

# David Smith



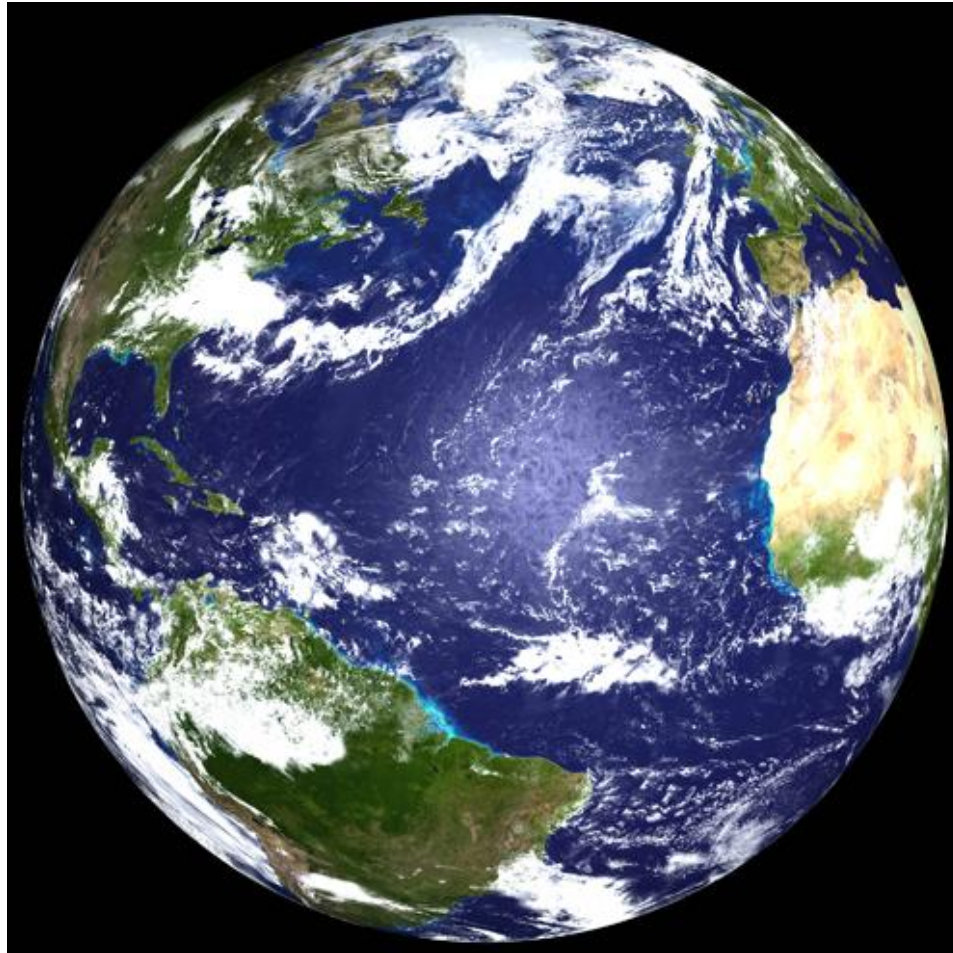
**THE SUNDAY TIMES**

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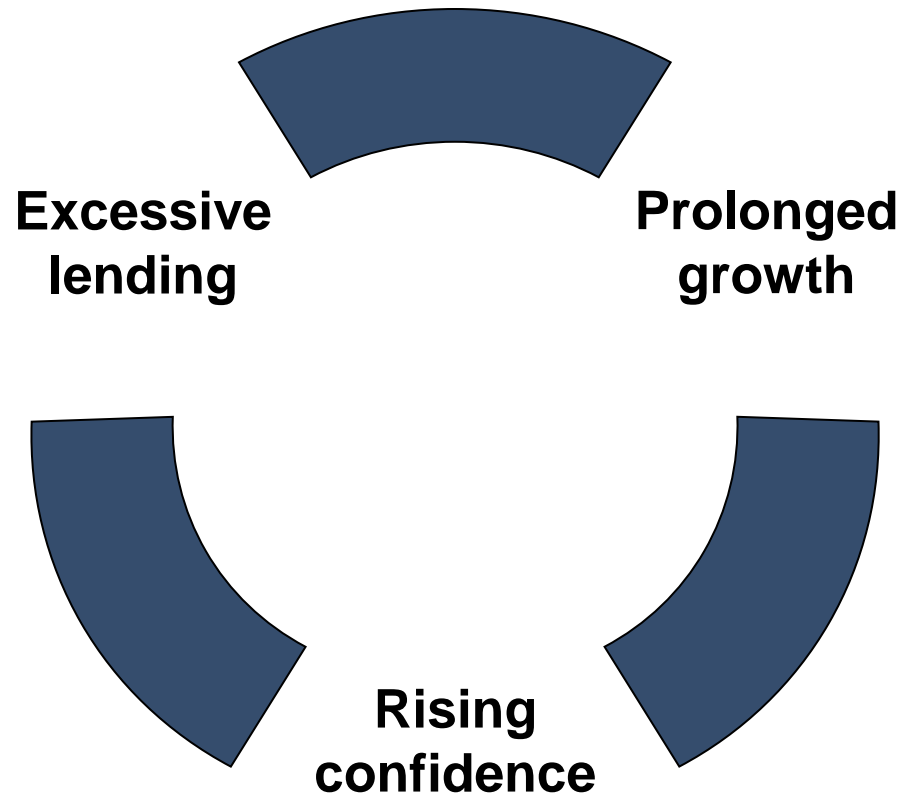
# An age of instability

