



# **Perspectives for emerging economies**

**V Workshop of the Latin American and the Caribbean Debt  
Management Specialists Group  
Debt Sustainability and the Global Crisis**

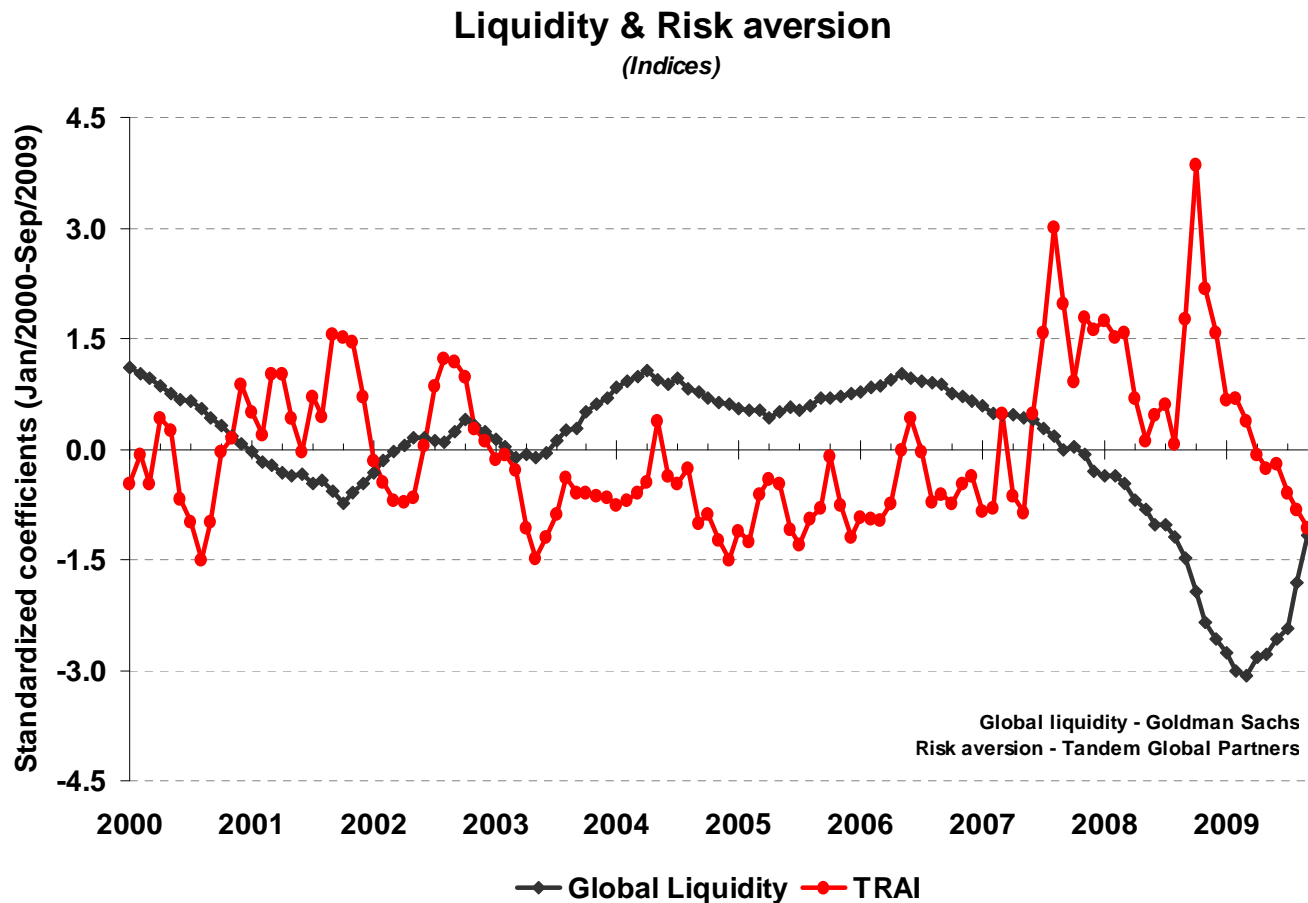
Inter-American Development Bank  
Washington, DC - October 20, 2009

