ADVANCED ECONOMIES

GROWTH vs STAGNATION

PART I

The desire planted within emerging economies (EEs) is exuberant; thoughts of unimaginable expansion, dominance, a dangerous avidity to dethrone advanced economies (AEs) as the transcendent economic powerhouses.

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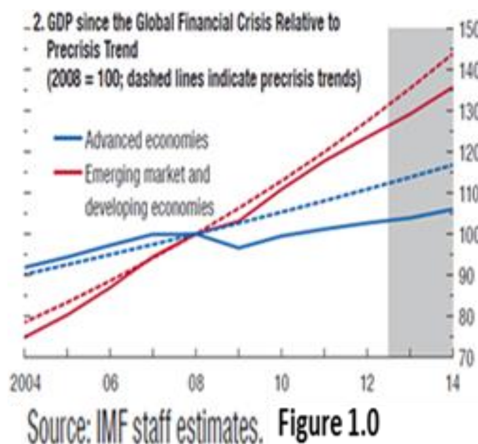
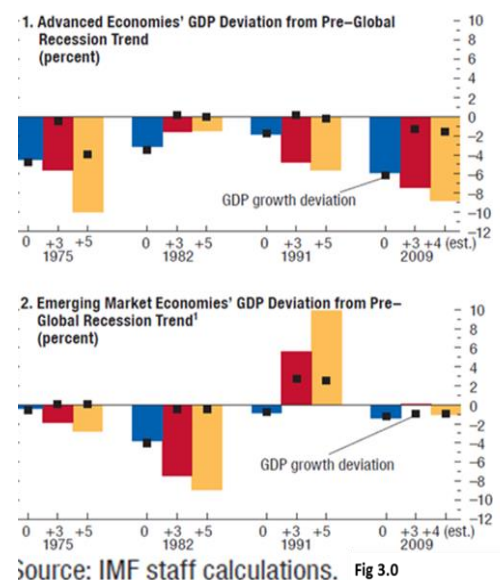
‘Emerging markets’ (EMs) is a term coined in 1981 by Antoine W Van Agtmael, a World Bank economist. Emerging is defined as ‘to come forth into view or notice, as from concealment or obscurity.' Emerging markets are far from concealed nor are their unambiguous ambitions. AEs are yet to comprehend the magnitude of the growing importance of EMs in the global arena. EEs represent 1/3 of world output at market exchange rates due to stronger external demand for EEs’ exports (Xs), an increase from 20% in the 1990s.Erstwhile peripheral players, now systematically important trade & financial centres. The global market is witnessing the actualisation of a neoteric dominant force. Ceaseless prospects of growth is now synonymous with EEs, forecasts now a reality.



Source: IMF staff estimates. **Figure 1.0**

EMs have, are & will continue to experience robust growth. The top 30 EEs constitutes 40% of global gross domestic product (GDP), growth is on a positive trajectory from Hungary to Columbia to Uganda’s mean 6.0% plus annual growth. Strong sustained increase in real GDP is supported by several factors; robust consumption via domestic demand increases is a reality due to the accelerating surge in the middle class & domestic monetary easing. Vast retail consumption in EMs exemplifies the gradual contraction in poverty & widening middle class.

Sustained real GDP accretion was threatened by the 2008 global financial crisis nonetheless EEs retain a faster rate of rebound from the crisis as seen in *figure 1.0*. Curtailment of post crisis output is less evident with EEs, with less than a 1½% average output loss as highlighted in figure 3.0. With signs of future dominance some may say that EEs are undeniably abating the economic supremacy of AEs, per contra the growth within these EMs is powered by Inward Investment (II) sourced from AEs, in addition growth results in increased consumption of AEs’ capital-intensive goods Xs with EEs absorbing 20% of the total Xs by AEs compared to 13% in 1990s.



