A Dose of Reality: Current World Economic Prospects

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Since 2011, the recovery of the world economy has been thwarted while "the South overmatching the North" has continued unchanged. The slowdown of Western economies has increased numerous risk factors: the sluggishness of US economy, intensified European debt crisis, and the negative growth of Japanese economy as a result of the devastating March earthquake. Emerging economies such as China and India continue to grow at high speeds, yet they are faced with increasing challenges. It is difficult to be optimistic for the world economy when the prospects of European debt are not clear, when global unemployment is still high, and when inflationary pressures are becoming bigger.

I. Western economies are downturned while emerging markets have decelerated.

1. US economy flies at a low altitude.

In 2011 the US economy slowed down after growth for three consecutive quarters in 2010. According to US Department of Commerce, in the third quarter of 2011 the annualized growth

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was 2.0%, which was higher than the two previous quarters of 0.4% and 1.3% but far below the level of 3.1% that it reached in the fourth quarter of 2010. Economic recovery falls far short of expectations, and economists in general are not optimistic regarding US economic growth prospects. The US economy is now faced with the following major difficulties.

Unemployment remains high. According to statistics released by US Department of Labor on October 7, 2011, the unemployment rate for the non-agricultural sector was 9.1% in September 2011 and stayed at this level for three months. Roughly 103,000 new jobs were created in the non-agricultural sector, but this amounts to far too few for such a big number of unemployed. The figure improved from the previous two quarters and raised the market expectation, but the nationwide unemployed population still reached 14 million, with an additional 9 people million underemployed. In the third quarter, government spending was very strong, but annual growth of 2.0% could at best relax the deteriorating high unemployment, but not enough to increase jobs in big numbers. High unemployment is taking away the endogenous dynamics of US economic growth.

There has been no improvement in the real estate sector. Real estate is one of the pillar industries of the US economy. The market has not fully recovered since the bubble burst in 2006, an occurrence that later triggered the financial crisis. According to new statistics, sales of new homes rose in October 2011, but both house prices and permissions of building new houses fell, reflecting weak market confidence. The current economic recession is both periodical and structural, and the periodicity is best seen in the real estate market. Prior to 2006, the housing market enjoyed a sustained period of prosperity, and many claim that it reached its ceiling. But when supply for homes greatly exceeded demand, housing prices plummeted and have yet to fully recover. The real estate market is bleak as a result of lowered prices of a great number of foreclosed homes caused by financial crisis. Despite this, it is structural problems that arouse even more worries. The biggest structural problem in the US economy is that the tradable sector increased value but kept jobs at a constant, while the non-tradable sector increased jobs without increasing in value. Structural problems are far more difficult than periodical ones. Both democratic and republican politicians have set out to reinvent the US manufacturing sector, but many believe that this is an impossible mission in our globalized world economy.

Public debt is too heavy a burden to make a turn-around. It is generally estimated that the US public debt-to-GDP ratio is 90%, and its economy is trapped in low growth. According to the latest IMF statistics, the federal debt-to-GDP in 2011 could reach 99%, further climbing to 103% in 2012. The new debt ceiling agreed upon by the two parties in July 2011 was 2.1 trillion USD on top of the current 14.3 trillion, while the government deficit is to be cut by 2.5 trillion in the coming decade. The debt economy will not only hold back individual and corporate spending and investment, but also reduce government spending and investment from its revenues. It will finally check the endogenous dynamics of US economic growth.

To revitalize the US economy, the Obama Administration enacted the US Manufacturing Enhancement Act on September 8, 2011, along with other programs to increase spending on infrastructure and cut corporate and personal taxes. It is evident that medium and long-term restructuring have given way to immediate economic growth targets. If these stimulus policies work, the US economy will grow in the last quarter of 2011 at an annualized quarter on quarter rate of 1.5%.

