Post crisis global growth trends

Summary

Q1 2014

This paper examines the long term outlook for world growth over the five years from 2013 to 2017 and contrasts that with experience in two historical five year periods: the five years preceding the crisis, 2003 – 2007; and the five years of the crisis 2008 – 2012. A key message is that confidence in world growth is increasing, but the pattern of regional growth is changing and that is evident in the data when plotted on the maps used in this paper.

In their latest World Economic Outlook in October 2013, the IMF forecast world growth to be about 1% per annum higher in 2013-2017 than in the crisis years of 2008-2012, but this is still about 1% per annum lower than in the five years to 2007. The picture is not uniform and there are regional and country specific variations. While confidence increased that Europe and Northern America would see a return to growth, the prospects of some of the largest emerging market economies deteriorated. 2013 may thus have marked a change not only in the geographic pattern of economic growth, but also in the factors which have been acting to stimulate or restrain that growth. Markets have been weighing the implications of the shifting pattern of growth.

Unsurprisingly perhaps, the growth outlook is a mixture both of the continuation of trends that have been in place for some time and the expected reversal of either accommodative or restrictive economic policies of one type or another. One such reversal is fiscal policy. While the UK and the countries in the Eurozone are expected to reduce budget deficits through fiscal tightening, or "austerity", by more than 5% of GDP, oil producers are expected to increase their budget deficits by a comparable amount. For others, most notably India and Russia, expectations about fiscal deficits reflect wider concerns about those countries' economies.

A second area where previous trends are changing is investment spending, which is expected to grow only modestly in the five year period to 2017. Asia continues to stand out for the level of its investment spending and this is expected to rise further, but in the region's most populous countries, India and China, it is expected to decline. Investment is also set to fall in Australia and it is notable that significant increases in investment are rare in other resource rich countries, even those with poor or over-stretched infrastructure. One of the more anomalous features is that expectations of the level of investment spending in regions other than Asia remain modest.

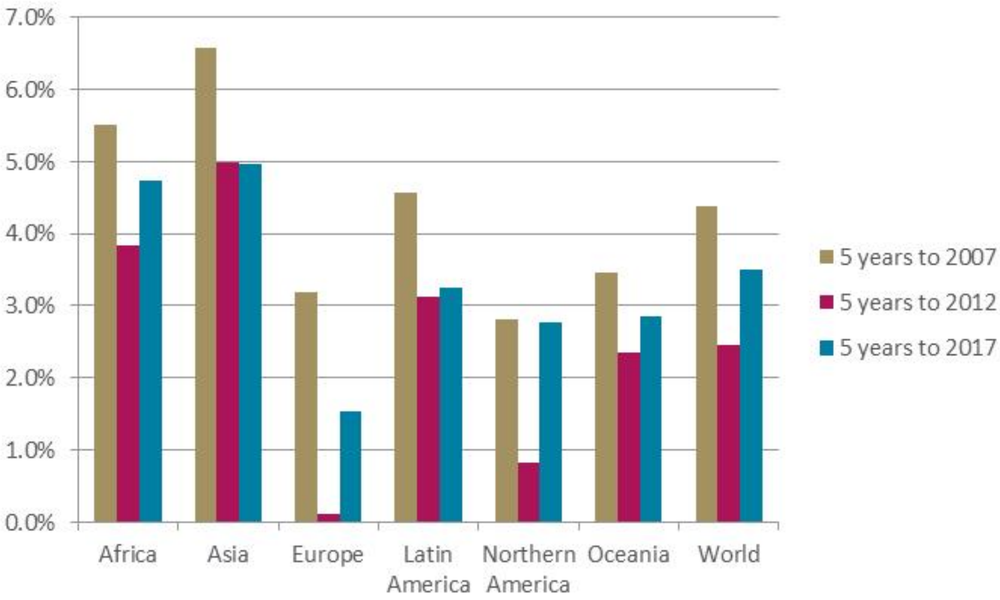
In 2013 confidence that Europe and Northern America would see a return to growth increased, but the prospects for some of the largest emerging market economies deteriorated affecting investor sentiment. 2013 may thus be seen to have marked the start of a new pattern of world economic growth. Economic growth in the current five year period is much more evenly spread across the world than in the two other five year periods considered. This growth outlook is a mixture of the continuation of trends which have been in place for some time; recovery in the crisis affected countries; and expectations of a reversal of either accommodative or restrictive economic policies of one type or another. Investment markets have been assimilating these shifting views and weighing their implications.

