INTERNATIONAL: China is key to emerging power fortunes

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Abstract (summary)

The outlook for global growth over the very long term.

If the surge in developing world growth that has dominated the last two decades has ended, global growth forecasts will likely return to old norms of 2-3% per annum. This would alter the outlook for old versus rising powers and commodity markets. It is important to consider the potential for, and implications of, more persistent divergence in growth across the developing world. The climb out of poverty for the lowest-income countries probably would be put on hold for some years and any restart would depend on the rest of the world regaining dynamism.

Full text

SUBJECT: The outlook for global growth over the very long term.

SIGNIFICANCE: If the surge in developing world growth that has dominated the last two decades has ended, global growth forecasts will likely return to old norms of 2-3% per annum. This would alter the outlook for old versus rising powers and commodity markets. It is important to consider the potential for, and implications of, more persistent divergence in growth across the developing world. The climb out of poverty for the lowest-income countries probably would be put on hold for some years and any restart would depend on the rest of the world regaining dynamism.

ANALYSIS: Impacts.

China's economic development has slowed and economic growth looks likely to be relatively subdued over the next 20 years.

Other emergers will struggle to overcome weakening in advanced economies and China, internal tensions and financial constraints.

The poorest countries, especially commodity producers, are unlikely to show meaningful progress against this backdrop.

The long-term global GDP growth outlook remains heavily dependent on the pace of development and scope for rising domestic consumer spending across emerging markets, especially Asia (*see PROSPECTS 2013 Q4: Global economy - September 2, 2013*). There is potential for massive gains. However, realising this scenario will be challenging. Diverging fortunes across BRICS look similar to the divergence currently seen across Europe. Underlying problems in fundamentals may prove equally intractable. Substantial uncertainties in the development process are apparent in a range of projections for the global economy to 2050.

Advanced economies also face uncertainty. However, even under varying scenarios, the range of outcomes is relatively narrow. They remain important in generating high-level technological and productivity gains and consumer trends that feed into long-term global development targets. Consumption demands are plateauing, with projected living standards and improvements in quality of life becoming more important to typical households. This argues in favour of greater investment in human capital, advanced sciences and environmental improvements. It will keep wealthy countries ahead of the developing world, even if the gap is narrowing.

Diverging BRICS.

Two economies illustrate the benefits created and strains imposed by development:

China. Although China has slowed markedly (*see PROSPECTS 2013 Q4: China - September 9, 2013*), it may be overcoming the 'development hump' (the resource-intensive phase of infrastructure building). It can now consolidate and grow at 6-8% per annum rather than 10% averages over the last 20 years. Given its current size -- about 12% of the global economy -- even these growth rates imply that China will add more to the global economy each year than it did when it was expanding at 10% a decade ago. The world economy would be confident of 3-4% growth rates per annum if China could continue at its current pace.

India. India has yet to conquer the development hump, particularly the infrastructure and organisational requirements necessary to sustain fast growth. It successfully side-stepped this during a few years of booming services exports, but now needs to tackle the fundamental problem or risk failure.

In addition, growth prospects in resource producers Russia and Brazil look lacklustre, though this is unsurprising given that these are upper-middle-to-high-income economies at a stage at which further advances are more challenging to sustain.

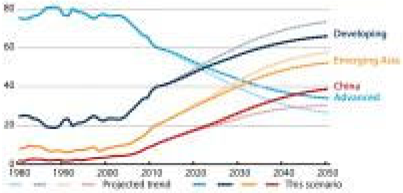
2050 scenarios under slower BRICS growth.

It is useful to examine how a slower world growth picture might emerge, and what it might look like, by considering potential contributions to such a slowdown. The starting-point is a moderately favourable world GDP forecast based on recent trends, and slight slowing in the developing world over the long run. Essentially, this forecast predicts that regional shares of world GDP will be much closer to regional population shares by 2050, as developing world productivity catches up.

Scenarios are variants of this trend forecast:

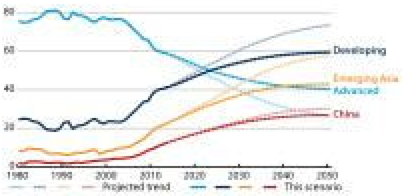
Step one case. The more sluggish and more fragile parts of the developing world could revert to much slower growth paths. However, advanced economies and China are assumed to keep performing in line with trend. This implies that by 2050, their shares of world GDP have risen sharply compared with the initial forecast.

Step two case. China may slow far faster than expected -- with annual growth dropping to 2.0-2.5% per annum by 2040-50, close to the 1.5-2.0% growth projected for advanced economies. With extreme Chinese slowdown, coupled with weak growth throughout the developing world, advanced countries maintain an even stronger position in the world economy.



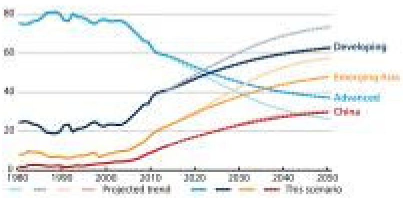
Scenario 1: Weaker non-China developing world
% of world nominal GDP, current prices, MER
Source: Oxford Analytica

Step three case. There could be negative repercussions and further failures in the developed world, taking growth to 0.5-1.0%. Coupled with the weaker growth of step two, this pulls back advanced countries' share in GDP towards the step one case. However, in contrast, China regains the initially forecast share of GDP. Nevertheless, all economies suffer weaker absolute performance.



Scenario 2: Weaker developing world including China
% of world nominal GDP, current prices, MER
Source: Oxford Analytica

China maintains an advance towards a 25-35% share of world GDP in all scenarios, while the developing world becomes over half of world GDP by 2020-25 (measured at market prices). The level of 2050 global GDP falls compared to the trend forecast base case in all scenarios. The drop is greatest at step one, moderate at step two and quite small at step three. Step one is feasible, with a potential fall in growth elsewhere in the developing world having significant effects on global GDP, but not a large impact on China and advanced economies. However, even if the slowdown is in all regions, additional weakening might have much lower impacts on world GDP and resource demands.



Scenario 3: Weaker growth in all regions
% of world nominal GDP, current prices, MER
Source: Oxford Analytica

Resource demand implications.

A slower world economy would moderate commodity demand. For example, 2-3% global growth would stabilise aggregate energy consumption. In particular, the failure of some poor countries to overcome the development hump would undermine demand for metals and minerals, as well as energy.

Effects of permanently weaker growth are likely to include:

far slower 'hard' development of China's rural areas and hinterland, with more emphasis on 'soft' services and resolving existing problems;

a long pause in India while financial issues are tackled and obstacles to growth come under political scrutiny;

moderate growth in Latin America and resource producers such as Russia, with Africa's development largely stalled;

tensions in countries dependent on resource revenues to sustain populations and consumer imports -- for example, parts of Eastern Europe, Central Asia and the Middle East; and

more investment in alternative long-run growth options in wealthy Gulf states.

There would be modest benefits for such resource importers as the EU and Japan from weaker world price profiles.

CONCLUSION: While China has slowed, it is still expanding solidly, and the probability is shifting in favour of moderate short-term improvement in growth and trade. This would have positive knock-on impacts on many other developed and developing countries. The immediate future of India is less assured. The financial crisis could worsen, and the roots of malaise, especially poor infrastructure, could take a long time to resolve. However, over the long term, Chinese growth is on a downward trajectory.

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