

FROM THE FOUNDER

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888 16th Street, N.W.
Suite 740
Washington, D.C. 20006
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com



The New Wildcard of Political Uncertainty

The world is an economic mess, and political uncertainty has become the global economy's new wildcard. Consider some facts.

In Germany, a typical retired person receives a public pension equivalent to 40.5 percent of average earnings. In the United Kingdom, the figure is 28.9 percent. For Greece? 93.6 percent. No wonder the European man on the street is so angry.

America's situation isn't much better. The salary package of a typical private sector worker is nearly \$70,000. A public sector worker? Nearly \$110,000, according to data from the Bureau of Labor Statistics.

In early May, European governments and the International Monetary Fund announced a bailout package for Greece. The austerity measures demanded in return—massive cost increases for the middle class and the poor—are arguably tougher than the measures attempted by Heinrich Brüning, the Chancellor of Germany in 1931–32, which paved the way for Adolph Hitler.

Roughly 50 percent of Greece's sovereign debt is held by foreign nonbanks (insurance companies, hedge funds, and others). What this means is that Greek pensioners are being asked to work longer for less so that foreign pensions holding Greek debt can be protected. No wonder there are riots in the streets.

German and French banks account for roughly half of the \$900 billion lent to Spain by all European banks. As part of the European rescue package, Spain is being told to reduce its labor costs to become more competitive with the stronger economies led by Germany and France. The problem: Spain already faces a 20 percent unemployment rate. How much higher can it go without leading to political chaos?

Americans are also worried about jobs. The Federal Reserve anticipates unemployment will remain above 9 percent until well into 2011. That's because the U.S. economy for 2010 will likely have returned to trend growth of only 3–3.5 percent.

Yet during America's last deep recession of comparable magnitude, the 1981–82 downturn, the outcome was decidedly different: During the first quarter of 1983, real GDP jumped by 5.1 percent, the second quarter by 9.3 percent, the

third by 8.1 percent, and the fourth by 8.5 percent. During the first quarter of 1984, the economy was still growing at an 8 percent pace. What's holding back today's economy? Probably in part the fact that Americans, as a result of the financial crisis, may have permanently lost a huge chunk of their fundamental optimism.

Incidentally, to bring today's jobless rate down from 9.9 percent to 5 percent over the next five years, the U.S. economy would need to produce 250,000 net new jobs per month every month for five years straight. How tough would that be? The average net new job creation since 1990 has been 90,000 a month.

As for the situation overseas, a recent International Monetary Fund study concluded that for the Chinese economy over the next decade to achieve 8 percent GDP growth—the minimum necessary to maintain political and social stability—China would need to double its share of global trade.

Good luck with that. On May 20, the Chinese Chamber of Commerce announced that this year's 14.5 percent depreciation of the euro against the renminbi is causing "huge losses" for Chinese exporters. Europe is China's biggest customer. In 2009, even prior to the recent euro weakening, China's exports to Europe were down by 27 percent. If the euro weakens further, Washington can forget about any Chinese currency appreciation against the dollar. Translation: global trade tensions are certain to rise.

Meanwhile, U.S. public debt is expected to approach an astounding 100 percent of GDP, a level not seen since World War II. Yet core inflation has *dropped* to 0.9 percent, a level not seen since the 1960s. Interest rates are likewise dropping.

No one can explain this phenomenon other than to say that as bad as America and the dollar look, large parts of the rest of the global economy look worse. In short, the world is a mess of ugly political uncertainty.

—DAVID M. SMICK

Mr. Smick is founder, editor, and publisher of The International Economy, and the author of The World Is Curved (Portfolio), now in paperback.

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