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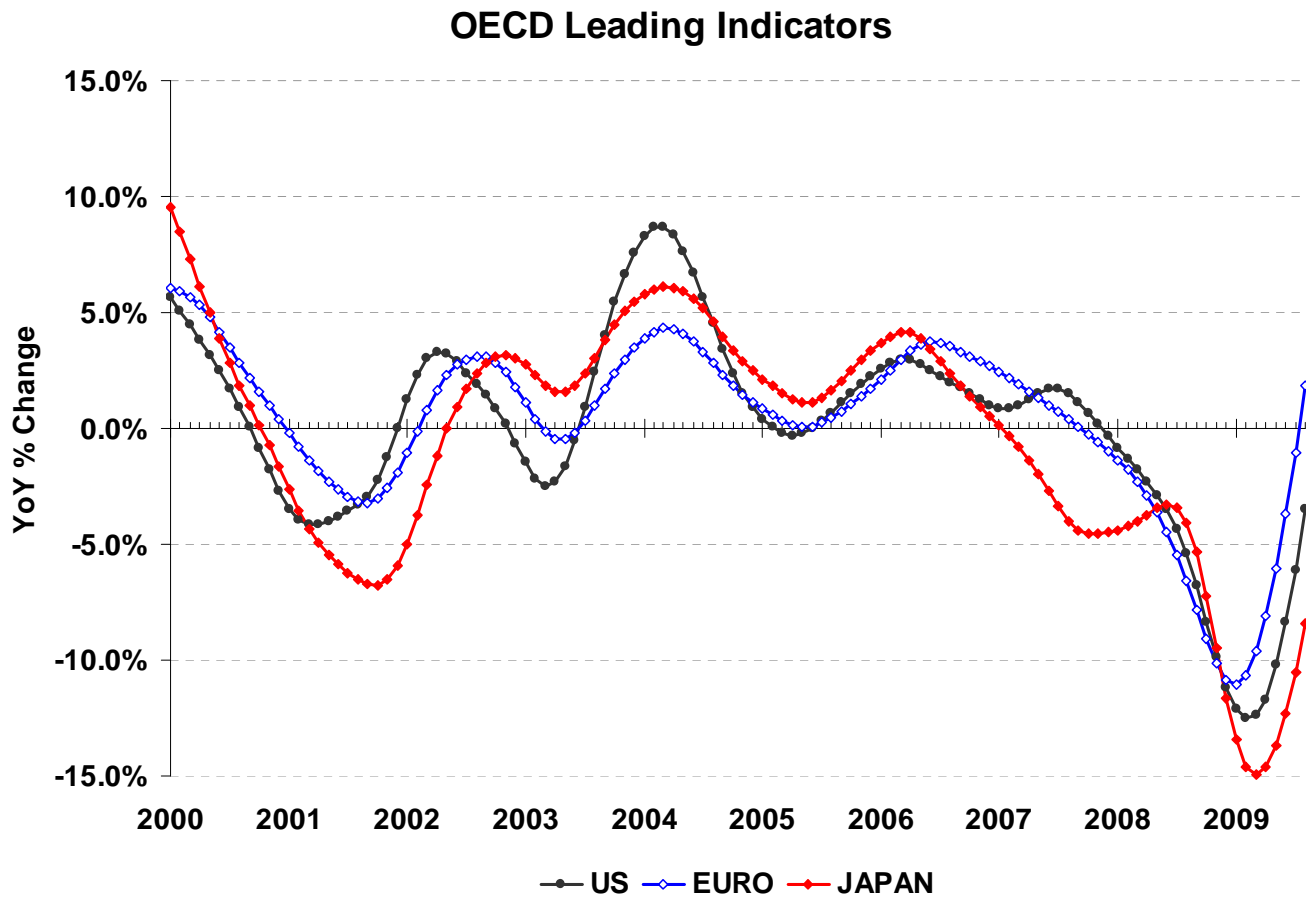
# Outline: Three questions

- EM: survived the storm and sails ahead, without ballast. Can it create its own wind?
- US: massive policy stimulus delivers the goods. What happens next?
- CHINA: can it carry the world? Can global imbalances adjust (China but also Germany, Northern Europe, etc) without slower growth?