The Changing Pattern of World Growth

In 2013 confidence that Europe and North America would see a return to growth increased, but the prospects for some of the largest emerging market economies deteriorated affecting investor sentiment. 2013 may thus have marked a change in the pattern and mix of world economic growth.

World growth is set to be about 1% per annum higher than in the crisis years, but this is still about 1% per annum lower than in the five years to 2007. Chart 1 shows the IMF expectations for average annual world growth over the five years to 2017 and the comparable numbers for the earlier periods and by region.

Chart 1: Average annual GDP per capita growth



Source: IMF World Economic Outlook October 2014; Cameron Hume Limited calculations

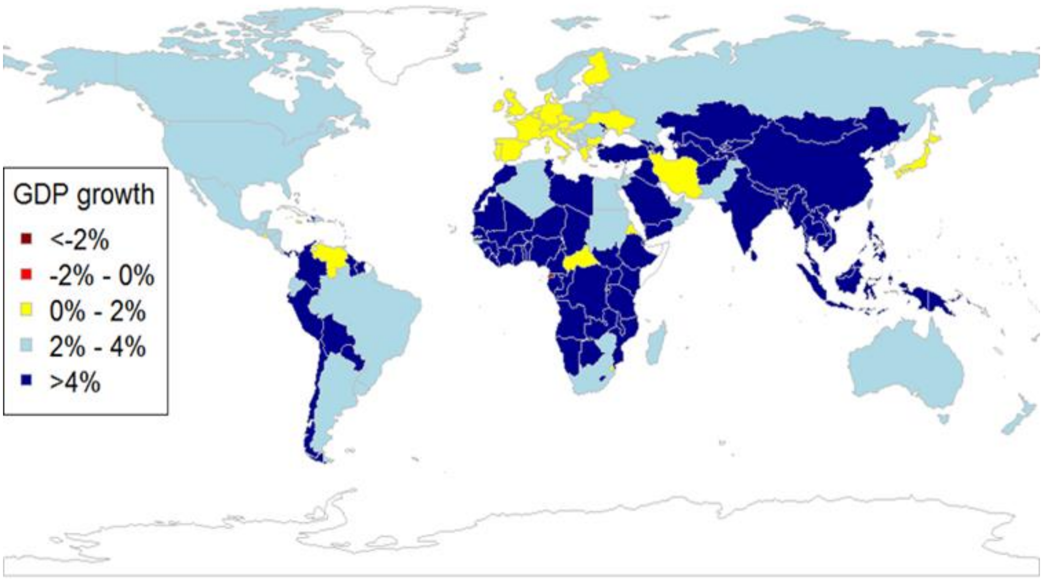
The patterns at the regional level are similar to the global picture: growth in each region is higher than in the five years to 2012, but lower than in the five years prior to the crisis. Asia is the only region where growth is no better in the next five years than in the prior period. The greatest recovery is expected to be in Europe and Northern America, those regions most severely affected by the crisis and its aftermath, and, indeed, the IMF expects Northern America to grow almost as quickly in the current five year period as it did in the pre-crisis era. In contrast, Europe, Asia and Latin America are expected to grow materially less quickly than they did in the five years prior to the crisis.

The regional data, however, hide a more subtle picture at the individual country level.

Chart 2 shows a map of the world with the colour shading of each country determined by the expected average annual growth in GDP per capita in the five years to 2017.

The chart clearly shows a general picture of positive growth. It shows the expected continuation of two broad trends: strong growth in Asia, Africa and the Pacific coast of South America; and lacklustre growth in Japan, the Eurozone and the UK. What is not so immediately apparent is that the major emerging market economies are expected to grow materially less quickly than their recent historical experience. We will look at some of the reasons for this later in this paper.