Source: IMF staff calculations. Fig 3.0

EEs' growth can be exogenous at least on impact thus

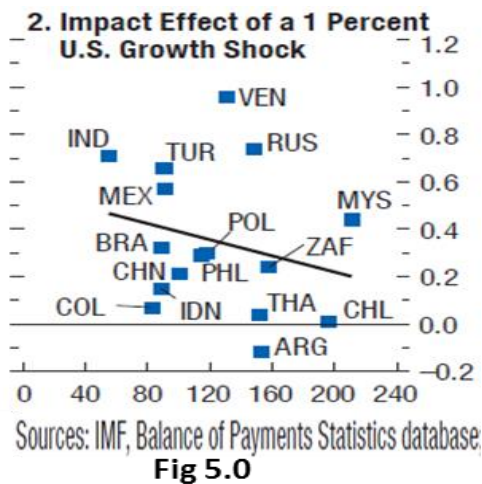


Fig 5.0

highlighting the parallel strengthening of both sets of economies, evident in figure 5.0. Positive growth shocks in EEs results in a positive impact on AEs & vice versa just as a 1 percentage point increase in US growth triggers a 0.3 percentage point growth increase for EEs on impact, conspicuous in figure 7.0.

Fig 7.0

Such positive aggregate effects endure beyond the short term with incremental repercussions remaining positive for 6+ years. Furthermore domestic consumption in both EEs & AEs is unequally parallel with AEs,

AEs experiencing nascent domestic demand revival as seen in: France, Germany & Spain. There is no scepticism that AEs are in the *modus operandi* of recovery growth thus leaving the unanswered question of who will ascend to the top? Or are we beholding a global market with a level playing field for both AEs & EEs? May 31st 2002, World Cup Group A, 29th minute. Diouf makes a monkey of the rapid Frank Leboeuf on the left wing and leaves him buried. An unstoppable cross & lo and behold Buoba Diop, the right place at the right time slots it in the goal; pure awe as Senegal emerges victorious. The crowd witnesses the inception of the French team's chronic descent. A decline replicated by AEs. Protracted stagnation as seen in Japan & the Euro area exposes AEs to lingering sluggishness if deflation dynamics take hold. Protracted stagnation as seen in Japan & the Euro area exposes AEs to lingering sluggishness if deflation dynamics take hold. Sluggish is an appropriate description of AEs' real GDP projection as fiscal policy weighs on activity; 1.5%, 1.4%, 1.0%, an illustration of the shrinkage in annual growth of AEs as seen in Japan.

Abated growth, as The Organization for Economic Cooperation and Development (OECD)'s members slide down the rankings for Xs, is a reality. The UK once boasted of a 40% share of global goods trade; with extensive trade surpluses from services since 1966 & considerable income surpluses from foreign/external UK investment, it is hard to fathom that both are outweighed by an £80billion goods deficit as seen in 2012, illustrated by figure 9.0.

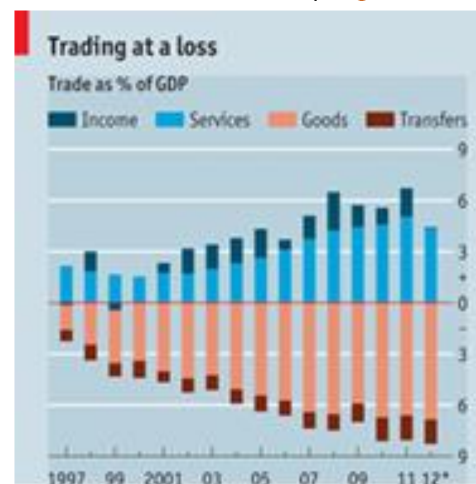


Fig. 9.0

Stagnant output by AEs is the reverberation of the 2008 crisis & highlights the lengthened fragilities in the recovery; however there are still interspersed pockets

Of growth in the Euro compass.

Additionally, decline is exacerbated by longstanding financial market volatility. Consequently contraction of credit in AEs is evident, such elisions of credit halts Small & Medium Enterprise (SMEs) growth, with these being the backbone of an economy this intern decreases long-term output & subsequently dwindles AEs' long-term competiveness. Such financial fragmentation weighs on growth as capital outflows increase & private domestic investment decreases. Furthermore, overt growth shocks in EEs could impinge upon their asset prices & currencies which would hurt AEs with sizable financial exposure to these markets. Foreign Direct Investment (FDI) into EEs, largely from Multinational Enterprise (MNEs), can account for the rapid asset & currency price appreciation. Globalisation in today's modern society is impelled by over 60,000 MNEs with 800,000+ subsidiaries around the world. MNEs now largely dictate the pace of growth in both AEs & EEs. TNCs account for the largest percentage of the private sector in AEs; of the UK's 24million private sector workers, 10million of which are employed by firms such as URENCO with 250+ employees highlighting the huge weight of large businesses in the UK economy like most AEs. A vast reliance on TNCs for (Xs) makes AEs vulnerable to operational decisions by MNEs such as shifts in production to EEs in order to create a hedge against currency turbulence & in addition strengthen the operations they retain. SMEs having the minority of the private sector workforce resulting in the inadequate rate of Xs among SMEs, combined with the unwillingness of inward firms to export in order to facilitate growth, explicate the reasons behind AEs' descending levels of Xs. Contrastingly, MNEs have galvanized growth in EEs via vast II facilitating growth. II into EEs have increase to a record total of $3trillion, the largest corporate investment cycle since the railway boom of the 19th century. Consistent II as seen in figure 12.0, into china is utilised

