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The state of the world economy in autumn 2011: a fragile recovery

- The world economy is still convalescent. The 2008-2009 crisis grew out of deep imbalances in the advanced economies, and in particular out of excessive levels of household, corporate and/or government debt. Stimulus plans have mitigated the consequences of this crisis, but at the cost of rising public debt, even though the process of private debt reduction has barely begun. It will take time to clean up economic agents' balance sheets, and global activity could hiccup considerably in the process.

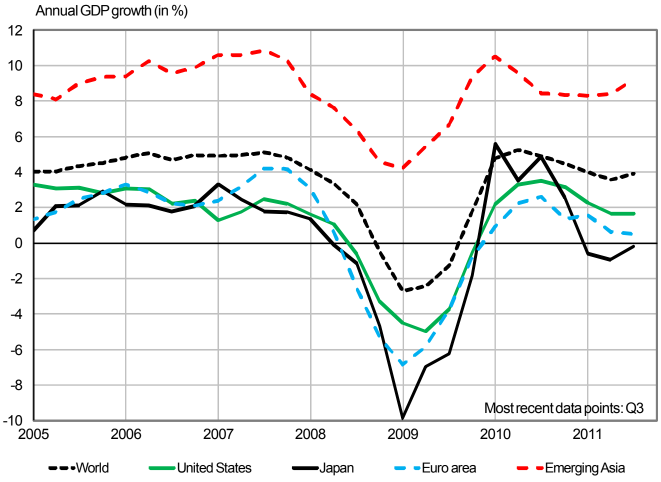
- Consequently, after a fairly strong upturn in 2010, the world economy slowed in the first half of 2011, due in particular to rising commodity prices and the Sendai earthquake in Japan.

- During the summer, bad news from the United States (namely a downward revision of growth, the sovereign rating downgrade, etc.) and European sovereign debt fears sparked a pronounced market correction. This financial turbulence sapped agents' confidence, especially among business heads, with the latest business sentiment surveys reporting a sharp downturn in the growth outlook. The global slowdown is therefore likely to continue to the end of the year, especially given governments' limited room for manoeuvre at present. In many of the developed economies, European in particular, fiscal policy is focused on consolidation while monetary policy is already highly accommodating. The emerging economies are in a more favourable situation, however, still enjoying strong growth.

- The world economy is expected to pick up in 2012. Private sector growth drivers (productive investment and household consumption) should resume progressively in the advanced economies. Japan's reconstruction effort too should support global activity, as should continuing strong growth in the emerging economies, in Asia especially. Without an exchange rate adjustment, the rebalancing of current accounts-which could revitalise global activity-would be very limited and would concern only a handful of countries.

- Global recovery remains seriously at risk, however, the gravest risk being heightened tensions in the financial markets, in Europe especially. Spillovers of these tensions to the real economy, notably via the credit channel, could lead to a contraction of activity in some advanced economies, especially in Europe, in Q4 2011, correspondingly hampering world growth in 2012.

The international environment: GDP growth



Source: DG Trésor calculations.
Note: The scenario presented here is based on information available at mid-November 2012.

MINISTÈRE DE L'ÉCONOMIE
DES FINANCES ET DE L'INDUSTRIE

1. An accumulation of negative shocks in 2011

1.1 Global activity slowed in the 1st half of 2011

After a distinct rebound in 2010, world activity slowed progressively from the start of 2011 onwards (see Table 1), chiefly as a result of two negative shocks, namely soaring commodity prices and the earthquake in Japan (see Box 1).

The first signs of weakening became visible in the Q1 2011, particularly in the United States (+0.1%, after a quarterly average of +0.8% in 2010). The slowdown observed in the world's foremost economy followed a downturn in private consumption, against a background of faster household debt reduction and rising energy commodities prices. In Japan, activity continued to shrink (–0.7%[1]) in the wake of the Sendai earthquake on March 11, which notably brought about a collapse in industrial output of around 15% relative to February.