Chart 2: Average annual GDP per capita growth 2013 - 2017



Source: IMF World Economic Outlook October 2013; Cameron Hume Limited. Note: countries for which there is no data appear white

The Changing Pace of Growth

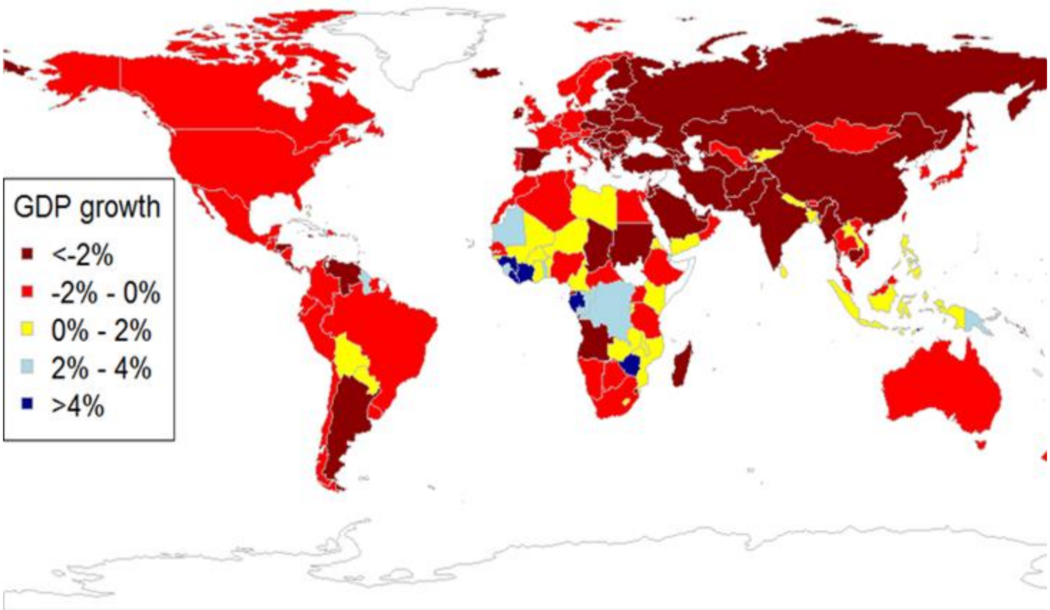
The changing pattern of world growth is evident in Chart 3, which shows the difference between the annual average growth in the current five year period and that prior to 2007.

Chart 3 shows very clearly that the pace of growth expected in the next five years is in most cases slower than that seen in the five years leading up to the crisis.

Some of the reasons for this slower growth relate to boom conditions in the period prior to 2007 – this is most clearly the case in Iceland, Ireland and Spain. For others it is a consequence of the crisis in the Eurozone – growth in Eastern Europe has been dependent not only on the pull from Europe, but also on the flow of capital from Eurozone countries. Growth in Eastern Europe is expected to be slower not because the comparison is with a boom period, but because: its biggest trading partners are growing more slowly; and investment, which was both a strong source of and stimulus to growth, is expected to be weaker. A cause of this investment slowdown is the weak capital position and poor profitability of the region's key lenders which are predominantly banks based in the Eurozone.

Not all countries are expected to grow more slowly. In Asia, Indonesia and the Philippines are expected to achieve modestly more rapid growth in the years to 2017 than they managed in the five years to 2007. In Africa, the optimism about the continent's growth may be seen in the relative buoyant expectations for countries in West Africa around the Gulf of Guinea and in east Africa in Kenya, Mozambique, Zambia and their neighbours.

Chart 3: Difference in average growth prior to 2007 and after 2012



Source: IMF World Economic Outlook October 2013; Cameron Hume Limited. Note: countries for which there is no data appear white

However, perhaps the most striking feature of chart 3 is the slowdown in Asia, particularly in China and India. China's growth prior to 2007 was very strong, driven to varying degrees by the shift in the workforce to industrial and urban activities and investment. This was sustained through the crisis years by loose monetary policy and a large fiscal stimulus.

