

The Global Economic Outlook

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Introduction

The world economy is, in my opinion, witnessing a shift in the balance of power. It is a shift in the balance of economic and financial power. It is not a shift in military power. And, despite the emergence of G20, it is not yet a shift in political power, although that may yet change. Within this shift, the winners will be countries that fit into one of three categories: they will be countries with financial resources, such as China or Qatar; they will be the countries with natural resources, such as water, energy, food or hard commodities and these countries will be from across the globe, across Africa, Brazil or Canada, for example, and the additional winners will be those countries that have the ability to compete by adapting and changing. Traditionally, the US fits into this latter category but this time many doubt it can, although in my view both the US and the UK have the ability to adapt and change, but it will take some time for both as they adjust to the aftermath of the credit and financial crisis.

This shift in the balance of power is characterised by a number of key, underlying, longer-term shifts. These include an industrial revolution in China. This takes place over decades. The first industrial revolution lasted from 1750 to about 1830, before there was a second industrial revolution around 1850. The present industrial revolution may take just as long. It will have profound implications everywhere. China's success has already triggered the opening up of India. The scale and pace of change on the ground across many emerging economies is considerable. The catch-up potential is huge. It is not just China and India. It is evident across many countries. Take the last decade and how Brazil and Indonesia have progressed, in both democratic and economic terms.

These longer-term shifts suggest to me that the world economy is in a Super Growth Cycle.

This may be hard to imagine, given the present pessimism and near-term challenges. But just as one should not underestimate the longer-term positive shifts underway in the global economy, one should not overlook the considerable near-term challenges. Despite my optimism, these are big, near-term risks. The world economy has still to work through debt and deleveraging in the West; exit strategies from policy stimulus need to be implemented across the globe; and the attractions of investing in the higher growth markets in the East threatens a jobless recovery in the West. This year and next will be tough.

Overall, the challenge is that the West has witnessed an Age of Excess. It is now in an Age of Uncertainty. It faces an Age of Austerity. In contrast, across the East, and

many parts of the emerging world, we have seen an Age of Boom. Now we are witnessing an Age of Investment as countries attempt to change their economic model. Next will follow an Age of Outperformance.

Against this backdrop there are three parts to my talk today. First, lessons from the crisis and issues to focus on. Second, the outlook in the emerging world. Third, prospects for the advanced economies.

Lessons from the crisis and issues to focus on

The financial crisis highlighted many things. In particular, it showed: first, an imbalanced global economy; second, systemic failure in the financial system; third, it highlighted the need to heed warning signs. Indeed, as we have seen in recent months with problems in Dubai and Greece, and previously with financial markets themselves, if something looks too good to be true, or if it appears out of line with reality, then it probably is too good to be true and it is probably out of line with reality. But it is hard to say when it will correct.

Consider the imbalanced global economy. There were a number of key aspects to this imbalance. Savings flowed 'uphill' from the Middle East and East Asia in particular, to the West, and in particular to economies such as the US, Spain and UK. In turn, these economies in the West experienced debt and credit expansions which fuelled their economic growth. This old model needs fixing. The challenge, of course, is that not everything broke and the features that need to be repaired take some time to be fixed.

For global economic balance we need to see: the West spending less, saving more; the East spending more, saving less; and currencies need to adjust. This takes time and may not occur in the order that we wish. The West may rebalance quicker than the East, leading to sluggish global demand. Moreover, when the West rebalances, as we are now seeing, a reduction in private borrowing sees private savings rise, and in response to the crisis, public debt has risen. Meanwhile, the tendency across Asia is to increase savings, not reduce them, in immediate response to the crisis. At last year's annual meeting of the Asian Development Bank in Indonesia, it was highlighted that for Asia to rebalance it needed to increase social safety nets; provide help to small and medium-sized enterprises, as these are key for future job creation; and deepen and broaden bond markets. All are key, as across Asia there is high savings across both the household and corporate sectors.

