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World economy
New sources of growth are slow to emerge; risks and uncertainties persist
An analysis by credit insurer Euler Hermes

The global economic rebound since the spring of 2009 has not neutralised the impact of the historic recession suffered by developed countries. In particular, the weight of OECD countries in global industrial output and trade has receded by several percentage points. The present rebound is very uneven and artificially boosted by significant but temporary support factors. The global economy is still going through a critical phase with numerous obstacles, uncertainties and risks, particularly in Europe where Euler Hermes, the world's leading credit insurer, considers the risk of the rebound running out of steam to be strongest.

"2010 is likely to be a moment of truth for the world economy, and particularly for Europe," said Wilfried Verstraete, Chairman of Euler Hermes' Management Board. The global economy ended 2009 on a note of rapid expansion, but global output and trade levels are still below their pre-crisis levels. "The global economy has entered a critical phase as the existing support factors are phased out before disappearing altogether," said Karine Berger, Euler Hermes' Head of Market Management - Marketing and Chief Economist. Global economic growth is expected to stand at around 3% in both 2010 and 2011.

1. The crisis has had a profound impact on industry in OECD countries

The world economy is rebounding clearly, but very unevenly

The world economy emerged from recession in the spring of 2009. The return to growth in **developed countries** was confirmed in the fourth quarter of 2009, with stronger growth in aggregate GDP (+0.8%) than in the previous quarter (+0.3%). This overall result, however, masks three contrasted realities. First, North America where the recovery has been confirmed, secondly, Japan where recovery is totally reliant on exports to Asia and the Americas, and lastly, Western Europe, which was still struggling in the fourth quarter.

In contrast, the economic upturn is far more pronounced for **emerging countries**, with a clear rebound in international trade volumes, up 9% in the second half of 2009, and industrial output, which grew by 8% in the same period. Emerging Asian countries are leading the global recovery, headed by India and above all by China. At the other end of the spectrum, economic recovery in the Central and Eastern European countries is proving slow and fragile.

The weight of OECD countries in global industrial output has declined by 5 percentage points

Despite the recovery in the second half of 2009, the OECD countries have recorded major contractions in **external trade** (down 15% in volume and 22% in value) and **industrial output** (down 13% in volume). As Karine Berger points out, "They have started the year at much lower activity levels than before the crisis, falling back by several years, as in the case of euro zone industrial output, which has dropped back to its 1999 levels." These levels will naturally require the adjustment in terms of employment and corporate investment to continue.

The structural impact for developed countries is significant: their weight in the world economy has shrunk considerably with the crisis, with their shares of global trade volumes and global industrial output declining by respectively 2 percentage points and 4.6 percentage points. The direct consequence has been a **massive contraction in employment** in developed countries, with more than 10 million jobs destroyed in 2009, of which 3.4 million in Western Europe.

2. More than €1,000 billion was injected into OECD countries under fiscal stimulus packages in 2009. The gradual phasing out of this support, combined with monetary tightening against a backdrop of tension on debt, will act as a brake on recovery

The two main props supporting economic recovery - restocking and stimulus packages - will crumble as from the spring of 2010. The end of the **destocking** movement that had exacerbated the fall in activity (20% of the drop in GDP of OECD countries in 2009) is not expected to contribute to the rebound beyond the first quarter of 2010. The **fiscal stimulus packages** will probably continue to produce effects in 2010 and 2011, but for most of these packages the bulk of the programmed measures will come to an end in the summer of 2010.

New brakes linked to debt reduction are now appearing. **Public finances** have deteriorated significantly in OECD countries. The crisis pushed up public deficits by around €1,150 billion, i.e. an average increase in public deficits of 5 percentage points of GDP in 2009. This deterioration has virtually eliminated the leeway of the governments concerned, which are now faced with a phase of fiscal consolidation already embarked on by some countries, such as Greece, Spain, Portugal and Ireland.

Lastly, **monetary policies** will provide no additional support. On the contrary, monetary policies are likely to tighten as the central banks are already focusing on their crisis exit strategies. Interest rate hikes have already been implemented in some countries (Australia and Norway) and could occur in developing countries where inflationary tensions are re-emerging, such as India and China. There is even a risk in Europe that abandoning the present accommodative monetary policy could trigger another strong economic slowdown.

