Challenges of the world economy

Martin Wolf, Associate Editor & Chief Economics Commentator, *Financial Times*

CIES

6th October 2015

Lima, Peru
Prospects for the world economy

- Slowing growth
- Deficient demand
- Today’s challenges
- Geo-economics meets geo-politics
- Conclusion
1. Slowing growth

• The world economy is slowing
• This is true for both high-income and emerging economies
• It is due to both demographic changes and slowing productivity growth
• Trade growth is slowing, as well
• Catch-up growth in emerging economies is crucial
• But few economies have sustained it
• The futures of China and India are critical
1. Slowing growth: declining forecasts

CONVERGENCE MEANS DIVERGENT GROWTH

MOVING AVERAGE GROWTH RATES: PREVIOUS SIX YEARS INCLUSIVE (Source: IMF)
1. Slowing growth: declining forecasts

UNEXPECTED GLOBAL SLOW-DOWN

Successive Medium-Term Growth Forecasts (five years ahead) (Source: IMF, World Economic Outlook, April 2015)
1. Slowing growth: high-income economies

POOR PRODUCTIVITY GROWTH

POTENTIAL OUTPUT GROWTH IN ADVANCED ECONOMIES (Source: IMF)
1. Slowing growth: emerging economies

THE CHALLENGES TO CONVERGENCE

POTENTIAL OUTPUT GROWTH IN EMERGING ECONOMIES (Source: IMF)

- Capital growth
- Potential employment growth
- Total factor productivity growth
1. Slowing growth: fading globalisation

TRADE REBOUNDS BUT ITS GROWTH SLOWS

GROWTH OF THE VOLUME OF GLOBAL TRADE AND OF GDP (per cent) (Source: IMF)

- Total trade in goods & services
- Real GDP at market prices
1. Slowing growth: emerging economies

THE CHALLENGES TO CONVERGENCE

GDP PER HEAD RELATIVE TO THE US
(at purchasing power parity)


Brazil China India Indonesia Mexico Russia Turkey
1. Slowing growth: emerging economies

THE CHALLENGES TO CONVERGENCE

GDP PER HEAD RELATIVE TO THE US
(at purchasing power parity)
2. Deficient demand

- Real interest rates have fallen to zero
- The decline in real rates long preceded the crisis, but the crisis brought rates to zero
- Economists talk of “savings gluts”, even “secular stagnation”
- Certainly, we seem to be “bubble-dependent”
2. Deficient demand: savings glut

SLIDE INTO DEPRESSION RATES OF INTEREST

REAL HOUSE PRICES AND REAL INDEX-LINKED YIELDS

US real (S&P Case Shiller National)  
UK real Nationwide  
Spain real  
UK 10-year IL gilts

Index-linked Yield

Real House Prices (index number)
2. Deficient demand: demand and output

LOST OUTPUT AND LOST GROWTH

IMF Pre-Crisis Forecasts and Outcomes for GDP of High-Income Economies (Source: IMF, World Economic Outlook April 2015)
2. Deficient demand: eurozone “recovery”

DIVERGENCE BETWEEN THE US AND EUROZONE

GDP AND REAL DOMESTIC DEMAND

- US GDP
- US Domestic Demand
- Eurozone GDP
- European Domestic Demand
2. Deficient demand: eurozone

THE COST OF THE EUROZONE CRISIS

GDP per Head in Crisis-hit Eurozone Countries
(at purchasing power parity) (Source: The Conference Board)
2. Deficient demand: after the crisis

WHAT THE ECB TELLS US ABOUT EASY MONEY

Official Policy Rates
(Source: Thomson Reuters Datastream)

- US Fed funds
- UK (BoE base rate)
- Europe (Bundesbank repo/ECB repo)
- Japan (BoJ uncollateralized call money)
2. Deficient demand: after the crisis

WHAT JAPAN TELLS US ABOUT BALANCE SHEETS

Central Bank Balance Sheets (assets over GDP; per cent)
(Source: Thomson Reuters Datastream and Bank of England)
2. Deficient demand: low inflation

EASY MONEY AND LOW-FLATION

CORE CONSUMER PRICE INFLATION RATES

UK core  US core  Eurozone core
2. Deficient demand: low inflation

LOW REAL YIELDS AND INFLATION EXPECTATIONS

YIELDS ON 30-YEAR CONVENTIONAL BONDS (per cent)
2. Deficient demand: debt overhang

THE FAILURE OF DELEVERAGING

CHANGE IN DEBT AS A SHARE OF GDP 2007-14
(per cent) (Source: McKinsey)
2. Deficient demand: eurozone

TURNING INTERNAL INTO EXTERNAL IMBALANCE

Eurozone Imbalances on Current Account (as per cent of eurozone GDP) (Source: IMF, World Economic Outlook Database)

Graph showing the Eurozone Imbalances on Current Account from 1999 to 2020.
3. Today’s challenges

- China’s adjustment
- Falling commodity prices
- Declines in foreign currency reserves
- Exchange rate movements
- Financial fragility
3. Today’s challenges

TRANSFORMING THE WORLD ECONOMY

SHARES IN WORLD GDP (at PPP)
(Source: IMF)

<table>
<thead>
<tr>
<th>Year</th>
<th>European Union</th>
<th>United States</th>
<th>Japan</th>
<th>Other advanced economies</th>
<th>China</th>
<th>India</th>
<th>Other emerging economies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>14</td>
<td>10</td>
<td>4</td>
<td>25</td>
<td>28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>17</td>
<td>9</td>
<td>7</td>
<td>24</td>
<td>25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>20</td>
<td>9</td>
<td>8</td>
<td>21</td>
<td>22</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>21</td>
<td>9</td>
<td>9</td>
<td>19</td>
<td>18</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: IMF)
3. Today’s challenges: China

CHINA’S UNBALANCED ECONOMY

Shares of Spending in China’s GDP
(Source: Haver Analytics)

- Investment
- Household Consumption
- Govt Consumption
- Net exports
3. Today’s challenges: China

**CHINA’S SLOWING ECONOMY**

Contributions to Chinese Growth (percentage points)
(Source: Haver Analytics)
3. Today’s challenges: commodity prices

END OF THE COMMODITY PRICE SUPERCYCLE

REAL COMMODITY PRICES
(Goldman Sachs, deflated by Industrial Countries' Export Unit Values)
3. Today’s challenges: exchange rates

CURRENCY GAMES AS RATES DIVERGE

REAL EFFECTIVE EXCHANGE RATES (JP Morgan)
3. Today’s challenges: reserve falls

CHINA’S UNBALANCED ECONOMY

GROSS FOREIGN CURRENCY RESERVES ($m)

China  Other Asia  Other developing  Industrial countries
4. Geo-economics meets geopolitics

- World is integrating and dividing:
  - Ageing high-income countries
  - Changing power balance
  - Widening zone of chaos

- Risks of:
  - Conflict
  - Mega-terrorism
  - Climate chaos
  - Mass migration
5. Conclusion

- The world economy is at a very delicate moment
- Growth continues, but seems likely to slow further in the short run
- The savings glut problem may get bigger
- The policies used to cope with it are destabilising
- The high-income economies have been profoundly affected by the aftermath of the crisis
- China’s impact is now changing, as it copes with structural reform and its own debt overhang