A new cycle for emerging economies

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A new cycle for emerging economies?

- ✓ It is a fact that developing markets are growing more slowly.
- ✓ Few still believe that the spectacular economic convergence experienced by Asian countries, and less spectacularly by most Latin American and African countries, will be sustained in the next decade.
- ✓ The high commodity prices, rapid globalization, low interest rates and multilateral rule system stability that underpinned this extraordinary period are unlikely to persist.
- ✓ More important, export-oriented industrialization may have run its course.
- ✓ The problems that many EMs' currencies have address as the US Federal Reserve simply announced to tighten monetary policy could be just the start.
- ✓ One hypothesis is that there are deep-seated structural problems behind it.

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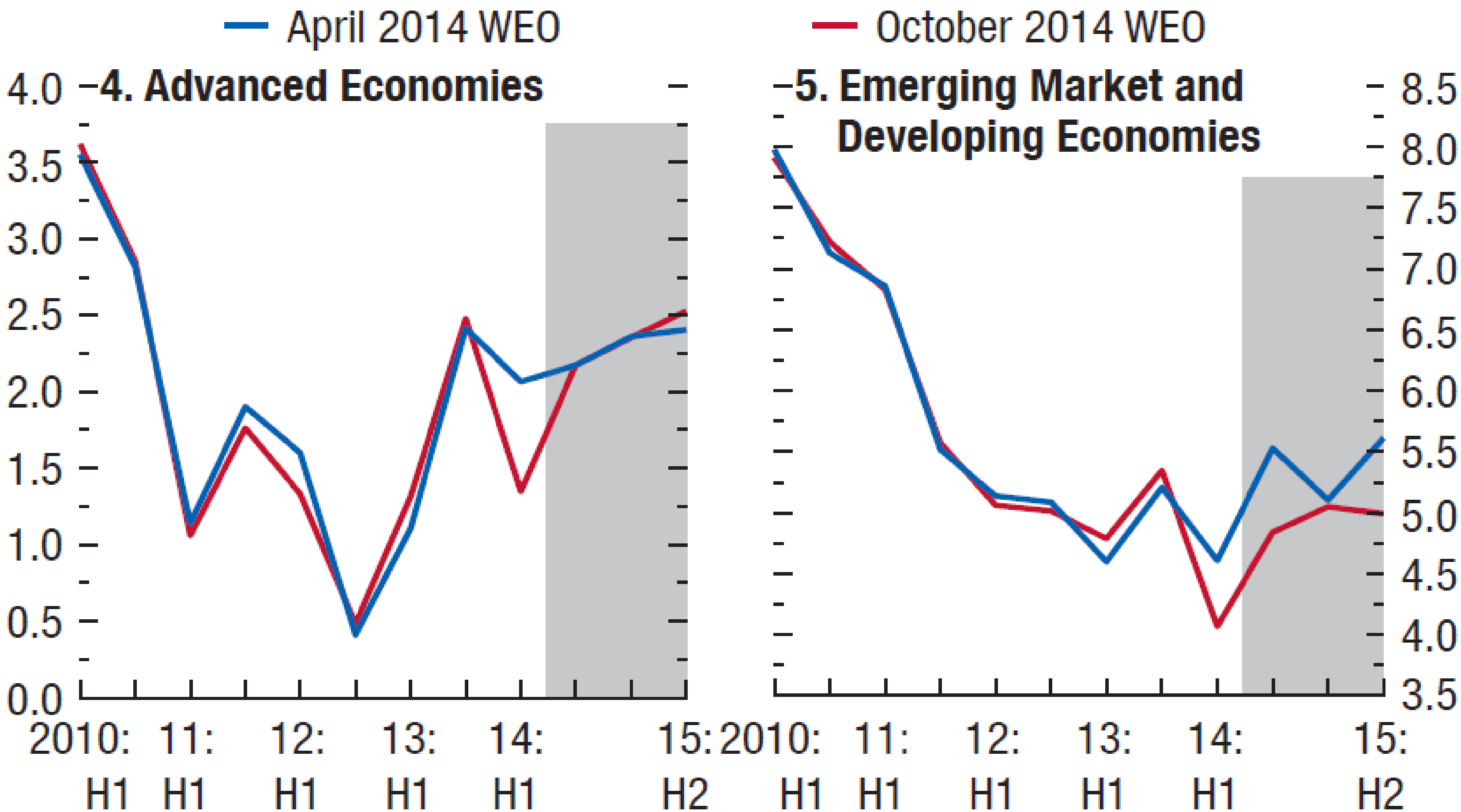
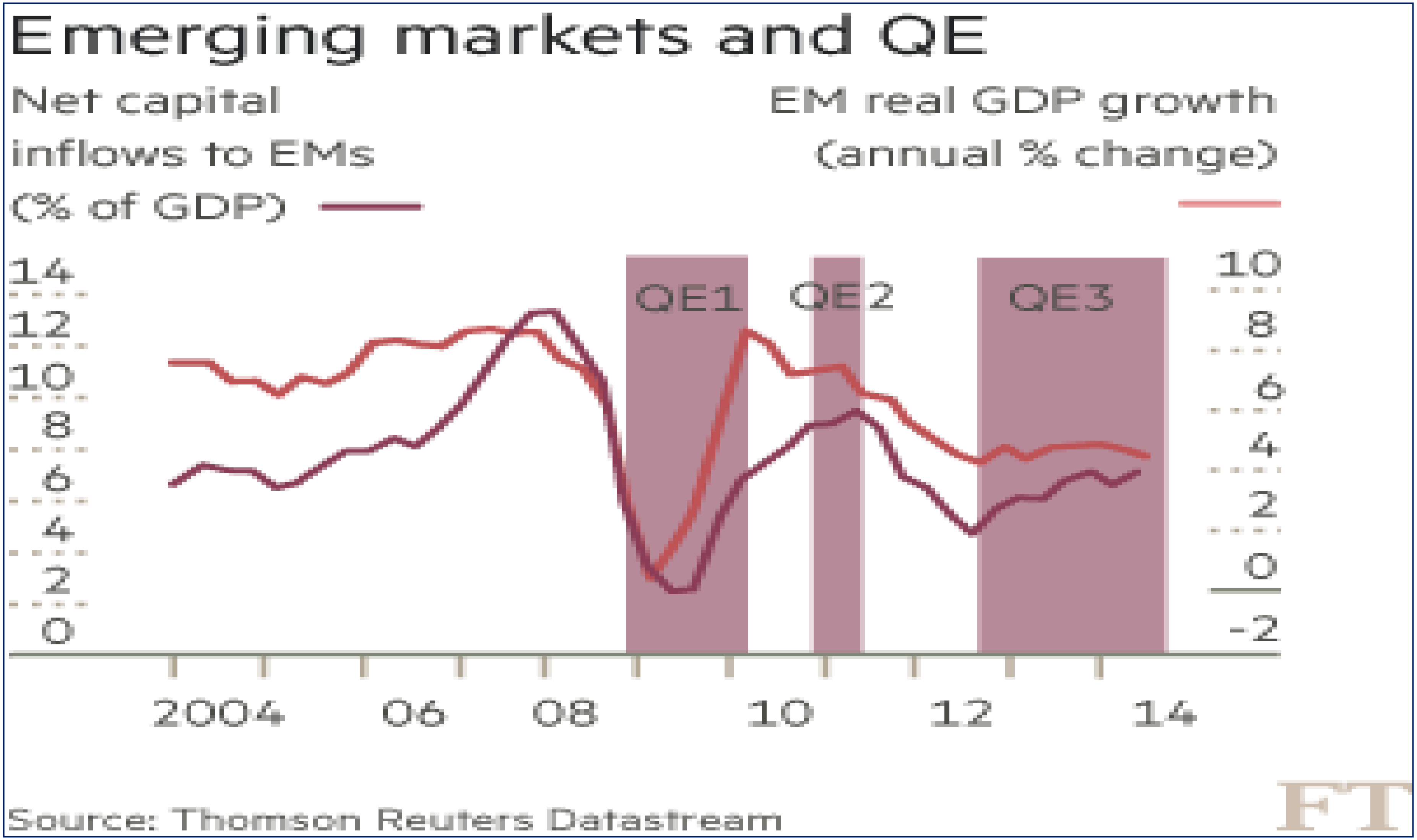
GDP Growth
(annualized semiannual percent change)