2. European debt crisis is intensified.

From the beginning of 2011, sovereign ratings of debt-driven

European countries have been downgraded. Following Greece, Spain, Ireland, Portugal and Cyprus, Italy became the sixth downgraded eurozone country in the same year. In short, the debt crisis is spreading.

First, the risk of a Greek default is rising. In June, Greek debt reached 255 billion euros, climbing to 200% of its GDP in a two-year period. Higher default risk made its treasury bonds impossible to guarantee in the market and its banks are now facing high liquidity risks. The panic soon spread to other eurozone countries. French banks own 15 billion euros worth of Greek treasury bonds and other loans totaling 56.7 billion euros, while German banks have 34 hundred billion euros. Both countries are at high risk.

Second, Italy has slipped further into an economic bog. Italy now has a debt of 1.13 trillion, 120% of its GDP, more than twice than that of Spain and three times that of Greece. Debt interest is 4.8% of its GDP, second only to Greece (6.7%). Since Italian debt is still growing, Standard and Poor's has downgraded its sovereign rating and maintained negative prospects. The Italian government also lowered its 2011 growth rate to 0.7% from 1.1%, and 2012 growth to 0.6% and 2013 growth to 0.9%.

Third, Spain is also faced with severe problems. By August, 2011, its debt had reached 680 billion euros, 64% of its GDP, lower than the average level of 83% in the euro debt countries. It must be noted that a series of austerity programs to cut spending and increase taxes have worsened the already catastrophic high unemployment rate. According to a national statistical authority in Spain, unemployment rose to 21.5% in the third quarter from 20.89% in the second quarter of 2011. The unemployed population reached 4.98 million people, the highest rate in all developed economies. In October 2011, Standard and Poor's downgraded Spain to an AA- credit rating. In addition, by the end of 2010, France, one of leading economies in the EU, had accumulated a debt of 1.59 trillion euro. Amounting to 81.7% of its GDP, this debt is unlikely to be reduced in the coming few years. For this reason, Moody's downgraded Crédit Agricole, reflecting market awareness of a potential crisis of the French banking sector. Moody's estimates that the expected growth rates of 2.1% in 2011 and 1.9% in 2012 are both unlikely to be achieved.

3. Post-quake reconstruction in Japan has a long way to go.

The Japanese economy is under the triple tests of the 3/11 earthquake, the tsunami, and the subsequent leaks. The three most hit prefectures of Iwate, Miyagi and Fukushima are home to many pillar industries in Japan, such as steel, petrochemicals, automobile manufacturing and nuclear energy. A good number of famous electronic manufacturers are located there, such as Fujitsu, Toshiba and SONY. The earthquake seriously destroyed much of the infrastructure of the power grids, roads and ports, while paralyzing nuclear plants. A heavily reduced power supply ceased production of a good number of world-famous brand companies, such as Toyota, Nissan and SONY. As a result of the quake and the subsequent tsunami, nuclear leaks from the First Fukushima Nuclear Power Station, run by Tokyo Electric, caused panic and further complicated the crisis. The Japanese government estimated that the combined economic damage caused by the quake, the tsunami and the leaks reached between 16-25 trillion yen, much higher than the 10 trillion caused by the previous Kobe earthquake. It is the greatest catastrophe for Japan in the 60 years since WWII. It is analyzed that Japan's real GDP will shrink by 0.2-0.5% as a result of the earthquake, while the impact on long-tern economic development will also be profound. According to economic statistics published by Cabinet Office of the Government of Japan on November 14, 2011, GDP in the third quarter of 2011 rose by 1.5% from the previous quarter at an annualized rate of 6%, the highest since March 2010. Domestic demand contributed 1% and overseas market demand contributed another 0.4% of GPD growth, which was the first growth seen since the March earthquake. In spite of signs of growth, most economists believe that the momentum is not likely to swing in the coming months, because large government spending on reconstruction after the earthquake has its limits. In addition, post-war record high exchange rate of the Japanese yen and the deteriorated European debt crisis have both seriously threatened the prospects of Japan's exports. There are thus sings of a weakened momentum of recovery.