Table 1: quarterly GDP trends (real, seasonally and working-day adjusted, in%)

	2010				2011			2008	2009	2010	2011 *outturn*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3				
United states	1.0	0.9	0.6	0.6	0.1	0.3	0.5	–0.3	–3.5	3.0	1.6
China*	2.4	2.3	2.1	2.7	2.0	2.4	2.3	9.6	9.2	10.4	8.9
Japan	2.5	0.0	0.7	–0.7	–0.7	–0.3	1.5	–1.2	–6.3	4.1	–0.3
United Kingdom	0.2	1.1	0.6	–0.5	0.4	0.1	0.5	–1.1	–4.4	1.8	0.9
Euro area	**0.3**	**0.9**	**0.4**	**0.3**	**0.8**	**0.2**	**0.2**	**0.3**	**–4.2**	**1.8**	**1.6**
Germany	0.5	1.9	0.8	0.5	1.3	0.3	0.5	0.8	–5.1	3.6	3.1
France	**0.1**	**0.5**	**0.4**	**0.3**	**0.9**	**–0.1**	**0.4**	**–0.2**	**–2.6**	**1.4**	**1.7**
Italy	0.6	0.5	0.3	0.1	0.1	0.3	nd	–1.3	–5.1	1.5	0.7
Spain	0.2	0.3	0.1	0.2	0.4	0.1	0.0	0.9	–3.7	–0.1	0.8
Belgium	0.1	1.1	0.4	0.5	0.9	0.4	0.0	0.9	–2.7	2.3	2.0
Netherlands	0.4	0.6	0.3	0.6	0.7	0.2	–0.3	1.8	–3.5	1.6	1.5
Greece	–1.9	–1.3	–1.6	–2.8	0.2	nd	nd	1.0	–2.3	–4.4	–3.1
Ireland	1.5	–0.4	0.2	–1.4	1.9	1.6	nd	–3.0	–7.0	–0.4	2.0
Portugal	0.9	0.4	0.3	–0.5	–0.6	–0.1	–0.4	0.0	–2.5	1.4	–1.1

* Recalculated on a quarterly basis (check that) by the DG Trésor until 2010.

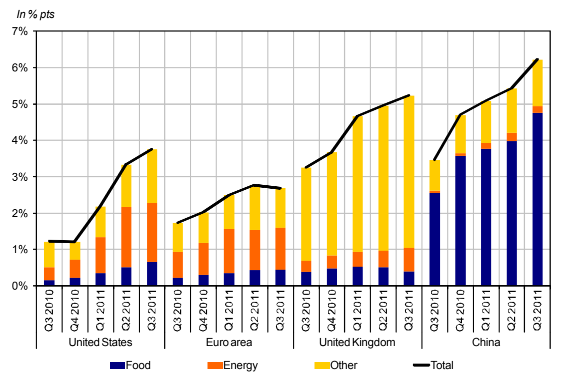
Source: quarterly accounts; thee may be slight discrepancies relative to the annual accounts due to the treatment of working days.

Box 1: Rising commodity prices and the earthquake in Japan affected the global economy in the 1st half of 2011

Oil prices rose by nearly 35%[a] between 2nd-half 2010 in 1st-half 2011. This sharp rise in prices was due to a supply deficit during this period. Output was notably penalised by events in Libya, where production declined from 1.6 million barrels per day (mbd) on average in 2nd-half 2010 to 0.2 mbd in April 2011, and has remained at a very low level since then. Demand, meanwhile, has been relatively buoyant, powered by the bounce back in global activity. Food commodity prices also have risen significantly over the same period (by 21% according to the Commodity Research Bureau), pushing up global inflation (see chart 1).

Inflation in the developed economies, and particularly in the United States and the Euro area, was fuelled by energy prices, whereas in the emerging economies, China notably, it was food prices[b], that fuelled inflation. Most of the rise in prices in the United Kingdom, on the other hand, stemmed from other factors such as the VAT increase in January 2011 and the weakening of the pound.

Chart 1: Contributions to total inflation



Sources: National accounts and DG Trésor calculations.

The earthquake at Sendai in Japan, on March 11, impacted global activity significantly. To begin with, falling demand from Japan has worked its way through to the rest of the world via the trade channel. Meanwhile, production in the countries that import intermediate good from Japan (i.e. the southeast Asian countries) has suffered, particularly in the electronics and car manufacturing sectors. In the short term, the global impact is thought to be close to –1% in China, –1½% in Southeast Asia, and –¼ % in the United States, the United Kingdom and the euro area. The impact is likely to be smaller for 2011 as a whole, with the return to normal pushing output back upwards from the 2nd half onwards.

a. Brent spot price in US $.
b. The proportion of food products in the basket of goods is significantly greater in the emerging economies.

