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Growth Key for Euro-Zone Deal

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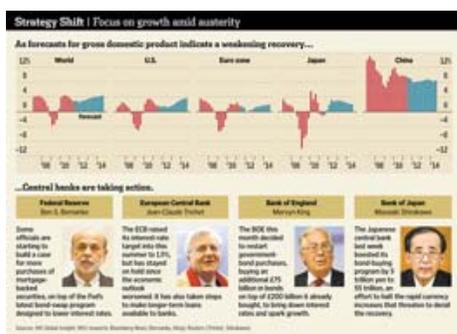
Despite all the cheering about Europe's latest debt deal, worries are mounting that it won't succeed without stronger economic growth.

At the current pace of expansion, unemployment will stay high and incomes will stall. Debt-saddled governments will have an even tougher time generating revenue to pay bills. That could spark more default fears or higher interest rates in Greece, Italy and others under pressure.

Projections for global growth have been falling. The forecasting firm IHS Global Insight now expects the world economy to expand just 3% this year and next, down from 4.2% in 2010. The U.S. is forecast to grow just 1.4% next year, a pace that could push the 9.1% jobless rate higher. The 17-nation euro zone, meanwhile, will flirt with recession in 2012 with projected growth slightly above zero.

Even in Asia, a critical engine of the recovery, prospects are dimming. Many Asian countries—China, South Korea, Singapore and others—are already growing more slowly this year than they did during the 2002-07 boom, according to Edwin Truman of the Peterson Institute for International Economics.

Yet nations remain divided on what to do about it: enact new measures to boost growth or focus on cutting deficits?



On one side of the debate is the U.S., backed partly by the International Monetary Fund, pressing other members of the Group of 20 industrial and developing economies to keep their focus on supporting growth in the short run, while aiming to shrink government debt in the long run. In this camp are some advanced and emerging economies, such as Canada and Brazil, that are still growing but increasingly worried about the slowdown.

President Barack Obama plans to take that message to the G-20 summit meeting in Cannes, France, this week and other gatherings of world leaders in November, pushing for a focus on growth. He'll highlight his own proposals, though stymied in Congress, for short-term tax cuts and spending measures to expand growth, combined with steps to reduce the U.S. budget deficit over the next decade.

"The global recovery remains fragile," Mr. Obama said in a Financial Times op-ed Friday, calling for growth "that boosts global demand and creates jobs and opportunity for our people."

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At the other side of the debate are countries such as France and the U.K. that say they must focus on deficit cutting now even if it means slower short-term growth. They're worried that without

more belt-tightening—such as spending cuts or tax increases—they'll lose their triple-A credit ratings, which could send interest costs up and make debt repayment harder. In a worst-case scenario, as in Greece, such concerns could fuel fears of a government default, slamming financial markets.

French President Nicolas Sarkozy, who heads the G-20 this year, plans to unveil another package of austerity measures for France after the government lowered its growth forecast to just 1% next year from 1.75%. He is urging other countries to take steps to support global growth.

Meanwhile, weaker countries such as Greece and Italy are under intense market pressure to adopt severe austerity measures and aren't making enough structural changes in their economies to boost their longer-run growth prospects. "In a sense, it's the worst of all possible worlds," said Eswar Prasad, a Cornell University economist and senior fellow at the Brookings Institution. "You're choking off short-term growth with your policies."

The latest efforts by the U.S. and some allies mark a recognition that G-20 agreements last year in Toronto and Seoul, where leaders agreed to make deficit-cutting a primary goal, aren't putting the world on a path to lift employment and output.

Budget cuts in the U.K. and some northern European nations are threatening to weaken automatic stabilizers—programs such as jobless benefits that are triggered by a weak economy and can help cushion a downturn, as they did in 2008 and 2009. The U.S. and the IMF are encouraging stronger countries to keep those programs in place today to support short-term growth, even if the nations miss near-term deficit goals.

"The strong countries seem hell-bent on tightening fiscal policy with no pressure from the bond markets," said Fred Bergsten, director of the Peterson Institute. "Why are they doing that? It's kind of an obsession. That seems unnecessary and counterproductive."

The U.S. is also pressing China and other fast-growing economies to boost demand at home instead of relying heavily on foreign consumers in weaker advanced nations.

Many developing economies were experiencing robust expansions until a few months ago, worrying mostly about high inflation and hot money flowing in from abroad. The relatively positive outlook led central banks in those countries to start raising interest rates to cool growth and slow inflation. Now, almost all of those nations have stopped raising rates. Some emerging economies, such as Brazil and Indonesia, have started to cut rates, bracing for Europe's problems to hit them.

Central bankers in advanced economies, too, are increasingly worried. The Federal Reserve and the Bank of England are trying to push down borrowing costs to spur faster growth. But even they would acknowledge they're just offsetting the drag from government budget cuts. If political leaders don't step up to the plate to fight the growth slowdown, Europe's debt crisis could worsen over the next year.

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