Sources: CPB Netherlands Bureau for Economic Policy Analysis; Haver Analytics; Markit Economics; and IMF staff estimates.

THE CURRENT PHASE: SLOWDOWN and CYCLICAL FACTORS

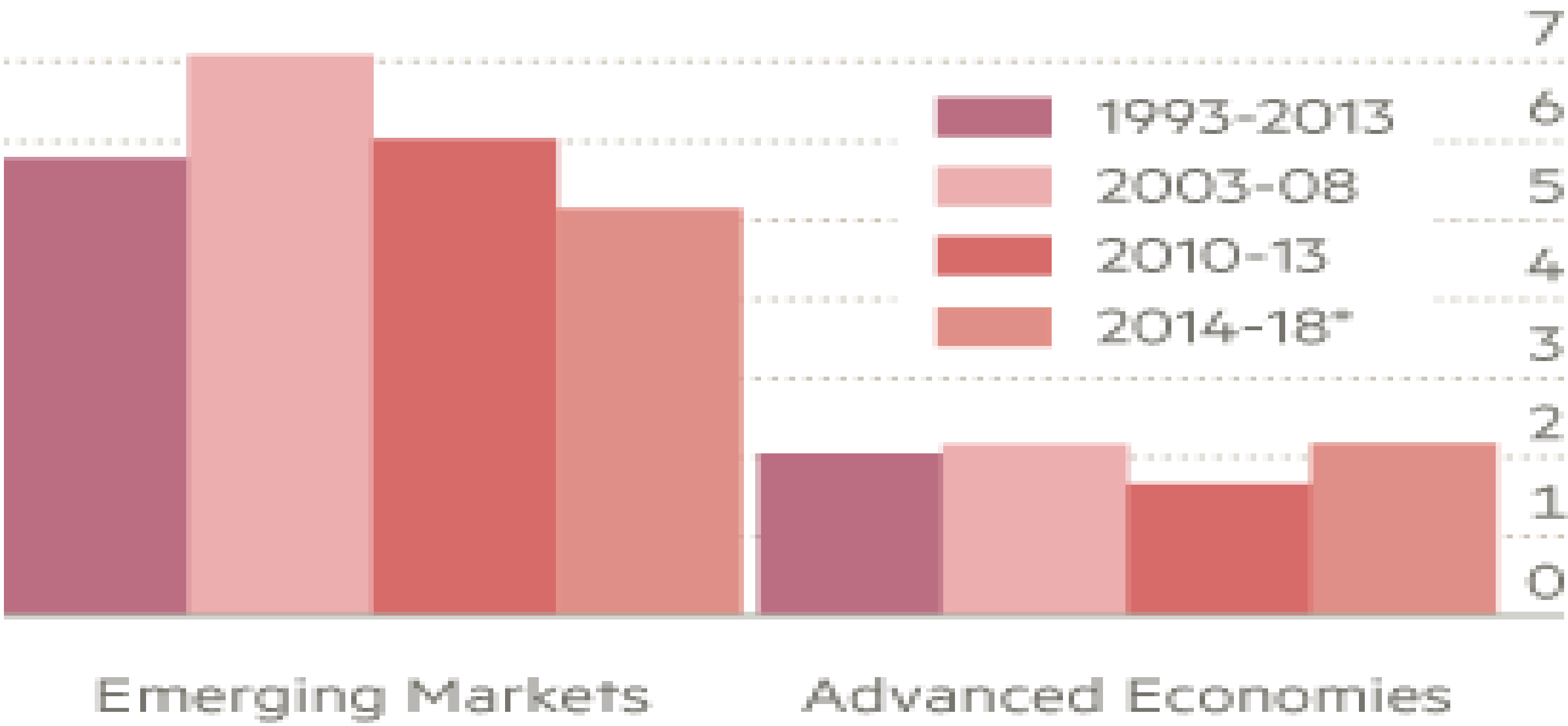
- Despite manifest differences in economic structure and quality of policy making, emerging markets have suffered together this year from fears about rising interest rates and sliding commodity prices.
- EMs face the competing challenges of unbalanced global growth, weaker oil prices and gradual Fed normalization.
- In general, the economic outlook has stabilized in Asia and we are seeing a cyclical rebound in EM Europe (ex-Russia) on easier financial conditions and the weaker euro
- However, Latin America has weakened (Colombia, Chile), with low energy prices requiring more extensive fiscal adjustment (Colombia, Mexico) and political risks/mismanagement hitting output in Brazil
- Russia (with Brazil) is the only major economy to face recession this year



Fears that the US Federal Reserve will soon begin to "taper" its monetary stimulus programme have prompted a sharp sell-off of assets in emerging markets suffering from wide current account deficits

Developed and emerging economies

Average GDP growth (%)