3. Particularly contrasted growth prospects around the world in 2010 and 2011

"The new sources of growth seem inadequate or too slow to appear. There are still obstacles and brakes to growth, particularly in developed countries, which weigh on the exports of emerging countries and increasingly force them to develop their domestic markets," explains Karine Berger.

Driven by China, **emerging Asia** will probably continue to lead the way with growth of around 7% a year in 2010 and 2011. We expect the economic recovery in the **United States** to be confirmed with growth of around 2.9% in 2010, but the strong decrease in stimulus measures programmed for 2011 is likely to act as a structural brake, slowing growth to around 2% in 2011. Lastly, the **European Union** is expected to lag behind with growth of less than 2% a year in 2010 and 2011.

All in all, after contracting by a record 2.1% in 2009, the global economy will recover in 2010 (+2.9%) but recovery will not accelerate in 2011 (+2.9%), with the scenario more unfavourable for developed countries (growth of 1.8% in 2010 and 1.7% in 2011) than for emerging countries (5.1% in 2010 and 2011). The trend in world trade, whose growth is likely to be mainly intra-zone, is likely to be similar, with growth of 10% in 2010 and of 7% in 2011.

4. New post-crisis imbalances are appearing

The recovery is still very vulnerable and there are numerous potential shocks: rise in commodities prices driven by activity in emerging countries, disclosure of further losses in the financial system, doubts with regard to trends in public finances, etc.

"Although vigilance is still called for in the present environment, Euler Hermes is strongly assisting companies to expand their businesses by increasing the cover provided whenever we consider it appropriate. We have come through the crisis with an extremely solid financial situation that enables us to be ambitious for the present recovery period," said Wilfried Verstraete.

Table: GDP growth 2008-2011

GDP growth	Weights (%)	2008	2009	2010	2011
World	100.0	2.0%	-2.1%	2.9%	2.9%
USA	24.6	0.4%	-2.4%	2.9%	2.2%
Canada	2.6	0.4%	-2.6%	2.7%	3.0%
Japan	8.5	-1.2%	-5.2%	1.8%	0.9%
EMU	23.5	0.5%	-4.0%	0.7%	1.3%
Germany	6.3	1.0%	-4.9%	1.5%	1.4%
France	4.9	0.3%	-2.2%	1.0%	1.8%
Italy	4.0	-1.3%	-5.1%	0.5%	1.0%
Spain	2.8	0.9%	-3.6%	-0.6%	0.8%
Netherlands	1.5	2.0%	-4.0%	1.0%	1.6%
Belgium	0.9	0.8%	-3.0%	1.3%	1.6%
Austria	0.7	1.9%	-3.5%	1.4%	1.5%
Finland	0.5	1.2%	-7.8%	1.5%	2.0%
Greece	0.6	2.0%	-2.0%	-1.7%	-0.2%
Ireland	0.5	-3.0%	-7.0%	-1.1%	1.5%
Portugal	0.4	0.0%	-2.7%	0.7%	0.9%
UK	4.6	0.5%	-5.0%	0.9%	1.6%
Sweden	0.8	-0.5%	-4.7%	0.6%	1.9%
Denmark	0.6	-0.9%	-5.1%	1.0%	1.2%
Norway	0.8	1.7%	-1.4%	1.6%	2.1%
Switzerland	0.8	1.8%	-1.5%	1.5%	1.7%
Central and Eastern Europe	7.7	4.3%	-6.2%	2.4%	3.0%
Russia	2.9	5.6%	-7.9%	3.0%	3.0%
Asia (exc. Japan)	16.6	6.7%	5.3%	7.1%	6.9%
China	7.5	9.6%	8.7%	9.5%	8.8%
India	2.0	6.7%	6.8%	7.5%	8.0%
Latin America	7.1	4.2%	-2.1%	3.1%	2.7%
Brazil	2.7	5.1%	-0.2%	4.8%	4.3%
Africa & Middle East	2.3	5.8%	1.1%	4.2%	4.6%

Sources: IHS Global Insight, Euler Hermes forecasts (*) GDP 2008 weighing at current exchange rates

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