CITY A.M.

Global growth has peaked for now – but no need to panic

By Allister Heath
February 5, 2014

IT'S NOT time to panic about the global economy just yet. Yes, equity markets are in freefall left, right and centre but the situation is far from universally disastrous. Growth is slowing after a strong run but isn't about to end. There's little chance of broad-based global deflation.

The Fed's belated decision to reduce the rate at which it pumps money into the economy has rattled investors' nerves, and a number of emerging markets face a genuine crisis, in many cases exacerbated by a reduction in the spillover from US liquidity. Bubbles are bursting, as many of us always thought they would; it is a shame that so few people had prepared for this inevitability properly.

That said, Raghuram Rajan, India's excellent central bank governor, was right to hit out at the fact that the world's leading economies exercise their monetary powers with no regard to the consequences on smaller, developing economies. Tapering is pushing upwards pressure on US bond yields, sucking in money from other economies, pushing down their currencies, putting pressure on local central banks to hike rates, which in turn could choke them.

There are also renewed worries about Japan, and US manufacturing seems to have undergone a hiatus in its recovery. But the world economy is not about to tip back into recession, even if we are undoubtedly entering a new phase in the global economic cycle. The reason why it's not time to run for the hills is that plenty of economic indicators remain upbeat, and the Eurozone is clearly recovering at last. UK construction is buoyant, and manufacturing is still expanding quickly, even if the rate of growth has diminished slightly. The key gauge of manufacturing strength – the purchasing managers' index – remain in positive territory almost everywhere in the world, with growth in 81 per cent of countries. More than half the countries surveyed are still improving.

There are exceptions, of course. Argentina, for one, has committed economic suicide by embracing a ridiculous cocktail of socialist and economically illiterate ideas: as the Cato Institute's Ian Vasquez points out, total government spending has rocketed from 22 per cent of GDP just 11 years ago to 44 per cent last year. The populist politics that started with Argentina's crippling debt default in 2002 have led to the printing presses being used to finance spending.

Inflation has hit 25-30 per cent over the past 12 months and the primary deficit – which excludes interest payments – has gone up fivefold. No wonder there has been so much sabre-rattling over the Falklands; while the Fed's gradual tightening is having a global impact, Argentina's demagogic and incompetent politicians have only themselves to blame.

But while investors shouldn't lose their nerve, they should heed the warnings from Simon Ward of Henderson, the only top economist to predict the extent and timing of the UK's recovery last year.

Drawing on monetary trends and the OECD's country leading indicator data, Ward cogently argues that global industrial growth peaked at the end of last year, the rate of expansion of the money supply – six-month growth of currency plus demand deposits deflated by consumer prices – peaked in December 2012 and fell significantly during the first half of last year; given the lags, this had suggested for a while that there would be a loss of economic momentum from late 2013.

He argues that the US economy's expansion will be slower than expected in the first half of the year. In the UK, by contrast, the slowdown in real money expansion has been limited and GDP growth could run at about three per cent during the first half. The recovery is maturing and parts of the global economy are finally readjusting to a slightly less abnormal monetary policy. It is a major challenge – but one we should welcome, not fear.