The IMF's relative caution on the outlook for China is based in part on the concern that the social consequences of the shift in the workforce are likely to mean that the rate of transformation progresses more slowly. Also, the large increase in indebtedness of the private sector in recent years may have made the economy more vulnerable and may require a period of tighter monetary policy and slower growth to correct.

The ambition of the Chinese authorities to introduce further economic reforms and liberalising measures seems undaunted however and they may yet confound the more pessimistic commentators.

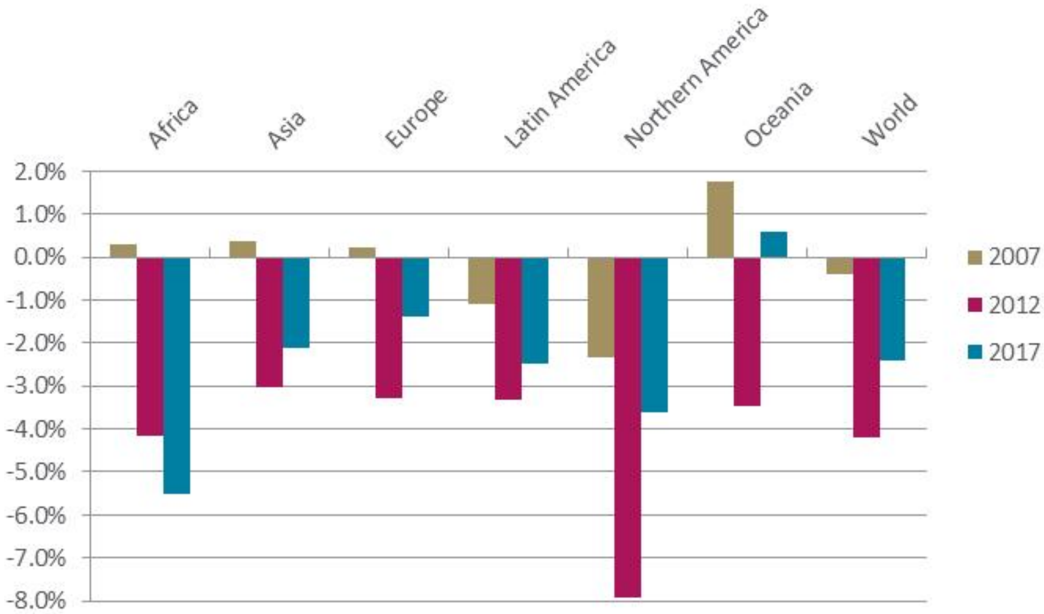
India has been much less successful in transforming its economy than China, and the forecast slowing of growth reflects disappointment both with the apparent lack of appetite for economic reform and the accumulated excesses of loose fiscal and monetary policy. The list of challenges facing India is long: the country has both a large current account deficit and a large fiscal deficit; inflation is high and growth disappointing; credit growth has been very strong and doubts have grown about the resilience of the banking sector, encouraged in part by the banking authorities' leniency. Economic reform looks to be urgently required in India, which the current government acknowledges and has appointed an authoritative and reform-minded central bank governor. However, with an election due and obstacles to reform deep seated, material progress is both uncertain and may take some time.

Economic growth in the current five year period is much more evenly spread across the world than in the two earlier periods. Unsurprisingly perhaps, the growth outlook is a mixture both of the continuation of trends which have been in place for some time and the expected reversal of either accommodative or restrictive economic policies of one type or another. One such reversal is fiscal policy, which is changing the trend of government deficits.

The Changing Influence of Fiscal Policy

Chart 4 shows the IMF's expectation for government budget deficits in 2017, 2012 and 2007 for the world and by region.