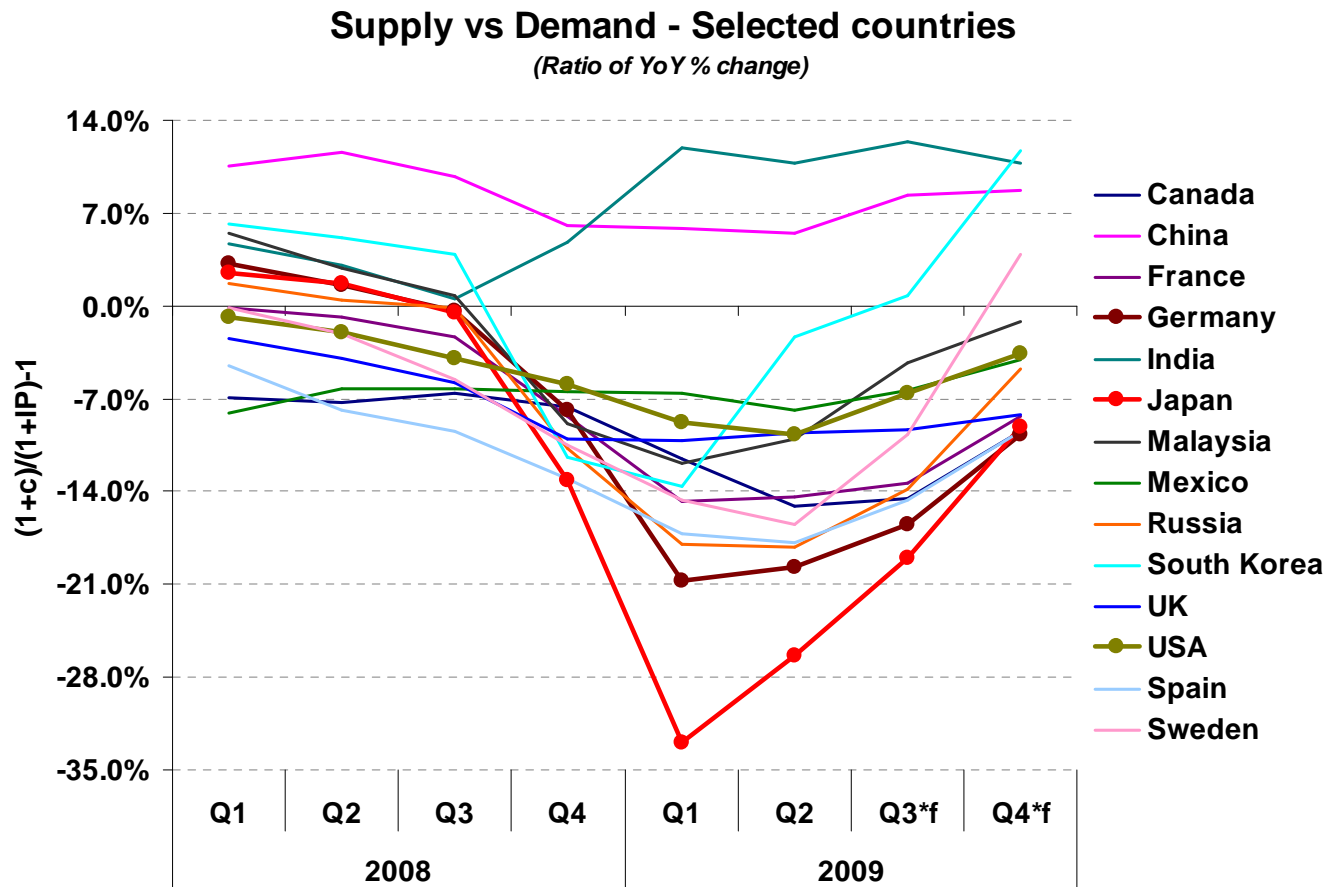
# Back to pre-Lehman levels: policy-induced expansion in liquidity trumps risk aversion