The systemic failure in the financial sector highlighted a number of features: a lack of risk management; a lack of liquidity management; and pro-cyclicality which added to the boom and excesses. I have described this pro-cyclicality as the three G's: Glass Steagall, Greenspan and greed. Although reintroducing Glass-Steagall is not the way to address current problems, its abolition in 1999 played an important part, as did Greenspan's accommodative monetary policy and collective greed as many sought higher returns, along with low rates, regardless of increased risk. Despite all this, it is important to stress that not all broke in the financial system. Banks that were well run, conservative and liquid survived better. Moreover, a number of countries emerged from the crisis in better shape, reflecting effective supervision as well as appropriate regulation, such as India, China, Canada and Australia. It is important to fix what broke and keep what worked.

In my view, the response to the crisis has taken two channels. First, a technocratic, regulatory response, with the involvement of banks, focussed on capital and liquidity issues, with groups like the Basle Committee and Financial Stability Board, playing a key role. There is progress, but it appears slow to much of the wider world. Second, the public and political response, where in response an angry public mood, the political focus has been on structural issues such as size and pay. This focus is linked into issues such as moral hazard, lack of market discipline and the ability of governments to cope. There is a need to align these regulatory and political debates, to avoid unintended consequences of possible regulatory overkill, and the need to have global and not national responses. At the G20 level there need to be cross border international coordination with respect to regulatory reform.

Another key aspect of this crisis has been the lesson that policy works. In 2008 it was said that President Bush's tax cut had achieved the three T's: timely, targeted and temporary. Using a similar analogy, I would say that last year's global policy stimulus had achieved the three S's: sizeable, synchronised and successful. The question now is whether it is sustainable?

I have called the policy stimulus in economies such as the US and UK as the Good, the Bad and the Ugly. The good is that fiscal and monetary policy were used to pull us back from the brink, the bad is that this was not done from a position of strength. In the boom times, budget surpluses should have been run and interest rates should have been higher. The ugly is the consequences. What are these?

Policy has led to a shift in what the markets are worried about. A year ago, the markets were fearful of depression. By last autumn, the worries were that there could be a double dip as the stimulus from the policy boost wore off, that low interest rates could create new bubbles, and that policy measures could further undermine the dollar. Now, the concern has turned to debt. In particular, and a worry highlighted in Davos this January, was that a financial crisis is often followed by a sovereign debt crisis.

In fact I would say that there are four possible ugly consequences linked to the policy stimulus:

- the impact of exit strategies in the West. Will private demand take up the slack?
- if the stimulus remains in place will it trigger debt or inflation problems, as the markets fear?
- I am not as concerned as the markets appear to be about the debt or inflation outlook. Instead, for me, the ugly is more basic: higher taxes or spending cuts, either or both of which will be another factor contributing to a weak recovery in the West.
- and another ugly is that the policy cupboard in the West is bare, meaning there is no policy response if there is another shock.

Avoiding a double dip is still a potential issue. In my view if there is to a double dip it is likely to be triggered by one of two factors: one, an external shock such as higher oil prices, triggered by for instance a further shock from Iran, say; two, a policy shock, either triggered by the cumulative effects of regulatory overkill that restrain lending and credit growth, or exit strategies that lead to premature policy tightening. As Japan showed, with its exit from quantitative easing, it is important to have an announced exit strategy to keep the markets onside, but this exit should be conditional upon the state of the economy.

The biggest ugly for the markets is the high level of government debt and what it means. In my view, markets should worry but they should not panic. And some of the recent analysis has been more of a panic. Worries about debt thus need to be kept in context. Deficits are rising sharply, as growth and tax revenues are hit, and as government expenditure has been boosted by the impact of automatic stabilisers and the policy measures unveiled over the last year. Debt levels have risen in many Western economies, but are not yet at alarming levels. The key is to avoid a debt trap: where debt is over 100% of GDP, and where the rate of interest on the debt is higher than the rate of economic growth. Greece is in a debt trap. So too was Dubai. There are one or two others. Japan is a concern. The best way to reduce a deficit is through stronger economic growth. The trouble is, in the West, growth may not be strong enough to alleviate market worries. Hence the focus on spending cuts and tax increases in a number of Western countries. Consistency between fiscal and monetary policy is essential and thus it is vital that if action is taken to address budget deficits that monetary policy remains accommodative.

