The West's turn

Much of the good economic news will come from the rich world, says **Leo Abruzzese**

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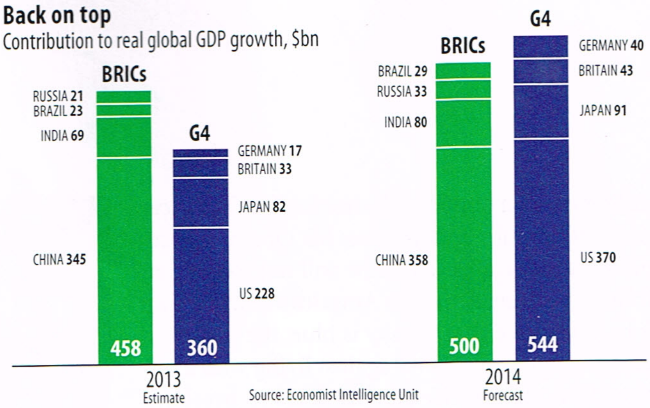
Contribution to real global GDP growth, $bn



Source: Economist Intelligence Unit

In 2014 America will add more to global economic growth than China (at market exchange rates) and Japan will add more than India. Yes, China and India will grow faster than their rich-country counterparts, but the emerging-market upstarts aren't what they used to be, and the West is looking sprightlier, with output growing simultaneously in its three big regions, America, Japan and Europe—a rarity in recent years.

The American economy has created 4.3m jobs in the past two years, and will create another 2m or so in 2014. Cheap shale gas is driving down energy costs, making American manufacturing more competitive. The Federal Reserve, which has kept printing money for the past five years, will slow the presses in 2014 as the economy recovers; this will boost American interest rates and the dollar, luring footloose capital back to American shores. In battered Europe, government deficits have fallen by half. Productivity is improving, unit labour costs are falling and once-large current-account deficits in Italy, Spain and Portugal are disappearing. Britain is also growing again, and Japan is cheering Abenomics, a bet-the-farm recovery plan named after its popular prime minister, Shinzo Abe.

None of these rich economies will go on a tear in 2014. America will do well to grow by 3%, Japan by 2% and the euro zone by 1.2%. Most emerging markets will do better than that, but the performance gap will narrow. As the Fed's tide of cash recedes, money will flow out of many developing economies, exposing weaknesses that were overshadowed—and ignored—during the good times. India's infrastructure remains appalling, Brazilians still do not invest enough and Turkey's current-account deficit is widening again. China's bloated banks, fat with loans that companies will find hard to repay, are looking like Japan's in the 1990s and America's in the 2000s. China's "shadow" banks shuffle trillions more yuan between investors and borrowers, mostly in ways dangerously invisible to regulators.

Attention in 2014 will focus on the Fed, under its new chairman, Janet Yellen (see next leader). It will stop printing money only if the American economy is recovering, but the less it prints, the higher interest rates could go, threatening the recovery. Escaping this trap will require a deft touch—a slow pull-back in its stimulus programme, and a clear, consistent message to markets on its plans. If the Fed mumbles and stumbles, as it often did in 2013, the outlook will be less certain. America's recovery should, though, accelerate in 2014, provided long-term interest rates—the ones that matter most for mortgages and consumer loans—do not surge. Debt in America is being repaid, consumers are spending and businesses are investing again.

The euro zone, happily, will grow in 2014, even though the cracks in its foundation have not disappeared. A banking union, critical to stabilising the currency bloc, will remain at best a work in progress and austerity will keep growth from rising as much as it should. The ropier countries on the periphery, notably Greece, may not have a long-term future in the euro, but their day of reckoning is some years off. For now, the euro area is out of recession and confidence is climbing, led by stalwart Germany.

Japan is also enjoying a resurgence. Falling prices have been a scourge on the economy for much of the past 20 years, but the Bank of Japan's money-printing operation has pushed the currency down and prices up—usually a worrying combination, but not in deflation-prone Japan. A 1980s-style growth surge is not on the cards: Japan's population is shrinking and the country remains overregulated. Mr Abe must bring in structural reforms if the pick-up is to last, and he has so far been hesitant. Japan will also raise taxes in 2014 to tackle its deficit, which could bring the economy to a sudden halt.

Some of China's recent growth was a mirage

Emerging troubles

China is the global wild card. The new leadership that took power in 2013 accepts that the years of 10% growth are over. China will not expand by much more than 7% in 2014, but that is fast enough for a $10 trillion, middle-income economy. The more so because some of China's recent growth was a mirage, conjured up by easy loans that boosted capacity in industries that did not need it. China will not suffer a banking collapse in 2014, but loan repayments will slow.

Bad loans are also piling up in India's banks. One curiosity of 2014 will be that once-enfeebled banks in the West will strengthen while emerging-market banks chase after customers who cannot pay back their loans. As global growth edges up, much of the good news will come from the West. ■

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