INSTITUTE FOR WORLD ECONOMICS
OF THE HUNGARIAN ACADEMY OF SCIENCES

Hungary's EU Presidency Series
IWE Short Notice on current developments of the European Union **No. 21.**

The state of the world economy at the beginning of 2011, with special attention to European Union competitiveness

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In 2010, following on the heels of the crisis, *the world economic boom began*. Economic growth in the USA (on a quarterly basis) was 2.8 percent, 2.2 percent in Japan and 1.8-2.0 percent in the European Union. Among the emerging economies, growth was 9.8 percent in China, 8.2% in India, 5.0% in Brazil and 5.0% in Russia. At the same time, it should be pointed out that, *except in the US, the rate of growth decreased in the developed countries in the fourth quarter*: the growth in the EU's GDP on a quarterly basis was only 0.2 percent and Japan's GDP declined by 0.2 percent. As a group, in the fourth quarter, the OECD countries increased their GDP by only 0.4 percent, equal only to an annual 1.6 percent rate of growth (EIU and IMF data). The *reason for the decline in growth rates* was that the principal components of the renewed economic boom, international trade, industrial growth and the increasing rate of investment, all had begun to slow down compared to the previous quarters. This in turn was largely a natural consequence of the initial rapid boom and the catching-up to or attainment of pre-crisis levels.

Here I examine a little more closely the real economic forces driving growth in 2010 (export, industry, productivity and investments) in order to demonstrate that *Europe suffers competitive lags in several respects*. The *export of goods* from the Euro zone grew by only 6.3 percent last year (on a quarterly basis the more dynamic Germany grew by 10.7 percent). At the same time the growth rate was 18.2% in the USA, 19.4% in Japan and ranged from 20-38% in the BRIC countries. However, by the end of the year, the international trade dynamic had begun to decline everywhere. (Let me add as well here that, according to the IMF, world trade in goods and services grew by 12 percent in 2010, but will most likely rise only 7 percent in 2011 and only 5 percent for the developed countries.). With regard to growth in *industrial output*, the field of the developed countries was more balanced; 7.9 percent in the Eurozone (13% in Germany), 5.8 percent in the US and 4.7 percent in Japan (principalglobalindicators.org). Industrial output illustrated a similar pattern in the emerging countries and was considerably higher, 13-18 percent, only in China and South-East Asia in general (and in the Baltic region, Slovakia, Slovenia and Turkey). However, despite the relatively good performance of European industry, it must immediately be added that during the crisis Europe fell behind in the competition over *productivity*. While work productivity kept growing in the US in 2008-2009, by 3.2 percent during the two years, it dropped 0.8 percent in Europe and 0.5 percent in Japan. With regard to *investments*, in 2010 (quarter on quarter) growth was 6.5 percent in the USA and only 1.7 percent in the EU (7.5 percent in Germany) and 1.6 percent in Japan. Since investments provide the basis for economic growth in the following period, there is no reason to be optimistic. And this does not even consider the fact that in the 4th quarter of 2010 (compared to the previous third quarter) investments came to a halt in both Europe and Japan, or even decreased (by 0.8 and 0.4 percent respectively), while they increased by 1.3 percent – 5.3% on an annual basis – in the US. So in the United States the incentive to invest has only slowed to a small extent (OECD data). In the emerging countries the investment boom has declined considerably.

In reply to the decline in exports, industrial production and investment, American and Japanese economic policy responded by, following upon the previous ones, introducing new fiscal incentive packages at the end of the year (while in some of the more developed EU countries the previously modest packages for the most part came to an end). Obviously, the US and in Japan *had counted on the fact that GDP and its components, production, investment and international goods trade turnover, cannot grow beyond a certain limit without extending consumption*, which is mainly household consumption. It is not certain that the international deficit financing the domestic consumption of the USA can be maintained in the long run, but it is clear that *small-scale commercial retail sales* in the US grew by 5-6.4 percent(!) in 2010 (final household consumption grew more slowly), while, despite intense incentives, it declined by 0.6-0.7 percent in the Euro zone and by 0.3-0.4 percent in Japan. It must, however, be added that in the "core" countries of the EU, those at the centre, the annual growth of domestic consumption amounted to 2-4 percent on average, while it stagnated in the European peripheries as a result of (more) restrictive policies and decreased in some countries (by 19 percent (!) in Greece, 4.7 percent in Spain, 4.5 percent in Portugal and 0.5 percent even in Italy; World dataBank and EIU data).