(1) The 0.7% decline in activity in Q4 2010 followed the ending of the car-scrapping scheme and a steep rise in the price of tobacco.

The slowdown in global activity became more pronounced in the 2nd quarter, affecting all of the main developed regions of the world.

In the Euro area, activity slowed sharply in Q2 (+0.2%, after +0.8%), as expected, coming after the distinct rebound in Q1, fuelled in part by temporary factors such as the climate effect and car scrapping schemes. This slowdown stemmed also from the halt to private consumption, penalised by rising energy commodity prices. This affected the "core" economies in particular: growth slowed significantly in Germany (+0.3%, after +1.3%), in France (–0.1%, after +0.9%) and the Netherlands (+0.2%, after +0.7%). Italy and Spain, where growth was less buoyant in Q1, continued to grow at a moderate pace (respectively +0.3% and +0.1%).

Activity also flagged in the United Kingdom (+0.1% in Q2, after +0.4%), due to a slowdown in British industry, the one-day holiday to mark the royal marriage[2] and the impact of the Sendai earthquake on global supply chains.

Unsurprisingly, the earthquake continued to impact powerfully on the Japanese economy, with a further decline (0.3%), albeit smaller than expected thanks to rebuilding of inventories and the initial impact of public reconstruction measures.

US growth remained sluggish by American standards (+0.3%, after +0.1%). Accelerating energy prices again dampened private consumption, even as households continued to pay down their debt. The breakdown in global supply chains in the wake of the Japanese earthquake also hurt activity. This slow pace of growth in the US was all the more disappointing as hefty downward revisions of past figures showed the United States had still not recovered its pre-crisis level of activity at the end of Q2 2011.

In China, growth picked up relative to Q1 (+2.4% coming after +2.0%). This was still slightly below the pre-crisis level of around 2.8%, however, due to the impact of the Japanese earthquake, accelerating food prices, and further tightening of lending conditions aimed at keeping a lid on inflation.

Altogether, global trade was flat in Q2 2011, reflecting and amplifying the global slowdown in activity.

Box 2: **Revisions to national accounts**

National institutes of statistics or equivalent revise the national accounts annually, generally resulting in a change in growth figures for the major economic aggregates for the past 3 years. This year's publication was accompanied by an overhaul of national accounting methods and concepts, commonly referred to as a "change in base", which occurs at less frequent intervals of around 5 years or so. The French national accounts are now labelled "base 2005", this being the new reference year for the main macroeconomic metrics. This change in the national accounts has led to revisions of unequal scale in GDP estimates, particularly for the purposes of evaluating the severity of the crisis and the start of the recovery.

The German national institute of statistics, Destatis, has reported a sharp contraction in activity in 2009, of –5.1%, versus –4.7% as estimated previously.

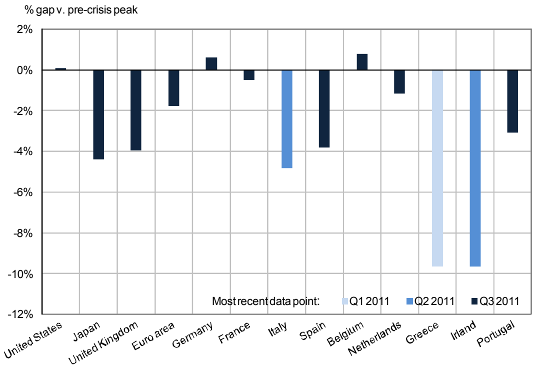
In the United States, the Bureau of Economic Analysis (BEA), which is responsible for the national accounts, has also revised US activity downwards. The 2009 recession was more severe than previously estimated, with activity declining by 3.5%, versus 2.6% previously. The main revision concerns private consumption (–1.9% versus –1.2%) and household disposable income (–2.3% versus +0.6%), which declined, finally, the first time since 1974. The growth figure for Q1 2011 too was revised downwards (+0.1% versus +0.5%).

The revisions for France are distinctly smaller. The recession is described as marginally more pronounced (–2.6% versus -2.5% before revision) and the recovery as a little weaker (+1.4% versus +1.5% before revision).

In the United Kingdom, the change in base, conversely, describes a smaller contraction in activity in 2009 (–4.4% versus –4.9% before revision) and a more robust upturn in 2010 (+1.8% versus +1.4% before revision). In Italy, the change in base reveals a smaller contraction in 2009 and a slightly stronger upturn.