*2014-18 are forecasts

Source: IMF

THE SLOW DOWN OF THE EMs: STRUCTURAL FACTORS

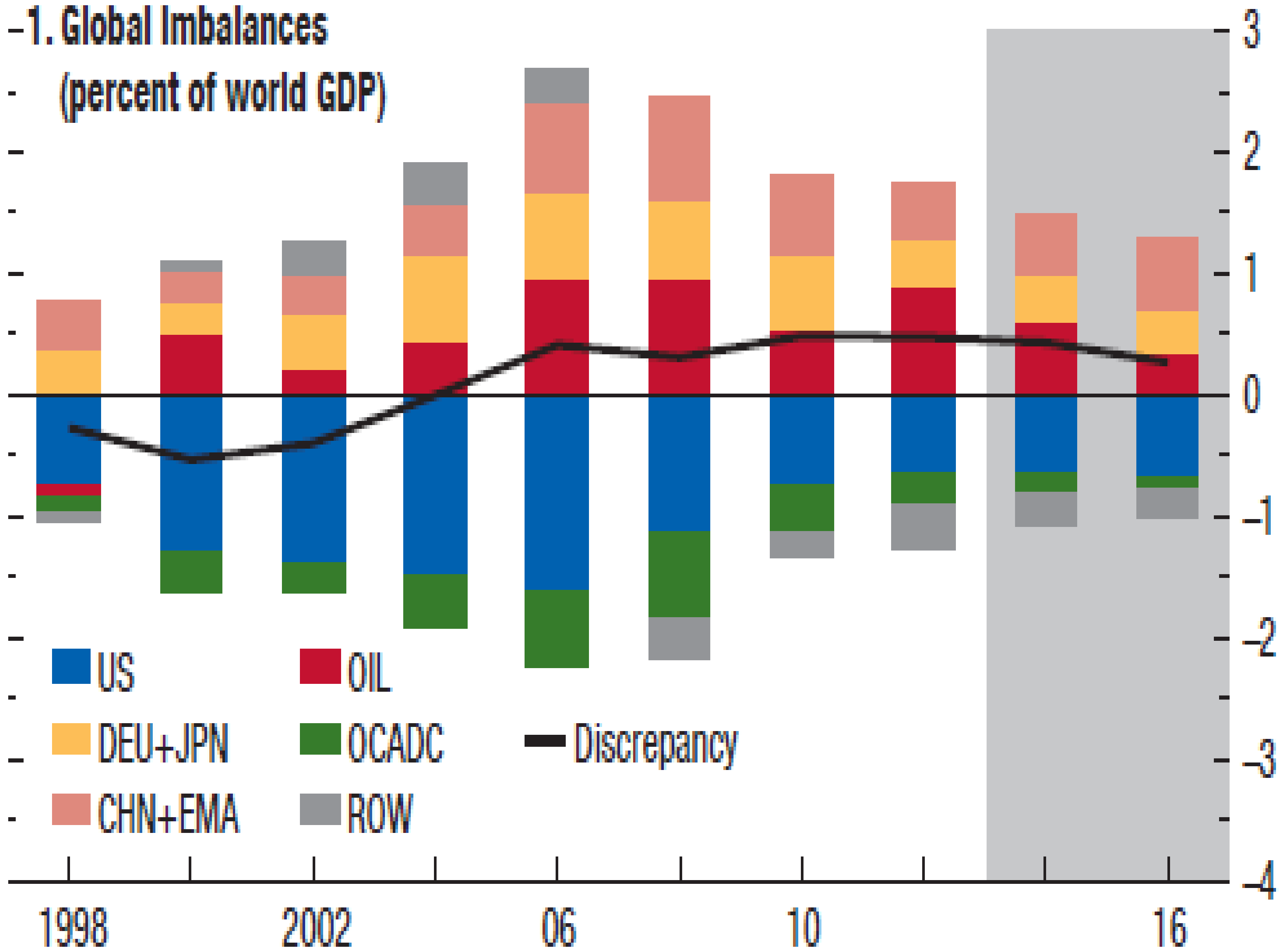
There are also structural reasons to be gloomy about emerging market growth prospects

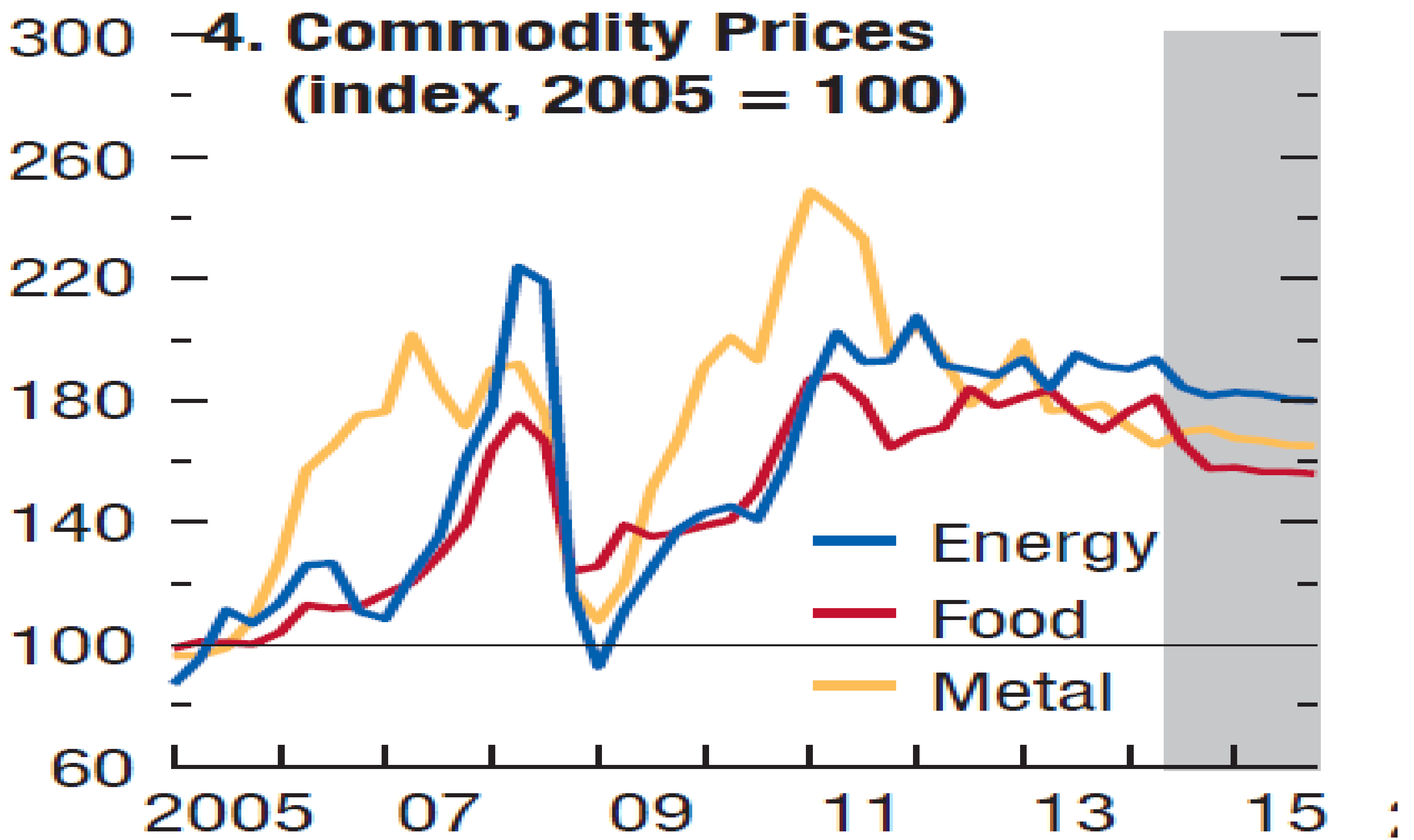
First, the US will no longer be the consumer of first resort for emerging markets, given its improved competitiveness, high debt and reduced energy dependence

