

# UNCERTAINTY WEIGHS ON GLOBAL GROWTH

Global economic expansion weakened in 2012. Europe's ongoing debt crisis and recession hampered growth and heightened uncertainty in the rest of the world. Even the emerging economies of China, India, and Brazil, which had been growing robustly for some time, weakened. Economic conditions may not improve quickly as we enter 2013, and the downside risks facing numerous countries are likely to remain elevated.

Over the course of 2012 through the third quarter, global economic growth decelerated, and economic forecasters continually revised down the outlook for most major economies. In addition, downside risks to the world's economic expansion appeared to intensify around midyear. Growth in global manufacturing flagged. World trade barely grew. All-around uncertainties shook confidence. Most forecasters were expecting only a slight acceleration in global growth in the final months of the year and in 2013—if uncertainties dissipate and as the latest round of global monetary policy easing boosts economic activity.

Overall, low growth and high risks characterized the world economy in 2012, and economic conditions in most parts of the world are not likely to improve rapidly as we head into 2013.

#### **Despite austerity measures, European debt problems persist**

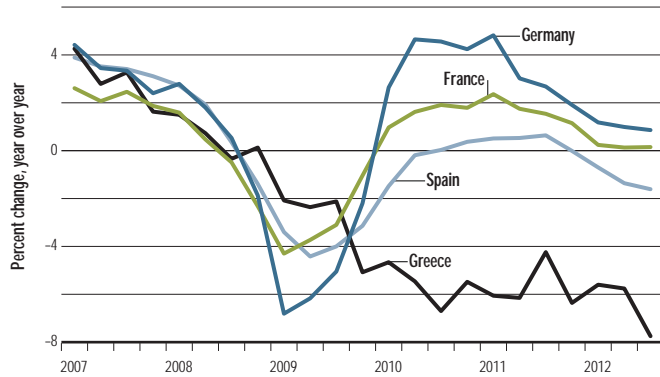
The financial crisis brought on by high levels of government debt has battered Europe since 2009 and proved a formidable impediment to global growth. Greece has been in the eye of the storm, with Ireland, Portugal, Spain, and Italy also suffering from the devastating loss of investor confidence. The crisis abated somewhat in the beginning of 2012, in part as a result of the European Central Bank's (ECB) provision of relatively cheap three-year funding to European banks that allowed them to refinance maturing debt. But a few months later, market sentiment deteriorated again amid rising concerns about Greece's potential abandonment of the euro, Spain's ability to address its fiscal and banking sector problems, and continued worsening of the euro zone's economic prospects.

As the crisis intensified, European leaders agreed at their June summit to develop a road map toward strengthening the European Union's fiscal, financial, and economic integration. On the financial side, as a step toward forming an area banking union, the European Union's finance ministers decided in December to establish a single supervisory mechanism for the region's banks under the ECB.

However, the June summit failed to prevent the financial crisis from deepening. Market sentiment became progressively worse until late July, when ECB President Mario Draghi said, "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough." In early September, the ECB followed through by announcing that it would buy short-term bonds of euro zone governments without limit, but the purchases would be subject to strict conditions. The central bank would buy the bonds only of those countries that have applied for help from the region's rescue funds—the European Financial Stability Facility and its successor, the European Stability Mechanism—and accepted the funds' policy conditionality, essentially submitting to outside control of the countries' fiscal matters. The announcement caused financial markets to rally in relief, but it will likely be months before the outlook substantially improves for the broader economy.

The euro zone's economy, weakened by the loss of confidence and severe austerity measures, has not grown since the third quarter of 2011. Although Germany and France—the region's largest economies—have managed to avoid recession thus far, the economies of fiscally weak countries in southern Europe have been contracting for a number of quarters, in some cases at

Chart 1  
Gross Domestic Product, Europe



Note: Data indicate 2005 chained euros.  
Source: Haver Analytics

alarming rates (see chart 1). The unemployment rate for the region as a whole reached a record high of 11.7 percent in October, with rates of joblessness varying from less than 6 percent in Germany to more than 25 percent in crisis-stricken Greece and Spain.

### Emerging economies weaken

Through trade and financial interconnections, the euro zone's crisis has impeded economic growth and heightened uncertainty all over the world.

Advanced economies as a group have grown at a lackluster pace since mid-2011. Actual growth has varied across different parts of the world—from moderate expansions in Canada and Australia to pronounced weakness in the United Kingdom and double-dip recessions in southern Europe. Japan's economy grew strongly in the beginning of the year as the country rebuilt after the devastating 2011 natural disasters, but economic output fell in the third quarter as both domestic demand and exports weakened.

A recession in the euro zone and tepid growth in the rest of the developed world have put the brakes on growth in export-oriented emerging market economies, including commodity-exporting countries. Although domestic demand has by now become an increasingly important source of growth in emerging markets, exports continue to be a key driver of economic activity. Most developing countries still cannot grow at their trend rates if growth stays weak for a long time in advanced economies. Recently, domestic demand itself has lost momentum in key developing countries, in part as a result of earlier policy tightening as well as increased global risk aversion that dampened capital flows to emerging markets.

For emerging Asia, the outlook markedly deteriorated, mainly because of the deceleration in China. The world's second-largest economy was hit by a double whammy of weakening European demand for its exports and earlier domestic tightening measures intended to cool the red-hot real estate sector. China's economic expansion has been decelerating for more than two years. In response to slowing growth, the country's authorities recently introduced a package of fiscal and monetary stimulus measures. While it may take time for these measures to affect the economy significantly, the latest available data show that at the end of the third quarter, growth momentum in China had picked up somewhat.

