Global Economic Outlook
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"It's not the recovery we wanted. It is a recovery beset by tensions and strain, which could even sow the seeds of the next crisis"

Dominique Strauss-Kahn, IMF chief, speaking in early February

Mr Strauss-Kahn was referring directly to the imbalances that have emerged during the latest upswing, which in some respects are now bigger than before the 2008 credit crunch. The IMF chief cited China and Germany for their over-reliance upon exports. Germany sells BMWs, Mercedes and Porsches to rich Chinese. China continues to industrialise at a frenetic pace, racking up bigger trade surpluses with countries such as the US and UK.

China is not more productive or innovative than the West. However, it has displaced US and UK workers by the use of cheap labour and – critically – through aggressive currency intervention, hitting a record US$393bn in the second half of 2010 alone. All talk of rebalancing in the UK economy is fanciful so long as politicians grovel to China and other Asian mercantilists.

But self-imposed austerity will not secure the much sought rebalancing. Last year, retail sales rose just 0.5% in volume terms in the UK. This was the lowest annual gain since 1995. And yet, UK imports from China rose 25.1%. The UK trade deficit with China hit a record £23.1bn in the year to January.

The UK retail sector is dominated by a small number of monopolistic giants, for whom by-passing the UK worker has become an article of faith, as they seek to widen margins and drive profits – already at record levels – remorselessly higher.

There has been much trumpeting of the recovery in the UK manufacturing sector in some of the less discerning newspapers. But manufacturing output is still below the low point of the dotcom downturn. Manufacturers have reversed less than half the loss in output sustained during the credit crunch. Furthermore, manufactuing employment had barely risen from the new low of 2.53m reached in the recent recession. When the Conservatives came to power in 1979, there were 6.68m manufacturing jobs in the UK.

It is perhaps ironic to hear the UK Tesco chief executive, Richard Brasher, recently fretting over the squeeze on real disposable incomes for the UK consumer, and the impact on retailers' margins. Mr Brasher seems willfully oblivious to the self-evident contradictions. Even Henry Ford recognised in the 1920s that if the US auto

manufacturer wanted workers to buy the cars it was producing, then it had better pay them accordingly.

The Bank of England governor, Mervyn King, might have been too optimistic when he suggested that real wages could stagnate for six years. The imbalances in the global economy, which precipitated the credit crunch of 2008, have now indirectly pushed commodity prices close to the levels reached nearly three years ago. That now threatens to send inflation to above 5% in this country, at a time when the average wage is rising by just 2.2% y/y according to the latest data from the Office for National Statistics.

It is perhaps worth reflecting upon the linkages between globalisation and rising inflation. Critics of the Bank of England and the Federal Reserve have been quick to denounce quantitative easing for the recent surge in commodity prices. In truth, these policies were an unavoidable response to the deep recessions created by the crisis of 2008. Indeed, there was no quantitative easing at the time of the last commodity price 'boom' in 2008. Furthermore, both the US and UK have continued to be net recipients of capital from emerging market countries, again contradicting claims that 'loose' monetary policies in the West have been responsible for the run-up in inflation

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The cause of the commodity price 'bubble' lies on the other side of the fault line – emerging market countries have been running excessive credit policies, reminiscent of Thailand and others in the run-up to the infamous Asian crisis of 1997. China, Brazil, India, and a host of others have presided over double-digit money supply growth and consumer led booms that have fuelled the rise in commodity prices. Time and time again, we have seen countries trying to play catch up with the West lose control over their monetary policy, often as they seek a competitive advantage, intervening in the currency markets to keep their exchange rate too low. As Mr Strauss Kahn warned, herein lie the seeds of the next credit crunch, a potential replay of 2008.

Of course, we should not lose sight of the role played by Peak Oil and climate change in driving inflation higher either. The aggressive promotion of ethanol in the US, which now subsumes 40% of the country's corn output, has been a major cause of higher food costs globally. But the pressure to develop ethanol stems from the logic of Peak Oil. The failure to develop sustainable alternatives to fossil fuels is hurting the global economy.

Japan's crisis is a manifestation of the same failings. Japan has relied too heavily on nuclear energy instead of promoting safer, cleaner alternatives. The safety record of the industry has been called into question regularly too, long before the power stations in Fukushima malfunctioned.

The political upheavals of North Africa and Middle East can be traced to the commodity price bubble too. China's extreme intolerance for dissent in recent weeks also underlines the many contradictions of a global boom, based on the gains that have been eschewed to narrowly in favour of a new class of emerging market billionaires, fuelling popular dissent. Ironically, as geopolitical risk rises, many of these individuals are relocating to the West end of London, creating further distortions in the UK property market.

While the financial sector has at least enjoyed a swift recovery from the dark days of 2008 on the back of business generated by many of the credit bubbles overseas, confidence elsewhere has evaporated. In its latest survey of the UK consumer, the Nationwide reported that confidence had collapsed in February to its lowest level since records began. Respondents were more depressed than even at the worst point of 2008 crisis, and when Northern Rock folded in 2007. The survey's spending index had tumbled to record lows. The fear factor was likely to be reflected in less spending, which suggests the Q4 contraction in GDP may not have been an aberration.

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The fight to defend public services may well dominate the political stage over the coming weeks and months. But a broader issue looms, how to rebuild an economy against the global backdrop wracked by extreme imbalances.

Judging by the manner in which the current Prime Minister, aided by the Business Secretary Vince Cable, have traveled the globe touting the UK's rather limited export portfolio (defence and not a lot else), it is quite clear that the coalition government does not comprehend the monumental challenge it faces trying to achieve the elusive rebalancing.

It is not clear either whether the current opposition party has much of an idea either of the real causes of the crisis. The debate has been too narrowly confined to how quickly it is safe to cut public spending. A serious economic debate over this ongoing financial crisis requires a thorough evaluation of the risks which stem from participating in today's global economy.