Recession Risks Propagate Globally

We are now on the cusp of the worst global recession in nearly three decades.

Decoupling Denial For quite some time, the received wisdom was that while the U.S. economy would go into recession, the rest of the world – especially Europe – would decouple and escape relatively unscathed. But as we pointed out in this publication last fall *(↗Vol. XII, No. 11, November 2007)*, even a slowdown in U.S. economic growth would significantly damage growth in European exports. The notion that Europe would be largely unaffected by recession in the U.S. was clearly a fantasy.

Divergent Outlooks

	Current Growth	Consensus Growth Outlook	ECRI Growth Outlook
↗U.S.	Recessionary	Recessionary/Slow	Recessionary
↗Canada	Slow	Slow	Slow
↗Mexico	Slow/Average	Slow	Recessionary/Slow
↗Germany	Slow	Slow	Recessionary/Slow
↗France	Slow	Slow	Recessionary/Slow
↗U.K.	Slow	Recessionary/Slow	Slow
↗Italy	Recessionary/Slow	Recessionary/Slow	Recessionary
↗Spain	Recessionary/Slow	Recessionary/Slow	Recessionary
↗Switzerland	Slow/Average	Slow	Recessionary/Slow
↗Sweden	Slow	Slow	Recessionary/Slow
↗Austria	Slow/Average	Slow	Recessionary/Slow
↗Japan	Slow	Recessionary/Slow	Recessionary/Slow
↗China	Average	Average	Average
↗India	Average	Slow/Average	Slow/Average
↗Korea	Slow/Average	Average	Slow/Average
↗Australia	Average	Slow/Average	Slow
↗Taiwan	Slow/Average	Slow/Average	Slow
↗New Zealand	Slow	Recessionary/Slow	Recessionary/Slow
↗South Africa	Slow	Recessionary/Slow	Recessionary/Slow

FOCUS: Indian Economic Outlook

Four months ago *(↗International Cyclical Outlook, Vol. XIII, No. 4, April 2008)*, we called a southern European recession. The weakness predicted then has become increasingly evident in recent weeks, with Spain and Italy clearly in recession.

Even worse, growth in the German Long Leading Index, which had already plunged to a six-and-a-half-year low *(↗International Cyclical Outlook, Vol. XIII, No. 7, July 2008)*, has now dropped even further *(↗Chart 11b, page 14)*, and is around the worst readings seen in recent decades, making a German recession a serious threat.

Recession is also very likely in France, whose long leading index growth rate has dropped to a four-year low *(↗Chart 13b, page 16)*. Even in Austria, which was showing fairly decent growth until recently, recession risks have now emerged. Thus, the Eurozone is racing headlong into a full-blown recession.

Even European economies outside the Eurozone are likely to succumb. The Swiss economy, for example, is now facing significant recession risk *(↗page 23)*, as is the Swedish economy *(↗page 24)*. Growth in U.K. GDP has already stalled, though an outright recession in that country is not as inevitable as most observers believe.

With the U.S. recession a reality, it is no surprise that recession is a growing threat in both Canada *(↗page 10)* and Mexico *(↗page 11)*. There are also other developed economies outside Europe and North America, such as Japan *(↗page 28)*, where there is serious recession danger and export growth prospects have dimmed sharply *(↗page 26)*. Even smaller economies, such as New Zealand *(↗page 35)* and South Africa *(↗page 36)*, may slide into recession.

Growth is also set to slow in non-Japan Asia. Specifically, as we discuss in some detail *(↗pages 4 to 5)*, India is now facing its worst slowdown in at least a decade, and soaring inflation is forcing its central bank to tighten monetary policy, further hurting Indian growth prospects. While a global recession does damage the Indian export outlook, the silver lining is a significant shift in its export destinations to favor fast-growing economies rather than the more mature developed economies. Growth is also set to see cyclical slowing in China, Taiwan and Korea, all of which are heavily dependent on exports.

August 2008 International Cyclical Outlook Economic Cycle Research Institute Volume XIII, No. 8

The problem is especially acute in the Eurozone because the European Central Bank has not only failed to cut interest rates, but actually raised them further last month. It is difficult to fault them, since such action is consistent with the rise in the German Future Inflation Gauge to a fresh 26-year high (*Chart 10, page 13*). The question is why inflation pressures are so strong in Germany when they are already falling in the other major Eurozone economies. Part of the explanation, as we discuss later (*page 12*), is that German job growth has yet to falter. In any case, the lack of monetary accommodation in the face of recession is likely to worsen the Eurozone downturn.

Confronting Concerted Contractions It has been a long time since the global economy was faced with such concerted contractions. This becomes evident from an examination of ECRI's regional coincident and long leading indexes.