The latest trends and statistical data are summarized in the following table.

As far as the trends in investment, industry, productivity and export potential are concerned, it is not surprising that the main forecasting institutions predict high economic (GDP) growth of 3.0-3.3 percent for the US in 2011. At the same time, for the EU and Japan, only about 1.7 percent growth is predicted, slightly lower than their performance in 2010. In the emerging and developing countries, after 7.1 percent GDP growth in 2010, "only" a 6.5 percent increase is predicted (about 9 percent in China and India and app. 4 percent in Brazil and Russia) for 2011 and in Middle Eastern Europe 3.6 percent after last year's 4 percent. The world's total GDP grew by 5 percent last year and is expected to increase by 4.4 percent this year (prognoses by the IMF and the EIU).

All these trends will become reality as long as no unexpected or no completely unexpected events take place. But the IMF is of the opinion that we face *considerable risk factors*.

The general danger lies in the fact that despite the crisis global imbalances have not disappeared. The financial system has stabilized to some extent, however, the financial sector remains bloated. For example, the daily value of speculative transactions related to trade in derivative and exchange finances still exceeds 4.5 trillion USD. The finances registered at the American stock exchanges amount to almost one and a half times as much as GDP, etc. The real estate market bubbles are still big (at the moment the situation is the worst in China). Speculation plays a very significant role in the rise of raw material and food prices which generates considerable social tensions

Trends in the most important growth components and GDP

	2010 [a]							2011
	Export	Industry	Productivity[b]	Investment	Investment 4th/3rd Q	Small retail turnover	GDP	GDP prognosis[c]
EU	6.3	7.9	-0.8	1.7	-0.8	0.6	1.9	1.7
GER	10.7	13.0	-2.5	7.5	-1.1	2.5	2.5	2.4
USA	18.2	5.8	3.2	6.5	1.3	6.0	3.2	3.1
JAP	19.4	4.7	-0.5	1.6	-0.4	-0.3	2.2	1.7
BRIC	20-38	13-18	.	.	.	.	5-9.8	4.5-9.6

Remarks: [a] 4.Q/4.Q; [b] 2008+2009 (two years together); c./Annual prognosis.
Source: EIU, IMF, OECD, World dataBank.

worldwide. However, bank financing of the real economy has not yet reached pre-crisis levels, not even in the developed countries. Many banks are still going bankrupt in the US and the European banks are threatened, as well. Some of the states in the US are fighting heavy payment difficulties and the same applies to several European countries. The global deficit/surplus of the countries' international payment imbalances has hardly diminished. At the beginning of the crisis it amounted to 2.5 percent of the world's GDP and today it makes up 2 percent (in 1996 this number was only 0.5 percent). In fact, the fiscal consolidations required by bloated national debts have not yet begun and will – partly because of natural social resistance to austerity – not be a smooth process. It is most likely that countries will attempt to inflate away their debts (the first experiment in this regard will perhaps be the United Kingdom where inflation is already 4.4 percent, while Japan is suffering from disinflation).

For similar reasons, experts at Roubini Global Economics are still estimating the possibility of a W-form crisis of around 10-25 percent.

From a European perspective, the greatest concern is that *it is precisely the EU which demonstrates the tensest assortment of risk factors*. The IMF has even elaborated an alarm scenario for a "strong EU periphery stress" which may cause even a 3 percent divergence by the middle of 2011 compared to its basic EU GDP prognosis (WEO January). Although these developments are less probable, it is worth paying attention to how strongly the IMF warned that the situation of the Eurozone may worsen further. Consolidating the Irish, Spanish and Portuguese banks will require another $120-150 billion capital injection. Portugal has already collapsed. Perhaps Spain or Belgium will be next. Greece is again on the brink of insolvency. Thus *Europe is not only troubled by slower technological development, the productivity problem, the strong Euro, export difficulties and austerity measures which slow the rate of economic development and lead to increased social tension, but also by divergence resulting from differing initial levels of development, uneven development and divergent economic interests*.

The IMF published a rather candid analysis. It stressed that the world economy faces three forces threatening to pull it apart and divide it: 1) that between the EU's core countries and the periphery; 2) that between financial market tensions and the real economy; and 3) that between the developed and the emerging countries. Because of these forces, the world economy is held apart and is not united enough (WEO January).

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