It is generally believed that demand to invest in reconstruction will facilitate GDP growth and therefore enhance economic development. Ten years ago, the special demand generated by the Kobe earthquake strongly stimulated the economic recovery in Japan. However, this time the post-quake reconstruction effort is faced with a more complicated domestic and foreign economic environment, shading more uncertainties on the prospects of economic recovery. Here are some major difficulties with the reconstruction effort.

First, budget constrains limit policy maneuvering. In recent years, government debt in Japan amounted to double its GDP, the highest amount of any of the OECD countries, while the figure was only 86.2% in 1995 at the time of the Kobe earthquake. The huge funding needed to repair the damage can hardly to be obtained through increasing government revenue or reducing other government spending. The already high debt leaves little room for fundraising by issuing more treasury bonds. This makes it difficult for the government to fund large-scale reconstruction projects. In addition, the long lasting zero interest rate policy has squeezed all the room for lower rates. With the aim of stabilizing the financial market and satisfying the cry for more funding, the Bank of Japan decided to inject extra liquidity of 23 trillion yen into the capital market. Large-scale capital injection will not only deteriorate its fiscal conditions but also lead to a downgrading of its credibility.

Second, the competitive environment has constrained Japan's export growth. In recent years, as the industrialization of emerging economies has accelerated, the recovering Japanese manufacturing industries may face competition from both emerging big manufacturing countries like China and traditional large manufacturers like Germany. On the one hand, China, India and other countries are rising. According to the 2010 Global Manufacturing Competitiveness Index research report jointly released by Deloitte and the US Council on Competitiveness, Asian giants like China, India, and the Republic of Korea are projected to dominate the index in five years, as they already do now. In 2010, China accounted for 19.8% of the world's manufacturing, slightly higher than the 19.4% of the US. On the other hand, Japan's high end manufacturing is now faced with a competitive Germany.

Third, the nuclear leak is a heavy blow on the Japanese people. The Fukushima leaks are far more serious than those seen at Chernobyl, and its impact on Japanese people is more than simply economic. It reduces the confidence of many in the future of Japan.

Fourth, Japan can hardly expect major external aid. The global economy is weak and the world is still rehabilitating from the crisis. There still exists the possibility of a double dip, and under such circumstance, the US and European economies are trapped in high debt while unemployment can hardly assist Japan with funding.

4. Emerging economies are facing distinctly more challenges.

First, the momentum for growth has weakened. In 2011, though still growing at higher rates than other developed economies, emerging economies slowed down their growth under the influence of austerity policies and the deterioration of the European debt crisis. In the first half of 2011, the growth of India, Russia, Brazil and South Africa was respectively set back to 7.7%, 3.4%, 4.2% and 1.3%, record lows in recent years. In addition, according to September statistics of the Purchasing Managers Index (PMI) in these countries, manufacturing in some emerging economies has started to shrink as compared to the previous expansion, with the primary cause being a decline in export trade. Korea dropped to 47.48, a record low in 11 months, India to 50.4 and Brazil to 45.5, below 50 in four consecutive months. As one of the leading indicators of economic activity, the fall of PMI to some extent reflects a gradual economic growth slip in emerging countries. As the US long-term credit rating downgraded and the European debt crisis worsened, the risk of a double dip in the global economy has increased. The continuous slip-back of economic indicators in emerging markets has assured an economic slowdown for three consecutive quarters. In the IMF report released in September 2011, Asian emerging economies are expected to grow at 8.2% in 2011, 8.0% in 2012, lower than 8.4% for both 2011 and 2012 estimated in June.