China's slowdown has brought the commodities super-cycle to an end, raising a new set of questions about commodities. Lower commodity prices, especially substantially lower oil prices, are driving changes in the winners and losers among EMs

Highly correlated, China is shifting to a more domestic demand-led model. The market perception is that China economic growth will significantly slow down

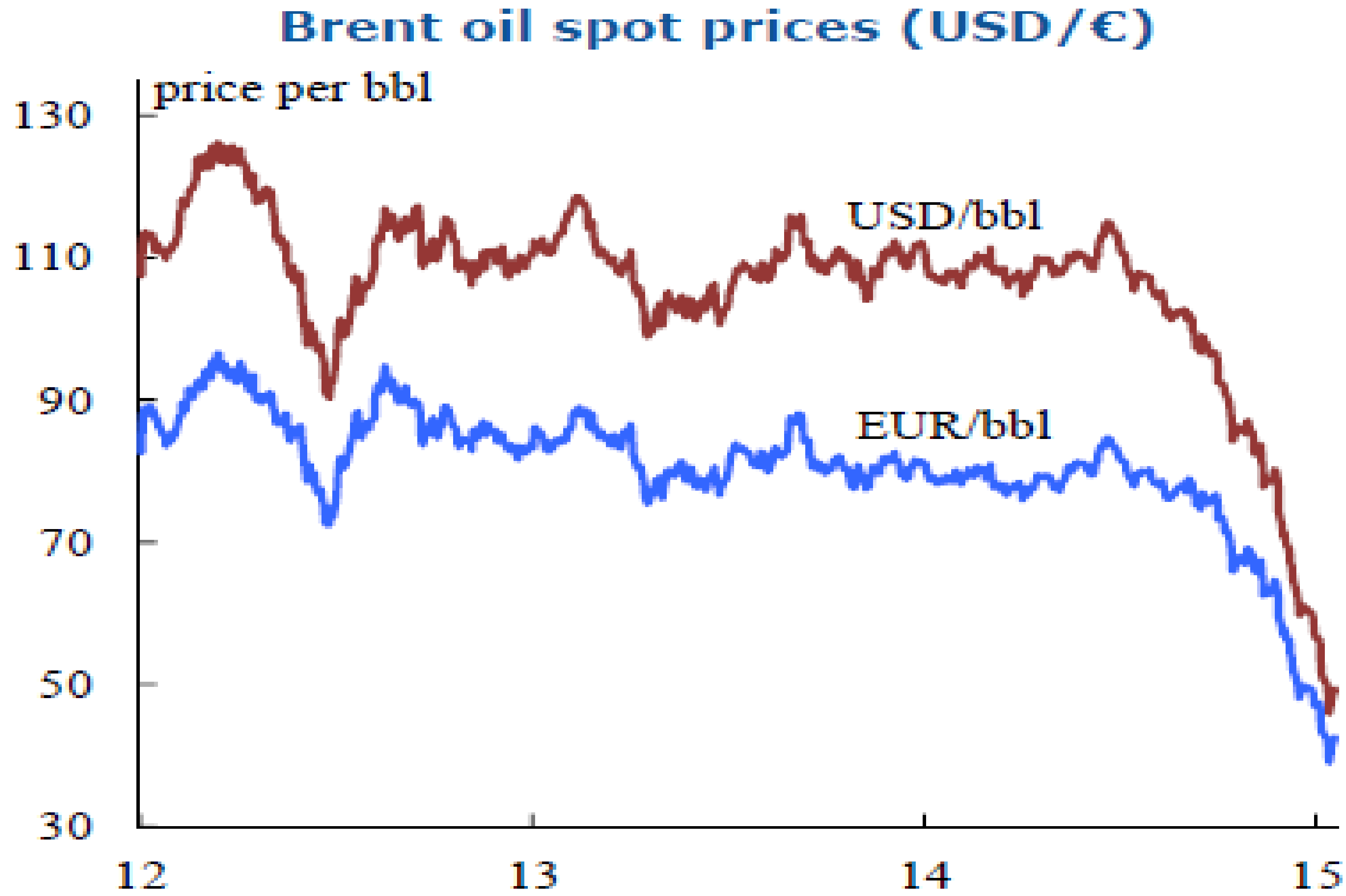
Finally the trend towards deindustrialization in many developing countries. This is called ‘premature’ deindustrialization