Ultimately, only the United States, Germany and Belgium are estimated to have exceeded their pre-crisis GDP levels in Q3 2011. Activity in France and the Netherlands are reckoned to be close to their pre-crisis peaks. In some euro area countries (Italy, Spain and Portugal), on the other hand, along with the United Kingdom and Japan, activity still languishes well below this peak.

Chart 2: Gap between real GDP and pre-crisis peak



Source: DG Trésor.

Interpretation: In Germany, real GDP growth in Q3 2011 was 0.6% above its pre-crisis peak (Q1 2008). In France, it was slightly below (–0.5% relative to the Q1 2008 peak).

(2) This was not taken into account when correcting for the number of days worked.

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1.2 Financial markets tensions worsened in the summer

After a difficult spring, summer brought a wave of market instability, following a series of events unsettling investor confidence on both sides of the Atlantic. The US economy suffered a spate of bad news, with the revision to the national accounts and rising concern over the public debt (with the debate over the raising of the debt ceiling and S&P's downgrading of America's sovereign debt), in particular. In Europe, market fears also rose in response to worries over sovereign debt, concerning not only countries in debt relief programmes, but also Spain, and above all Italy.

Falling confidence triggered a stock market slide, essentially between the late-July and early-September[3]. Interbank spreads also widened, particularly in the euro area, though they were distinctly below the levels reached in the midst of the Lehman Brothers collapse[4].

This financial turbulence is expected to hurt the real economy in the short term. The loss of confidence on the part of private agents could lead to postponement of consumption and investment decisions. The sharp fall in share prices is degrading the balance sheets of holders of financial assets, and is likely to affect household consumption via a negative wealth effect. The falling value of the shares of quoted companies will probably also penalise investment[5]. Company financing costs could rise, moreover.

Further, some countries have responded by either initiating or reinforcing existing fiscal consolidation, which could squeeze activity in the economies concerned as well as that of their trading partners, in the short term. Italy and Spain in particular have implemented measures expected to make an impact as early as 2nd-half 2011.

Despite worsening cyclical indicators since the beginning of 2011 (see Chart 3), **euro area activity grew by 0.2% in Q3**, i.e. at the same rate as in Q2. Growth is very contrasted across the euro area, with activity gathering speed in the two main economies, France and Germany, (+0.4% and +0.5% respectively). It slowed more or less markedly in the other countries in the zone. Austria and Finland, for example, registered moderate growth (+0.3%); there was nil growth in Spain and Belgium, while growth was negative in the Netherlands and Portugal (respectively –0.3% and –0.4%). **Q3 growth was more robust in the world's other major economic regions**. It regained vitality in the United States (+0.5%, coming after +0.3% in Q2)-bolstered by household consumption and business investment, but penalised by inventories-and in the United Kingdom (+0.5%, after +0.1%). Japan's GDP registered very lively growth (+1.5%, after –0.3%), on the rebound from the Sendai earthquake, fuelled in particular by the upturn in exports and dynamic private consumption. Finally, China again registered vigorous (+2.3%) growth.

The relatively healthy state of activity in Q3 2011 comes as something of a pleasant surprise, given the financial turbulence in the United States and Europe over the summer. However, these financial tensions could work their way through to the real economy further down the road.

1.3 For Q4, the main cyclical indicators now available are pointing to a fairly sharp slowdown in euro area activity, and to a lesser extent in the United States and the United Kingdom

Q4 activity is expected to suffer from weaker consumer and manufacturers' confidence, although the scale of the decline in activity in certain advanced economies is still unsure at this stage. Indeed, purchasing managers' (PMI) surveys have been reporting a deteriorating business climate on either side of the Atlantic since the summer, in manufacturing especially. The euro area business climate worsened again in October (see Chart 3), clearly within the zone that indicates shrinking activity. The climate was still signalling growth, albeit slow, in the United States on the other hand.

The most recent quantitative information bears out this trend. In the euro area, manufacturing output fell sharply (–2.5%, see Table 2). Part of the fall needs to be seen in context, however, coming after the exceptional 3.6% rebound in both Germany and Italy in July. In Germany, the rise in July followed by the fall in September were due in part to calendar and seasonal effects resulting from the fact that holidays began later than usual in several regions. The situation is more contrasted outside the euro area. Manufacturing output tumbled 3.2% in Japan, stabilised in the United Kingdom (+0.1%), while it grew moderately (+0.5% in the United States in October, after +0.3% in September.