**The crisis and the  
changing shape of the  
world economy**

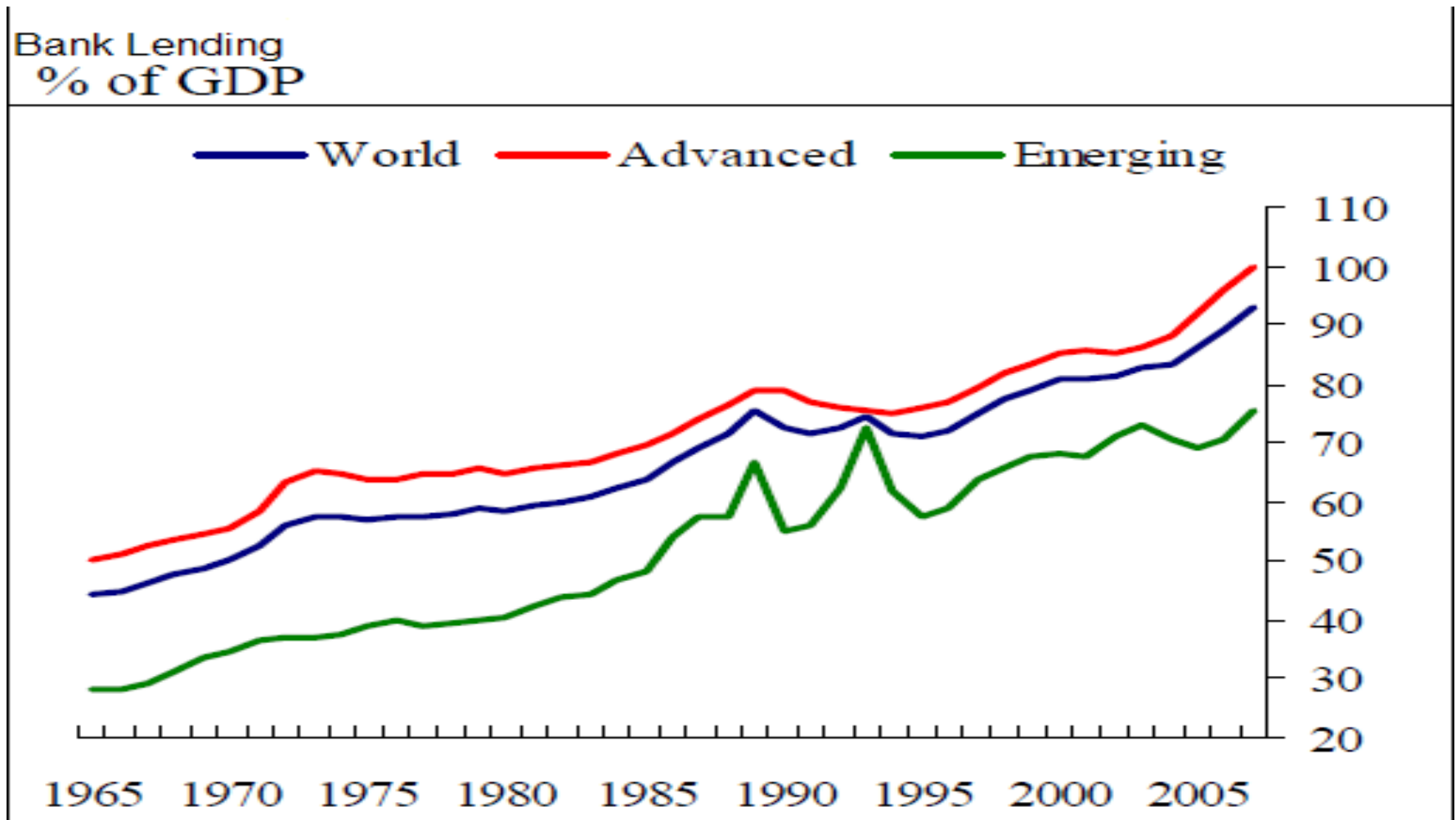
# The world as it was



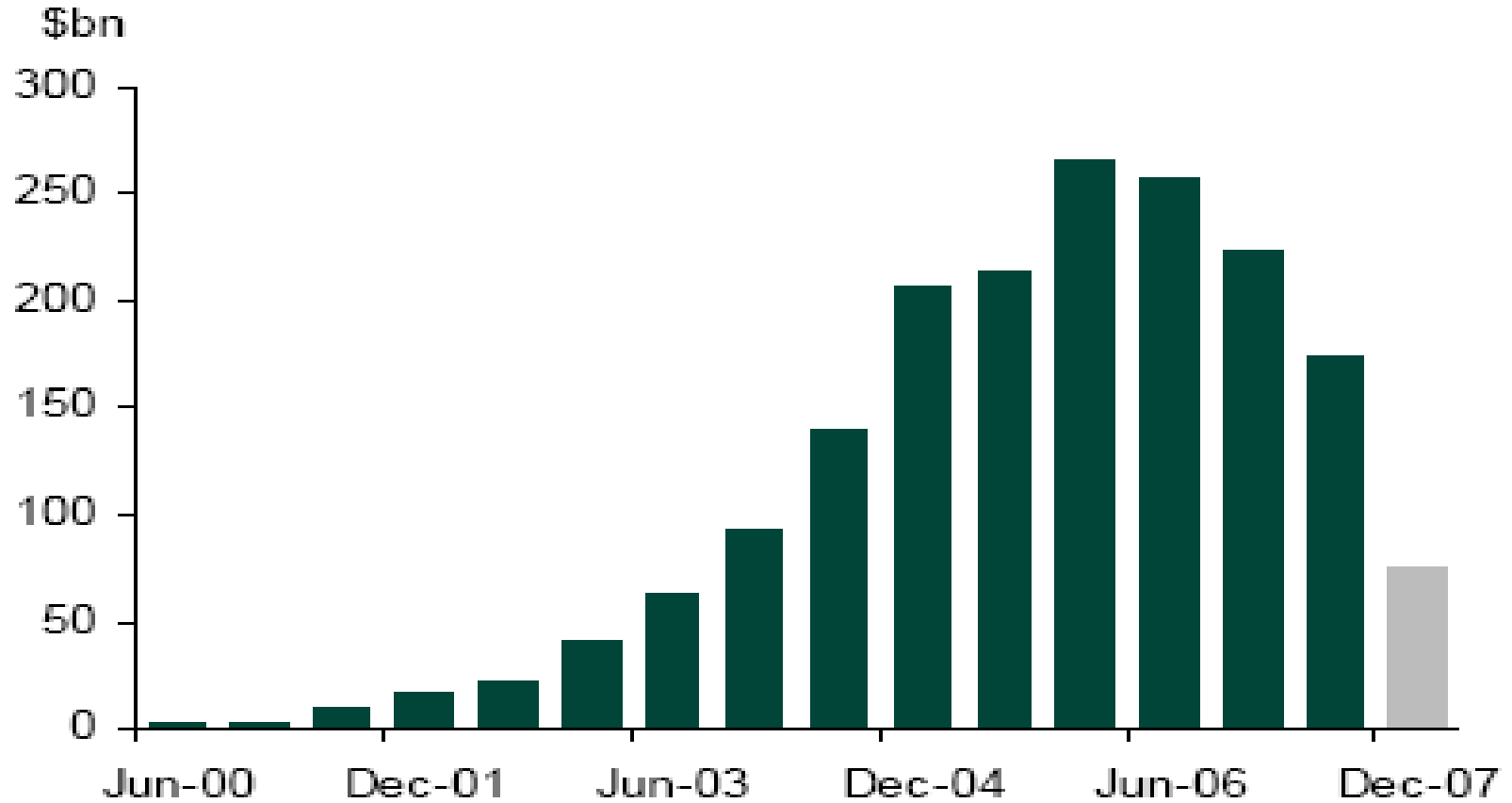
# A self-feeding cycle



# The long credit boom



# The rise and fall of sub-prime



# House of cards topples

- US house prices start to fall sharply, first big national fall since the depression.
- Subprime loans and securities start to look unsafe – not AAA but junk.
- Banks realise they are heading for huge losses and, importantly, so are other banks.

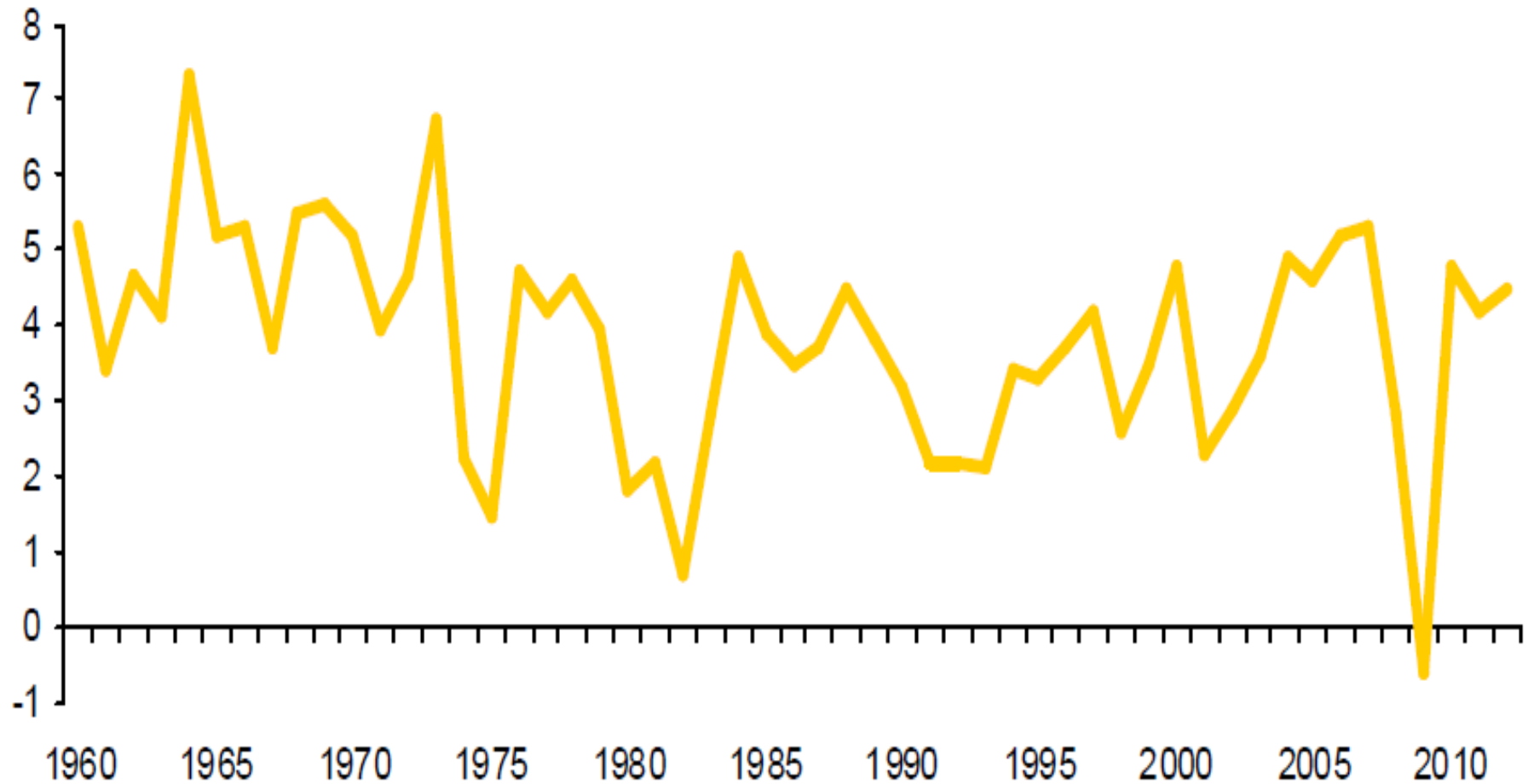


# The biggest financial storm in a century

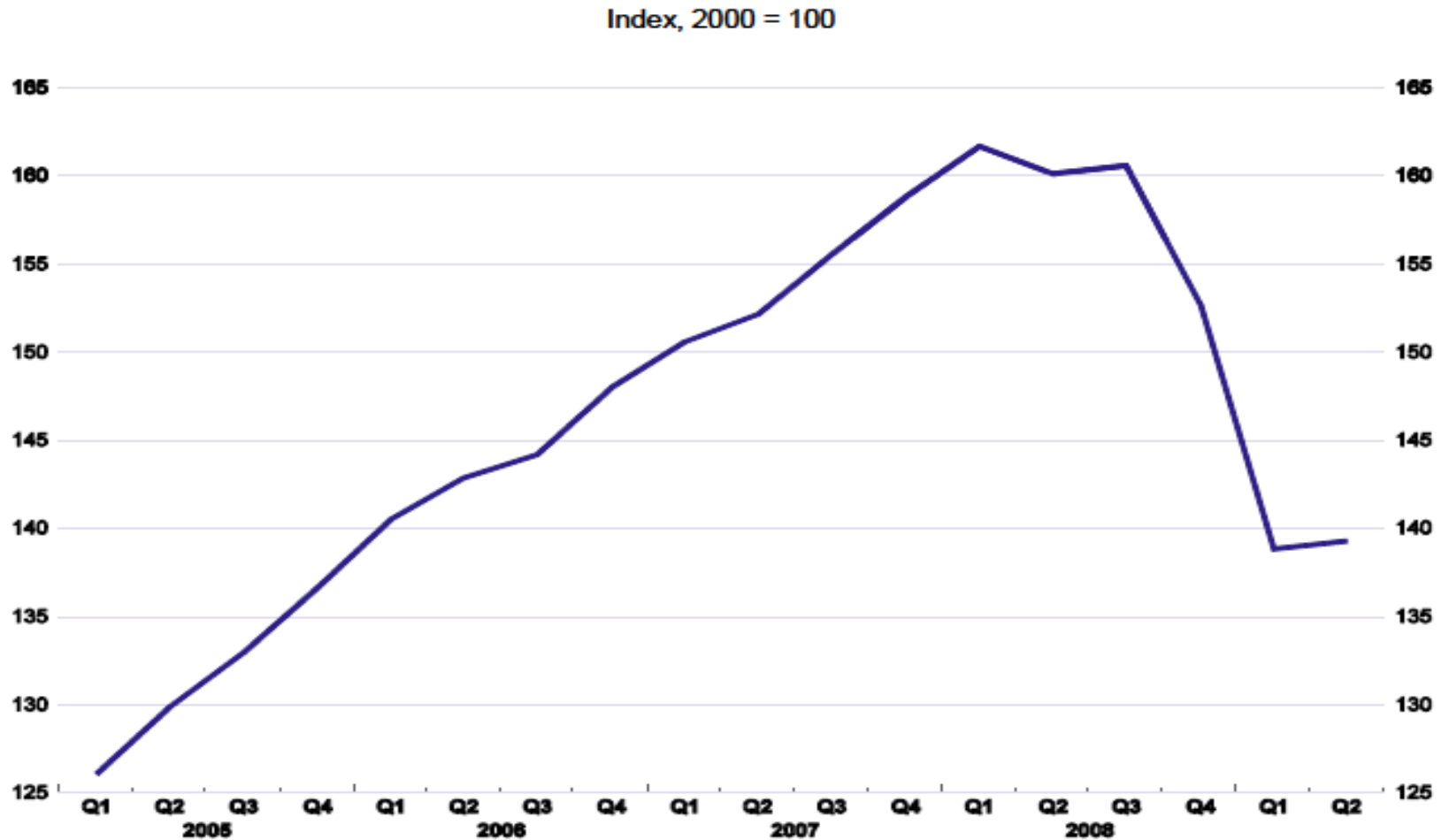




# The worst post-war world recession



# And a world trade collapse



Source: OECD Secretariat.

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So where are we now?