Second, pressures of inflation have been on the rise. Since the beginning of 2011, China's CPI maintained levels of more than 6% for a few months. In Brazil in July 2011, the year-on-year CPI went up by 6.75%, higher than the central bank's target of 4.5%. In the first five months in India, wholesale prices rose by 9.25%, staying at roughly 8% for 17 consecutive months. In Russia, CPI rose by 9% year-on-year in July 2011. In the same month Vietnam saw an even higher inflation of 22%. The IMF estimates that inflation in Vietnam and Indonesian will respectively reach 13.5% and 7.1% in 2011. To manage inflation and inflationary expectations, emerging countries have adopted tight fiscal policies and started to hike their interest rates. In 2011, the people's Bank of China raised its reserve requirement six times and raised the benchmark interest rates twice. The central bank of Brazil announced that it would raise interest rates at five different meetings in 2011. Korea's central bank raised interest rates three times by 0.75%. The central bank of Thailand raised interest rates by 1.25% accumulatively. The central bank of India raised rates 11 times since March 2010. International financial instability caused by the European debt crisis may well offset the benefits, even if tight fiscal policies in emerging countries are effective, and inflation rates may fall in 2011. In view of price hikes, local currency appreciation, and asset bubbles, macroeconomic policy-makers in emerging countries are faced with the fact that tighter fiscal policies, intended to harness inflation, may actually hold back economic growth.

Third, the risk of foreign capital outflow has increased. Since July 2011, the local currencies of India, Brazil, Russia and other emerging countries depreciated by large margins in spite of the momentum of continued revaluation. Accompanying this trend was a rarely seen large-scale outflow of foreign reserves, in particular in Asian countries but including a good number of Eastern European and Latin American countries. In September 2011, the combined outflow amounted to 80.4 billion USD, second only to the amount in 2008, in 15 major emerging countries including China, India, Korea, Thailand, Malaysia, Brazil, Mexico, Argentina, Russia, Poland, Czech, Hungary, Ukraine, Turkey, and Indonesia. Despite this, Asia, known as the world's factory for many years, inevitably has excess capacity, while Eastern European emerging economies are relying heavily on the economic development model of Western Europe and therefore have endogenous vulnerabilities, and Latin American economies have already accumulated risks from their high interest rates and exchange rates. Large foreign capital outflow causes difficulties for the healthy development of economies. It is analyzed that foreign capital outflows may become the prelude of systemic risks in emerging economies.

II. Major risks continue to exist and the prospect of the world economy remains pessimistic.

1. The sovereign debt crisis will continue to hold back the global economic recovery.

First, it is important to acknowledge that there is no immediate solution to the European debt crisis. The major breakthrough in EU summit rescue package is to reduce Greece's debt by 50% and give the market a chance to "catch its breath." The international community is able to see some faint hope to resolve the debt crisis, but there is still a long way to go. Most experts believe that the debt write-down is not sufficient to handle the high debt of Greece. According to the rescue package, the write-down will begin in 2012 and be completed over an eight year period. Deficit will appear in bank accounts if the write-down is too big at the beginning. The write-down is indeed debt restructuring, truing due debts into new bonds. The EFSF will provide 300 billion euros to guarantee new bonds. Since the write-down is broken down over eight years, the initial write-down cannot be too big. Greece's total debt will grow in the next two years, because new debts will be added. Estimates claim that according to such a solution, the debt-to-GDP ratio of Greece will rise from 160% in 2011 to 170% in 2012, before peaking at 186% in 2013. The debt will then roll back gradually beginning in 2014 and to 120% in 2020. The EU summit also was able to restructure bank capital, requiring a core capital adequacy ratio of 9% to offset the write-down and other possible impacts. Banks are required to complete capital-raising by June 2012, and if they fail to do so, the states will force the injections. However, the question remains over how much capital is needed to reach the target ratio. Some guess that 100 billion euros are needed, while other guesses float around 300 billion. Whatever the figure, it is not clear where the money can possibly come from; it is unclear whether the emerging economies will prove generous enough this time.

