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ECONOMIC
OUTLOOK



There are two sides to the world economy. On one, the fear is about the ability of countries to recover in the face of fiscal austerity and damaged banking systems.

The eurozone's sovereign debt crisis is the symbol of the advanced world's post-crisis hangover. Take that as your guide and you could be forgiven for being very gloomy indeed.

Fortunately, there is another side to the global economy and, on a visit to Asia, I have been sampling it. In Asia the concern is about too much growth — overheating — rather than too little.

You see that growth in the statistics. While it will take another year or two for most advanced economies, including Britain's, to get back to pre-recession levels of gross domestic product, Asian economic activity and Asian trade are comfortably above pre-crisis levels and rising fast.

You also see it in booming construction, with new skyscrapers dwarfing and in many cases replacing the old ones. Rising Asian prosperity is tangible, as the world's top retailers, which populate its shopping malls, are aware. Nowhere in the world is the middle class growing more rapidly than in Asia.

Asia is not the whole story of this new growth phenomenon. Many economies in Africa are booming, and not just on the back of soaring commodity prices, as is much of Latin America. Asia, however, is

the driving force, the world's locomotive.

In 2009, the worst year for the global economy in the post-war era, Asian economies grew by 4% while advanced economies shrank by a similar amount. Last year Asia grew by more than 8%. This year, according to Goldman Sachs, Asia will grow by more than 7%, three times advanced country growth and nearly four times the rate of growth in the eurozone.

China, by offering to help the eurozone with its difficulties, is demonstrating the country's increased economic clout.

That looks set to increase further. HSBC, in its exercise *The World in 2050*, has China as the world's biggest economy by then (encouragingly, with Britain in fifth place, ahead of Germany). In fact, China is likely to get there well before that.

Standard Chartered identifies a new supercycle for the world economy, led by emerging economies in general and Asia in particular, in which China overhauls America by the early 2020s.

It is not just a China story. HSBC emphasises prospects in India, which it sees moving to a faster growth rate than China, as well as economies such as Indonesia, Malaysia and Thailand. Perhaps nothing illustrates the Asia story better than the strong performance of Vietnam and Cambodia, in contrast to the former communist economies of eastern Europe.

It is easy to forget that it has not always been this way. A decade or so ago, growth rates in emerging economies taken as a whole were barely higher than in the advanced world. Asia was coping with the aftermath of its 1997-98 financial crisis, which apparently snuffed out prospects of a miracle in the region.

Asia learnt from that crisis and now the boot is on the other foot. My view is that the hangover from the more recent global financial crisis for advanced economies will have the effect of accelerating the global shift to economies such as China and India by five to ten years.

What does Britain get out of this global shift? Potentially quite a lot. Last week on a visit to Britain Li Keqiang, China's vice premier, played Lady Bountiful, with £2.6 billion of export contracts and com-

mercial agreements and a loan of pandas to Edinburgh zoo.

Though export trade is biased towards the slower-growing European Union for good reason (inward investors came to Britain to sell into Europe, not ship back to the Far East), things are changing.

The latest Ernst & Young Item Club forecast, published tomorrow, notes that more than 80% of Britain's exports go to advanced economies rather than the emerging ones. Change is afoot, however. With east Asia's share of the global economy on course to double from 16% in 1990 to 31% by 2015, Britain's exporters are starting to respond. Exports to China are up 45% over the past year. Exports to the rest of the European Union are up 12% but non-EU exports are up 21%.

Peter Spencer, Item's chief economic adviser, is optimistic. "UK exporters have been able to refocus successfully in the past, and the strong growth in exports to the emerging Asian and other markets suggests that this is happening again."

Item predicts that Britain's overall exports will rise by more than 7% this year, 9% next year and 8% in 2013.

Part of the reason for my trip to Asia was to give a lecture at a conference organised by Nottingham University's Globalisation and Economic Policy Centre. Nottingham has a 4,000-student campus near Kuala Lumpur, Malaysia, which is impressive. Education is one of the many services Britain can export successfully to Asia.

What could go wrong? The view on the ground is that high Asian inflation, evident in commodity prices and in some cases wages, is manageable without much of a slowdown in growth.

Those looking at these big long-term shifts have to be humble. I remember visiting Japan in the late 1980s when construction was also booming and the prosperity tangible. It was followed by the bursting of Japan's bubble economy and two decades of economic stagnation.

Today Japan is benefiting from the boom in Asia and grew by more than 4% last year. But talk of it overhauling America, once popular, has been forgotten.

I don't think the rest of Asia will go the

same way, or that a similar fate will befall its economic giants like China, though you can buy books warning of its imminent economic collapse. Such books have been published regularly for most of the three decades in which Chinese growth has averaged 10% a year.

Asian growth is more broadly based and less dependent on booming asset prices than Japan's was in the 1980s. The world is changing and that change has been brought into sharper focus by the crisis. For Britain, the key message is a simple one. Every effort has to be made to ensure the economy can take advantage of these shifting global sands.

PS: Thursdays are going to be a bit more nervous from now on, at least once a month. Last Thursday passed without incident but at some stage the Bank of England's monetary policy committee will raise interest rates.

One way the Bank could make life easier for itself is suggested by Alan Davies, former chief economist at Barclays. He says the Bank should give more emphasis to CPIY, the consumer prices index excluding indirect taxes.

The latest figures — for November — show CPI inflation at 3.3% but CPIY inflation less than half that, 1.6%. Though the truth may be a little more complex than that comparison suggests, at face value inflation would be below the 2% target if not for George Osborne's and Alistair Darling's tax hikes. It doesn't make sense to respond to higher taxes with higher interest rates.

Inflation figures on Tuesday will be the last before the impact of 20% Vat. But, while it makes sense for the Bank to emphasise CPIY a bit more, and there is talk in the air about its discomfort with the current remit, I doubt that we will see a change of target. People are still smarting from the switch to CPI from RPIX, the retail prices index excluding mortgage interest payments, currently rising at a 4.7% rate. Not only that, but Vat is real enough to those who pay it.

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