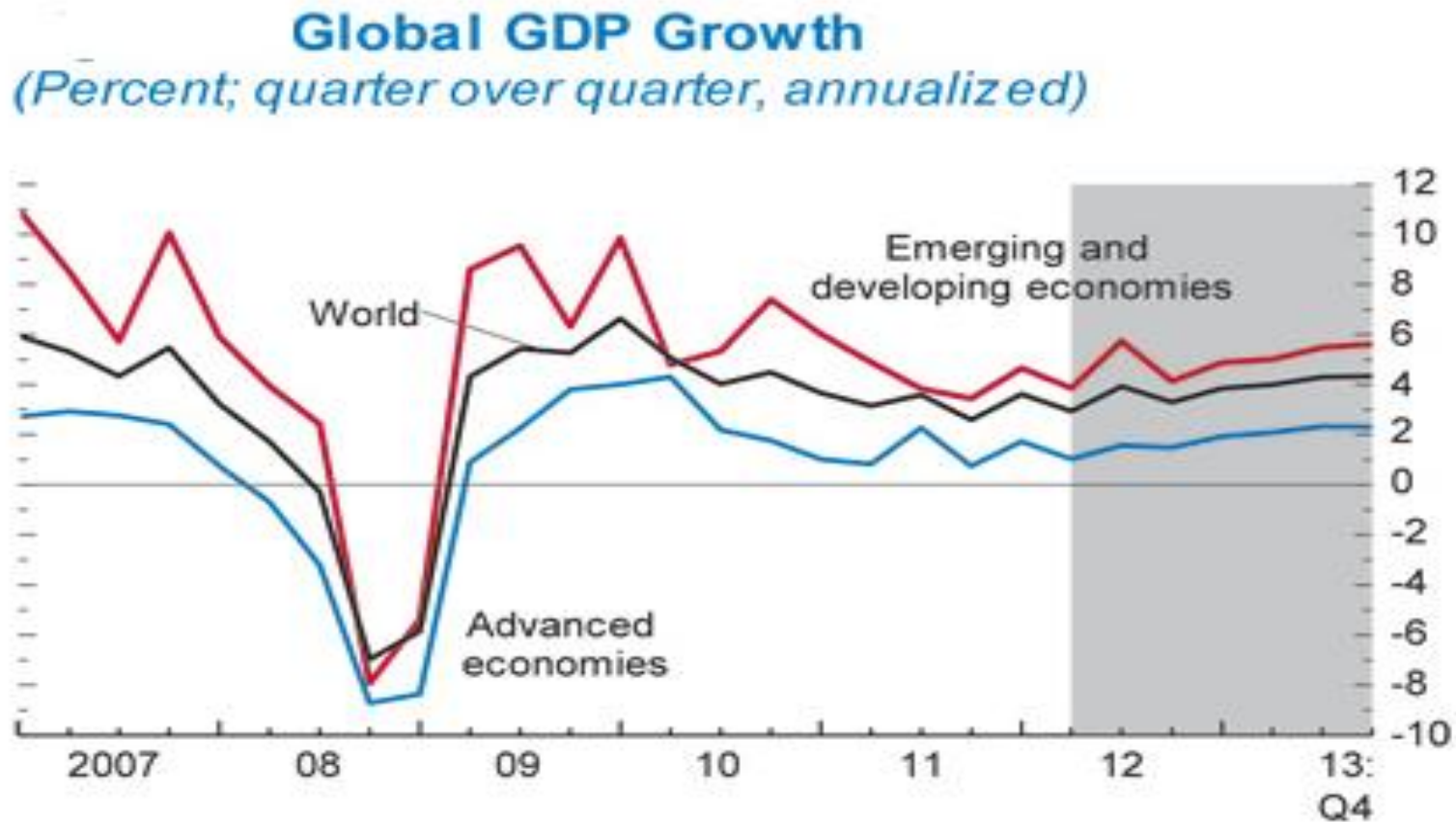


# There is a global recovery ...



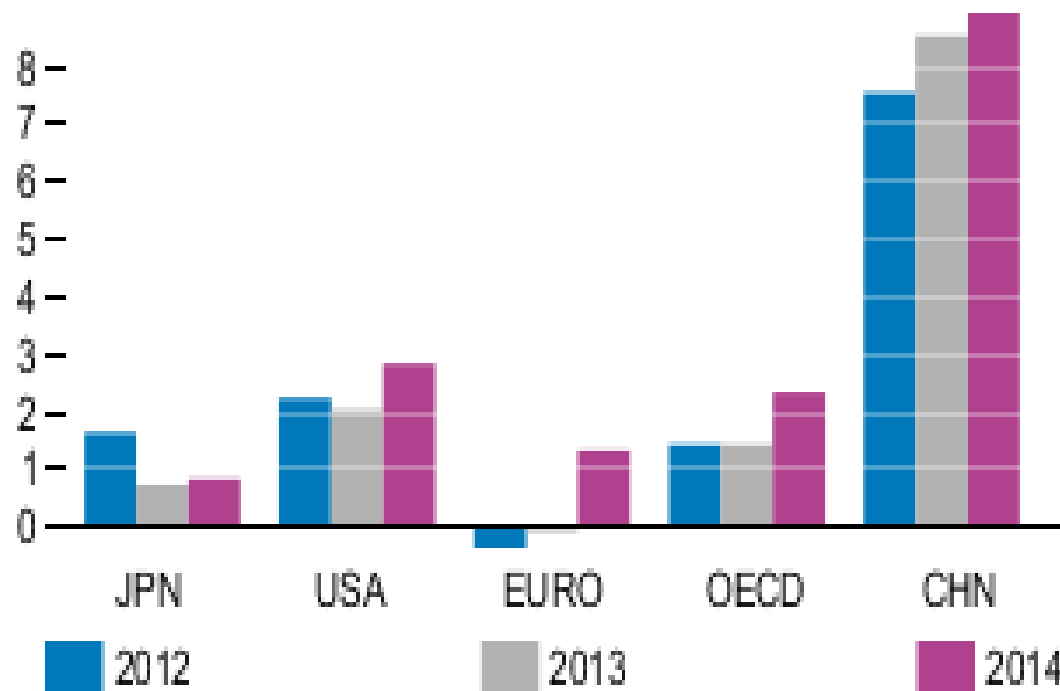
Source: CPB.

... led by emerging economies



Source: IMF staff estimates.

# ... and in particular China

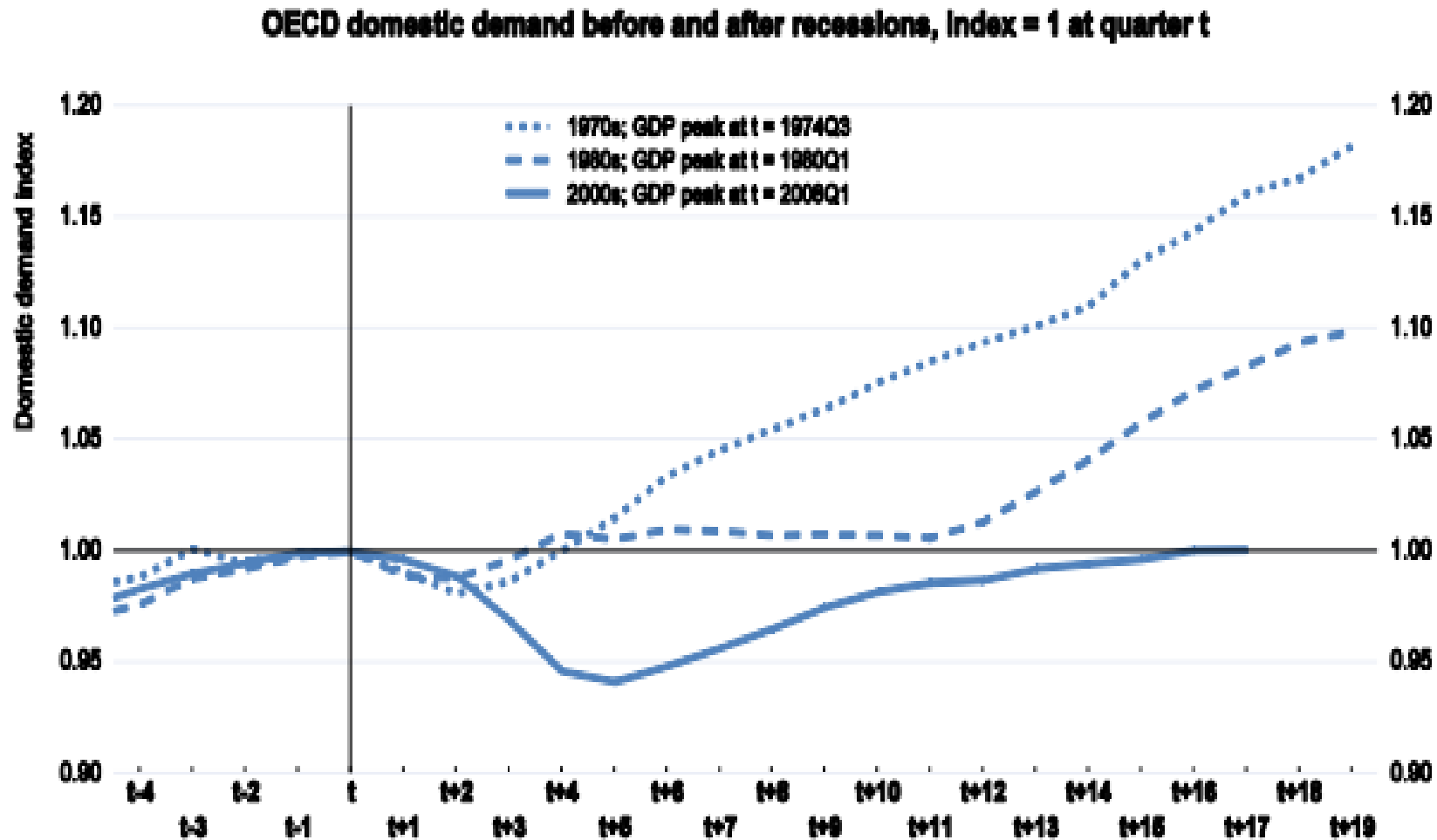


Source: OECD economic outlook database

# Advanced economies: post-crisis hangover



# A very weak OECD recovery

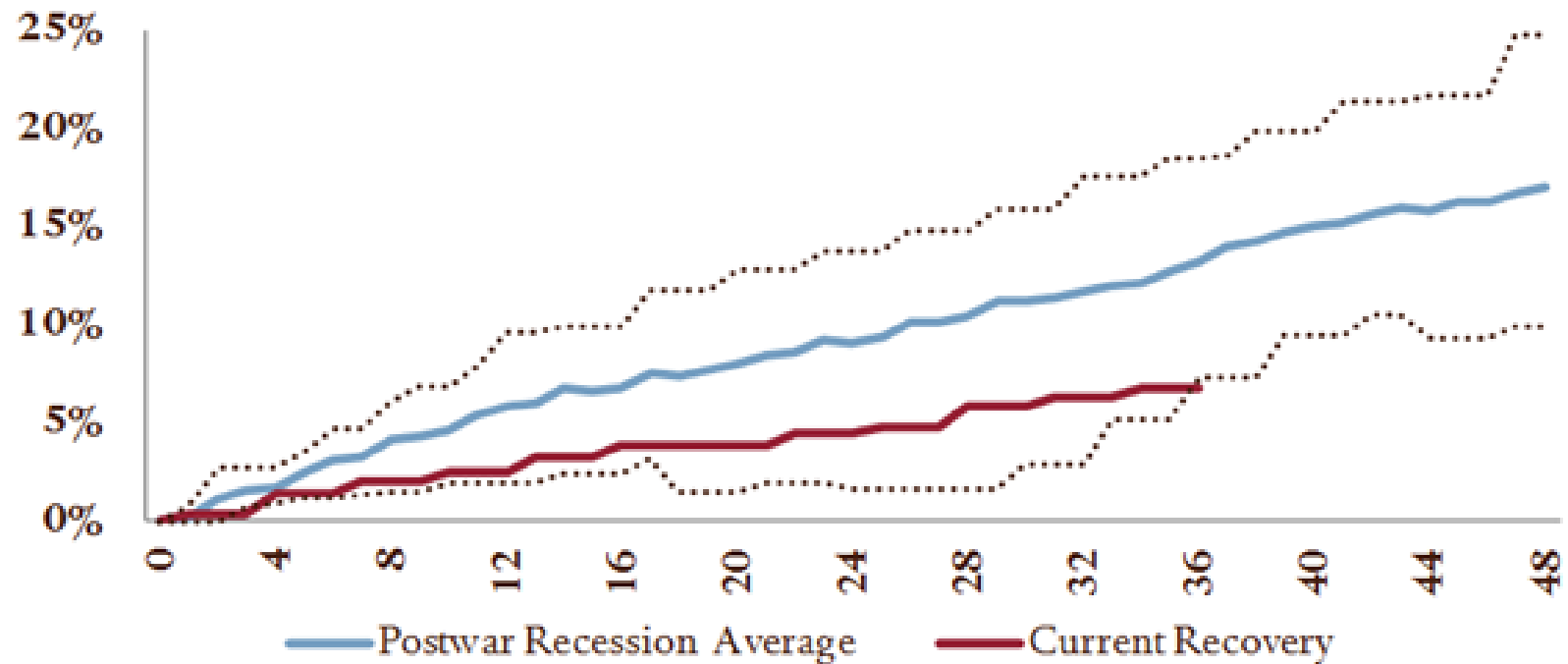


Source: OECD Economic Outlook 92 database.