Second, the US, Japan and other countries are also facing potential sovereign debt risks. Since the breakout of the Dubai sovereign debt crisis in 2009, the crisis has been spreading around the globe. International communities have begun to worry about the US federal debt threat to the global economy. Globally, the sovereign debt crisis in various countries still exists and any sovereign debt can evolve into a crisis and spread market panic and become the "invisible black hand" to hold back the global economic recovery. Presently, the sovereign debt crisis is no longer a European problem, and countries like the US and Japan are also facing it, which never appeared to be the case in the past twenty years. Though debt problems of three major economies of the US, Japan and Europe differ and negative prospects of world economy still exist, the US economy is particularly worrisome. Statistics released by the US Bureau of Public Debt on November 21, 2011 showed that public debt reached a record high of 15 trillion USD since the end of WWII — exceeding US GDP in 2010 (14.6 trillion USD). Despite this apparent imbalance, market risks have prompted government to pursue more stimulus and job creation schemes, becoming the major reason for US debt rise. In August, 2011, Standard and Poor's cut the long-term US credit rating by one notch to AA+ from AAA, the first time in history that the US lost the triple A rating, which immediately stirred serious concerns in the international communities. The myth of risk-free US government bonds was debunked with the downgrading, and there are more fears among investors about the uncertainty of the EU's economic prospects. Stock markets fell around the globe. The US government warned in November 2011 that the economy might fall into a double-dip recession if the rising public debt was not brought under control. Public debt to GDP ratio in Japan was far more than 200%, a level that is even higher than Greece, which had debt of 120%. Different from Europe, 90% of debt in Japan is domestic, but the Japanese government will be under pressure to pay off high debt in the next two years. In Central and Eastern Europe as a whole, sovereign credit risk is on the rise, with foreign debts in Latvia, Hungary, Lithuania, and Estonia all larger than their respective GDPs.

Third, the debt crisis reflects institutional deficiencies in Western economies, hardly to be corrected in a fundamental way in the near future. To take Europe as an example, public debts in 13 of the 27 EU member states broke the upper limit of 60% of GDP, leaving its newest member Estonia being the only country keeping fiscal deficit under 3%. The European Commission seems to be incapable of enforcing fiscal discipline. Its major member states have their own calculations in bailing out Greece and other countries. Any agreement must be approved by all 17 eurozone counties. The conflict between a single currency and decentralized fiscal policies cannot be resolved in the near future. Of course, the fundamental cause of the European debt crisis is its high welfare economic system. The social economic system and lifestyle of welfare benefits, high consumption, and low savings leads to long-term accumulation of public debt. Current measures to deal with the debt crisis are short term and will eventually increase the debt sizes of each country. If there is no fundamental institutional transformation, the structural contradiction that induced the crisis will persist and become a risk element to the entire world economy. An overall economic recovery is hardly conceivable unless the European debt crisis is effectively brought under control, which will certainly become a drag on the process of global recovery.

2. High global unemployment rates are an obstacle to a steady recovery.

As population grows, the United States has had to create 125,000 new jobs to prevent the current unemployment rate from rising. In October 2009, the rate peaked at 10.1% as compared to 9.1% in September 2011, a drop of 1% between 20 months, a drop that is unparalleled since WWII. According to the latest Eurostat statistics, in spite of the strong growth momentum of the eurozone in the second quarter of 2011, business confidence in the prospects of economic recovery was still weak, and showed no growth in recruitments. In July 2011, unemployment in the eurozone stayed at 10% for five consecutive months, with 668 thousand more people laid off when compared with the previous year. Unemployment in Italy dropped to 8.4% from 8.5%, and maintained the same at 6.9% in Germany and 10% in France. Unemployment rose from 13.3% to 13.6% in Ireland, and from 20.2% to 20.3% in Spain. It also reached more than 4.5% in Japan. Since the economies of emerging and developing countries have been included in the division of labor of multinationals, growth fluctuation of developed economies constrain their export industries, growth and employment.