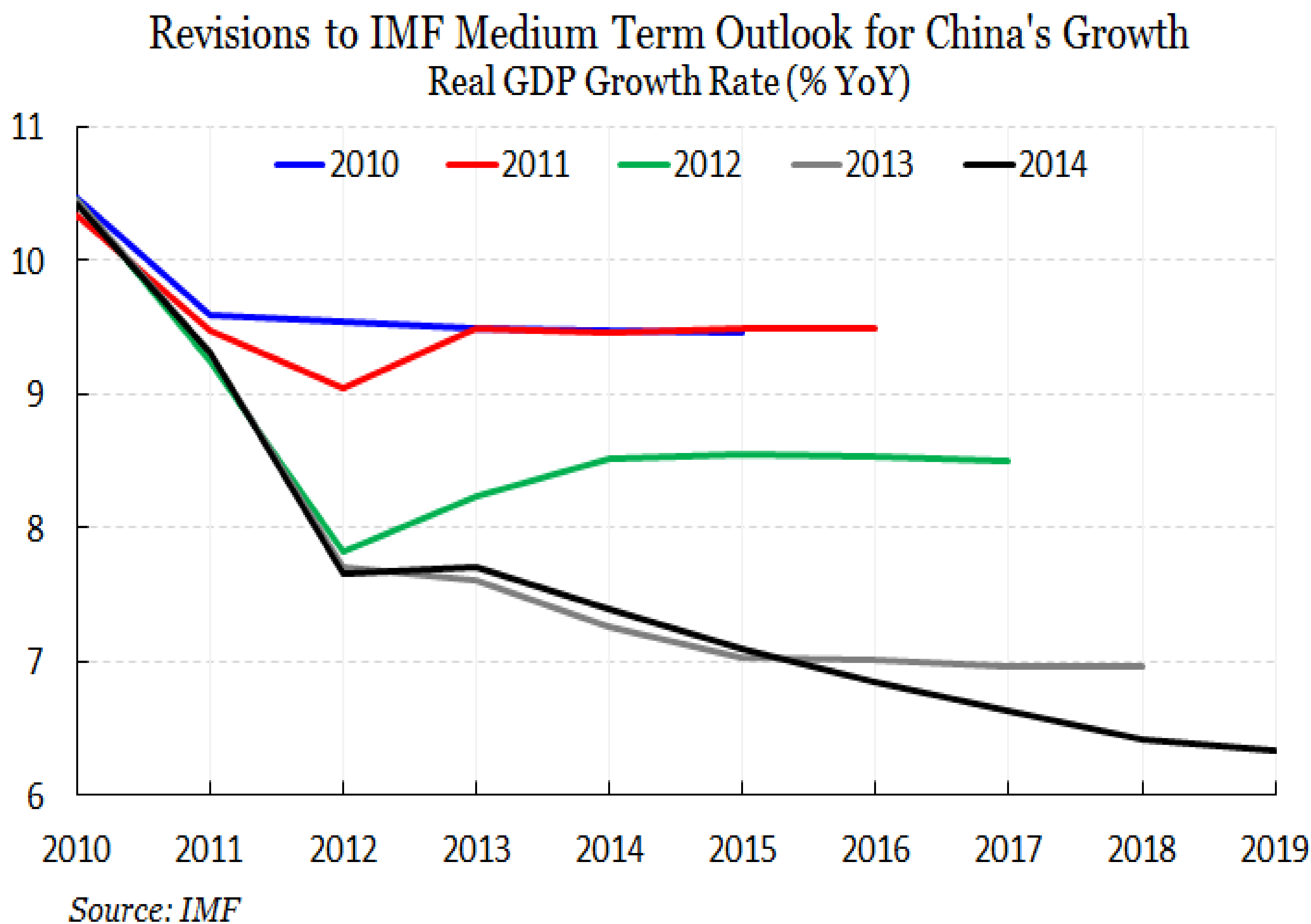

1. Global Imbalances
(percent of world GDP)
3
2
1
0
–1
–2
–3
–4
US
OIL
DEU+JPN
OCADC
Discrepancy
CHN+EMA
ROW
1998
2002
06
10
16