# Coming up but still a long road to recoup accumulated slack



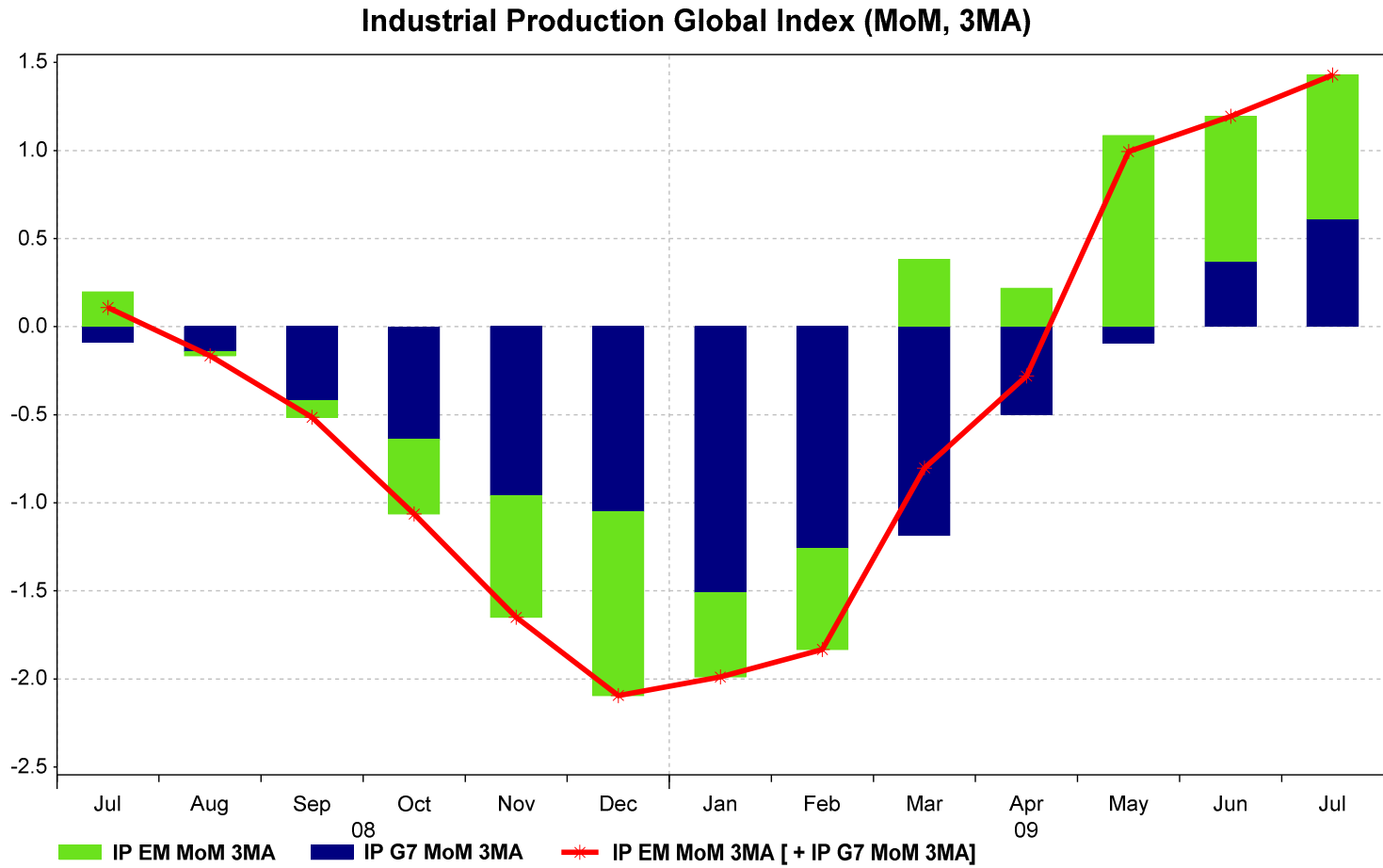
# V shape down ... V shape up. What next? Will growth take over post Q2/10?