# In America

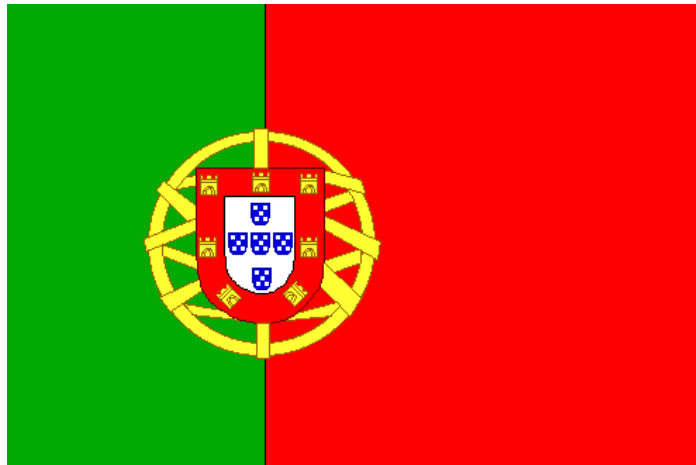
## Real GDP Relative to End of Recession



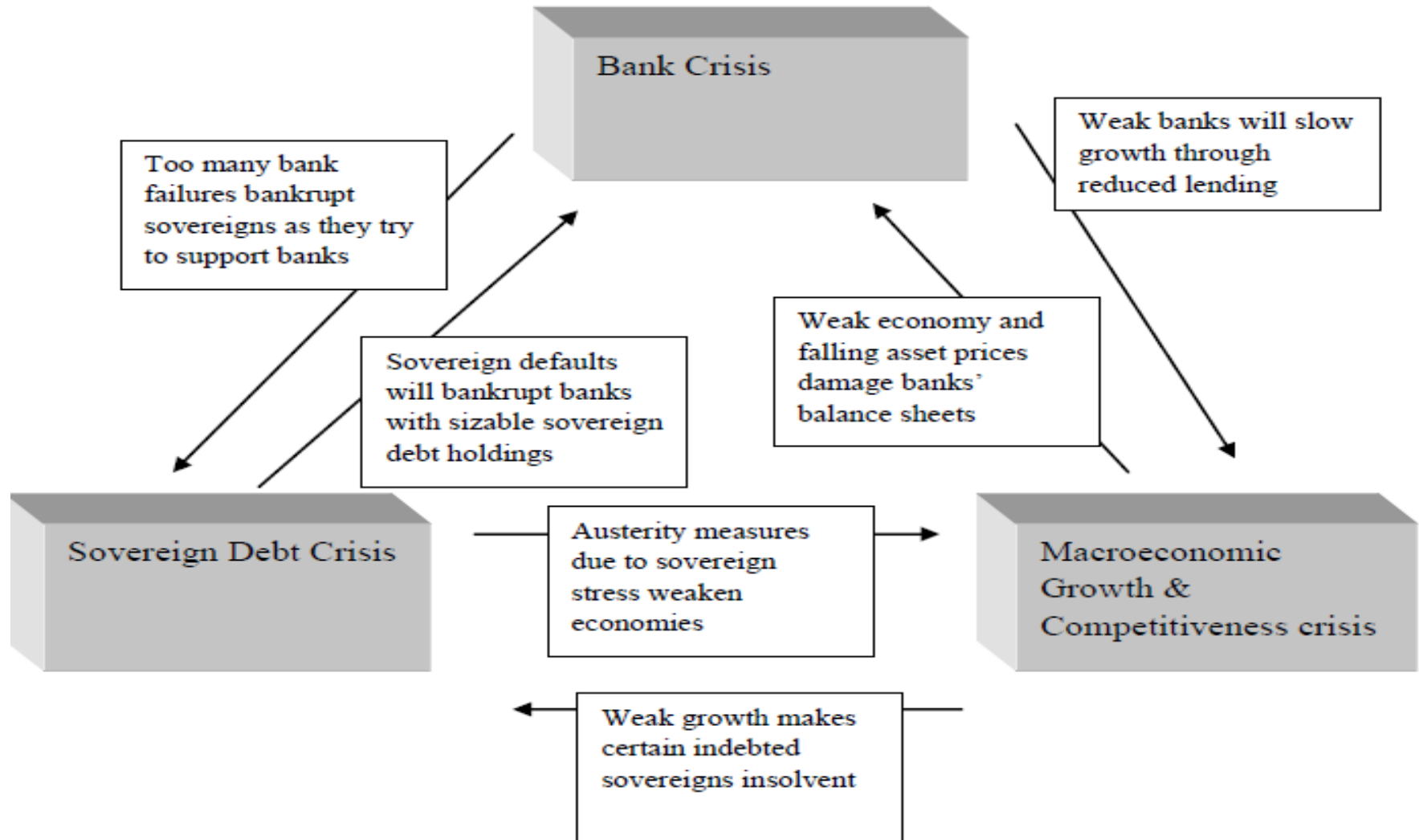
Data Source: BEA.

[www.cfr.org/cgs](http://www.cfr.org/cgs)

