INTERNATIONAL: Decoupling could pose future threat

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Abstract (summary)

The effects of emerging-market 'decoupling' from advanced economies.

While in late 2011 doubts had resurfaced about the ability of the developing world to sustain growth, decoupling reasserted itself at the end of last year. Indeed, evidence pointing to the emerging-market growth cycle turning up again includes Chinese expansion possibly increasing from 7.8% in 2012 to over 8.5% in 2013, as well as a pick-up in a number of South-east Asian economies, as well as in Brazil. Moreover, 'South-South' trade maintained a good pace despite the cyclical downturn in the major emerging markets, which caused the overall near-stagnation in global trade last year.

Full text

SUBJECT:The effects of emerging-market 'decoupling' from advanced economies.

SIGNIFICANCE:While in late 2011 doubts had resurfaced about the ability of the developing world to sustain growth, decoupling reasserted itself at the end of last year. Indeed, evidence pointing to the emerging-market growth cycle turning up again includes Chinese expansion possibly increasing from 7.8% in 2012 to over 8.5% in 2013, as well as a pick-up in a number of South-east Asian economies, as well as in Brazil. Moreover, 'South-South' trade maintained a good pace despite the cyclical downturn in the major emerging markets, which caused the overall near-stagnation in global trade last year.

ANALYSIS: Impacts.

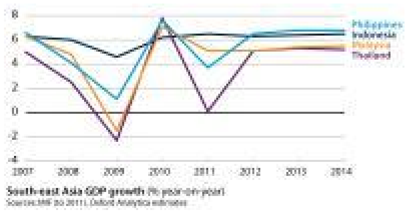
Developing economies will contribute to an upswing in global trade and growth this year.

Indeed, global GDP could expand faster than expected in 2013 if emerging markets grow more quickly than currently anticipated.

Yet cycles in the developing world's interlinked pattern of growth are only just forming and not yet well established or understood.

Developed-economy policymakers will increasingly have to scrutinise and interpret cycles in emerging markets.

Over the last decade there has been a recurring debate over the supposed 'decoupling' of the developing world from the advanced economies (see INTERNATIONAL: Decoupling economic trend is revived - September 9, 2009). Critics of the decoupling thesis argued that emerging market growth was derived almost entirely from export industries and thus a domestic demand driven model would be unlikely to emerge for many years to come:

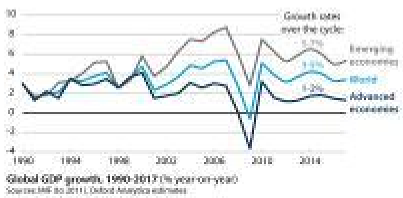


South-east Asia GDP growth (% year-on-year)
Sources: IMF (to 2011), Oxford Analytica estimates

In fact, prior to the 2002-08 boom period, there was little or no sign of decoupling and no debate.

Except in occasional years of peak growth, there was no growth premium for the developing world bloc and its cycles were very strongly interlinked with those of the developed world, primarily the United States.

The ability of emerging markets to sustain much higher growth than the developed world, even in global downturns, has only been established over the last decade. However, it now seems clear that not only is the developing world block capable of generating an independent business cycle from the developed world, but it is also capable of acting as the driver of global economic expansion. It is leading rather than lagging (see INTERNATIONAL: Emerging markets concerns overstated - March 15, 2012).



Global GDP growth, 1990-2017 (% year-on-year)
Sources: IMF (to 2011), Oxford Analytica estimates

The latest phase of the present cycle is adding further weight to the pro-decoupling argument. According to the IMF's latest assessment, published last month, the developing world's growth was starting to turn up at the end of 2012 while growth in the developed world, dragged down by Europe and Japan, was continuing to decline (see PROSPECTS 2013: Global economy - November 1, 2012).

Increasing size and interlinkages .

The increasing size and internal dynamics of the developing world mean it is now able to generate its own economic cycles and pull the world economy along with it. In total, developing countries account for about half of world GDP in purchasing power parity (PPP) terms -- and almost a third at market exchange rates. China, the world's second largest national economy, looks set to overtake the United States in about the next decade or so:

China may still have a relatively low consumption-to-GDP ratio (about 35% based on official statistics), although such an extremely low figure is debatable -- given likely measurement errors that could imply a consumer share in the 40-50% range.

Furthermore, many other emerging market economies have much higher consumption shares. For example, Brazil, India, Indonesia, Malaysia, South Africa and Thailand all enjoy consumer spending rates in line with Europe's share of 50-60% of GDP, while in Mexico this is over 60% and in the Philippines it is as high as 70% (similar to the US rate).

The pace of growth in the developing word is also so high compared to OECD expansion that it accounts for an even larger 70-80% share or more of global GDP growth. This is a far cry from the status quo of just a decade ago. In particular, the developing world can now grow robustly even when the developed world and its markets are weak. The leading emerging markets can thus offer a counter-balance to soft patches in the advanced economies and drive world recovery.

Quarterly GDP growth (%, annualised)
Sources: IMF (to 2011),
Oxford Analytica estimates

Risk ahead.

However, the developing world can also help drive a downturn. It will only became clearer with time just how newly forming emerging-market cycles will operate and whether they can be successfully managed consistently to boost world growth.

This new ability of the developing world block to generate its own interlinked cycle independent of the advanced economies also has a dangerous side, posing risk of increasing instability in:

the developing world itself (eg a downturn in China will affect Brazil and other commodity exporters); and

ultimately in the global economy (see INTERNATIONAL: Mid-sized powers drive risky growth - March 23, 2011).

More specifically, deep recessions will be a persistent threat whenever the developed and developing world cycles strongly converge. Synchronised downturns, provoking rapid downside momentum, will recur (along with sharp upturns). Even if they are less dramatic than the shock of 2008 (and the 2010 upswing), amplified cycles will pose a challenge for policymakers attempting to manage the global economy and their own finances.

The influence of emerging markets will also become more hazardous if key countries fail to adapt to cycle management within their own economies -- economic policy goals may need to be modified and new policy tools developed to deal with these potentially turbulent new dynamics.

CONCLUSION: The economies of the developing world are now sufficiently large and internally dynamic to generate independent economic cycles. Their positive trends add to hopes of more economic uplift in the developed world in 2013, especially for the export sensitive European economies. However, it is not clear whether the emerging-market cycle will mutate from a benign offset to the advanced economies' cycle to become a new source of instability. Deep recessions will be a threat whenever the developed and developing world cycles converge in a sharp downturn.

Indexing (details)

Subject	International; Economic conditions; Economic growth; International relations; International trade; Public policy
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