

## Economics

## Martin Wolf



## ‘Made in China’ recession perfectly plausible

Is a global economic recession likely? If so, what might trigger it? Willem Buiter, Citi's chief economist and the *Financial Times*' erstwhile Maverecon blogger, answers these questions: "Yes" and "China".

His case is plausible. This does not mean we must expect a recession. But people should see such a scenario as plausible.

Mr Buiter does not expect world output to decline. The notion here is a "growth recession", a period of growth well below the potential rate of about 3 per cent. One might imagine 2 per cent or less. Mr Buiter estimates the likelihood of such an outcome at 40 per cent.

His scenario would start with China. Like many others, he believes China's growth is overstated by official statistics and may be as low as 4 per cent. This is plausible, if not universally accepted.

It might become even worse. First, an investment share of 46 per cent of gross domestic product would be excessive in an economy growing 7 per cent, let alone one growing at 4 per cent. Second, a huge expansion of debt, often of doubtful quality, has accompanied this excessive investment. Yet merely sustaining investment at these levels would require far more borrowing.

Finally, central government, alone possessed of a strong balance sheet, might be reluctant to offset a slowdown in investment. And the shares of households in national income and consumption in GDP are too low to do so.

Suppose, then, that investment shrank drastically as demand and balance-sheet constraints bit. What might be the effects on the world economy?

One channel would be a decline in imports of capital goods. Since about a third of global investment (at market prices) occurs inside China, the impact could be large. Japan, South Korea and Germany would be adversely affected.

## Commodity prices

A more important channel is commodity trade. Commodity prices have fallen, but are still far from low by historical standards.

Even with prices where they are, commodity exporters are suffering. Among them are countries like Australia, Brazil, Canada, the Gulf States, Kazakhstan, Russia and Venezuela. Meanwhile, net commodity importers, such as India and most European countries, are gaining.

Shocks to trade interact with finance. Many adversely affected companies are highly indebted. The resulting financial stresses force cutbacks in borrowing and spending upon them, directly weakening economies. Changes in financial conditions exacerbate such pressures. Among the most important are movements in interest and exchange rates and shifts in the perceived soundness of borrowers, including sovereigns. Changes in capital flows and risk premia and shifts in the policies of important central banks exacerbate the stresses.

At present, the most important shift would be a decision by the US Federal Reserve to raise interest rates.



As Warren Buffett said, "You only find out who is swimming naked when the tide goes out."

According to the Bank of International Settlements, credit to non-bank borrowers outside the US totalled \$9.6 trillion (€8.5 trillion) at the end of March. A strong dollar makes any currency mismatches costly. These may start on the balance sheets of non-financial corporations. But the impact will be transmitted via their losses to banks and governments. The reversal of "carry trades", funded by cheap borrowing, might have havoc.

## Deteriorating terms

A visible shift is a decline in foreign exchange reserves, driven by deteriorating terms of trade and capital flight. This might cause "quantitative tightening", as central banks sell holdings of longer-dated safe bonds. This is one of the ways that these shocks might be transmitted to the high-income countries, including even the US.

But this also depends on what the holders of the withdrawn funds do with it and on the policies of affected central banks.

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What we might see, then, is a series of real and financial linkages: declining investment and output in China; weaknesses in economies dependent on that country's purchases or on prices set by its buying; and reversals of carry trades and shifts in exchange rates and risk premia that stress balance sheets.

## Infrastructure investments

How might policymakers respond? China will surely let its currency go rather than continue to lose reserves, not least because usable reserves are smaller than headline numbers, which include infrastructure investments in Africa and elsewhere that cannot quickly be sold. The policy space of other emerging economies is greater than in the past, but not unlimited. They will be forced to adjust to these shocks rather than resist them.

Meanwhile, the policy choices of high-income countries are restricted: policies has almost universally ruled out fiscal expansion; the intervention rates of central banks are near zero; and, in many high-income economies, private leverage is still quite high. If the slowdown were modest, nothing much might be done.

■ Paper tiger money: There is a plausible, if not universally accepted, understanding that China's growth is overstated by official statistics and may be as low as 4 per cent.

PHOTOGRAPH: JASON LEE/REUTERS

The best response to a big slowdown might be "helicopter money", created by the central bank to stimulate spending. But its use seems quite unlikely. The conventional rules.

In brief, a global growth-recession scenario "made in China" is perfectly plausible.

If it were to happen, a decision by the Fed to tighten now would come to look downright foolish. We are certainly not talking about the sort of disaster that accompanies a global financial crisis.