The primary reason for serious unemployment around the globe is sluggish economic growth and its consequent employment shortage. No country can deal with unemployment successfully without substantial economic growth. The rise of unemployment holds back consumption and economic growth. Secondly, the progress of science and technology brings about industrial upgrading. Technological development raises productivity as well as organic composition of capital. Capital can become less capable of absorbing labor, which can lead to structural and frictional unemployment. The service sector makes up 70% of GDP in developed economies, but for the modern service sector, it has low demand for labor, a bottleneck for creating new jobs. Thirdly, the high-benefit welfare system in developed countries encourages laziness, and this phenomenon is an important factor contributing to voluntary unemployment during the crisis period. Unemployment in emerging and developing countries results from labor surpluses out of abundant labor resource and capital scarcity. Of course, with the development of industrialization and urbanization, rural workers have moved to cities and the chronic hidden unemployment becomes visible and appears in statistics.

3. Increasing inflation has become a big challenge for many countries.

First, there is still a possibility of a third round of quantitative easing (QE3) in the United States. Ben Bernanke, chairman of the Federal Reserve, pointed out that QE3 must satisfy two conditions: economic stagnation and sustained inflation at a low level. The US economy has not fallen into stagnation, but it continues to hover low; inflation is rising, but it has not yet reached the Fed's warning line. The possibility of QE3 is increased against the background of an intensified European debt crisis and rising global economic risk. Now global prices of bulk commodities are restrained not only by demand, but more importantly by the US dollar. When the dollar is strong, prices fall. Otherwise, prices go up. Once QE3 or something similar appears, the US dollar will depreciate, causing excess global liquidity and price hikes. A new round of global inflation will be inevitable then.

Second, rising food prices exert pressure. For some years, international food prices have had a tendency of having a high price cycle. Frequent extreme weathers, supply-demand imbalances, high energy prices, reduced farm land as a result of urbanization and industrialization, as well as other factors, all make high food prices more rigid. In May 2011, the Food and Agriculture Organization (FAO) announced that the average food price index rose to 232 points, rising by 37% year-on-year. On the supply side, this may be caused by usual global weather fluctuations, such as storms in South Asia and Australia caused by el Nino and la Nina phenomena. Accompanying them was a severe drought which affected the food exports of the United States, Brazil, Argentina, and Germany. On the demand side, apart from conventional food consumption, the rise of oil prices stimulates the demand for new energies to produce food. In recent years, the United States has been actively working on a scheme of developing biomass energy from maize. The ethanol production industry uses 36% of the maize produced in the United States. Consequently, US maize stock and export have declined. Since 55.6% maize in the international market is from the United States, the increasing demand for grain to produce energy deteriorates the balance between supply and demand in the global market for agricultural products.

Third, oil prices remain high. The first reason for this is that political instability in the Middle East and North Africa has given rise to risks in the premium of oil prices. The price difference between US Texas crude oil and UK Brent crude oil is hovering around 15 US dollars. The second reason is that a weak dollar has a "valuation effect." Since the end of 2010, the nominal dollar index devalued by 4%, causing price increases in oil and other dollar-denominated bulk commodities. It is estimated that the valuation effect on the rise of the oil price is around 5 dollars. The third reason is the momentum of global economic recovery. Emerging economies have good prospects in the long run, supporting increases in price for bulk commodities. Recently, there was some price adjustment of bulk commodities, but both oil and copper maintained high prices, suggesting that the fall might have been a short-term adjustment.

Fourth, the price of labor has entered a high rise cycle. The rise of the labor price is becoming a new pressure on inflation. In the past 20 years, emerging economies, taking advantage of comparatively low labor costs and the "Smith growth" brought about by the intensified global division of labor, have reaped huge growth bonuses. However, insofar as most emerging economies develop into middle-income stages, the population bonus is reducing and the cost of urban living is rising, so the rise of and compensation for the labor price is an inevitable rule. Currently, wages in emerging countries, especially the BRICS countries, are rising universally. Since the breakout of the financial crisis, China has raised minimum wages to a significant extent and reformed the personal income tax. India has sustained high increases in wages in recent years, growing at 6.6% in 2009 and 11.7% in 2010. Since 2000, Russia has been raising its minimum wage levels every year, and the minimum wage in 2009 was four times as high as it was in 2006. Between 2003 and 2010, the minimum wage in Brazil rose by 112%. Of course, whether the rise of labor cost will be transformed into larger and sustained price rises depends on the growth rate of the labor price against the growth rate of productivity. If labor prices go up while the factors supporting the growth of productivity are relatively weak, the pressures of inflation will increase. To avoid a spiraling rise in wages and inflation, governments will have to be proactive and resourceful.