And even more so in Europe

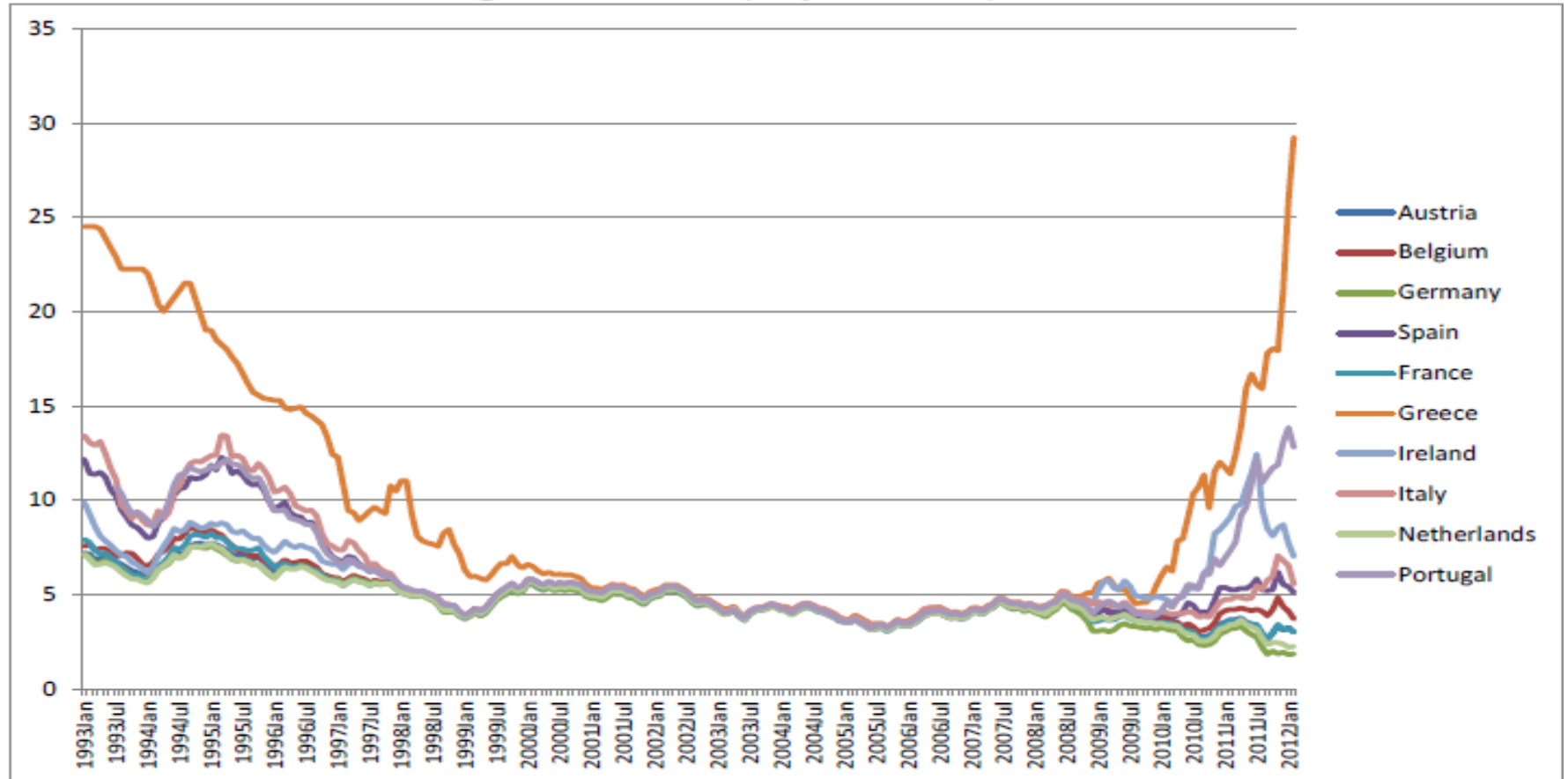


# Three euro crises in one



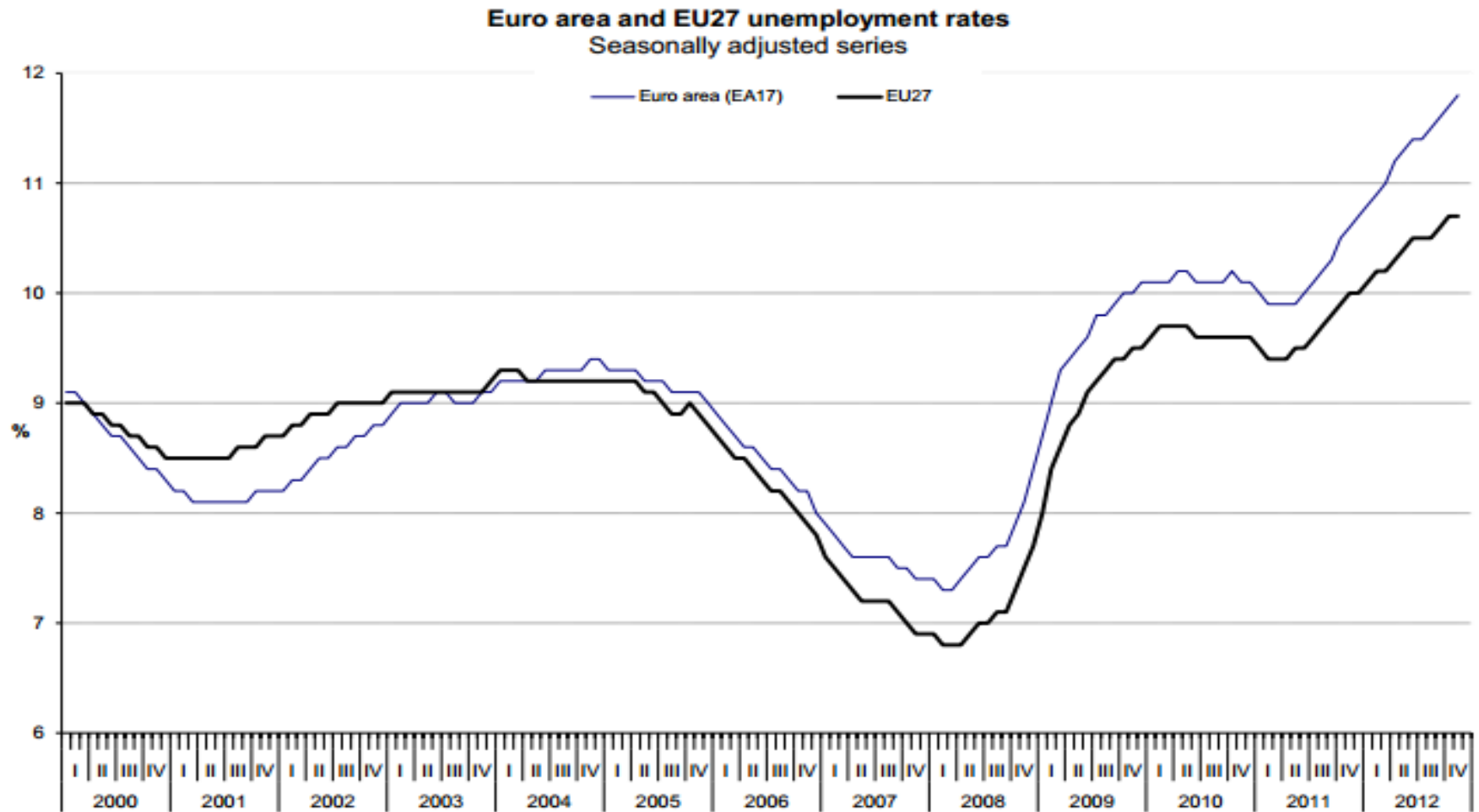
# A system under deep strain

**Euro Area Sovereign Debt Yields (10 year bonds)**

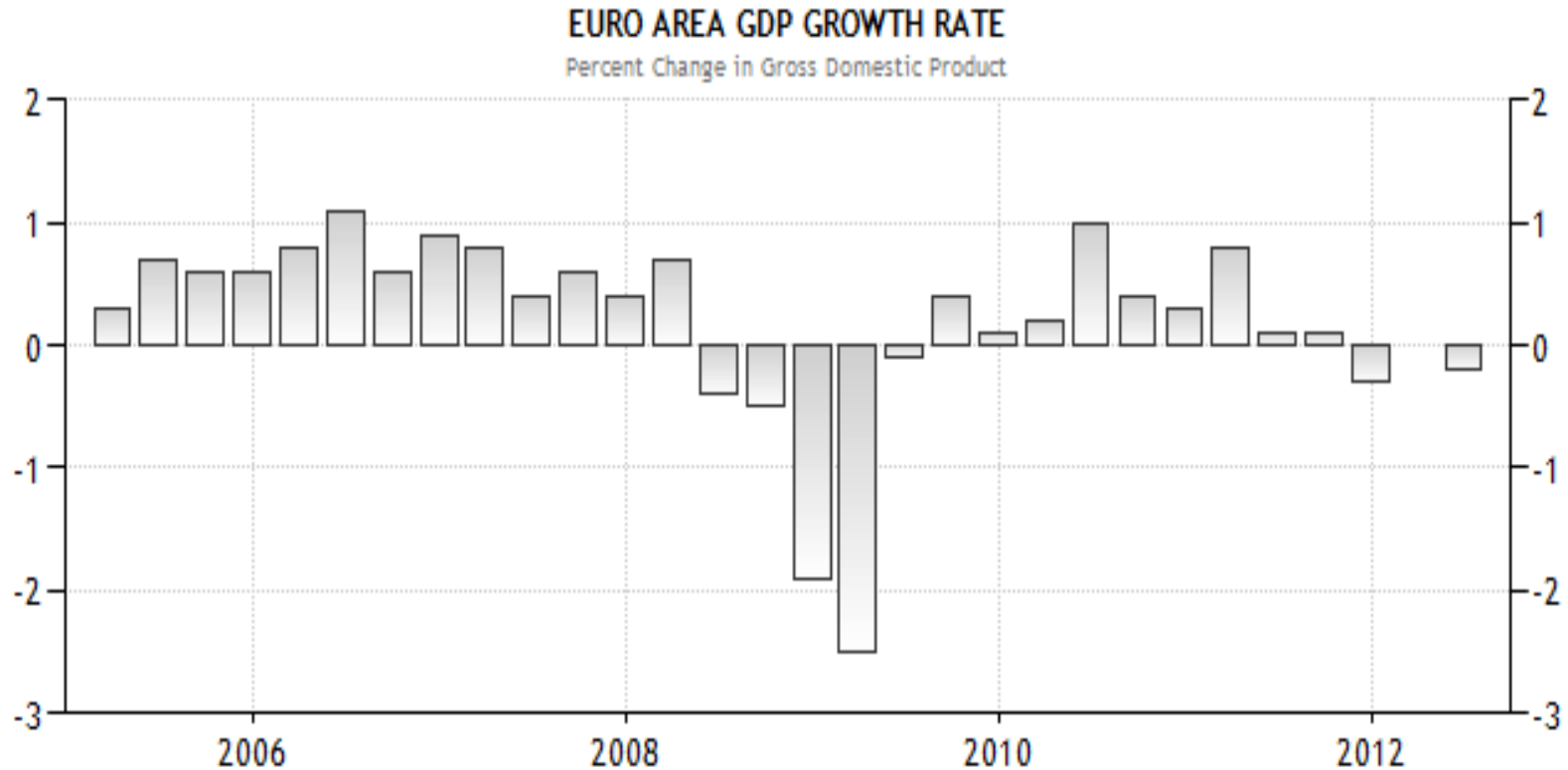


Source: Eurostat

# With very high unemployment



# And a stop-start-stop recovery



SOURCE: WWW.TRADINGECONOMICS.COM | EUROSTAT

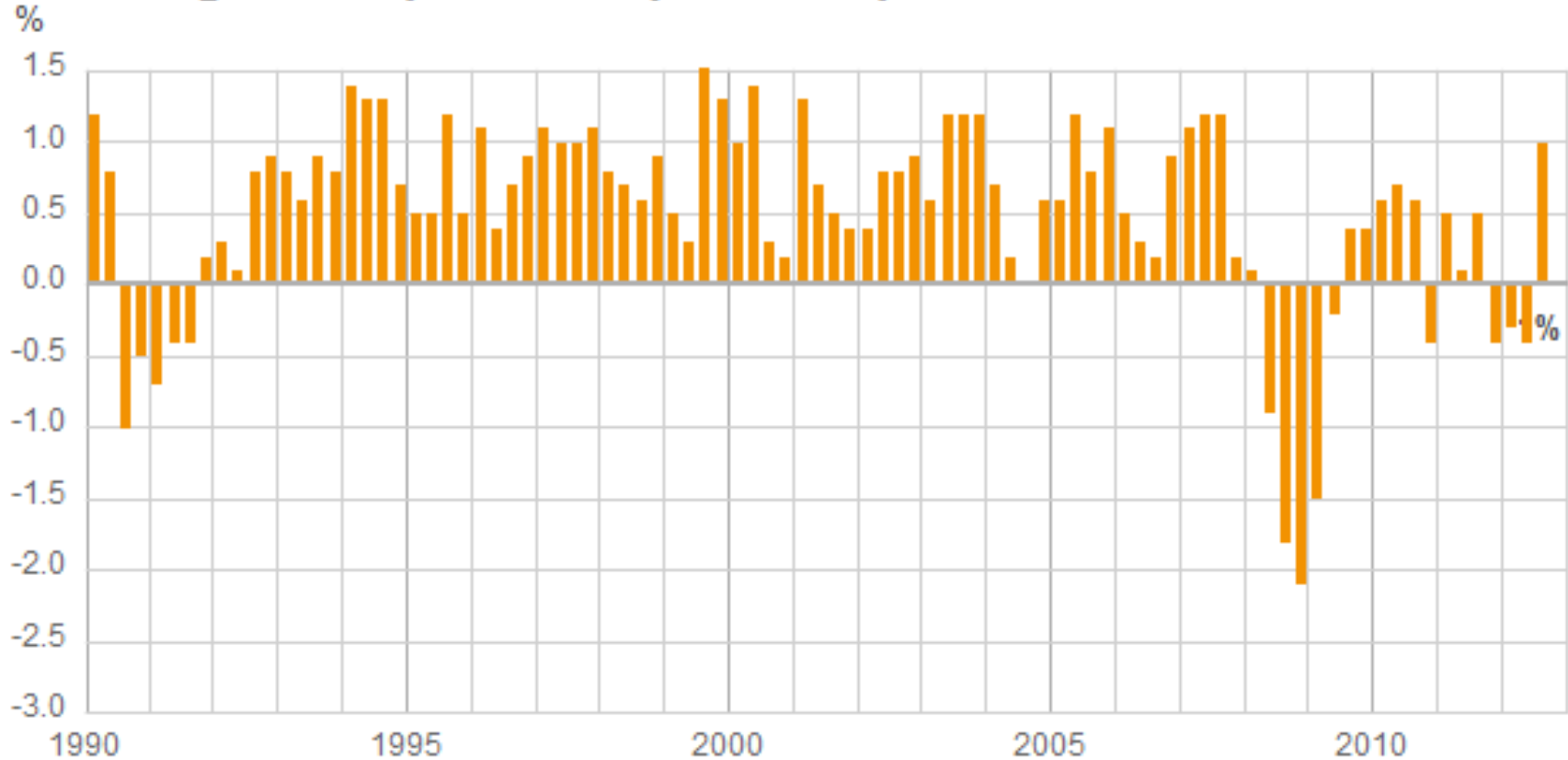
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# Options for the euro zone

- A rapid move towards fiscal union – spreading the deficits around.
  - Muddling through – the ECB's 'bazooka' has changed the mood.
  - Partial break-up: Greece leaves and defaults, ring-fence and bolster banks and the rest.
  - Narrowing the euro: a smaller number of compatible economies stay in.
  - Disintegration/return to national currencies.
-

# UK recovery has disappointed

UK GDP growth, quarter on previous quarter



Source: ONS



# For a variety of reasons

- Fiscal consolidation
- Weak credit growth
- A high-inflation squeeze on real incomes
- Weakness in main export markets
- Household/corporate sector deleveraging