But the world economy will remain vulnerable to adversity until China has completed its transition to a more balanced pattern of growth, and the high-income economies have recovered from their crises.

It is not there yet.  
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Small Business Inside Track Q&A  
John McGuinness, founder of Mulch

## Nothing is wasted for founder of unique garden compost firm

John McGuinness was working in landscaping when he realised there were no good facilities to get rid of garden waste and similarly no place to get good compost either in Ireland or Britain.

**What sets your business apart from the competition?**  
Mulch is a green waste recycling and compost depot – or the McDonald's drive-through of gardening, as we like to call it. You drive your garden waste to our centre – you can unload it or we can do it for you – and the more you bring the cheaper it is.

Then you head out the back door without ever having to leave your car. We then recycle this waste and produce a range of products for gardeners and landscapers, including compost and bark.

We've put a friendlier, cleaner spin on the whole waste industry. I want the guy in the cleanest suit to arrive in our depot, drop off his green waste and not be any dirtier than he was before when he goes out the back door.

We have built the company from the customer's perspective so it's based on what they want.

For example, we offer free coffee to our customers, and the thousands of euro that it costs to run every year is worth it, because it adds value to our service overall.

**What has been your greatest**

## success to date?

It's great to hear customers compliment your truck drivers on how friendly they are, and when companies are coming to you having been recommended by another, you know you're doing something right. It's all the little things that are a constant reassurance.

## Who do you admire in business and why?

Steve Jobs is someone I really admire because he made his products as simple and as clean as possible. It's all about eliminating the initial confusion of the customer. That's why we have one name on the bag – Mulch – and if they want to know more, they're just one click away.

## What's the best piece of advice you have received?

A friend of mine once gave me a piece of paper with three circles and asked me to fill them in with the percentage of time spent working, time spent on relationships and time I spend alone. I filled it in as 80 per cent work, 15 per cent relationships, and 5 per cent myself.

He showed me a second piece of paper with 33 per cent in each circle and said: "That's how the most successful business owners allocate their time." Not really a quote, but it had an effect on me.

**What's the biggest mistake you've made in business?**  
When you start a business, you



“I'm not really a corporate type of a guy; I'm more proud of building a facility people want to use – that means more to me than a figure on a piece of paper”

– John McGuinness

Road Warrior  
The business of travel

Why use luggage when you can just pack your jacket?

The latest incarnation of wearable luggage is the Baubax. The innovative jacket is designed for road warriors and has a variety of pockets and uses.

There is a built-in place for your earphones, an inflatable neck pillow, an eye mask, pockets big enough for iPads, a variety of pockets for phones, sunglasses, passport, drinks etc. The zip is even a pen and stylus.

Baubax has raised more than \$9 million on Kickstarter and you can order yours on Indigogo.

The jacket comes in a range of styles from sweatshirts to blazers from \$149.

## Airport TV is about to take off in Ireland West

Watch out for Airport TV at Ireland West Airport, where you could be the star.

The airport has launched a new online television channel where it will broadcast news stories, along with travel experiences of passengers who use the airport and holiday reviews.

Airport TV will also support local food producers and tourism providers in the region. The channel will be broadcast at the airport and online at [irelandwestairport.com/airporttv](http://irelandwestairport.com/airporttv).



■ Ryanair believes 25 per cent of its passengers are business travellers and 9,000 per day are buying the Business Plus fares

## Enjoying nice revenue streams in the wings

Some interesting figures on the generation of ancillary revenues by airlines have appeared in the *Cartrawler Yearbook of Ancillary Revenue* by IdeaWorksCompany.

Last year it accounted for \$38 billion of revenues, up 21 per cent on the previous year.

Ryanair believes 25 per cent of its passengers are business travellers and 9,000 per day are buying the Business Plus fares, over half a million euro per day.

United earned \$5.86 billion from passengers and on Jet2 ancillary fees averaged up to \$56.28 each.

Lufthansa earned \$90 million from its Miles and More programme.

## Hotel managing firm announces €30m in funding

The PREM Group, a leading Irish hotel management company and suites provider has announced a funding package worth €30 million with Proventus Capital Partners.

In his blog, Jim Murphy, PREM Group's chief executive said the company intends to use the funds to finance its expansion into freehold hotels, serviced apartments and hotel management in Europe.

PREM's portfolio includes 42 hotels and serviced apartment buildings in Belgium, France, Germany, Netherlands the UK and Ireland.

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In conversation with Gráinne Ní Aodha