5 Things to Know About the Global Economy Right Now

Why Japan is a wildcard, the Eurozone's in trouble, and the BRICS are a bust.

BY DANIEL ALTMAN

Things could be worse, right? Having shaken off the jitters that saw shares drop at the end of July, the major markets have been enjoying another period of relative stability. Apart from Argentina's comic default and a few geopolitical flare-ups, little has happened to raise fears of another crash. The unemployment rate has been falling steadily -- if slowly -- in the United States, Eurozone, and even Japan, where more people are also joining the labor force. Domestic demand has returned even as the fringes of the global economy have frayed. But is there a storm around the corner? Here are a few things to keep in mind as we look to the next couple of years:

1. The Federal Reserve is not out to surprise anyone. For years, the Fed has been saying that it will wait until 2015 to raise interest rates. Nothing has happened to change that plan. As the new year approaches, long-term interest rates -- the kind you pay on a mortgage or car loan -- are sure to rise in response to the coming increase in the short-term rates controlled by the central bank, which is likely to be sustained for some time. Before that happens, we may see a rush of house purchases in the United States as buyers scramble to lock in their loans. Continued strength in the labor market, which gives people faith in their future income, will likely reinforce this demand. Rising rates will be a signal that the Fed believes the economy is on a firm footing, and new inflows of foreign capital are likely to follow. The gap between rates of return in the major markets and frontier economies will shrink, which could be bad news for the latter group -- but more on that later.

2. The Eurozone is still in trouble. At the moment, the Eurozone is in a race against itself.
Households have been drawing down their wealth to pay their bills while waiting for jobs to return; young people have been kept afloat by their parents. The question is whether employment will increase before the wealth runs out. In the past few months, the unemployment rate has begun to fall in several of the countries most affected by fiscal and financial crises. Italy is still suffering, however, and is heading for last place. New rules for fiscal stability and banking, the two centerpieces of the European Union's recovery package, won't save the economy in Italy or anywhere else in the short term; it's a long road back even for countries like Spain, which has tried to revitalize its economy with extensive reforms of the public sector. Two summers ago, a group of graybeards suggested the Eurozone would not recover fully until 2018; that prediction may well be accurate.

3. **Japan is a wildcard in global credit markets.** The central banks of the United States, the Eurozone, and Britain are far more independent than Japan's, and their leaders coordinate policies more closely as well. But a shift in domestic political winds can change economic policies dramatically in Tokyo, as it did when Shinzo Abe led the Liberal Democrats to a huge victory in 2012. Within weeks, the Bank of Japan initiated a whatever-it-takes quest for inflation. The next general election is in 2016. If Abe's policies fail to yield growth by then, Japan could be under new management once again. A sudden disruption in the global economy's ample supply of liquidity is most likely to come from here. The Bank of Japan currently buys about $70 billion in securities every month as part of its credit easing program, which is only a bit less than the Fed bought at the height of its activities. The Fed has tapered its purchases slowly and with plenty of warning. Japan might not.

4. **China has an enormous opportunity to grow.** It hasn't been the best few years for
China. Its dependence on exports, not to mention its internal struggles with credit markets and state-led investment, has led to big downgrades in expectations for growth. The shift from foreign to domestic demand sought by Beijing has not been easy. Between April 2011 and April 2014, the International Monetary Fund's forecasts for growth from 2012 through 2016 fell by a total of 14 percent of gross domestic product -- the equivalent of about two years of current growth going up in smoke. Since then, the forecasts have stabilized, and the ambitious package of economic reforms proposed last year may soon start to push them higher. Xi Jinping has consolidated his power. If he pushes the reforms through without causing too many dislocations in financial markets, particularly as the shadow banking system is formalized, then a new flood of foreign capital will be sure to follow. If it turns into a gold rush, then interest rates in other markets -- especially emerging markets -- could rise as the supply of credit dries up.

5. **Emerging market acronyms are marketing tools.** Remember the BRICs, or BRICS? Growth has petered out in all of them except China, and even there the numbers have disappointed. Then there were the Next Eleven. Of those countries, fewer than half -- Bangladesh, Indonesia, Nigeria, the Philippines, and Vietnam -- experienced the kind of expansion that would make investors' eyes sparkle. And who can forget the CIVETS? They were supposed to grow by 4.5 percent per year through 2030. That may still come to pass if we treat the group as one big economy, but for all of the individual countries it seems unlikely. With the Fed gradually decreasing the supply of easy money starting next year -- and more opportunities perhaps opening up in China -- investors will be a bit pickier in emerging markets; that means looking at them one by one rather than in arbitrary groupings.

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Despite sanctions on Russia, belligerence in East Asian waters, chaos in the Middle East, and other distractions, the biggest wheels in the global economy have continued to turn.
Even as the companies that move markets have expanded around the world, investors and executives have become more adept at insulating themselves from temporary hotspots. Insurance, hedging using derivatives, the globalization of purchasing, and the proliferation of transport options have all helped. But geopolitical troubles still constrain growth and make it tougher to establish new business relationships. If things ever settle down, the world will be wealthier still.

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