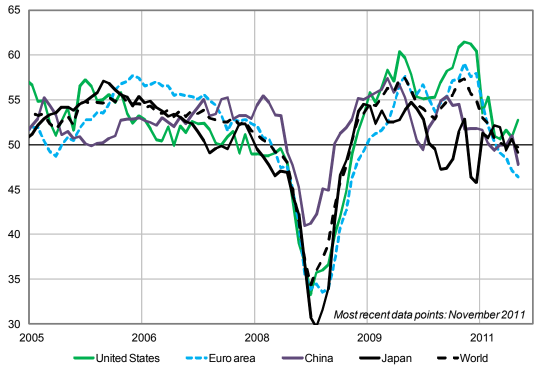
(3) The S&P 500 and the Eurostoxx 50 indexes were down 14% and 26% respectively, between July 25, and September 12.

(4) The gap between 3-month interbank rates and day-to-day expectations in the euro area has been close to 80 basis points, on average, since the beginning of September (versus around 180 basis points during the Lehman Brothers collapse).

(5) This decline leads mechanically to a deterioration in the ratio of a company's market value to its fixed capital replacement cost", otherwise know as the Tobin Q.

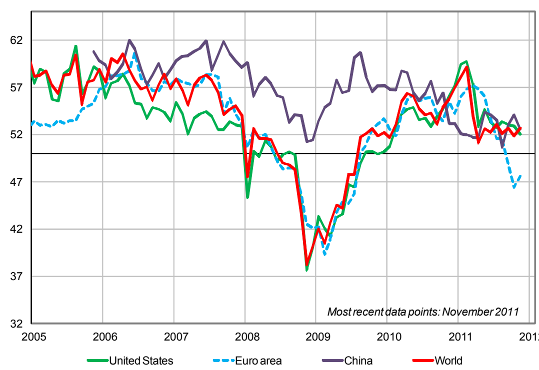
Chart 3: Purchasing managers surveys

Manufacturing PMI



Sources: ISM, Markit.

Services PMI



Sources: ISM, Markit.

Table 2: Manufacturing output: monthly and quarterly variations

	Jan-11	Feb-11	Mar-11	April-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Q1	Q2	Q3
United States	0.7	0.2	0.7	–0.6	0.2	0.0	0.8	0.3	0.3	1.9	0.1	1.1
Japan	0.0	1.8	–15.5	1.6	6.3	3.7	0.4	0.6	–3.2	–2.1	–3.9	4.2
United Kingdom	0.8	0.3	0.4	–1.3	1.8	–0.1	–0.1	–0.3	0.1	1.1	0.2	0.2
Euro area	0.7	1.2	–0.5	0.3	0.1	–1.1	0.8	1.6	–2.5	2.3	0.0	0.3
Germany	0.7	1.6	1.0	0.4	1.3	–1.0	3.6	–0.4	–3.0	2.3	2.2	2.1
France	**2.2**	**0.8**	**–1.0**	**–0.1**	**1.3**	**–1.9**	**1.5**	**0.6**	**–1.6**	**3.2**	**–0.3**	**0.5**
Italy	–1.3	1.1	0.6	0.9	–0.8	–0.4	–0.6	3.6	–4.3	0.0	1.0	–0.2
Spain (*)	1.1	0.1	–1.3	–0.3	–0.1	–0.8	–0.8	1.0	–1.5	0.4	–1.5	–1.1

(*) Industrial output .

Sources: national.

Amid this economic gloom, economic policy could help limit the forecast slowdown in activity. There is little room for manoeuvre on the fiscal side, especially in the European economies, due to rising tensions in the sovereign debt markets. There does appear to be a little more leeway for monetary policy, though. Indeed, now that inflation risks are rather more balanced, and given the increasing downside risks to growth, the initially expected monetary tightening is unlikely to materialise. Monetary policy therefore could well remain highly accommodating, with greater recourse to non-conventional measures (see Box 3).

