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Five key risks for next year

Deepening growth concern, weak sovereign and banking sector balance sheets, and inflation are among the worries

AS it enters 2012, the global economy will be pretty much the same as it was in the year before in at least one aspect deep-seated uncertainty will still be there, clouding any forecaster's prognosis of what's in store in the year ahead.

Nevertheless, the consensus view is that everything hinges on the fate of Europe.

Although the rest of the world is not exactly in the best of health either, the other countries are not faring as poorly as the home of the euro.

There are bubble worries in China, sputtering growth concerns in the United States, and unsettling questions about a number of emerging markets, especially in Asia, but none of these can match the troubles of the economies of the eurozone.

“The global economic recovery from the 2008-09 crisis is on a faltering trajectory. There is no end in sight for the two-year-old European debt crisis,” says CIMB Investment Bank chief economist Lee Heng Guie in a recent report.

But that is not all, of course. Lee sees five key risks for 2012. One is the deepening growth concern; as developed countries tackle their debt burden, they will slip into sub-optimal growth.

Weak sovereign and banking sector balance sheets are also a source of anxiety as liquidity becomes a problem from bad debts and loss of faith among depositors in the crisis-hit countries.

Spillover effect on Asia

Another thing to watch out for will be the spillover effect on Asia.

“Asia will not be unscathed if there is a hiccup in the developed economies. The financial channel transmission effect of heightened financial market tensions in the developed economies is powerful, as reflected in stock market sell-offs,” says Lee.

“At the same time, greater global risk aversion in emerging markets leads to sudden capital outflows

and depreciation of regional currencies,” he adds.

And here is the flipside to that the accommodative policies of the Western economies will result in a huge inflow of capital, driving up currencies and creating asset bubbles. That recipe will ensure that the Asian markets will remain volatile.

The fourth key risk is inflation. Although the inflationary pressure in the West has dissipated somewhat, it continues to be strong in Asia. More volatility in the global commodity markets will lead to more supply and demand shocks, and these will fuel the rise in prices in Asia.

And the fifth concern is that China is slowing down and a painful fall is becoming more likely.

“Monetary tightening since the beginning of this year to fight inflation and credit measures to arrest rising property prices have raised fears of a hard landing for China's economy,” says Lee. “More importantly, there are major fears that the large infusion of credit over the past few years could lead to a dramatic rise in bad debts, especially those of local government entities.”

These factors, combined with the weakening of the developed economies, can translate into slower growth for Malaysia.

The country's exports, currently propelled by commodities, may slow down. Amid the growing uneasiness, companies will become less sanguine about pouring money into investments next year.

Lee thinks growth will slow to 3.8% next year, after the country expanded by 5% in 2011.

However, a difference in opinion is apparent among local economists.

Affin Investment Bank economist Alan Tan says the consensus on the growth numbers wildly fluctuates between 1.9% and 5.5% for 2012.

Tan is in the bullish camp. “We are not as pessimistic as a lot of others,” he points out.

He forecasts that Malaysia's economy would grow by 4.9% in 2012 but that too will depend greatly on how the global economy performs.

“We feel the recession in Europe will be felt in the first half of 2012,” he says, adding that a recovery should take place in the second half of the year. “The outlook rests with the eurozone.”

But there are caveats to this viewpoint. For one, Tan thinks there will be no recession in the United States. Although unemployment remains a major headache for the Obama administration and a worry for economists, it (together with the debt consolidation issue) will not be enough to sink the US economy.

Says Tan: “The latest indicators are showing signs of a recovery.”

Although third-quarter gross domestic product (GDP) numbers in the United States have been

lukewarm at best, signs of optimism are emerging in other areas.

New home building is up and so is manufacturing. Unemployment, likely to remain a thorny issue, is slowly improving.

At the same time, other statistics sow doubt about the US economy. For example, consumer spending was up a modest 0.1% in November. Unlike many other places in the world, the United States is driven by consumption, and any weakness in that area will cause some nervousness.

The wellbeing of the United States and Europe has great significance for Malaysia. Although much of our exports went to other parts of Asia in recent years, the country remains sensitive to developments in the United States and Europe.

Notwithstanding a collapse in Europe or the bubble bursting in China, Tan believes that Malaysia would have registered economic growth of 5.5% this year.

“For Malaysia, 2011 turned out to be better than earlier expectations,” he says.

Domestic demand driven

Exports of commodities, such as oil and gas and palm oil, have helped Malaysia the most. Another arrow in the economic quiver has been consumer spending; despite the global worries, it showed no sign of taking a breather.

MIDF Research chief economist Anthony Dass believes that the base case for Malaysia is a growth of 4.8% next year, assuming global growth is 3.7%. The bulk of growth will come from domestic demand, which has been a driver of growth in recent years, and the export of commodities.

His worst-case scenario is growth of 3%, and that is if the world grows by 3.1% in 2012. “That means Europe and the US will enter a recession,” he says.

Global growth will be boosted if US growth improves under Obama's plans to spark the economy. Economists in the United States have forecast that the world's largest economy will expand by 2.4% in 2012 after falling below 2% in 2011. That is heartening for everybody around the world, and if the figure is achieved, the threat of a global recession may be reduced.

Right now, Dass sees a 35% risk of a recession for the world's three largest economies, and for Malaysia, 40%.

“The risk is higher because of the openness of the Malaysian economy as it is vulnerable to a global recession,” he explains.