That leads directly on to the inflation outlook. In recent years, inflation has been low, but there has been asset price inflation. The trough in core inflation across the globe appears to have been around last September. Now, there is intense global competition which looks set to keep headline inflation low. Despite this, we expect commodity price inflation to rise. Relative to last year already we are seeing worries about energy and food prices. Energy prices are more of a concern in the West, food prices are a bigger issue across the emerging world. The inflation outlook needs to be considered on a country by country basis, but generally across the emerging world there will be a greater case for policy tightening with higher interest rates. In the West, whilst the greater challenge is to avoid premature policy tightening, there will be a focus on normalisation of monetary policy as opposed to tightening, with an end to quantitative easing and a withdrawal of the liquidity provided to the markets. But official policy rates will stay low for some time.

Overall, a key issue is that monetary and fiscal policy need to focus on achieving economic stability, in terms of non-inflationary growth. A lesson of the crisis was the important role played by macro-prudential measures in economies such as China and India. And thus, one lesson for countries everywhere is the importance of using macro-prudential measures to achieve financial stability.

Emerging world

The outlook over the next year depends on the interaction between the economic fundamentals, the policy response and confidence. Of these, confidence is the hardest to call, and frequently in a recovery it can surprise on the upside, thus leading to V-shape recoveries. At Davos there was talk of a L-U-V shape recovery: L in Europe, U in the US and V-shaped across the emerging world. My reading of Davos was that last year the mood was pessimistic, this year it was realistic but it may have to wait a few years until it is optimistic. For the emerging world, the fundamentals are far better than in the advanced economies. There are also policy challenges, which I will refer to below.

Whilst it is important to focus on the shape of the recovery, it is also vital not to lose sight of the importance of levels. At the end of 2008, the world economy was \$61 trillion in size. It is hard to picture this, but it compares with a size of \$31.5 trillion a decade ago, highlighting how strong the expansion of the world economy was prior to the financial crisis.

Ahead of the financial crisis there was much debate on whether emerging economies were decoupled or not. Thankfully, we used the phrase that emerging economies were, "not decoupled but better insulated". So it proved. But it is also worth bearing this in mind in the recovery. Two thirds of the \$61 trillion world economy is accounted for by the West. So if the West is not booming then emerging economies will not boom. And the West, as I will touch on later, will not boom. But there is no doubt that, regardless of the pace of growth in the West, emerging economies will outperform. Whether one is bullish or bearish on the West, growth across emerging economies will be higher. In fact, there will be many similar characteristics to recovery in the East as in the West: growth will not be as strong as potential. Also, it would not be a surprise to see increased volatility along that upward trend across the emerging world.

The crisis showed that for emerging economies, the innocent were hit like the guilty. This was seen as a Western financial crisis across the emerging world. This is borne out by the data on toxic assets. Since Q3 of 2007, total writedowns and credit losses worldwide have reached \$1.73 trillion. Of this, 66% of writedowns (\$1.14 trillion) were in the US, 32% (or \$0.55 trillion) in Europe and only 2% (\$0.04 trillion) in the rest of the world. Many emerging economies had learnt the lesson of the 1997-98 Asian financial crisis, and this included higher foreign exchange reserves and effective supervision of the financial sector.

