary policy stance**, whether policy-makers like it or not. I know who will like it: so-called risky assets.

**Do snakes like snow?** I guess not. So, fingers crossed that I will be able to fly to Boston later today to start my week of east coast marketing on time. Enjoy your Sunday!

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