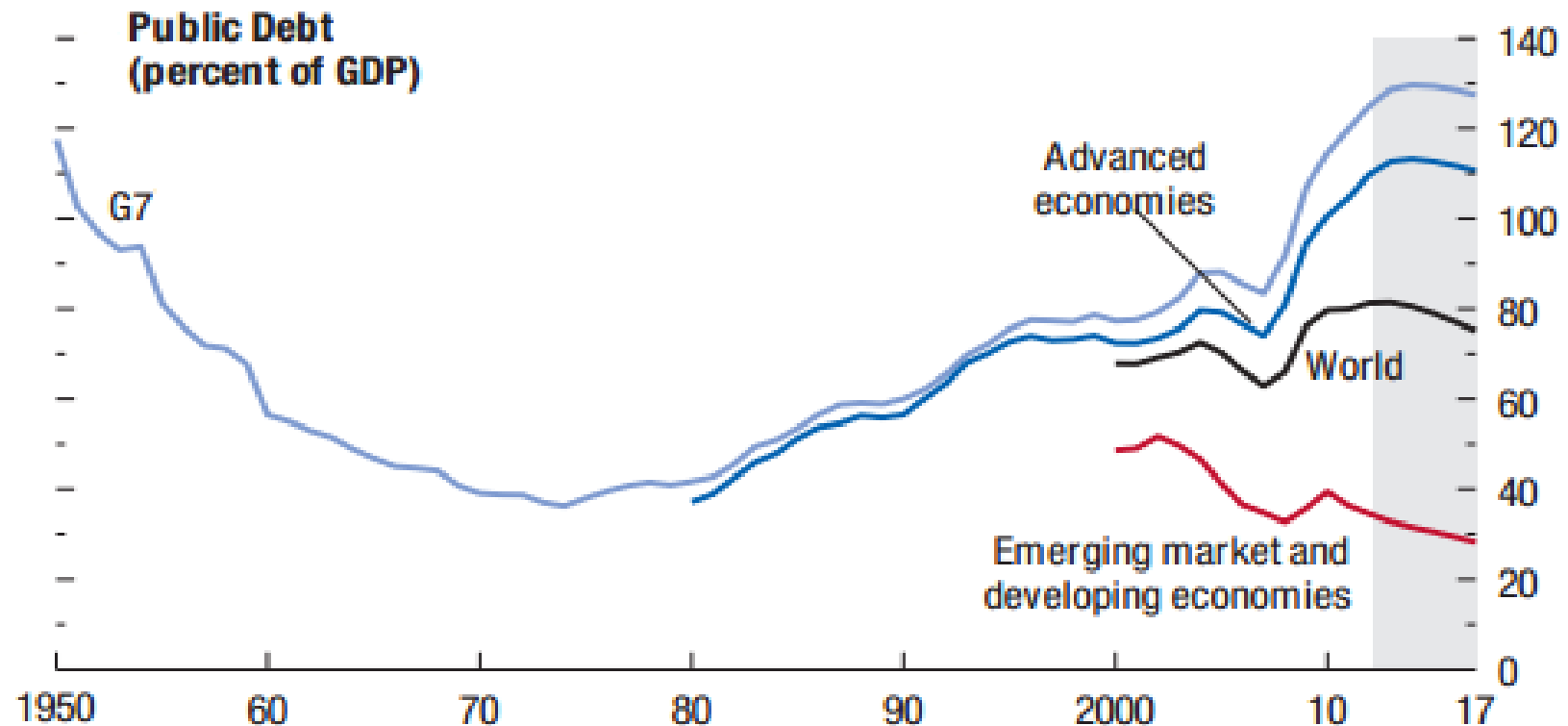
# An emerging economy locomotive



# Emerging economies: room to grow

- Plenty of scope to catch-up
- No fiscal hangover
- No significant banking hangover
- Past crises increased resilience – and restricted financial rope to hang themselves
- Openness and trade interdependence
- (Mainly) younger populations

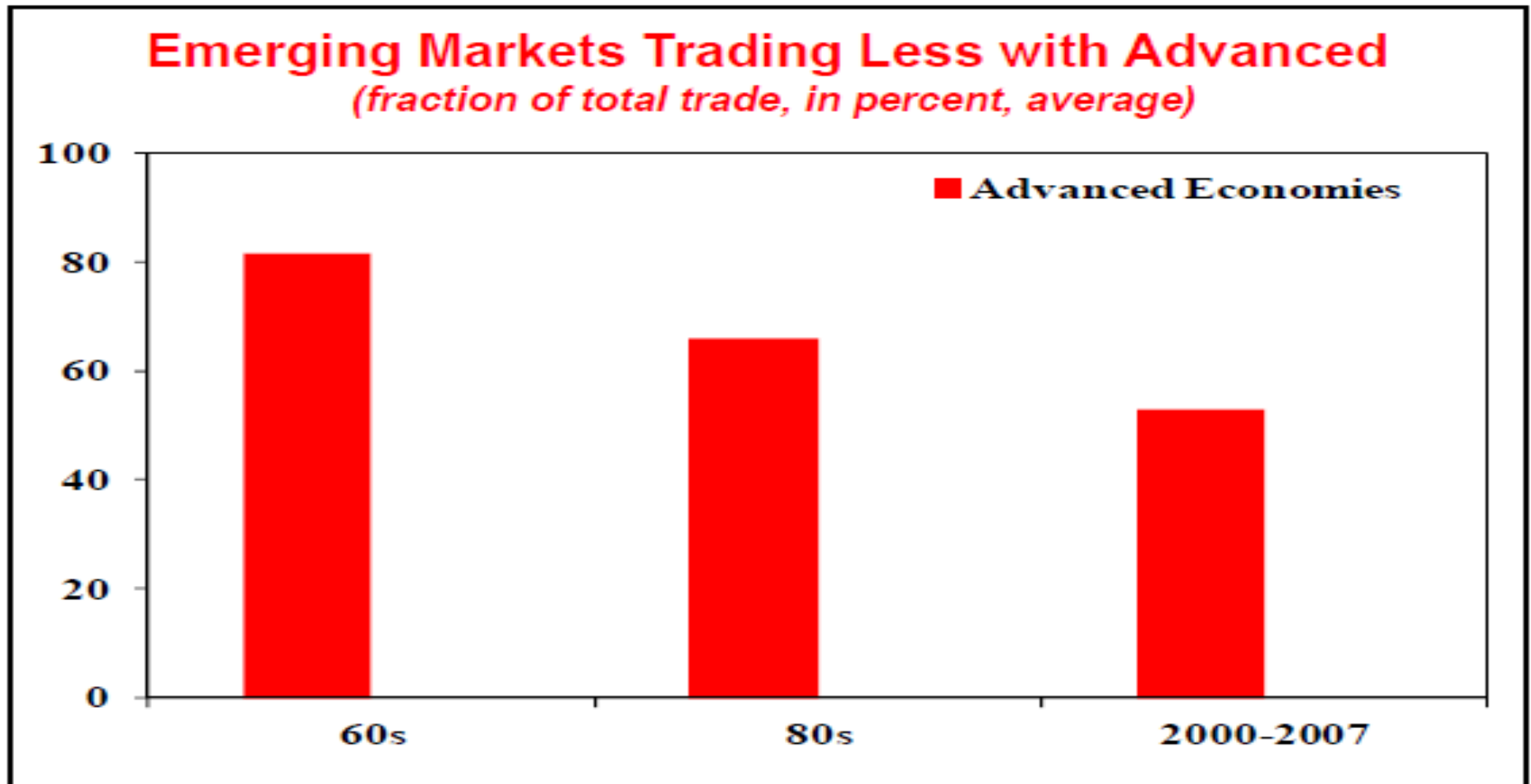
# Fiscal divergence



Source: IMF staff estimates.

<sup>1</sup>G7 comprises Canada, France, Germany, Italy, Japan, United Kingdom, and United States.