The main transmission mechanism in this crisis to the emerging world was trade. In fact it was not just open emerging economies but also some of the advanced countries like Japan, South Korea and Germany that were hit hard by the collapse in trade. In Q4 of 2008 and Q1 of 2009 trade fell off the edge of a cliff. This was explained by a combination of factors: lower demand, an inventory correction, a collapse in trade finance and also, in some cases, a reduction in insurance cover and credit protection also impeded trade. A year ago, there were worries, highlighted in a paper by the European Central Bank, that trade flows globally could mirror the early 80s recession. Then it took four years for global trade to return to the levels seen before the recession began. That was in contrast to the more normal two years in which it takes for global trade to return to pre-recession levels. Trade volumes collapsed by about one-fifth during the crisis, bottomed last May and were off the floor by November. On current trends, the level of global trade could return to pre-recession levels by this July. That would be about three years, so longer than the usual recovery after a normal recession but better than was once feared.

When one looks across the emerging world it is important to differentiate. In the worst shape is central and eastern Europe, where growth prospects are poor and external imbalances high. Within that region, it is the Balkans and Baltics that appear in worse shape. One needs to be aware of possible contagion risks, particularly into Western Europe, its biggest trading partner. Next worst is Latin America. This is not a homogenous region. There is no natural leader. Yet, Chile and Brazil appear in best shape. Mexico, meanwhile, is heavily linked into US prospects. Then comes Africa. In past recoveries Africa's recovery has usually lagged. But not this time. Africa appears to be recovering sooner. This is good and fits in with our positive underlying view that there has been a significant underlying shift in African growth prospects. Indeed, we have spoken of a future 'Arc of Growth' from China, through India, into Africa. Next is the Middle East, where it is important not to have a Dubai centric view of the region. In the financial markets there is considerable focus on the Gulf. Outside of the markets, the focus is on the rest of the region. Demographics, diversification and the dollar characterise our view of the region and the need for it to shift to more diversified growth. Notwithstanding the near-term political risks we are optimistic.

Then there is Asia, where the crisis highlighted the need to differentiate between economies such as Indonesia and India where growth is domestically driven and some of the more export-led economies. China, despite its impressive trade and imbalanced economy, can also be seen as a domestically driven economy.

Usually it is only in a crisis that one can test if policy tools and institutions work. In that respect, emerging economies passed the test in this crisis. But it may be the case that the big test is in the early stages of recovery. Monetary policy across the emerging world appears accommodative, and it needs to tighten in response to domestic factors. One of the challenges may be how policy responds to future capital flows. Whereas in recent years there were many signs of emerging economies being able to absorb direct investment inflows, capital flows are slightly different in nature. The crisis highlighted the volatility of bank lending flows, particularly as European banks responded to the crisis at home and problems from central and eastern Europe, by curbing flows to emerging economies. Now the challenge is whether emerging economies can absorb portfolio and capital inflows. The lack of depth and breadth of capital markets means such flows find a home in equity or real estate, adding to asset price inflation. This can lead to a policy dilemma on monetary policy, where if interest rates are hiked, it may attract more hot money, but if rates do not increase, asset prices may rise. It explains why there was much interest and focus on Brazil's decision to hike taxes on inflows, at the end of last year.

One country where the policy dilemma and exit strategies are centre-stage is China. The imminent annual National People's Congress will see the economy once again taking centre-stage. In 2007 China grew 11.9%, 9.6% in 2008 and 8.7% last year. Having been hard hit by the fall-out from the financial crisis at the end of 2007 policy was relaxed, and now we are seeing issues that are similar to those that took centre-stage a few years ago. In 2007 Premier Wen Jiabao described the economy as unstable, unbalanced, uncoordinated and unsustainable. That led to talk of the need for a harmonious society, prosperous society and scientific development. In essence, the focus had switched from the need for strong growth to that of sustainable growth. There was too much investment and too much focus on exports, and there was a need to increase private consumption. The policy debate has, indeed, turned full circle. At the end of 2008, social stability and jobs were centre-stage, policy was eased. Now, avoiding inflation and overheating are important.

