



## Global austerity: Make or Break

### Overview

The global economy was hit by the European debt crisis early this year after it gradually recovered from the financial crisis in 2008. The crisis situation is now under control, but the market pressure and concerns on European debt remain important. Contrary to the Euro zone, the US is playing the role of safe heaven in a context of renewed global uncertainty. Despite a higher public deficit, the US has shown a real capacity to adapt to new conditions of productions at global level, and the capacity to maintain a reasonable rate of growth in the coming years. Due to the absence of significant adjustment and lack of coordination between country members, the Euro zone has come across structural difficulties to re-emerge at regional level and market doubt on debt sustainability of its most fragile member countries.

**Economic outlook of the US and Euro zone in 2H10-2011.** The US household consumption and corporate investment have been regaining momentum required for a self-sustainable path of growth. Due to the recovery of the private sector, the double-dip scenario is now a low probability indicating a smooth pace of GDP growth after significant rise in 2H09 and fall in 1H10. We forecast that US GDP will grow by 3.2% YoY in 2010 and 3% YoY in 2011, compared to -2.4% YoY in 2009. In the Euro zone, its cycle and recovery are lagging behind the US in terms of job market, the banking sector and productivity. Austerity is now in full measure to control public debt; on the other hand, however, the quick fiscal tightening seems to have come too early as demand remains weak and thus needs the help of the public sector. The absence of new sources of growth, the lack of competitiveness and the severity of austerity will lead to low growth. We forecast Euro zone GDP to grow by 1.0% YoY in 2010 and by 1.1% YoY in 2011, compared to a decline by 4.1% YoY in 2009.

**Austerity post debt crisis.** The time of austerity has come. A general outlook on public debt of the US, the UK, Japan, Germany, France, Ireland, Spain, Greece, Italy and Portugal are provided. We analyze public debt and austerity from three different time horizons: the short-term (within 1 year), medium term (1-3 years) and long-term periods. In the short term, we believe that the European debt crisis is under control, after European authorities, with the support of IMF and the US, have taken the right decisions for stabilizing public debt, banks and financial markets. In the medium term, debt insolvency risk still remains. European countries have to solve a dilemma: to implement austerity and to complete the recovery at the same time. Its most fragile member countries, like Greece, Spain and Portugal, are likely to have difficulties in reaching the balance and thus avoiding default. In the long-term, debt sustainability is mainly decided by GDP growth on the revenue side and health care expenditure on the expense side. Debt sustainability varies among countries. Debt default in certain European countries is possible, requiring a debt restructuring and sharing losses inside Euro zone if it wants to preserve its unity. On the contrary, the US is likely to maintain a high potential of growth and thus ensure sustainability of the debt, due to its clear industrial policy, high level of productivity and demographic dynamism.

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Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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