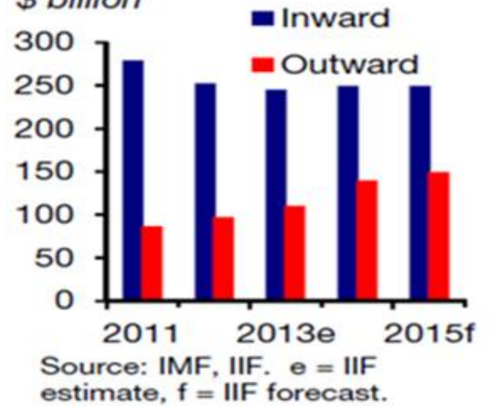


Figure 12.0

to build advanced infrastructures whilst providing employment, a reflection of activities in most EEs. Demands from the Tanzanian government to TNCs extracting natural gas have stimulated huge structural reforms via the use of MNEs' capital resulting in sustained growth. Diminishing confidence in AEs' financial markets has seen the consequential rise in II into EEs by large commercial banks from both AEs & EEs. Monumental mergers such as that of ICIC's acquisition of 20% of South Africa's Standard Bank is creating bread baskets for sustainable growth as well as fuelling a growing interdependence among EEs. Such prospect of sustained growth augments the profitability of EEs thus attracting II from TNCs who are evidently becoming more profitable in EMs; Boeing illustrates this by greater quantity of sales in China & Latin America. Conspicuous propitiousness has seen US firms making a 12% ROE in 2012 & EU firms tripling their percentage of sales to EEs to 33%, depicted by figure 14.0.

Positive outlooks for EEs are however still undermined by both external threats & idiosyncratic domestic risks. The recent downgrade of growth rates in Russia, Brazil & Turkey due to investment & supply

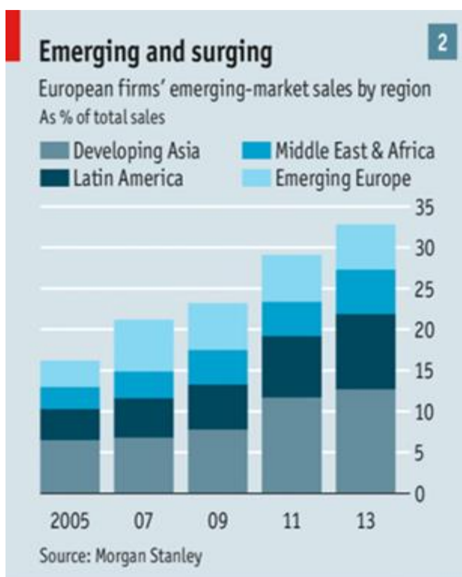


Figure 14.0

constraints plus domestic policy weakness has set EEs' growth back due to the interdependence among EMs. Some EEs like Brazil possess an anachronistic economic & political status which without great reform will weigh on future growth. Slowdown in growth of the BRICs economies halted EEs' growth for a period due to their systematic importance; however the slowdown will prolong sustained growth in EMs. With EMs heavily reliant on commodities, the volatility of their prices could produce weaker terms of trade thus reducing growth; this is balanced by their robust agricultural sector as seen in Paraguay & governments' use of a buffer stock scheme. Post 2008 crisis caused concerns about EEs' capital flow volatility due to tighter external financing conditions however the net outflow of equity investment have been minute, in addition EEs' strong fundamentals can see them somewhat exempt from slowing capital flow pressures as seen in emerging Asia during the mid-2013 & early 2014 capital flow slowdown.