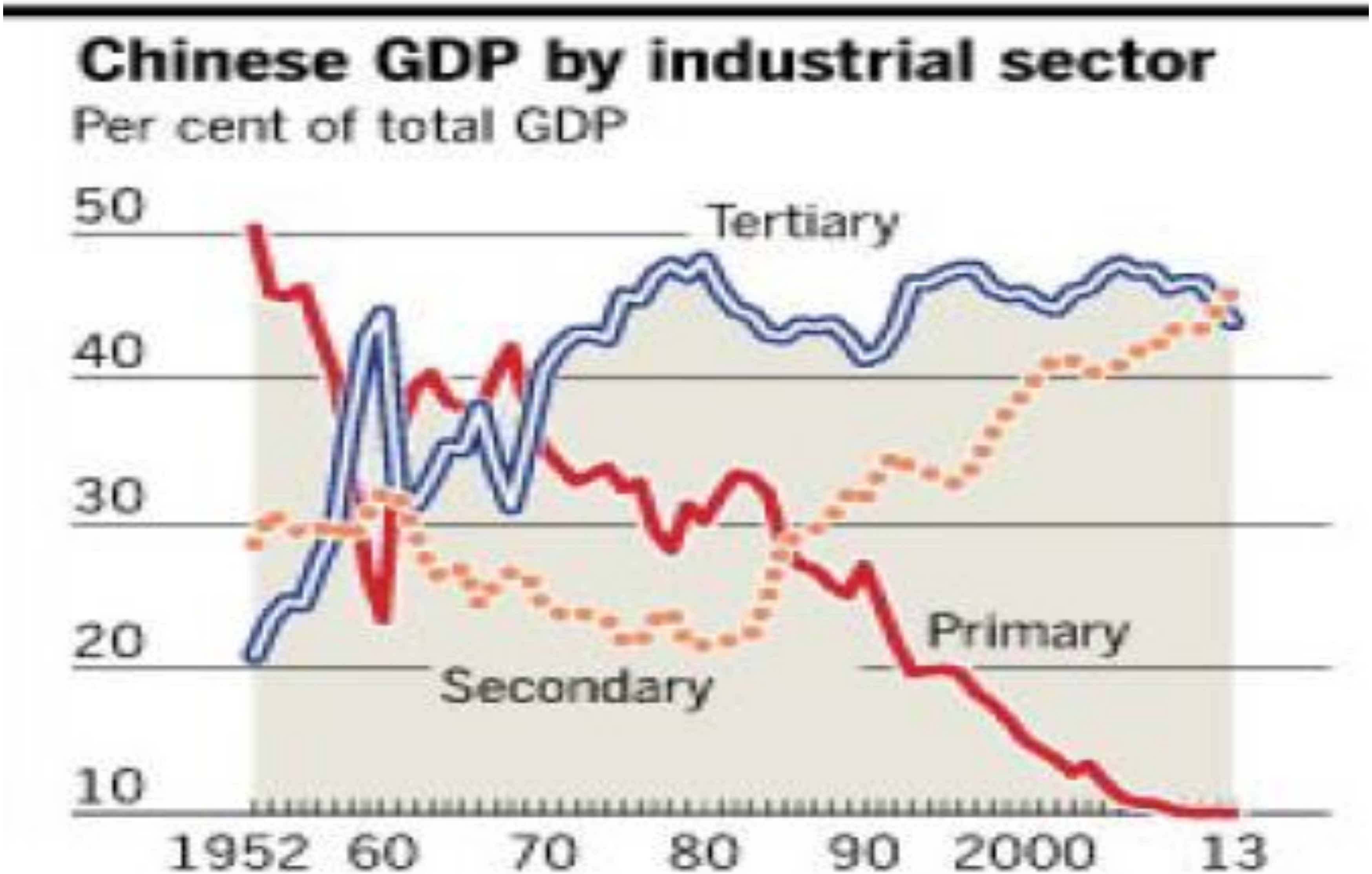


Sources: Consensus Economics; IMF, Prim
staff estimates

Steep fall in oil prices




Revisions to IMF Medium Term Outlook for China's Growth
Real GDP Growth Rate (% YoY)
2010
2011
2012
2013
2014
11
10
9
8
7
6
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
Source: IMF


Chinese GDP by industrial sector
Per cent of total GDP
50
40
30
20
10
Tertiary
Secondary
Primary
1952
60
70
80
90
2000
13

Re-balancing challenges

(1) Increase reliance on own market, less on exports

(2) Raise consumption, reduce inefficient savings

(3) Grow private sector, reduce distortions from state-owned sector

(4) Increase innovation, as imitation limits reached

THE DIFFERENTIATION TRENDS

✓Still the impact of these big macro trends differs among countries. One could expect the theme of EM differentiation to continue into 2015-2016 as EMs react in different ways to global shocks

✓Lower commodity prices, especially substantially lower oil prices, are driving changes in the winners and losers among EMs

✓Divergence and relative shifts in fortunes are also likely in Latin America. Mexico appears to have stronger short term prospects than Brazil or Chile

✓But in Asia as well EM differentiation is going to increase in the near future.

✓But markets and investors today are discriminating less between countries than their diverging economic fundamentals would suggest.