Loan growth doubled last year to 9.5 trillion CNY, and in January rose 1.4 trillion CNY. Thus a target of 7.5 trillion CNY has been set for this year, still well above 2008 but down 22% on 2009. Reserve requirements have also risen. Moral suasion and specific measures characterise the approach. Inflation, however, is still low, reaching 1.9% in December and 1.5% in January. The message is that there are bubbles in some areas but China is not a bubble economy.

Banks, which funded about 82% of last year's infrastructure boom, according to our calculations, face some potential challenges. But they should be able to cope. Non-performing loans are less than 2%, capital adequacy is over 10%. Even if banks have to fund some fall-out if bubbles burst in property and asset markets, the public finances are in good shape to cope. The government is able to continue boosting spending on social areas and education again this year, has a budget deficit under 3%, and public debt is low, around 18%, even though there are some off balance sheet borrowings. Overall, China's policy cupboard is far from bare.

Will China compensate for the US? The answer is No if one looks at levels. But if one focuses on the rate of change then it has the potential to fill the gap. Indeed, last

year, the rate of increase in consumption in China and India combined was greater than the fall in consumption in the US. Last year also saw car sales in China exceed those in the US. Indeed since 2005, emerging economies have contributed more to global growth than advanced economies, with Asia explaining half of emerging markets' growth. By 2014, based on our forecasts, Asia alone will contribute more than the advanced economies. But it will not be a straight line. Expect volatility in China and across other markets.

Although we talk of China as if it is one economy the reality is that it is a multitude of economies. This highlights the challenges for policymakers. It also points to increased future volatility. For instance, whilst the Pearl River Delta bordering Hong Kong was in recession, hit by the collapse in exports, Western and Central China has seen strong growth, driven by increased domestic demand. It is understandable why, a few years ago, the leadership talked of the five imbalances: coastal-inland; urban-rural; social; environmental; and international.

What China does is naturally having a bigger international impact. It is the world's second biggest importer, after the US, accounting for 6.9% of global imports. About 40% of its imports are reprocessed for sale onto advanced economies, but increasingly China is a market in its own right for others to sell into. It accounts for two-fifths of global demand for steel and aluminium, one-fifth of global demand for copper and one-tenth for oil. Its impact is significant, for markets and economies around the globe. We talk of new trade corridors, where Asian trade with other regions is rising, with China at the centre: Asian trade with Africa, Latin America, the Middle East and Africa.

The other giant is India. Over one hundred and fifty years ago, as we have often pointed out, China and India's economies were the biggest in the world. The fact that since then they have underperformed highlights that demographics is not destiny. But India's demographics offer it a huge future opportunity. Unlike China, whose population starts to age rapidly in over a decade or so, India has half its population below 25. This young population needs jobs. That is India's challenge as well as its opportunity.

India had a relatively good crisis. Its domestically and service driven economy helped. The fact that companies had enjoyed five years of healthy profit margins also provided a good shock absorber. Whilst there were some fears that India would suffer from leverage this has proved to be isolated problems, not a generic issue. Last year's election also provides relative political stability. Despite this, there are issues. India, like China, is more than one economy. For India it is almost a tale of two economies: the West and South are industrialised, with well educated, English speaking populations. Three states account for over 50% of India's exports. In contrast, there is the Inland part of India, which is poorly educated and where the infrastructure is poor. There about three-fifths of the population work on the land, with agriculture accounting for less than one fifth of GDP.

But despite its problems with excess regulation and poor infrastructure, India has done well. It is also a democracy, an important factor in my view. From 2005-08 India grew by 9% on average, and in 2009 by about 7.5%. Its Budget at the end of February showed a determination to address fiscal challenges, which are still a concern but not as bad as they once were. Growth is the key and India has the potential to growth at around 12-13% per annum.