EEs as a whole are actually net exporters of capital via the accumulation of vast foreign-exchange reserves, as Martin Wolf of the Financial Times rightly put it, "*They smoked foreign capital but they didn't inhale.*" Decreased political stability in e.g. the MENAP region, figure 19.0 is a burden upon growth.

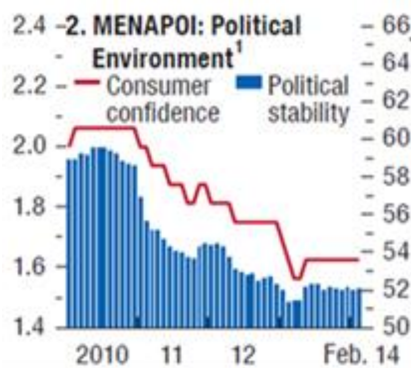


Figure 19.0

Excluding the MENAP region & currently emerging Europe, political stability on the whole has been augmented e.g. Tunisia where a new constitution has enabled greater internal & external confidence therefore stimulating growth. Increased political stability resulted in major fiscal reforms in EEs to improve tax efficiency & allocative efficiency of investment via strong macroeconomic policies, such adequate policy space increases the scope for countercyclical policies to cushion the growth effects of higher EMBI yields which normally would cause real-exchange depreciations subsequently crippling EMs currency's ability to support export growth. The increase transparency of the EEs' fiscal framework has multiplied the level of FDI which aids growth. (EM)s' avoidance of pro-cyclical fiscal stance addresses vulnerabilities in those countries more exposed to external shocks, this avoidance has subsequently triggered faster, sustainable growth thus relieving tension from burgeoning bottlenecks in infrastructure from rapid growth. Greater exchange rate flexibility & accommodative monetary policy reduces adverse fiscal consolidation on growth thus dampening the effects of external shocks on EMs, such prudent monetary policy can also be utilised to decrease inflation. Fiscal reforms elicit large-scale public investment thus advancing economic multifariousness, diversifying one-dimensional economies such as Angola from a solely oil dependent country to an

reliant upon various channels of activity such as: oil, banking, telecoms, construction & retail. Historic public investment in EEs as witnessed across the whole African continent will continue to dramatically subtract structural rigidities whilst creating more robust labour market conditions. Decreased structural unemployment & solid increases in real wages are the reality in most EEs though much work is still required to maintain both. Such progressions increase productive efficiency which increasing national output thus promoting export growth. Major investment in human capital from increase public spending has triggered large-scale innovation in EEs where their aim is not just to grow to the capacity of AEs but to do so in a sustainable manner that includes the vast use of sustainable energy in EEs. The African continent hosts communities that are solely dependent upon renewable energy from hydroelectricity to geothermal energy. Innovation is not however limited to energy but also extends to technology. TNCs again can credit themselves for stimulating a technological revolution in EEs exemplified by Nairobi which now boasts of the world's only completely cashless city, EEs economies are not just threatening to catch up to AEs but to become more superior economically & technologically with major energy projects in countries such as Niger.

The evolution of EEs has provided the optimum environment for past investments to mature in a profitable fashion for both EEs & foreign investors as seen in Mozambique as large-scale natural gas operations are now benefiting both parties. Repeatedly MNEs play a pivotal role in the growth of EEs, from 'oil super majors' to large mining companies all demanding structural reform before securing contracts thus in effect forcing economic development & growth in EMs.

The question is can this be sustained?

Are Advanced Economies in for long term stagnation?

Since economic liberalization began in 1978, China's investment & export led economy has grown 90 times bigger, now a recent poll on my personal blog hinted that the world is now shifting it's appetite to Africa as the next big world leader.

Just as a parent raises their child to watch that child grow & become independent, that child has greater prospects than its parent but will always rely on the wisdom of its parent. As the saying goes '*aetate et sapientia*', '*with age comes wisdom.*'

Just like that child, EEs have great prospects, they will achieve greater things than AEs, they will hit greater heights than AEs but as they grow they will always rely upon the wisdom & support of AEs who have deep & extensive reach into EEs in order to maintain both growth & political stability. AEs as a whole are in for long-term stagnation however EEs' growth will subsequently strengthen AEs with great exposure to these EMs. What will be evident is a parallel strengthening between EEs and certain AEs but unparalleled growth between EEs as a whole & AEs as a whole. EEs will ascend to the pinnacle of the global economy alongside the handful of dominant forces such as the United States & the United Kingdom.