Emerging market and Developing Economies Output

	2012	2013	2014	2015	2016
Latin America	2,9	2,8	1,2	1,3	2,3
Emerging Asia	6,4	6,6	6,5	6,4	6,2
Middle East and North Africa	4,6	2,2	2,8	3,3	3,9
Emerging Europe	1,4	2,8	2,7	2,9	3,1
WORLD	3,4	3,3	3,3	3,5	3,7

Source: Consensus

Concluding Remarks I

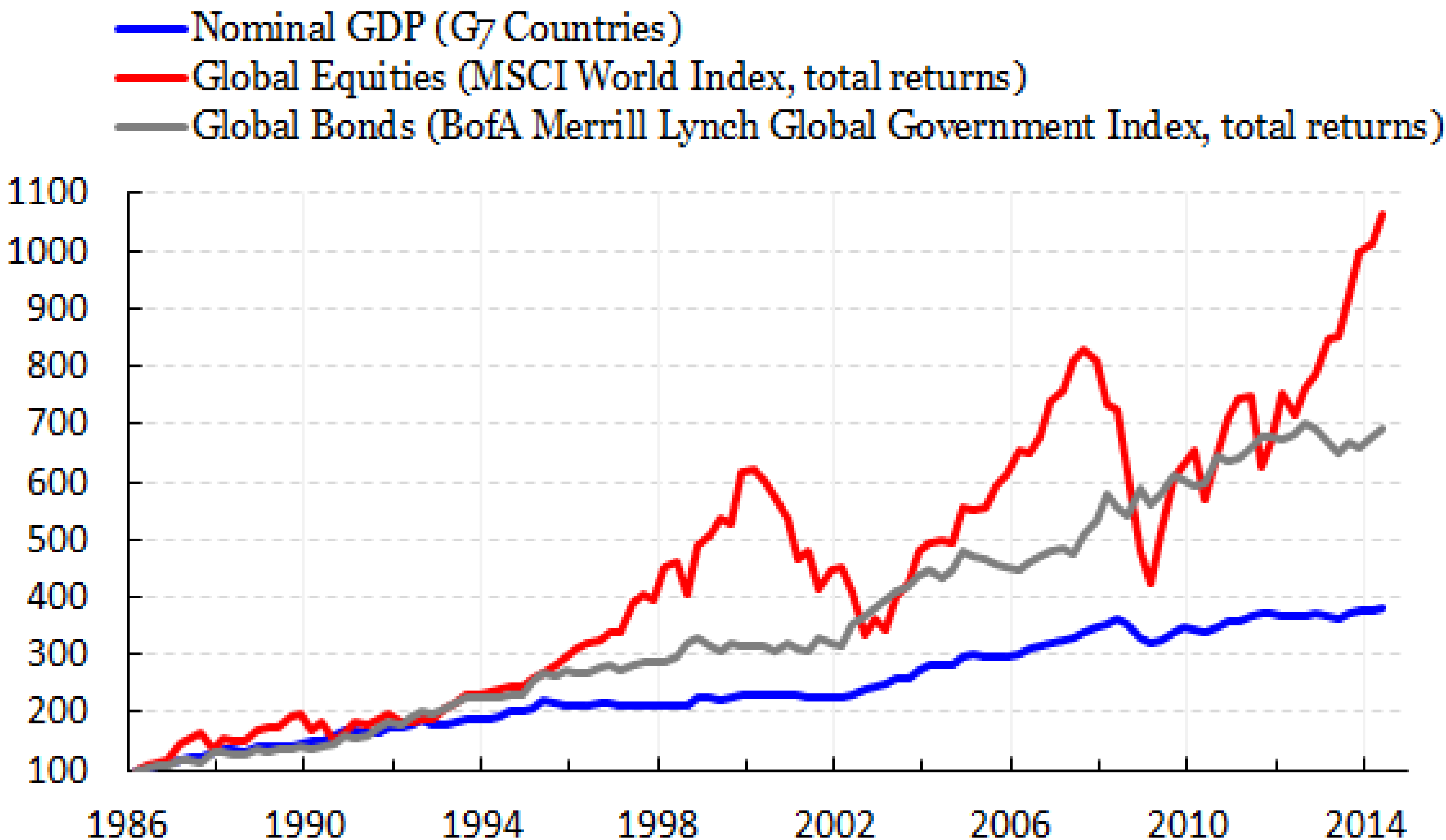
- It is not true that emerging markets' growth over the last two decades was based on a fortuitous (and temporary) set of external circumstances: high commodity prices, low interest rates, and seemingly endless amounts of foreign finance.

- On the other hand a benign world where all emerging markets are favored by demand from their richer neighbours is unlikely to return any time soon.

- Openness to capital flows was supposed to boost investment and reduce macroeconomic volatility. Instead, it has accomplished very mixed results

- The deeper problem lies with the excessive financialization of the global economy that has occurred since the mid 1990's. Greater volatility, reduced room to manage the real economy will continue to preoccupy policymakers in the decades ahead.

Global GDP and Asset Returns (Q1-1986=100)



Note: all variables are denominated in US dollars
Sources: Haver Analytics, Merril Lynch, MSCI

Concluding Remarks II

- The days of easy living for emerging markets are ending and hard work lies ahead.
- That makes it ever more important that countries implement policies to foster domestic long-run growth
- The details of appropriate policies will depend, as usual, on local constraints and opportunities.
- Every government should support the expansion of capacity in the modern sectors that have the greatest potential to absorb workers from the rest of the economy (structural changes).
- Growth will need to rely to a much greater extent on sustained improvements in human capital, institutions, and governance. And that means that growth will remain difficult to be implemented

The End

Thanks for your attention!