FINANCIAL TIMES

January 10, 2012 7:10 pm

# Hopes in emerging countries

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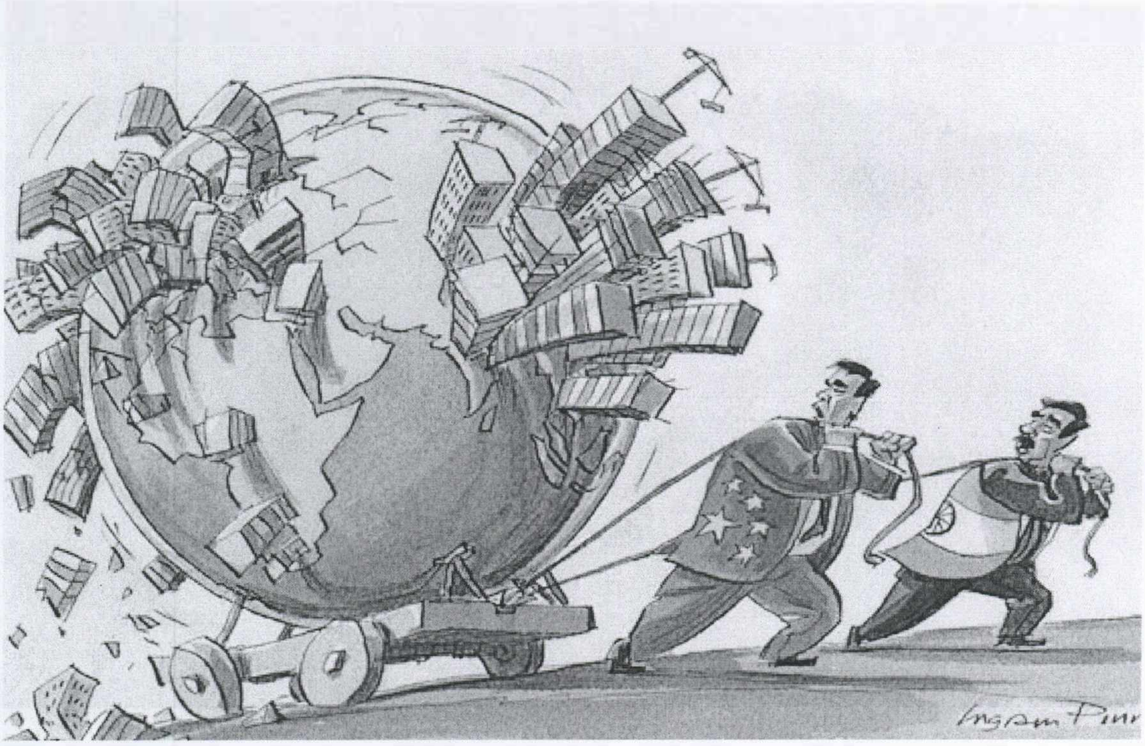

Between 2007 and 2012, the Chinese economy will expand by close to 60 per cent. Emerging Asia as a whole will grow by almost 50 per cent. Over the same period, economies of high-income countries will grow by a mere 3 per cent. Who can doubt that the world is undergoing a profound transformation? The speed of convergence in incomes per head is driving extraordinary divergence in growth between incumbents and newcomers. Moreover, this has continued despite the weak growth of high-income countries discussed last week. Huge shocks, such as those of 2008, do affect the growth rates of emerging economies. The same would probably be true if the eurozone imploded. But the effect does not seem to last (see charts below).

If we look at emerging economies' growth in detail, we see that Asia is the most dynamic region, and the one least affected by the global crisis in 2008 and 2009. Sub-Saharan Africa came second to Asia, on both points. Latin America and central and eastern Europe were less dynamic and more vulnerable to adverse external shocks.


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So what now? As the Institute of International Finance, an association of global financial institutions, argues in its latest Capital Market Monitor: "The key question for 2012 is whether the resilient parts of the global economic and financial system – the emerging market economies and the non-financial corporate sectors – are robust enough to cushion the potential impact of high credit risk to the mature economies."