Chart 4: Average government budget balances



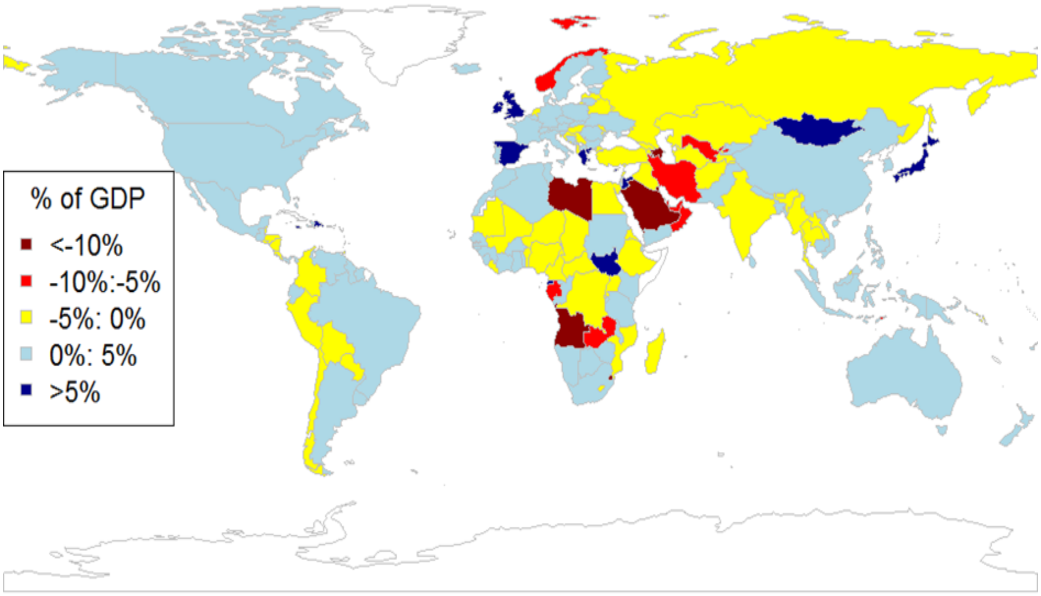
Source: IMF World Economic Outlook October 2013; Cameron Hume Limited calculations

If all else is equal, then the effect of the estimated reduction in budget deficits will be to reduce cumulative growth between 2012 and 2017 by approximately 1.5%, or 0.3% per annum. On the other hand, the extent of government stimulus, whether through deliberate action or passive stabilisation through social security systems, in the crisis period is clear too: budget deficits expanded by almost 4% of world GDP between 2007 and 2012. By that measure the greatest stimuli were in Northern America (5.5%), Oceania (5%) and Africa (4.2%). It is noteworthy that Africa is the only region where deficits are expected to widen in the next five years. This pro-cyclical behaviour may be one reason for caution in what is otherwise a positive outlook for the continent.

Governments reduce their deficits through the combination of spending restraint, tax increases and growth. The amount of reliance placed on each of these has been hotly debated by economists, but it is politicians who make decisions and they have been influenced at least as much by the political landscape as by economic arguments. This can be seen most clearly in individual country decisions displayed in Chart 5.

The governments of the UK, Ireland, Spain, Greece and Cyprus are expected to reduce their budget deficits by more than 5% of GDP between 2012 and 2017 and the other countries in the Eurozone are expected to reduce their deficits by up to 5%. For these countries the majority of the deficit reduction is expected to be achieved through fiscal restraint, or "austerity", rather than growth. It is commonly argued by US-based economists that this policy is wrong-headed and is contributing to the slow growth of the region and exacerbating the problems within the Eurozone. Economists and politicians in Germany and some other northern members of the Eurozone argue differently.

Chart 5: **Average in budget deficits between 2013 and 2017**



Source: IMF World Economic Outlook October 2013; Cameron Hume Limited. Note: countries for which there is no data appear white