# EM: Resilience & Rebound

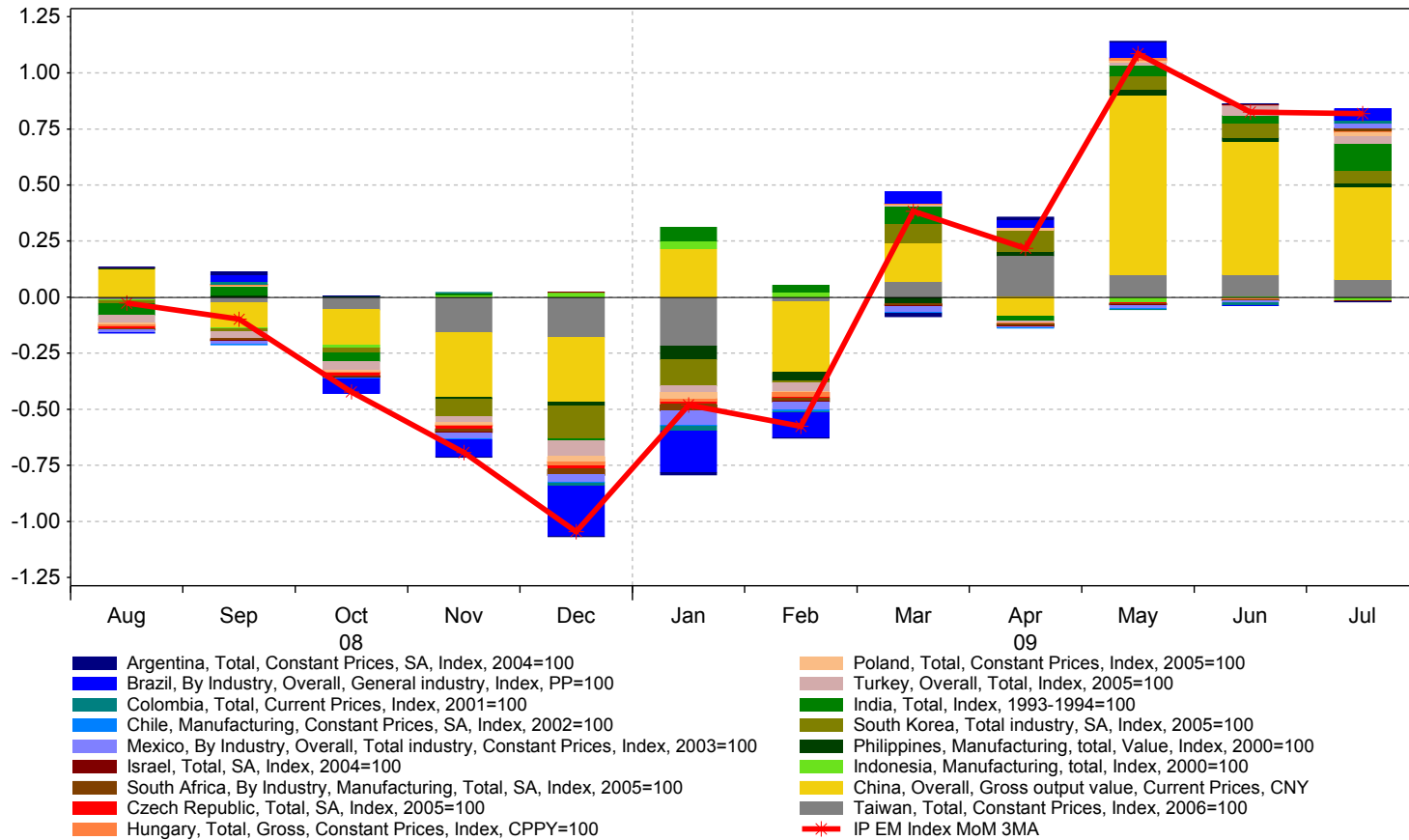
- Strong (exuberant?) rebound in EM
  - Started in China (fiscal stimulus + commodity restocking)
  - Spread to Asia + direct links (eg: Brazil)
  - Extensive throughout EM, including EMEA (leading G3)
- "Catarito" (but this time around it *was* different)
  - Mexico excepted, inelastic GDP response
  - Usual factors (virtue out of vices) but also some new virtues (macro + financial)
- Decoupling?
  - Convergence: faster growth at the margin (building on G7)
  - Divergence: growth w/o G7