# Falling trade dependency even pre-crisis

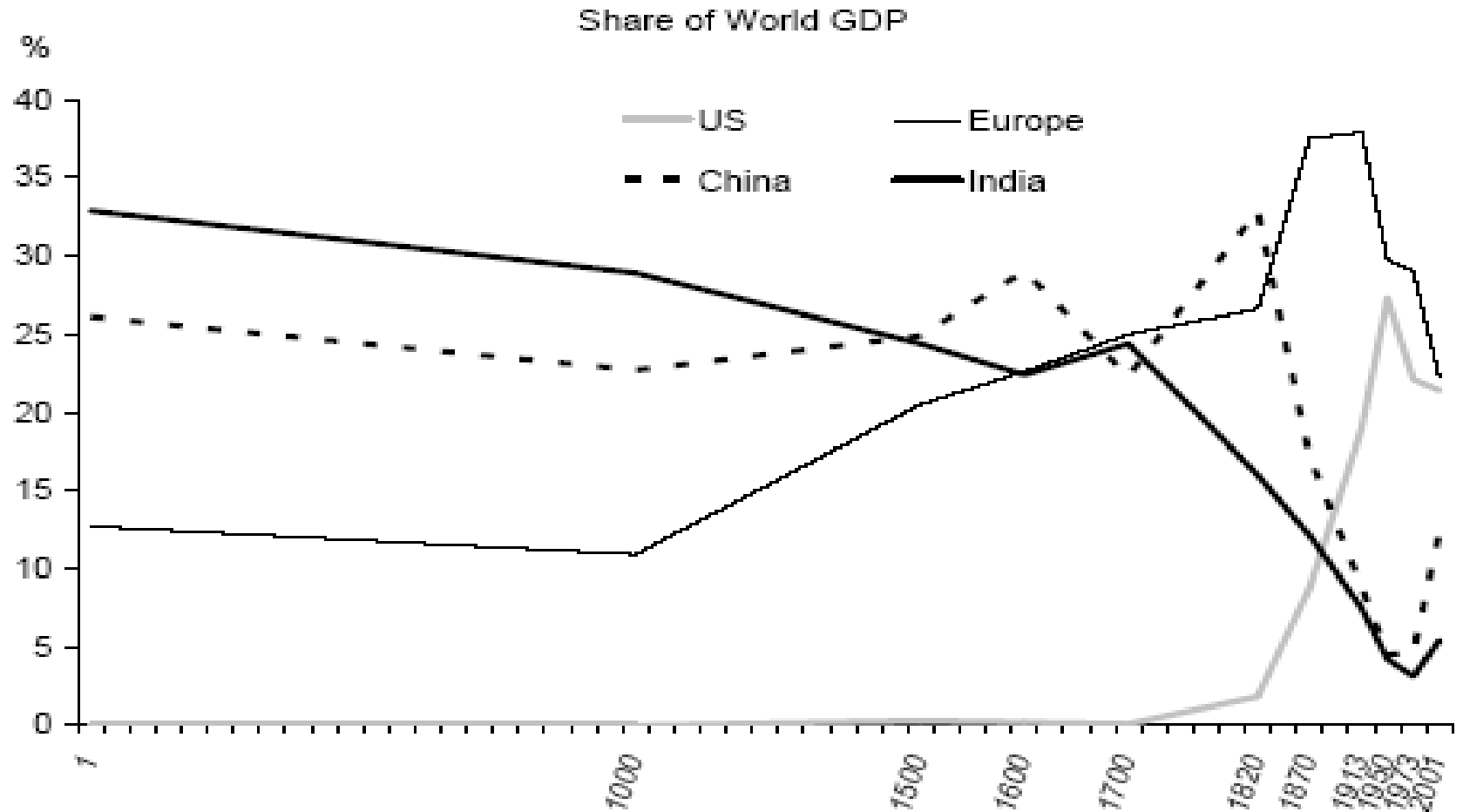


Source: Kose, Prasad, Asian Development Bank

So a fast-changing world



# China and India were mighty before

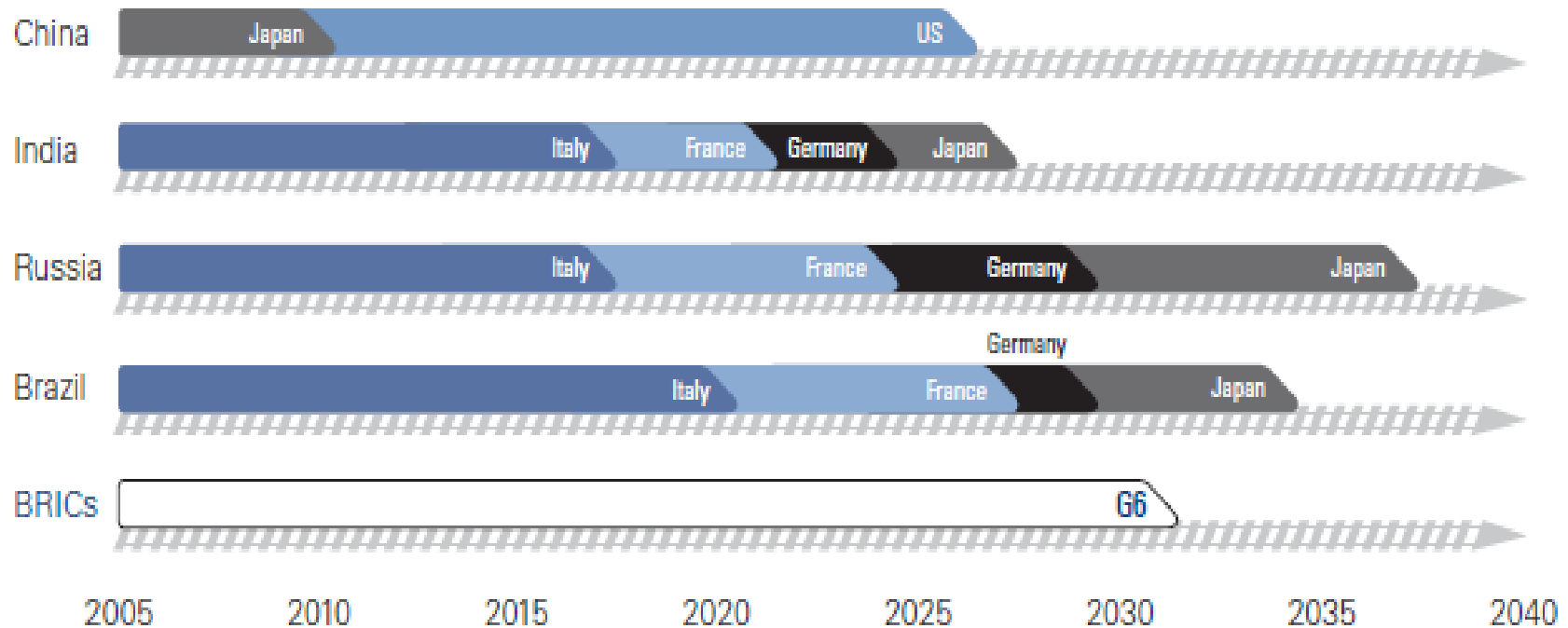


Source: Angus Maddison, *The World Economy: Historical Statistics*, OECD 2003.

# And they're becoming mighty again

In less than 40 years, BRICs GDP could overtake G6 GDP<sup>3</sup>

By 2040, the combined GDPs of the BRICs economies could exceed the combined GDPs of the G6



GS BRICs Model Projections.

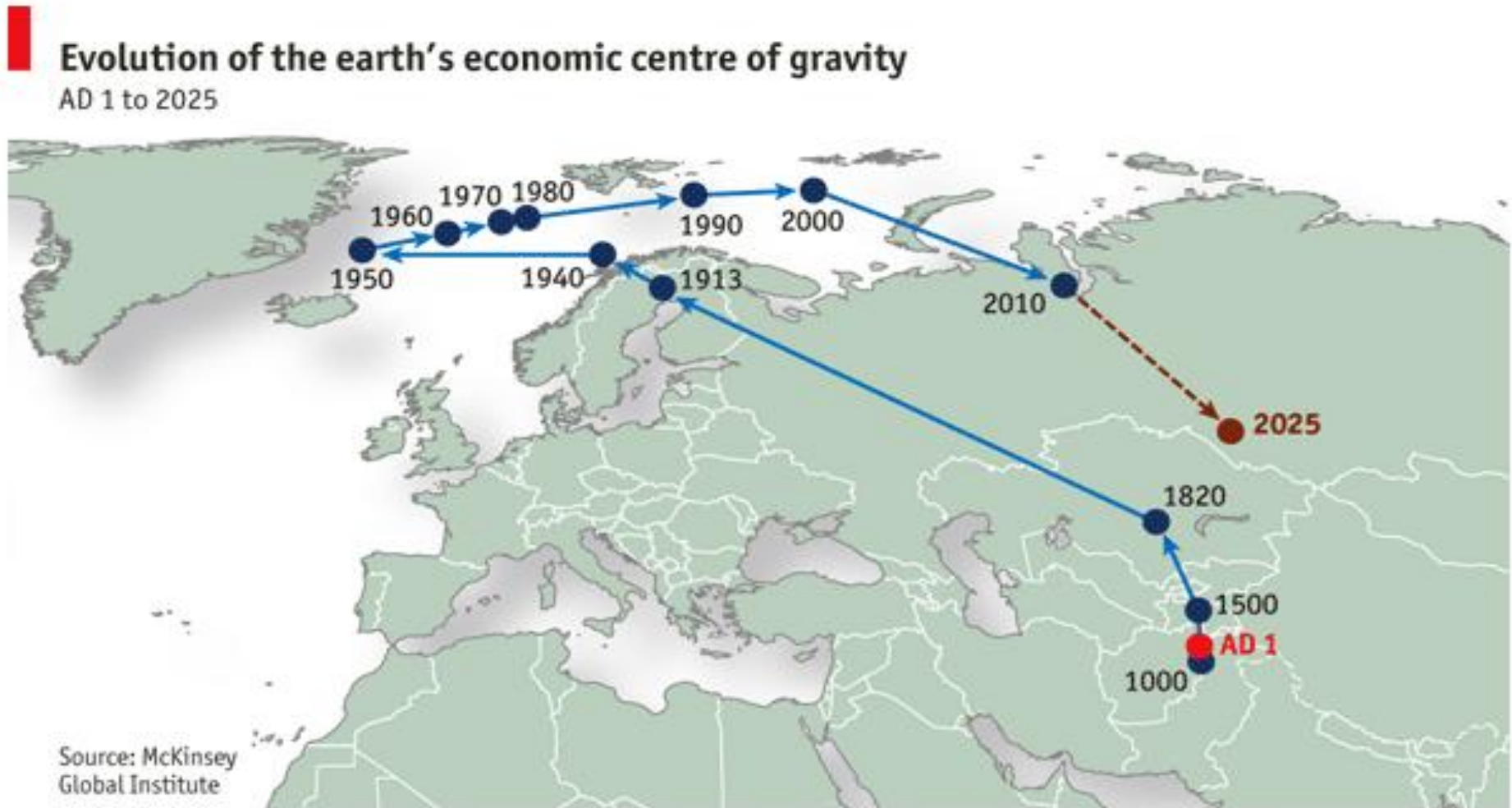


# The 2/3 -1/3 rule

- 1990s: Two-thirds of global growth from advanced economies, one-third from emerging countries.
- 2010s: Two-thirds of global growth from the emerging world, one-third from advanced.