Advanced economies

What then of the advanced economies? As I mentioned earlier, the outcome will depend on the interaction between the fundamentals, policy and confidence. The fundamentals across the advanced economies are not good compared with those in the emerging economies, although in both groups it is important to look at each country on its own merits. Just as the fundamentals in some emerging regions or countries are not good, likewise the situation varies greatly across the advanced economies. This is highlighted by present problems in the euro zone.

Europe is not a homogenous region. In Western Europe, the prospects in Germany look good, given its huge export machine which is well positioned to benefit from an infrastructure boom around the world and increased demand for capital goods. In contrast, parts of the euro zone are in deep trouble. The countries that used to attract concern were the Club Med countries, over the last year this has turned to the so-called PIGS: Portugal, Ireland, Greece and Spain. These economies are suffering from a combination of factors, including a loss of competitiveness, a weak near-term economic outlook and worries about their fiscal positions.

The problems impacting these countries should come as no surprise to anyone who has analysed the economics of the eurozone. I was heavily involved with the No Campaign that argued against the UK joining the eurozone. The euro makes sense for some countries, but not all. One size in terms of economic policy does not fit all. But the key issue is that history shows that no single currency of large sovereign nations has ever survived unless it becomes a political union. In fact a single currency region requires complete labour mobility so that people can move across the single currency area in search of a job. In addition, it requires a single Treasury so that a rich region in the zone can help out troubled regions in times of difficulty. A good example is the US itself, it has labour mobility and a single Treasury function. The eurozone has labour mobility but does not have the central Treasury function.

Thus, at some stage the euro would have come to a clear fork in the road, where it either goes down the route of greater political union, or even takes the other route where some countries leave. We may be at that fork now. But, possibly more likely, is action will be taken that delays that date. What then could happen now? For Greece not all the choices are open to them: devaluation is not an option; departure from the eurozone also appears unlikely as an option, as a country that leaves the euro has to leave the EU itself; thus depression in Greece is possible as it has to take action to curb its deficit problem. For Greece it is questionable whether the political will is there to take the full action needed, as it would imply the present economic crisis becoming a social and political crisis, as growth is hit and unemployment rises and living standards fall. Thus it is likely that help will be forthcoming. It could be from the centre, from the likes of Germany and France, although they would also expect Greece to be seen to taking action as well. Or, the IMF would be well placed to help, although that option may not be the most palatable on political grounds for the European countries themselves. With Greece set to provide a progress report to the EU Finance Ministers in mid March and with a large amount of debt due for refinancing in coming months this will remain a very fluid situation. One key issue in thinking at the centre in Europe is the need to prevent contagion from Greece to other countries in the eurozone, with concern about Spain particularly high. In Spain, unemployment is 19.5% and rising, house prices have fallen but still look high, government debt has risen and the immediate economic outlook is poor.

The UK, in contrast, has benefitted from remaining outside the eurozone and has seen a large devaluation in recent years. But present market concerns about the UK's present debt situation appear overdone; we should worry but not panic. The key to reduce the UK deficit is stronger growth, but the immediate outlook points to sluggish growth. But the UK needs to move up the value curve, investing in its infrastructure and think globally. In many respects, the UK's outlook is similar to that of the US.

What then of the US? The US faces a weak recovery, particularly by historical perspectives. After the last three US recessions, growth in the following three years averaged five per cent or more. Although confidence can always surprise on the upside, the fundamentals suggest that the aftermath of the crisis, and the need to repay debt and to deleverage point to a sluggish recovery. For consumers, wage growth will be sluggish, unemployment has yet to peak, housing is well off its peak and, despite the recovery in equity markets, pensions are a concern. That points to sluggish consumption. What about private investment? Large firms appear in better shape than small firms, many of whom find access to credit tough either because of credit rationing or the increased cost of borrowing. But there will be an incentive for large firms to invest elsewhere, say in Asia, in future growth markets, as opposed to at home in the US, where there is spare capacity and future demand may be sluggish. However, a weaker dollar may help the competitive position of the US.