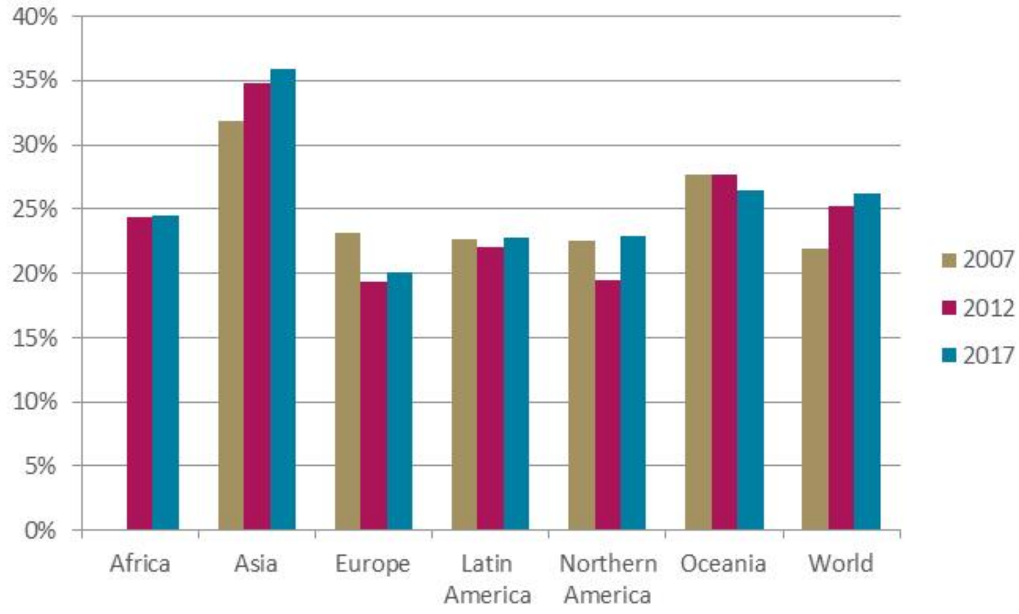
In contrast, some oil producers most notably the Gulf States, Norway and Angola are expected to increase their budget deficits by 5% or more of GDP. In part this is a contra-cyclical activity: spending savings built up over many years as growth slows with the expected weaker real price of oil, but in some cases, Zambia for example, it may be a more worrying sign of poor fiscal discipline.

Chart 5 also highlights one of the concerns about India, that its deficit is expected to deteriorate further, which reflects its signal inability to reform, or exercise fiscal discipline. Less obviously the behaviour of the Russian deficit illustrates one of the problems with the structure of that country's economy. As Russia is a large producer of oil, gas and other commodities and if one accepts the IMF's assumption of a weaker real oil price, then the Russian government might be expected to engage in some counter-cyclical stimulus, which indeed the chart shows: the budget deficit increases. However, the Russian government is so dependent on revenues from oil and gas that it has relatively little room to manoeuvre and has not accumulated large reserves of savings: some analysts estimate that the Russian government needs USD 100 oil to balance its books. The combination of a weaker real oil price, a relatively small amount of accumulated savings and a struggling financial sector all contribute to the relatively disappointing outlook for Russian GDP growth to 2017.

The Changing Pattern of Investment

The rise in government deficits was one of the features of the period between 2007 and 2012, another was investment spending. The collapse of the US housing market and the damage done to bank balance sheets by this and by both the more broad based credit crisis and the recession led to sharply reduced investment in Europe and Northern America. Notwithstanding the fall in investment here, the policies pursued in Asia meant that for the world as a whole investment as a proportion of GDP continued to rise.