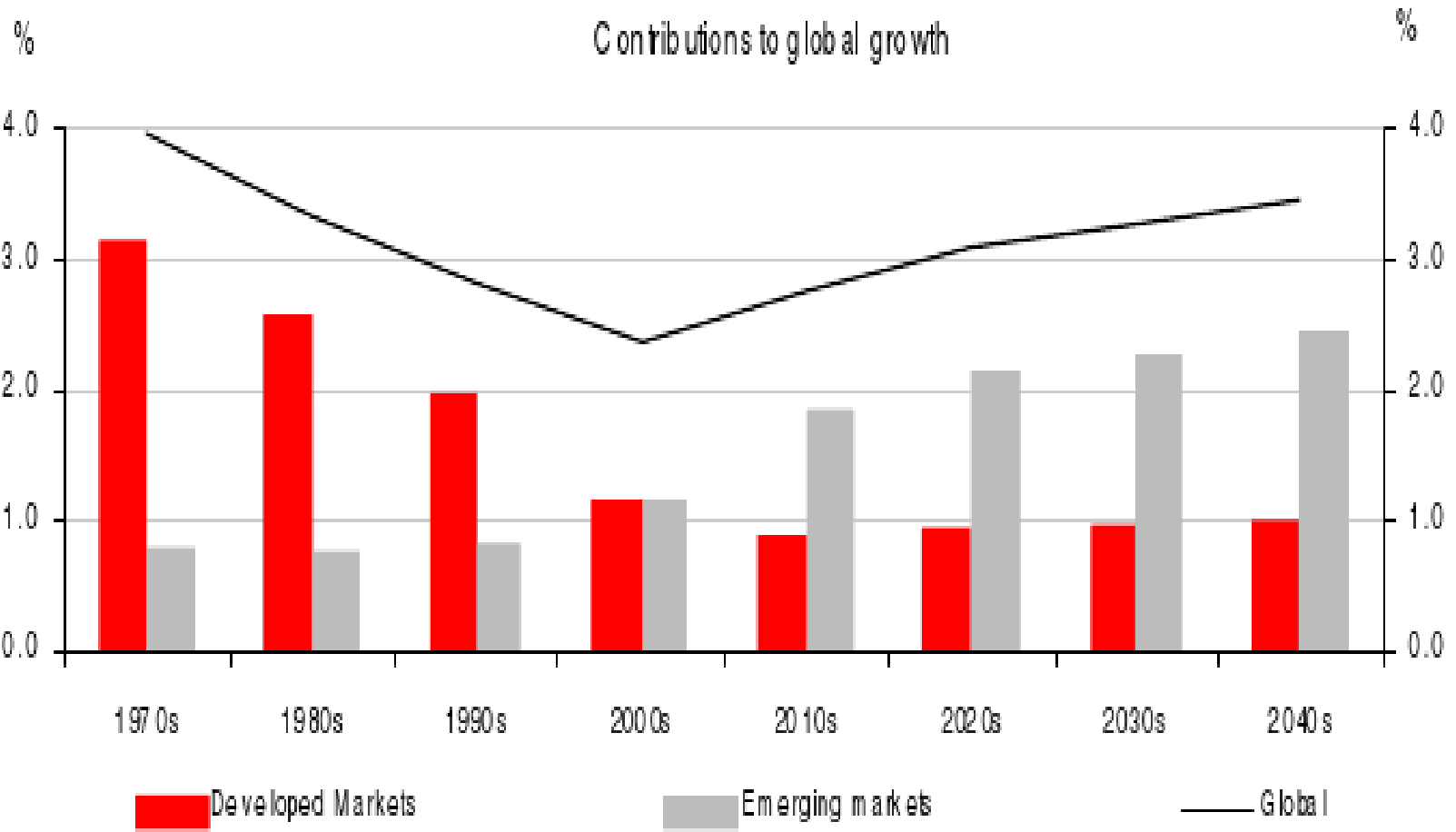


# The world's centre of gravity shifts



# And due to last many decades

Global growth will be powered by the emerging markets

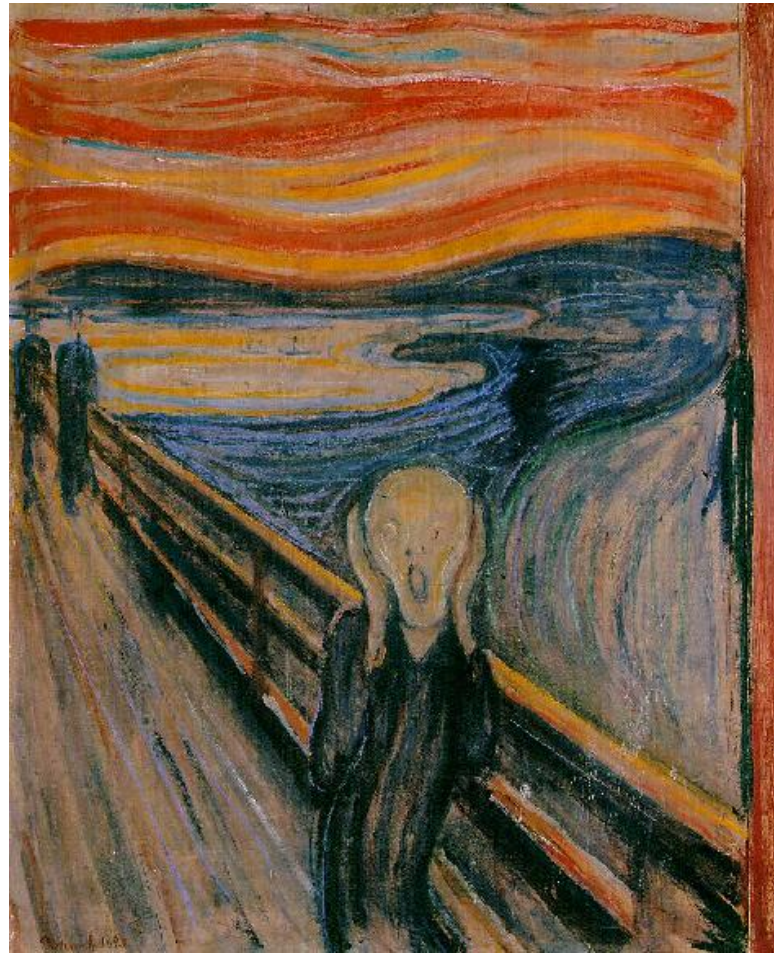


Source: HSBC estimates

# Should we celebrate this growth?

- Growth is growth, wherever in the world it occurs.
- Emerging-market growth creates opportunities for advanced-economy exporters (e.g. Jaguar Land Rover)
- The world's centre of gravity has shifted before (e.g. the rise of America)

Or be worried by it?



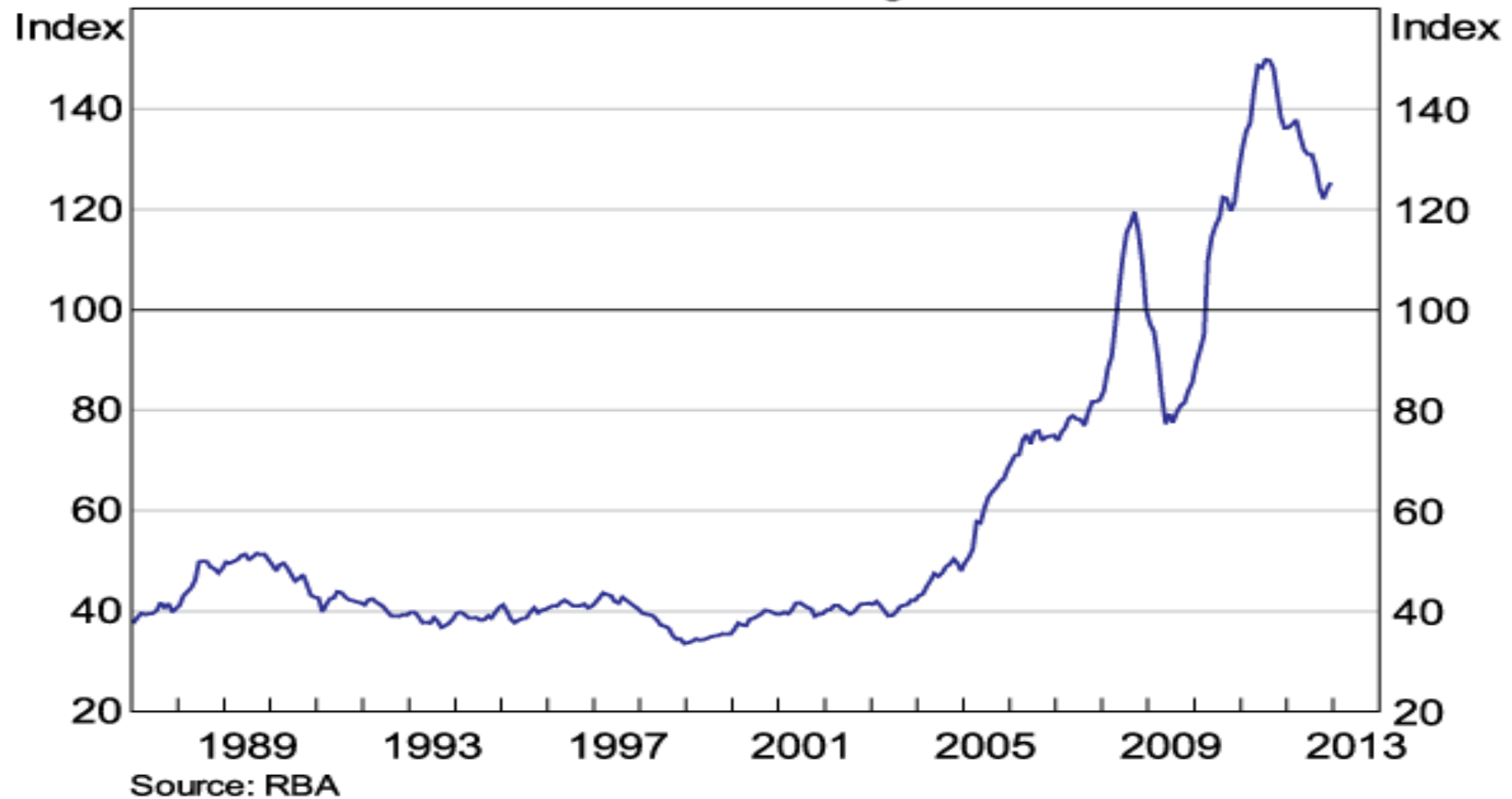
# The downside

- Commodity/energy hungry emerging economies cause imported inflation for advanced economies.
- Loss of control of monetary policy & inflationary squeeze on real incomes.
- Rise of low-wage economies boosts inequality by forcing down pay of unskilled/low-skilled globally.
- Pressure for reform of international monetary system – loss of dollar hegemony but no obvious successor.
- Unstable global capital flows/ the savings glut.

# The inflation/commodity price effect

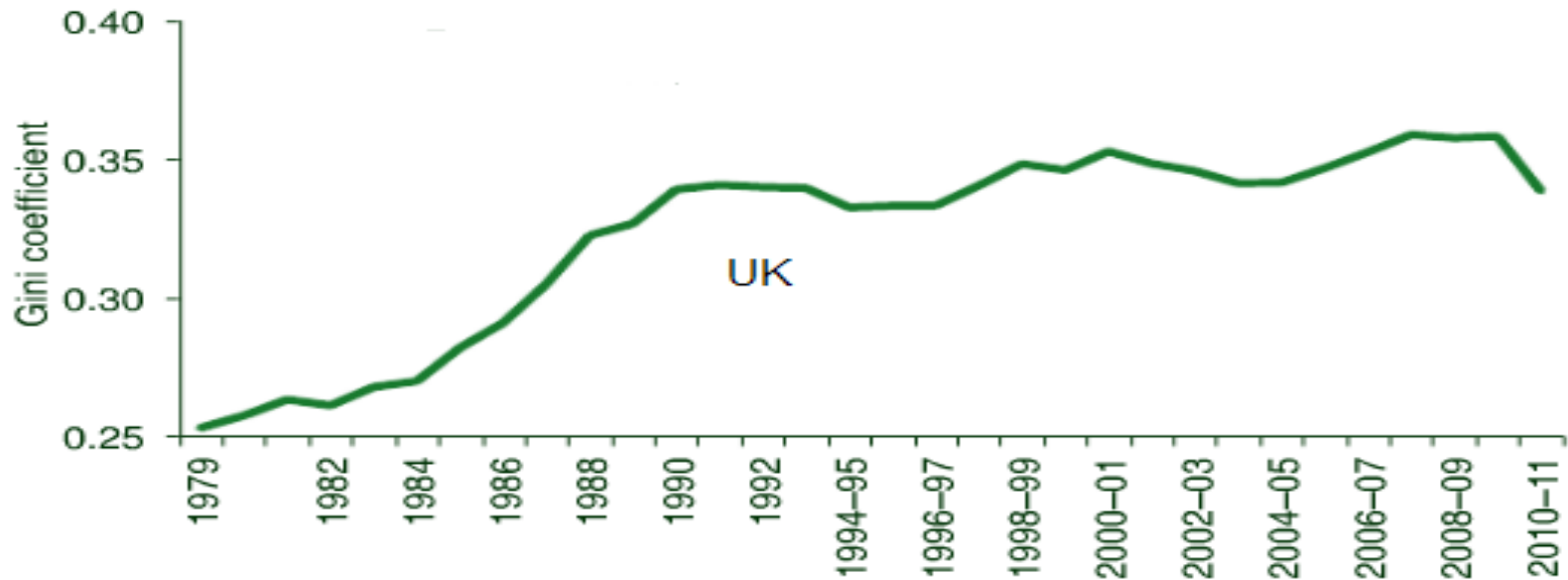
## RBA Index of Commodity Prices

SDR, 2008/09 average = 100



# Rising inequality

Gini coefficient since 1979



- Though note that most of the rise in inequality came before mid-1990s



# Conclusion

- Advanced economies are undoubtedly in a worse position than before the crisis – which accelerated a pre-existing trend.
- Uncomfortable though some of its effects are, advanced economies would be in an even worse position now if not for growth in emerging economies.
- Emerging economies are driving the upturn, though have not been entirely immune from the crisis.
- The world is a different place. Will advanced economies ever drive the global economy again?