Good economics is good politics, usually. Thus the difficult economic situation in the US, even if it is past the worst, points to a difficult political climate. This will be borne out in the US this year, with the mid-term elections. It will also have an international dimension to it. The mood in Washington towards China is turning negative. This may lead to increased pressure on China on its currency. There is a possibility that the US may cite China as a currency manipulator this April. It is not year clear cut that it will. But the possibility that it might could also have some influence on how the Chinese approach their currency policy.

Our view on the dollar at the beginning of the year was that it would have a rally in Q1, would consolidate in Q2 and then experience renewed weakness in the second half of the year. Problems in the eurozone could give the dollar some renewed near-term strength, but despite this the longer-term trend for the dollar is still weaker. The dollar rallied during the crisis, benefitting from a flight to quality, helped by its deep and broad and liquid capital markets, as well as from a reversal of carry trades. Over the last year the Chinese have tried to undermine the dollar by the back-door, questioning it as both a store of value and as a medium of exchange. This has already led to questions about the dollar's reserve currency role. But the reality is it takes some time to lose reserve currency status, as the UK showed a century ago. Indeed, what are the alternatives to the dollar? Not yet the euro. Not the yen. And not yet the CNY, which is not fully convertible.

As a result of this crisis we expect more emerging economies to increase their FX reserves, replicating what Asian countries did after their 1997-98 crisis. In the following decade, Asian countries holdings of FX reserves rose from one-third to two-thirds of the global total. This gave them support in this crisis. For many emerging countries the desire to increase reserves will be driven by either, or both, a desire to remain competitive against the CNY and also be the desire to increase their reserves as future protection. In our view, this increase in reserves will lead to what we call 'passive diversification'. Countries will not actively want to sell the dollar, lest it triggers the crisis they fear. Instead I would expect them to put less of their net new reserves into dollars: hence passive diversification.

Also, as a result of this crisis, and pre-empting this likely increase in future reserves, the IMF may issue more SDRs, replicating what we saw last year when as a result of April's G20 meeting in London, a decision was taken to allocate \$250 billion of SDRs last August, thus raising the ratio of SDRs in global reserves.

All of this should also turn attention to China's currency policy. In my view the CNY is undervalued, but the Chinese are likely to continue to adopt a gradualist approach to currency policy. This is active issue now, in China as well as attracting attention elsewhere. Later this year we expect to see the CNY appreciate. But it could happen earlier. This is an issue across the emerging world. With G7 growth sluggish, there exists concern in many countries about competing with China in third markets, say across Africa, or indeed worries that Chinese goods could flood domestic markets because of excess capacity.

All this should focus attention on global policy coordination. Global policy fora are changing, with G20 displacing G7 on global economic issues. Yet the failure of Doha and problems in Copenhagen does not augur well. Yet there are some key issues in the coming year on which global policy coordination is important. A global approach to regulatory reform. Global coordination on exit strategies, although the exact timing of these will be driven by domestic factors. And global action to avoid trade and protectionist pressures, and instead to focus on free and fair trade.

Conclusion

So, to conclude.

Growth rates across the emerging world will likely exceed those in the advanced economies. Inflation will stay low. Policy rates in the West will stay low, and will rise, driven by domestic factors across emerging economies. Commodity prices, including gold, look likely to rise. Equity markets have rallied, could rise further near-term, but appear to have discounted too much good news. Yield curves in the West should flatten, steepen elsewhere. And the dollar, despite current strength, should eventually trend weaker. The CNY needs to appreciate and, as it does, other Asian currencies should follow.

I believe we are seeing a shift in the balance of power in economic and financial terms. This shift points to the winners being those countries that fit into one of three categories: financial resources, natural resources, or the ability to adapt and change. I have looked here at the Good, the Bad and the Ugly. The Ugly is the aftermath of the crisis and exit strategies. The Good is the prospects for the emerging world. The Bad is the outlook in the advanced economies.

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