

# Rebalancing global growth

## A long way to go

Jul 23rd 2009

From *The Economist* print edition

The global recession is coming to an end, but the ingredients of a lasting recovery are still missing



WITH luck, the global slump has reached its trough. Asia's economies are looking rosier, buoyed by a spectacular rebound in China, where output grew at an annualised rate of some 16% between April and June. Even in America and the euro area, GDP is likely to stop shrinking during the summer. Trade, having fallen precipitately, is levelling off (see [article](#)). And, as firms rebuild their stocks, global growth over the next few months could be surprisingly robust.

That is a welcome prospect. But it is not the all-clear. For this "recovery" has fragile foundations. The boost from restocking will be temporary. And a big source of demand—government stimulus—is unsustainable. Across the globe governments have, rightly, stepped in to counter the economic slump. In America an increase of 12 percentage points in the budget deficit has cushioned the slump in private spending. Around 75% of China's growth this year will be state-directed, either through public spending or officially induced lending.

Governments can prop up economies temporarily, but rising budget deficits are not a route to sustainable growth. Eventually burgeoning debt will limit the room for fiscal manoeuvre, and politicians may balk at renewed stimulus long before then. Worries about the budget deficit are already weighing on political debate in Washington (see [article](#)). A solid global recovery demands healthy and balanced growth in private demand. Unfortunately, that still seems far off.

Before the financial crash, global demand was horribly skewed. It was far too reliant on spending from increasingly indebted American consumers: witness the country's gaping current-account deficit, which reached almost 6% of GDP

in 2006. The crisis—particularly the credit crunch and the destruction of more than \$13 trillion of household wealth—has wrecked the American shopping machine and changed the nature of the world's imbalances. As consumer spending has slumped, the external imbalances have shrivelled. America's current-account deficit this year is likely to be less than 3% of GDP. On the other side of the ledger, China's surplus is on course to fall by half from its 2007 peak, of 11% of GDP, by 2010. The surpluses of both Germany and Japan are shrinking fast.

## Laying out the to-do list

Rebalancing via recession is hardly to be recommended. Worse, even as imbalances between countries have unwound, those within them have worsened, as governments have stepped in. Chinese and German consumers are not spending more; the Chinese and German governments are. The task is to right these internal imbalances without recreating the external ones. The solution is well known: consumers in China and other emerging economies, and in thrifty rich countries like Germany, must become bigger engines of demand, while the former bubble economies, such as America, must continue the shift towards saving and exports.

How hard will this be? We will examine the task in a series of articles on the world's four biggest economies, beginning this week with America's (see [article](#)). The detailed to-do list differs from one country to the next, but three broad requirements stand out: a change of mindset for many policymakers; greater macroeconomic co-ordination than hitherto; and bolder microeconomic reforms.

The shift in mindset is most necessary in surplus economies. Too many German leaders seem to take the economy's export orientation as immutable. Few even grasp the need to nudge it towards domestic spending. China's authorities want to shift towards consumption, but are reluctant to pull the obvious lever: allowing the yuan to strengthen faster.

Macroeconomic co-ordination will be necessary, especially to ensure that the fiscal tightening which must follow the stimulus does not strangle the recovery. While central bankers are laying out their exit strategies from monetary looseness in detail, few finance ministers have done anything similar on the fiscal side. In the big economies they claim they will cut their deficits substantially in 2011, but there are few details, even on the appropriate mix of tax reforms and spending cuts.

The hardest part, however, will be the microeconomic reforms required to smooth the macroeconomic adjustments. China's leaders need to boost household income (for instance by encouraging more labour-intensive growth and forcing state enterprises to pay fatter dividends) as well as improve health-care and pension provision so that people feel less need to save. Japan and Germany both have to encourage investment in services, by freeing

markets from health care to education. America must counter the rigidities that have arisen after its asset bust. Millions of people with negative equity in their homes, for instance, cannot move to get a new job.

The to-do list is a long one, the risk of missteps is high, and it will take years to complete. That is why the world economy is not yet out of the woods.