Challenges and downside risks for the world economy

A year of living dangerously

UNCTAD, TDB
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“It’s the (world) economy... stupid”

- With tepid recovery in advanced economies and strong headwinds in many developing and transition economies, the crisis is not over and the risk of a prolonged period of turbulence and stagnation persists.

- Focus now on emerging economies (third phase)... but insufficient demand and failure to tame finance in AEs are compounding their problems.

- Combining monetary expansion with fiscal and wage restraint has been ineffective and spillovers to the rest of the world now turning negative.

- Weak demand, financial instability and high inequality leading to a new “abnormal”.... cant grow without adding to instability; cant stabilise without damaging growth ... a policy problem.

- Expansionary policies needed to address the roots of the crisis on both the demand and supply side; alternative G20 agenda.
The decoupling myth
“Brand new talk, not very clear”

- Growth estimates for 2015 and projections for 2016 revised down (IMF; UN); downside risks
- A perfect storm (World Bank); a global recession (OECD); growing risk of social unrest (ILO)
- Financial fragility with focus on weaknesses in emerging economies; unorthodox monetary policy + structural reforms (an increasingly vague term)
- Live in an interdependent world economy which continues to be dominated by the advanced countries
Headline numbers shaking global markets

Slowdown in China

Real GDP growth in China, 2002-2016

Falling commodity prices

Capital reversals

Net financial flows to developing countries and economies in transition, 2005–2015

US interest rates
First-round risks (1) “The market is very worried about China”

China's contribution to global growth remains robust

Vigilant policy action and plenty of room for further interventions

- Interventions in the real economy: rebalancing away from investment, promoting increased household spending, revamping the social security system, supporting local and state governments, etc.
- Fostering production upgrade
- Exchange rate policy shift (measuring the level of Renminbi against a basket of 13 currencies) and 'soft' controls over capital outflows
- Reunifying financial and economic policy to improve coordination
First-round risks (2) Falling commodity prices .....not translating to global acceleration

- G20 commodity-exporters' contribution to global growth (right axis)
- Non-oil commodity price index (2011=100)
- Oil price index (2011=100)

- G20 commodity-importers' contribution of consumption to global growth partly attributed to commodity price changes (upper range; preliminary) (right axis)
- Lower range; preliminary
First-round risks (3): exchange rate pressures

- Inflationary pressures
- Erosion of real wages
- Monetary policy responses of contractionary character (to 'attract capital', to 'contain inflation')
- Calls for fiscal austerity?
- Debt management crisis, affecting financial and corporate bonds and hitting the public sector (bail-outs?)
Second-round risks (1):
China’s adjustment to a new growth path
Weak investment recovery in emerging economies

Selected other countries’ fixed investment growth: before and after the crisis
Second-round risks (2)

• No coordinated policy stimuli across major G20 economies
• Developed economies face stronger headwinds, not only because of negative feedbacks from emerging economies, but also:
  • Impact of $ appreciation on net exports and net worth (value of assets abroad); limits to fiscal relaxation; negative effect on spending of corporations and households due to stock market falls (failure to address wage share decline)
  • Insufficient stimuli from EU fiscal policy, too weak recovery of real earnings and declining stock markets affecting corporate spending, a debt-deflationary trap may persist; wont 'export its way out' on the back of further monetary easing and devaluation
  • Return to a more deflationary trend in Japan with more fiscal contractionary measures combined with stock market falls and weak export growth