Economic conditions have also notably deteriorated for India. The country continues to suffer from a poor business environment and a lack of much-needed structural reforms. The country has dealt with two years of political gridlock, which has resulted in a failure to implement major reforms. India also continues to struggle with high public deficits and debt, as well as elevated inflation. Putting more downward pressure on economic growth in 2012 were unfavorable weather conditions that negatively affected agricultural production.

Latin America has also experienced slowing growth. The region's weak economic numbers mainly reflect a sharp slowdown in Brazil. As Brazil's economy began to slow in 2011, the country's central bank started aggressively easing monetary policy. The easing, combined with some fiscal measures, has had

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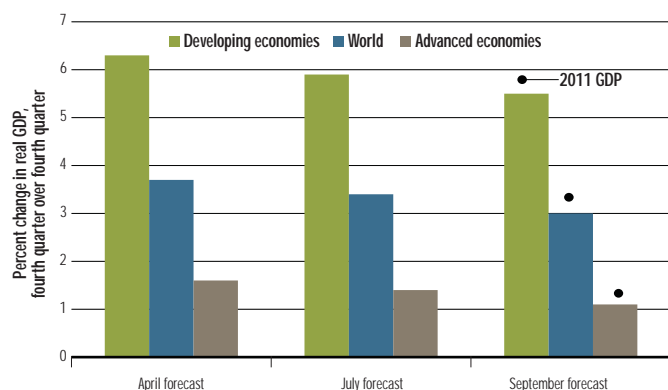
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Chart 2  
Changes in GDP Forecast for 2012



some positive effect—monthly data indicate that in the third quarter of 2012, industrial production grew for the first time in more than a year.

Globally, slowing growth has led to a number of policy actions, mainly in the monetary policy realm since, in general, governments and their citizens largely lack the appetite for additional fiscal stimulus. In addition, many of these countries are already coping with high levels of public debt. In advanced economies, the Federal Reserve and the ECB let loose

a new wave of monetary easing. Many emerging markets' central banks have been easing their policies as well, but few are in a position to undertake aggressive monetary easing because of domestic capacity constraints and inflation that is at or often above official targets.

### Global outlook remains uncertain

At the moment, the world economy is in a precarious state. In September, the International Monetary Fund (IMF) revised down its 2012–13 growth forecast for the global economy for the second time since April, citing the persistent intensity of the European crisis and policy uncertainties that have hurt confidence around the world (see chart 2). Similarly, the Blue Chip consensus forecast has recently showed broad-based and, for a number of countries, continued markdowns for growth this year and in 2013.

The IMF expects only modest acceleration in economic activity from 3.3 percent this year to 3.6 percent in 2013. In the euro zone, diminishing austerity measures and easing financial conditions are hoped to spur some positive growth. Most forecasters project continued lackluster growth in advanced economies, but relatively solid growth in emerging markets. In these markets, economic expansion is likely to accelerate, helped by relatively strong fundamentals in many countries. Still, the developing world's growth rates are not likely to return to precrisis levels in the near term.

The outlook for the global economy is highly uncertain and subject to a number of serious downside risks. The inability of European policymakers to contain the region's crisis is at the top of most forecasters' list of risks. Another risk is the so-called fiscal cliff in the United States. A sharp slowdown in China's economy and a jump in oil prices are also on forecasters' radars. All the risks and uncertainties are weighing on businesses' and consumers' decisions to invest, hire, and spend and are not allowing the global economy to gather strong growth momentum heading into 2013. ■

*This article was written by Galina Alexeenko, director, Regional Economic Information Network at the Atlanta Fed, Nashville Branch.*

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Underemployed workers in this category—also called “part-time for economic reasons”—grew during the recession.

Another factor shaping labor markets is the rate of participation, which has been falling since the early 2000s. This trend is largely the result of demographics—namely, the aging population. Of course, some of the decline in participation rates also reflects recent economic conditions. Consider, for instance, the millions of “marginally

**In my view, efforts to evaluate employment conditions must consider the complexity and dynamism of the U.S. labor market.**

attached” workers—people who indicate that they are ready and willing to work but are not actively searching. Many of these individuals will likely return to the labor market as conditions improve.

Additional aspects include the variations in employment conditions across regional labor markets, as well as the way in which new jobs are created. Research indicates that new and early-state businesses are responsible for a significant share of jobs created in this country. At the same time, young firms often do not survive past five years. Indeed, job creation in our country is in a state of continuous churn as jobs disappear due to business failure and are replaced by jobs in newer, growing industries.

#### **Determining what improvement looks like**

Hopefully, these factors provide some insight into the complexities that shape the U.S. employment market. This brings

us to the challenge my FOMC colleagues and I face as we consider the labor market’s progress toward “substantial improvement.” My framework for defining this important milestone is, admittedly, a work in progress. Although the monthly unemployment rate and payroll figures are a good starting point, I will look to additional data elements to reinforce and enrich movements in these two statistics.

Examples of what I would look for include a lowering of the unemployment rate that is driven by a steady stream of job-seekers into employment. Discouraged workers leaving the labor force would also lower the unemployment rate, but I would not necessarily interpret that as a sign of improvement. I’d also look for growing public confidence in labor markets, as indicated by greater labor force participation. I would like to see employment gains that are associated with reductions in underemployment. And finally, I’d look for signs that these improvements are gaining momentum, are sustainable, and are complemented by forward-looking indicators such as falling initial claims for unemployment insurance.

Adding context to the term “substantial improvement” is important, I believe, because future monetary policy actions by the FOMC hinge on improving labor market prospects. The latest monetary policy actions announced by the FOMC, in addition to earlier measures, demonstrate its commitment to the Fed’s dual mandate of price stability and maximum sustainable employment. We will not waver on that commitment. ■

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