4. The risk persists of a double-dip in the global economy.

First, the room for policy adjustment is limited. In the post-crisis era, there have been no marked signs of global recovery, with downturns and slowdowns in some countries still being the main theme of the global economy. The US and European economies, particularly affected by the sovereign debt crisis, are more likely to fall into long-term downturns. After the confidence crisis, prospects for global recovery look bleaker. The bottom lines of expansionary policies in developed economies have surfaced, and there is hardly more room for adjustment. Affected by huge amount of debts, behemoth fiscal deficits, and political factors, fiscal policy is indeed tight and traditional economic adjustment policy is less capable of restoring good prospects.

Second, the United States, Europe, and Japan are confronted with unprecedented economic difficulties. The first-ever downgrading of the US sovereign credit rating was a heavy blow to the international financial market. According to US official statistics released in the third quarter of 2011, although the manufacturing sector did better than expected, the economic slump in general worsened more than expected. In August 2011, employment growth was zero, lower than market expectations, reflecting insufficient endogenous growth dynamics. Investors were extremely disappointed, and the stock index in three US stock markets fell sharply, serving a heavy blow to the international financial market, and reflecting how difficult of a situation the economy was facing.

Third, the domino effect of the European debt crisis will likely be felt in the near future. For the first time in the past two years, the manufacturing sector in the euro zone has withered. In August 2011, PMI for the manufacturing sector dropped to 49, below 50, which is the dividing line between prosperity and decline. As the debt problem worsens, crisis has spread to major EU countries like Italy and Spain, and credit crises in the European banking sector have appeared one after another. In view of its tendency, it is generally believed that the current troubles are only the beginning, which is unlikely to be completely resolved in the coming two to five years. The expansion of the crisis will stir up international financial markets and the world economy. Reconstruction after the earthquake in Japan will be constrained by the external environment.

Continuous depreciation of the US dollar and a strengthening yen are thwarting Japan's exports.

Fourth, emerging markets are hardly immune to external markets. They have to adopt tight monetary policies and slow down their growth. Manufacturing indices in Asian countries also look low. According to the statistics of the China Federation of Logistics & Purchasing, PMI for China's manufacturing sector in August 2011 was at a low level of 50.9, and the export order index declined for the first time in two years. For India, PMI in August 2011 dropped from 53.2 to 52.6, a decline for four consecutive months at the lowest point in the past 29 months. These factors contribute to international financial market turbulence, pushing up the cost of raising capital, reducing consumer and investor confidence, and greatly offsetting the effect of positive factors on economic growth.

On December 1, 2011, the United Nations' Department of Economic and Social Affairs released World Economic Situation and Prospects 2012. The report points out that developed economies are now faced with four major risks: intensified European debt, financial sector fragility, high unemployment, and sluggish demand as a result of austerity policies. Decision-making mechanisms are also paralyzed by political deadlock and institutional inefficiency. A greater concern is that these four problems may fuel a vicious cycle which holds back developed economies and decelerates the growth of emerging economies. The global economy is stumbling towards the cliff of a "double dip recession". The report estimates that global growth will fall to 2.6% in 2012 from 2.8% in 2011 and 4% in 2010. The United Nations warns that even such a pessimistic report is based on the presumption that the European sovereign debt crisis will be brought under control and developed countries will not further tighten their fiscal policy. Perhaps the report is even a little bit too optimistic.