As is true for the high-income countries, the consensus of forecasts for this year has become gloomier since the beginning of 2011. But the downgrading is fairly modest. In December, China was still forecast to grow by 8.3 per cent in 2012 and India by 7.5 per cent. Not surprisingly, the data show a proportionately far bigger growth downgrade for central and eastern Europe, largely because of the risks in the eurozone. The view taken of Latin America – notably Brazil – is also gloomier than it was a year ago.

These do not seem implausible "best guesses" of the growth outcome for next year. What are the risks, on the upside and downside?

For the most important emerging economies upside risks may not be important, since their performance is already expected to be so good. Yes, China might grow by 10 per cent and India by 9 per cent. But that would hardly be a huge surprise. A part of the emerging world that might surprise on the upside is central and eastern Europe, provided the eurozone also does better than feared.

Far more significant is the possibility of big surprises on the downside, particularly for China, which has become such a powerful driving force for other emerging economies, especially commodity exporters. Maybe this is what equity markets seem to be saying, with large declines in the stock market indices since the summer of last year. But, as the adage goes, stock markets have forecast 10 of the past three recessions. The markets of emerging economies are particularly volatile: some are pure casinos.

- growth risks
- possibilities

So what are the credible downside risks to big emerging countries?

Some of the vulnerabilities result from growth itself. Development makes a society more mobile, more demanding, and better educated and informed. It also changes the nature of the demands: richer people naturally seek a degree of personal autonomy and engagement in public life. Their concerns also change: China's income per head is now at levels that have spawned powerful environmental anxieties elsewhere. Thus, a revolution of rising aspirations, reinforced by the new information technologies, constrains what a government can hope to get away with, even in a one-party state.

Furthermore, rapid development is almost always unbalanced. China is no exception. Wen Jiabao, the premier, called China's economy "unstable, unbalanced, uncoordinated and ultimately unsustainable". Among the challenges that result are those of managing the transition from investment-led to consumption-led growth and dealing with the aftermath of huge property bubbles.

In addition to such internal vulnerabilities, emerging countries suffer from external ones. The most obvious, at present, is of a huge shock in the high-income countries, probably emanating from the eurozone. Some combination of sovereign defaults, banking failures and even exits from the eurozone by important members would surely create turmoil. If such a low-probability, high-impact event were to occur, the open world economy itself would be threatened – and not just by Europe. The increasingly isolationist temper of the American right might then lead to resurgence of its once traditional protectionism.

A crucial point for emerging countries is access to essential resources at manageable prices. One of the most important novel features of the world economy is that commodities are so expensive, despite the weak growth of the high-income countries. This is a measure of the transformation of the pattern of global economic growth. A big shock to the oil market would be extremely disruptive. Given events in the Gulf, this is not inconceivable.

Yet, against this, remember that emerging countries still retain large opportunities to catch up with the productivity levels of high-income countries. At purchasing power parity, China's real income per head was barely above a fifth of US levels in 2010. India's was less than a 10th. These countries continue to enjoy what the economist Alexander Gerschenkron called "advantages of backwardness". Having started on the road to growth, the chances that they will continue to grow quickly are good. Moreover, many also possess substantial ability to weather shocks: enormous foreign currency reserves; robust public finances and comfortable external positions. In all these respects, China itself is a fortress. The combination of growth potential, economic momentum and such insurance makes it far more likely than not that growth will be rapid in any given year, in the near term at least. But, over many years, big adverse shocks are likely. As Hamlet argued: "If it be not now, yet it will come – the readiness is all."

An important additional question is whether sustained growth of emerging countries might pull the high-income countries out of their current sluggishness. The answer is: no. Most of the growth of the high-income countries will continue to come from internal demand. Yet a further rebalancing of today's pattern of current account surpluses and deficits would certainly help.

In sum, emerging countries, led by Asia, are likely to continue to grow rapidly in 2012, as they did in 2010 and 2011. That is immensely important for human welfare. Yet emerging countries are not immune to low-probability, high-impact disasters – internal, external or, more likely, some combination of the two. While they do have substantial cushions, these may not always be enough. Beyond this, emerging countries will be unable to pull the high-income countries into fast growth. The latter will have to save themselves by their own exertions. This is what leaders of emerging countries argue. They are right.