



# There are no quick wins

Viewpoint

**D**avos in Switzerland is the place to be as politicians, economists, business and community leaders gather to solve the world's economic problems. The theme of the World Economic Forum's annual meeting is The Great Transformation: Shaping New Models.

The world economy is changing. I saw this again at first hand during the past two weeks visiting Asia. Even though economies there are cooling, they are not collapsing, confidence is resilient and the scale and pace of change is dramatic. Given this, I think there are three key themes to focus on in Davos this year.

First, the economic outlook. The world economy grew by 4.4 per cent in 2010, 3 per cent in 2011 and is likely to slow to 2.2 per cent this year. The good news is the world is still growing. Indeed, it is amazing that since the beginning of this financial crisis the world economy has grown from \$62 trillion to \$70 trillion (£39.8 trillion to £45 trillion), an increase of 14 per cent. Some of this is because of inflation, but the vast amount has been growth across the emerging world, led by China.

The bad news is that the world is divided and disconnected. This year, the euro area and the UK are likely to be in recession, particularly in the first half of the year, the US will be growing at a steady but unspectacular pace of around 2 per cent, while China is likely to slow in the coming months before rebounding.

In Davos, it should be clear that the biggest division is between a fragile West and a resilient East, and the biggest disconnect is the high rate of youth unemployment.

In recent years, the mood in Davos has moved from pessimism to one of realism about the challenges ahead. This year, business confidence about their own firms is likely to be countered by a sense of caution about the global outlook.

Within that, the second big theme in Davos will be Europe. I expect to come across many cheerleaders for the euro. Indeed, many stops are being pulled out to help, with the European Central Bank acting as a shock absorber and the International Monetary Fund raising capital to help to bail out Europe.

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Davos is no stranger to controversy



turn, is exacerbating social issues that are now centre-stage. Europe has a high level of debt and it is important to bring that down. The trouble is, growth is needed to do this.

There are so many flaws with the euro, it is remarkable anyone thinks it is a good economic idea. It is built on imbalances and the core is as much to blame as the periphery for its problems. For instance, in the boom years it encouraged capital flows from Germany and the wealthy northern economies into the periphery, such as

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Ireland and Spain. That led to housing and other booms, which have since become busts. Moreover, these same economies are now uncompetitive against Germany. If Greece had its own currency, it would need to devalue 40 per cent to regain competitiveness. For Spain, it might be 25 per cent. Even France, if it had the franc, would need close to a 20 per cent fall. Of course, they don't have their own currencies. Hence, they have to make up for this lack of competitiveness through deflation, austerity and change.

Some change is clearly needed. But the economies in Southern Europe are so different from those in the north that the economic pain required may be unbearable. In turn, taxpayers in Germany and elsewhere may worry about the future bill they could pay, as history shows that political union is necessary for such a monetary union to survive.

These contrasting fortunes touch on what I think will be the third big focus in Davos: the ongoing debate about capitalism itself. If anything, Davos will highlight the painful adjustment needed in the West, as across the emerging world capitalism is creating jobs and prosperity.

The rapid pace of transformation in the global economy points to austerity in the West and the need to rewrite the social contract. This debate will cover a vast array of areas, particularly the role of the state and of business in addressing social issues. Trouble is, as with most of the issues discussed this week, there are no quick wins.

Yet, if Davos is to make progress it will be by addressing the twin issues of job creation and the social impact of globalisation and technological change.

With the lunar new year this week, Chinese participation in Davos may be low. Indeed, China hosts its own "Summer Davos" each September. This week in Davos it will be important not to lose sight of the industrial revolution taking place in China and the catch-up potential across vast parts of the world. As Davos debates this "Great Transformation", the UK needs to focus on how it repositions itself to benefit from this changing and still growing global economy.

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