Box 3: **World fiscal and monetary policies**

Monetary policy in the developed countries is still highly accommodating. The European Central Bank (ECB) reactivated its Securities Market Programme (SMP), purchasing sovereign debt, in August 2011, in response to contagion regarding tension over Spain's and Italy's sovereign debt. Total securities purchased amounted to €195 billion, or 2.1% of euro area GDP, on November 14, 2011, representing an increase of €121 billion since the beginning of August 2011. The ECB announced that would pursue its Covered Bond Purchase Programme, CBPP), raising its amount to €100 billion, versus €60 billion at present. Long-term (12 and 13 months) refinancing operations were also implemented in October, and there will be another in December. Finally, after two slight rate increases in April and July, the ECB cut its key policy rate by 25 basis points on November 3, lowering it to 1.25%. The Fed, apparently concerned above all by the sizeable output gap and under-employment in the United States, has announced that it will not be raising its key rate before mid-2013. Its commitment made at the meeting of the Federal Open Market Committee on September 21, 2011, to extend the maturity of its holdings of securities should put downward pressure on sovereign rates. The Bank of England (BoE) is unlikely to modify its key rates before the end of 2012 despite high inflation (4.2%) forecast for 2011, though the latter stems mainly from temporary effects such as the VAT increase, the weaker pound and rising commodity prices. The BoE too decided on October 6 to expand its securities purchases by £75 billion. Finally, faced with persistent deflationary pressures and the demands of reconstruction, the Bank of Japan (BoJ) is expected to maintain its zero rate policy over the time horizon of this forecast.

Fiscal policy is more heterogeneous, as between the need for consolidation and the need to support activity. All countries in Europe are now engaged in fiscal consolidation to varying degrees. Fiscal policy remains expansionary in the United States, however. The Tax relief, Unemployment Insurance Reauthorization and Job Creation Act, adopted in December 2010, represents a little over 6 percentage points of GDP, including just under 3 points for 2011. However, the clear impetus given by this plan in 2011 is likely to be smaller, since a substantial portion of this plan entails rolling over the measures contained in the February 2009 stimulus plan. Japan has already enacted two stimulus plans in 2011 representing around 1.2 point of GDP, particularly to cover post-earthquake reconstruction. A third and larger stimulus plan could be initiated in autumn.

Fiscal and monetary policy has become more restrictive in the emerging economies, on the other hand, although some countries, such as Brazil, appear to have shifted their stance, recently. China, for example, has introduced restrictive measures to address the overheating property market, notably, by raising compulsory reserves and trimming lending quotas, among other, while fiscal stimulus measures have been withdrawn progressively.

2. Activity to pick up starting in 2012, once tensions have been dispelled

Assuming financial markets return to normal, global growth should pick up progressively in 2012, fuelled by Japan's reconstruction effort, the emerging economies' dynamism, and gradual recovery of the advanced economies' private-sector growth drivers.

2.1 Global growth powered by the emerging economies and Japanese reconstruction

China's growth is expected to remain robust, albeit slightly below its pre-crisis pace. It should continue to be supported by vigorous domestic demand, private consumption in particular, as inflationary pressures abate (assuming commodity prices stabilise) and wages rise[6]. A partial rebalancing of domestic demand in favour of consumption is expected to take place, coming after the blatant distortion of recent years resulting from government support for investment[7]. External trade too is expected to support Chinese growth, though to a lesser extent as a result of factors curbing business's competitiveness (due to rising wage costs and the ending of subsidies). The current account balance is likely to show a surplus of slightly over 5 percentage points of GDP, compared to nearly 10 points of GDP over the period 2005-2008.

Growth in the other emerging countries is forecast to be equally vigorous. Brazil and India embarked on monetary tightening in early-2010 in response respectively to rising inflation and the risks of overheating. Brazil had already cut its key rate during the summer due to the slowdown in global growth, while India's monetary policy is expected to stay on hold. Overall, growth in the emerging countries is expected to remain robust and to support global trade.

Public and private reconstruction[8] should help the Japanese economy back on its feet. These efforts will support domestic investment and get the country's production capacity up and running again, but they will also push the Japanese trade balance into persistent deficit.

2.2 The advanced economies are expected to pick up in, albeit without reverting to its pre-crisis pace, 2012 driven by private domestic demand

Activity in the leading advanced economies is forecast to pick up in 2012 thanks to the gradual recovery of the domestic private growth drivers, corporate productive investment especially. Private investment should gather pace in most of the advanced economies: capacity utilisation rates have practically returned to their long-term average (see Charts 4), and businesses should continue to rebuild their margins, thanks in particular to rising apparent labour productivity. Moreover, monetary conditions should be highly accommodating once the financial turmoil is over, and this too would be conducive to spending on capital goods. In Japan, moreover, reconstruction spending is expected to spur investment.