Chart 6: **Investment as a percentage of GDP**



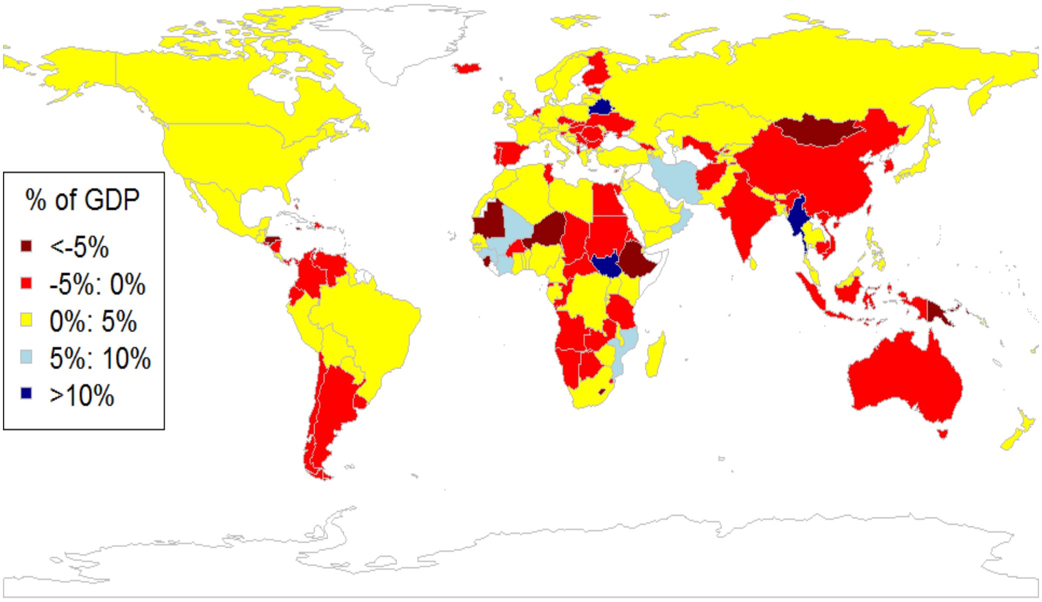
Source: IMF World Economic Outlook October 2013; Cameron Hume Limited calculations

Chart 6 shows investment as a percentage of GDP for the world and constituent regions at five yearly intervals – 2007, 2012 and 2017. The high levels of investment in Asia and to a lesser extent in Oceania stand out, but perhaps the most surprising feature is that investment spending in Latin America and Africa remains so low. More generally, the chart suggests that investment spending will not contribute significantly to growth in the current five year period. However this picture, too, varies from country to country.

Chart 7 shows the change in investment as a percentage of GDP for individual countries and therefore indicates the contribution to growth from investment over the current five year period. The countries with unusually strong or unusually weak growth in investment tend to be those recovering from or undergoing conflict, or a combination of political and economic strife.

More specifically, China, India and Australia, countries that have experienced material investment in recent years, are expected to see lower investment. In contrast, Japan and much of Europe are expected to see a modest recovery in investment. However, it is striking to see that despite a near collapse in investment in Spain and Portugal in the five years to 2012 the IMF sees investment shrinking still further in the current period. The effect of the Eurozone crisis on central and Eastern Europe is also evident in their weak investment outlook: the region's key lenders are banks based in the Eurozone. The brighter outlook for parts of Africa – countries around the Gulf of Guinea and some parts of southern and eastern Africa – is also reflected in the relative optimism for investment spending.

Chart 7: Change in Investment as a Percentage of GDP between 2012 and 2017



Source: IMF World Economic Outlook October 2013; Cameron Hume Limited. Note countries for which there is no data appear white

However, looking at chart 7 it is noticeable that significant increases in investment are rare even in resource rich countries with poor or over-stretched infrastructure: investment in central and southern America is modest as it is in much of southern Africa and Russia. Why this should be the case when global growth is good, the crisis countries are recovering and interest rates are low may be a reflection of the need for further economic reform, or perhaps that the IMF consensus is excessively pessimistic.

Conclusion

In 2013 confidence that Europe and Northern America would see a return to growth increased, but the prospects for some of the largest emerging market economies deteriorated affecting investor sentiment. 2013 may thus be seen to have marked the start of a new pattern of world economic growth. In the current five year period, economic growth is much more evenly spread across the world than in the two earlier five year periods considered. This picture is based on a mixture of the continuation of trends which have been in place for some time; recovery in the crisis affected countries; and expectations of a reversal of either accommodative or restrictive economic policies of one type or another. Investment markets have been assimilating these shifting views and weighing their implications.

Contact

Keith Logan
keith.logan@cameronhume.com
T +44 (0) 131 603 6988
M +44 (0) 7860 925131

Christian Torkington (alternate contact)
chris.torkington@cameronhume.com
T +44 (0) 131 603 6982
M +44 (0) 7834 946528

Disclaimer