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Recovery or Deflation, and New Financial Crises?

La reprise ou la déflation et de nouvelles crises financières ?

Arturo Guillén



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Recovery or Deflation, and New Financial Crises?

Arturo Guillén

*Research Professor, Department of Economic,
Universidad Autónoma Metropolitana, Iztapalapa, Mexico City.
General Coordinator of the Celso Furtado European/Latin American
Network for Development Studies Academic Chair of the PROMEP Financial Globalization
and Sustainable Development Network.*

*Not only the global crisis persists,
it seems far from over*

The global economic power has again sounded the fanfare announcing the recovery of the world economy. This is the second time it does. The first time was in 2009 when, thanks to costly bailout programs implemented by central banks and governments, was achieved a relative stability of financial markets. However, on that occasion the European crisis stopped this uncanny triumphalism. Now and again, optimism lies in the recovery of the U.S. economy, where growth has taken some force and the unemployment rate has declined somewhat, without yet reaching pre-crisis levels. For 2014 and 2015, the International Monetary Fund (IMF) estimates the growth of the U.S. economy at 2,8% and 3%, respectively, above the 2% achieved over the past three years. Christine Lagarde, IMF managing director, recently predicted the possible end of the bad times. "This crisis still lingers, she said. Yet, optimism is in the air: the deep freeze is behind, and the horizon is brighter. My great hope is that 2014 will prove momentous in another way — the year in which the 'seven weak years', economically speaking, slide into 'seven strong years' (Lagarde, 2014)".

In my opinion not only the global crisis persists, it seems far from over. Two problems are crucial right now: one is the continuation of the recession in Europe, despite a slight recovery in some countries. The European recession is influenced by the maintenance and deepening of the austerity programs, as well as the development of deflationary trends; the other one is the gradual withdrawal of monetary stimulus programs by the Fed and its impact, particularly on emerging economies.

The United States and the European Union exhibit contradictory economic signals. While the U.S. economy shows signs of recovery, in the European Union, deflationary tendencies accumulate. Prices in the EU increased only 0,8% in November from the same month last year, against 0,9% in October. The so-called "core inflation" (discounting prices of food

and energy) was even lower (0,7%), against an inflation target of 2% set by the European Central Bank (ECB). This disinflation coupled with the recession and adjustment programs portends a possible deflation, which, in turn, would prevent the reduction of the level of indebtedness, which is still very high. As Lagarde warns "with inflation running below many central banks' targets, we see rising risks of deflation, which could prove disastrous for the recovery. If inflation is the genie, then deflation is the ogre that must be fought decisively". The fight against deflation would involve greater monetary easing by the ECB, and greater incentives, which conflicts with the program of monetary normalization implemented by the FED, which has begun to reduce its bond buying.

The FED's program of monetary normalization, meanwhile, will provoke the arising of new financial turmoil in emerging countries. Since last May when Bernanke announced the Fed's willingness to gradually reduce its bond purchase program, emerging countries have begun to resent the withdrawal of portfolio capital that had arrived massively since 2009. While the influx of these capital flows allowed the accumulation of large currency reserves, it caused the overvaluation of currencies and the slowdown of economic activity.

Since May, capital flows have reversed. The Institute of International Finance (2013) estimates that capital flows to emerging economies are positioned at \$1,145 trillion in 2013, a decline of 36 billion dollars relative to 2012. For 2014, they forecast that they will decline to 1,112 trillion dollars, its lowest level since the 2009 recession. With the arrival of the New Year loomed the first signs of financial turmoil. Argentina's currency crisis is the "tip of the iceberg". While this crisis is also due to internal factors (lack of a credible program to control inflation), the trigger is the changing trend and orientation of external capital flows. The impact is widespread in the periphery.

Unlike of the stock markets of developed countries that closed 2013 in a climate of optimism, the stock exchanges of emerging countries began to fall. Currencies in Turkey, Argentina, Brazil, Mexico and elsewhere depreciated. Their systemic effects cannot be ignored. The global crisis continues, no doubt.

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