Private consumption should pick up too, though more progressively. Diminished inflationary pressures (see Charts 4), as commodity prices stabilise, and moderate underlying inflation, should support purchasing power. The return to normal economic and financial conditions would also help restore household confidence and consumption. On the other hand, unemployment is not likely to fall by much, due to relatively lacklustre job creation and to "flexion effects" (i.e. as people who dropped out of the labour when unemployment soared start seeking work again).

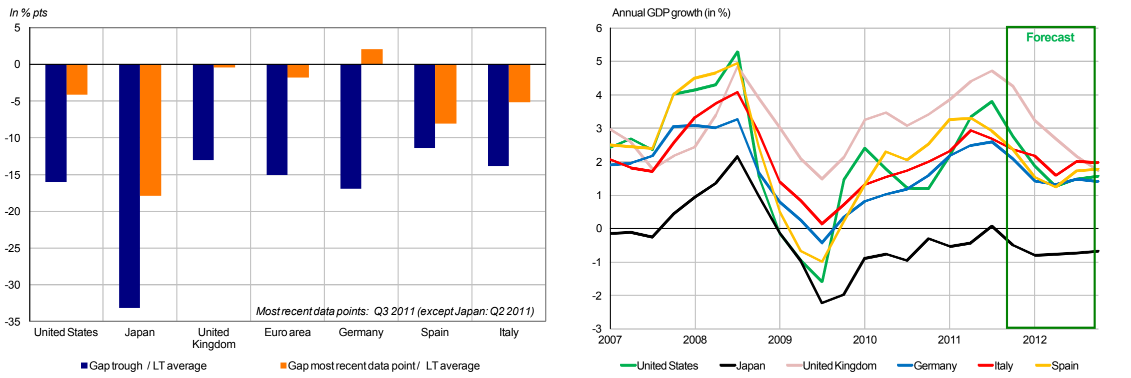
(6) The minimum wage has been boosted by nearly 20% in 2010 and 2011, in several Chinese cities, Shanghai and Beijing for example. Rising tensions in the labour market, with labour shortages in the coastal regions in particular, together with fewer arrivals on the labour market, are likely to push up wages in the short to medium term.

(7) Public investment has been supported by a massive stimulus plan, representing 13 percentage points of GDP over two years as officially announced. Actual spending is likely to be lower, however. Private investment has benefited from the introduction of measures to ease lending. Investment rose 23% overall in 2009.

(8) The government estimates the cost of post-Sendai reconstruction at 5 percentage points of GDP (23,000 billion yen). Of these 5 points, the expectation is that 4 points of GDP will be spent between 2011 and 2015. Two stimulus plans have been enacted already, representing 0.8 percentage point of GDP (of which nearly half for public investment) and 0.4 percentage point of GDP respectively. The third stimulus plan could represent close to 2 points of GDP and will probably be enacted in the autumn. That would leave a final plan of around 0.6 point of GDP to be approved after 2012.

Chart 4: Capacity utilisation rates and inflation in the advanced economies

Capacity utilisation rates | Inflation



Sources: National, DG Trésor calculations. *Source: DG Trésor.*

However, these private sector growth drivers are unlikely to be as dynamic as in the previous upward cycle of 2003-2007. In the United States, United Kingdom and Spain, household consumption will be hindered by slower-growing available income, continuing debt reduction and a diminished property-based wealth effect[9]. Spanish household consumption will also be squeezed by slack demand for labour, with unemployment nearing 20%. In Japan, private consumption is likely to be more or less flat, as many household income support measures expire.

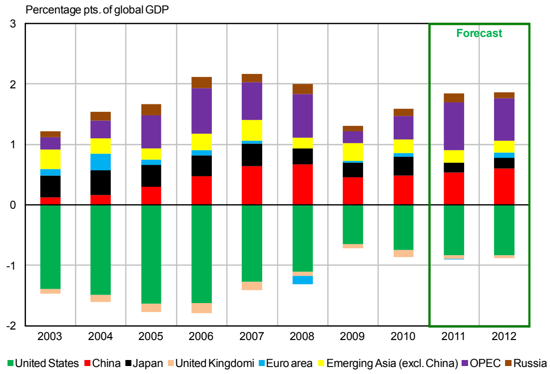
2.3 Substantial global and intra-euro area measures persist

The weak state of private growth drivers **means growth models will rebalance only gradually in 2012, as a result of which global imbalances will merely stabilise, at levels slightly below their pre-crisis level** (see Chart 5).