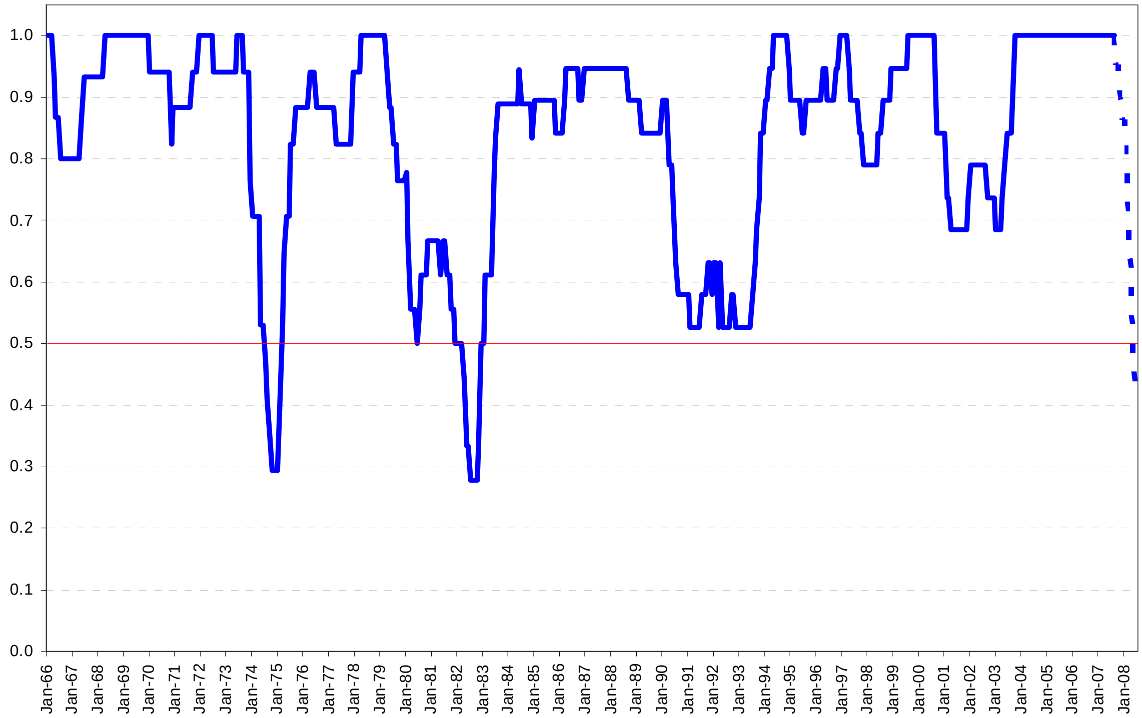
Growth in the North American Coincident Index has now dropped to a six-year low (*Chart 3b, page 6*), while the growth rates of the coincident indexes for Europe (*Chart 9b, page 12*) and the Asia-Pacific region (*Chart 23b, page 26*) have now dropped to five-year lows. But while growth in the forward-looking North American Long Leading Index is around a seven-year low (*Chart 3b, page 6*), the growth rates of the long leading indexes for Europe (*Chart 9b, page 12*) and the Asia-Pacific region (*Chart 23b, page 26*) have dropped to 28-year lows.

In other words, while the North American downturn is serious and likely to get worse, Europe and Asia may be facing their worst downturns since the early 1980s. The situation is especially alarming in Europe, where recessionary weakness is already either a reality or a clear and present danger in every major economy.

One reason why it is often difficult to compare recessions in different economies is that various countries define recessions differently. Thus, most European economies tend to define recessions as periods of below-trend growth, while in Japan a variation of the same concept is used. This is quite different from the official U.S. definition, which involves an actual contraction in the economy. This is one reason ECRI maintains authoritative historical chronologies of business cycle recession and expansion dates for all the economies we monitor each month, in a way that is comparable to the official U.S. chronology.

In order to determine how synchronized past global recessions have been, we constructed a time series showing the proportion of the 19 economies monitored by ECRI that were in business cycle expansions in any given month. As Chart 1 shows, the majority of economies have been in simultaneous business cycle expansions at all times in recent decades, except for

Chart 1: Proportion of 19 Economies in Expansions



two brief interludes in 1974-75 and 1982. Even in the global recessions seen in the early 1990s and the early part of this decade, more than half the economies continued to expand. It is instructive to try to understand the current plight of the global economy in that context.

It is, of course, too soon to authoritatively determine the start and end dates of the ongoing international business cycle recessions, which will not be definitively known for the next year or two. However, we can use our informed judgment about the state of the coincident indicators in each economy, along with the configuration of their long leading indicators, to estimate when each economy may have slid into recession, along with the likelihood of those occurrences. While the dates arrived at for any individual economy may not be entirely accurate, we are likely to see compensating errors so that, in the aggregate, these estimates will provide us with a reasonable picture of the evolving international cyclical landscape.

Worst Global Recession in Three Decades at Hand. No Upturns in Sight.

The estimate is shown as the dashed line in Chart 1, and suggests that we may be in the process of seeing a dramatic drop in the proportion of economies in business cycle expansions. In fact, this may be the most concerted global recession since the oil shocks of the mid-1970s and early 1980s. Even worse, according to the long leading indexes, there is no light yet at the end of the tunnel.

Lack of Locomotives It is natural, in such a situation, to try to understand what will pull the global economy out of recession. Of course, recessions always come to an end, but the driver of the next upturn is not yet evident.

After all, the Eurozone economies are not receiving the sort of monetary or fiscal stimulus that would help pull them out of recession. Nor are exports likely to come to their rescue, given the recessionary global outlook. This is just as true of Japan.

It is widely believed that the U.S. economy, which entered recession before Europe did, will also pull out of recession first. Unfortunately, there is no sign that this hoped-for upturn is anywhere in sight. This is understandable, given that recessionary job losses persist and the U.S. Leading Home Price Index is still in a decisive downturn, suggesting that the financial markets have little hope of stabilization in the prices of homes that lie at the core of their current credit problems. With the credit crisis dragging on, the Fed's rate cuts are unable to reach consumers and businesses, and are therefore not stimulating the economy. Under the circumstances, it is no surprise that by mid-August, growth in the Weekly Leading Index had plunged to a 28-year low.

In sum, we are on the cusp of the worst global recession in nearly three decades, with no end in sight. ■

