The Single-Engine Global Economy

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TOKYO – The global economy is like a jetliner that needs all of its engines operational to take off and steer clear of clouds and storms. Unfortunately, only one of its four engines is functioning properly: the Anglosphere (the United States and its close cousin, the United Kingdom).

The second engine – the eurozone – has now stalled after an anemic post-2008 restart. Indeed, Europe is one shock away from outright deflation and another bout of recession. Likewise, the third engine, Japan, is running out of fuel after a year of fiscal and monetary stimulus. And emerging markets (the fourth engine) are slowing sharply as decade-long global tailwinds – rapid Chinese growth, zero policy rates and quantitative easing by the US Federal Reserve, and a commodity super-cycle – become headwinds.

So the question is whether and for how long the global economy can remain aloft on a single engine. Weakness in the rest of the world implies a stronger dollar, which will invariably weaken US growth. The deeper the slowdown in other countries and the higher the dollar rises, the less the US will be able to decouple from the funk everywhere else, even if domestic demand seems robust.

Falling oil prices may provide cheaper energy for manufacturers and households, but they hurt energy exporters and their spending. And, while increased supply – particularly from North American shale resources – has put downward pressure on prices, so has weaker demand in the eurozone, Japan, China, and many emerging markets. Moreover, persistently low oil prices induce a fall in investment in new capacity, further undermining global demand.

Meanwhile, market volatility has grown, and a correction is still underway. Bad macro news can be good for markets, because a prompt policy response alone can boost asset prices. But recent bad macro news has been bad for markets, owing to the perception of policy inertia. Indeed, the European Central Bank is dithering about how much to expand its balance sheet with purchases of sovereign bonds, while the Bank of Japan only now decided to increase its rate of quantitative easing, given evidence that this year's consumption-tax increase is impeding growth and that next year's planned tax increase will weaken it further.

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