Expressed in percentage points of global GDP, the US deficit should fall to nearly half its pre-crisis level. This deficit will be offset in particular by the OPEC countries' surpluses, thanks to persistently high oil prices. China's current account surplus will remain high.

In the euro area, current account imbalances will fall slightly. Adjustment in the deficit countries such as Spain, Greece and Portugal will continue as private and public-sector agents continue to clean up their balance sheets. The German surplus is forecast to stabilise at below its 2006/2007 level thanks to healthy domestic demand, fuelled by rising wages and low interest rates, which should buoy residential investment notably.

Chart 5: Global current account balances



Sources: IMF and DG Trésor.

3. Substantial (mainly downside) risks, in a more than usually uncertain economic context

Numerous imponderables cloud the prospect of sluggish growth in the advanced economies and vigorous, though slowing, growth in the emerging economies. Most of the risks are on the downside, due to the high level of uncertainty permeating the markets in recent months.

3.1 Downside risks, mainly financial in origin

The main downside risk concerns the possibility that trends in the financial markets prove less favourable than assumed in our scenario. Persistent financial tensions would have a major impact on lending to the economy and, ultimately, on global activity.

This risk looks especially high in Europe, due to sovereign debt market tensions and their repercussions on the banking system. Failing a return to normal or, worse, an exacerbation of tension in the markets would have a very highly adverse impact on growth, via financial wealth effects, rising borrowing costs and a bank liquidity squeeze, in the short run, and in the medium run

(9) In the United States, property prices are expected to go on falling until mid-2012 due to the persistent overhang of dwellings standing vacant or in foreclosure, and to persistently high default rates. Starting in 2nd-half 2012, prices should move back into positive territory, but would still rise distinctly more slowly that before the crisis. In the United Kingdom, property prices should start rising after shrinking fairly sharply during the crisis. This growth should continue over the forecasting time frame, chiefly due to high supply constraints. However, weak demand for housing means prices will rise more slowly than in the 2000s. In Spain, house prices are expected go on falling due to persistent downward pressure on both the supply side (due to high inventories, possibly resulting form the progressive of stocks held by banks) and the demand side (with the prospect of rising interest rates and weaker household finances).

also, as governments might respond with further consolidation measures.

Two further downside dangers are worth mentioning. The first concerns the US economy and the risk of a rise in the saving rate in order to speed debt reduction, in a climate of greater uncertainty. That would hurt private consumption, by far the American economy's main growth driver. The second relates to the speed at which the Japanese economy recovers. If that proved more progressive than forecast, then world growth would suffer in 2012.

3.2 Conversely, a reduction in imbalances would be a fillip to global growth

DG Trésor's central scenario sees global imbalances stabilising, but these could diminish more rapidly. Since the onset of the crisis, an internal rebalancing has been at work among the advanced economies, since household consumption in these countries can no longer be sustained through borrowing. The emerging countries could boost their domestic growth drivers notably via public support measures, or by allowing their currencies to appreciate, in Asia especially.

Inside the euro area, Germany could continue to redistribute its value added in favour of wages, which would help sustain economies in their adjustment phase. This development is all the more plausible given the buoyancy of its labour market at present, with unemployment at just 6%, while the most recent pay talks have already boosted wages significantly.

Indeed, this is what these countries are hoping for. At the G20 in Cannes, the Action Plan for Growth and Jobs stated: "countries with large current account surpluses and those with relatively weak private demand will play an important role in rebalancing and sustaining global demand". For Germany and Japan, this means promoting private consumption and investment. China will "implement measures to strengthen social safety nets, increase household income and transform the economic growth pattern. Other surplus economies recognise that they too have a significant role to play in promoting global rebalancing and commit to encourage private spending (Indonesia, Korea)".

Moreover, "Australia, Brazil, Canada, China, Germany, Korea and Indonesia, where public finances remain relatively strong, taking into account national circumstances," [agreed] "to let automatic fiscal stabilisers work and, should global economic conditions materially worsen, agree to take discretionary measures to support domestic demand as appropriate, while maintaining their medium-term fiscal objectives".

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