# EM attenuated the downward shock and leads the global recovery



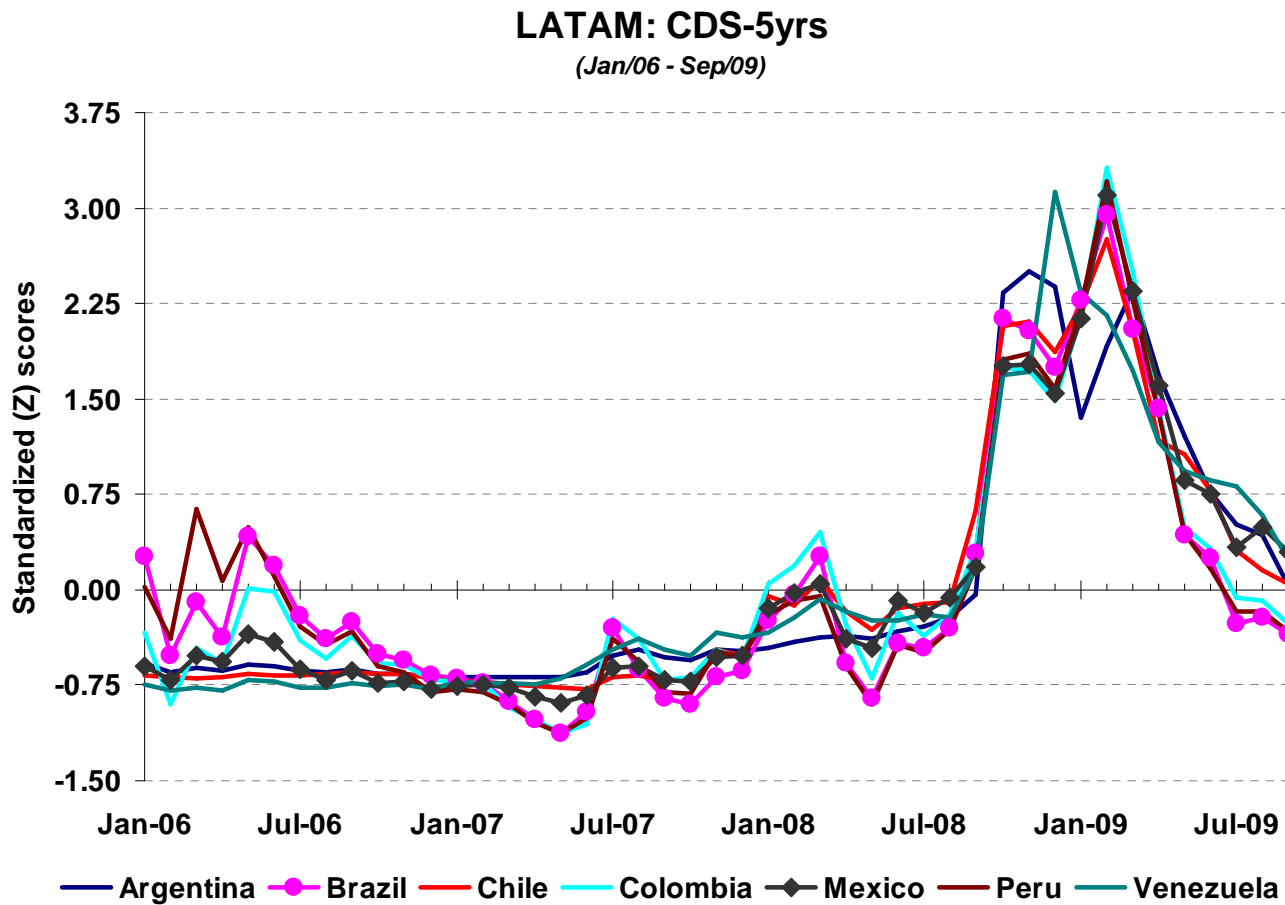
# Even if it is mainly China...

Industrial Production Emergin Markets Index (MoM, 3MA)

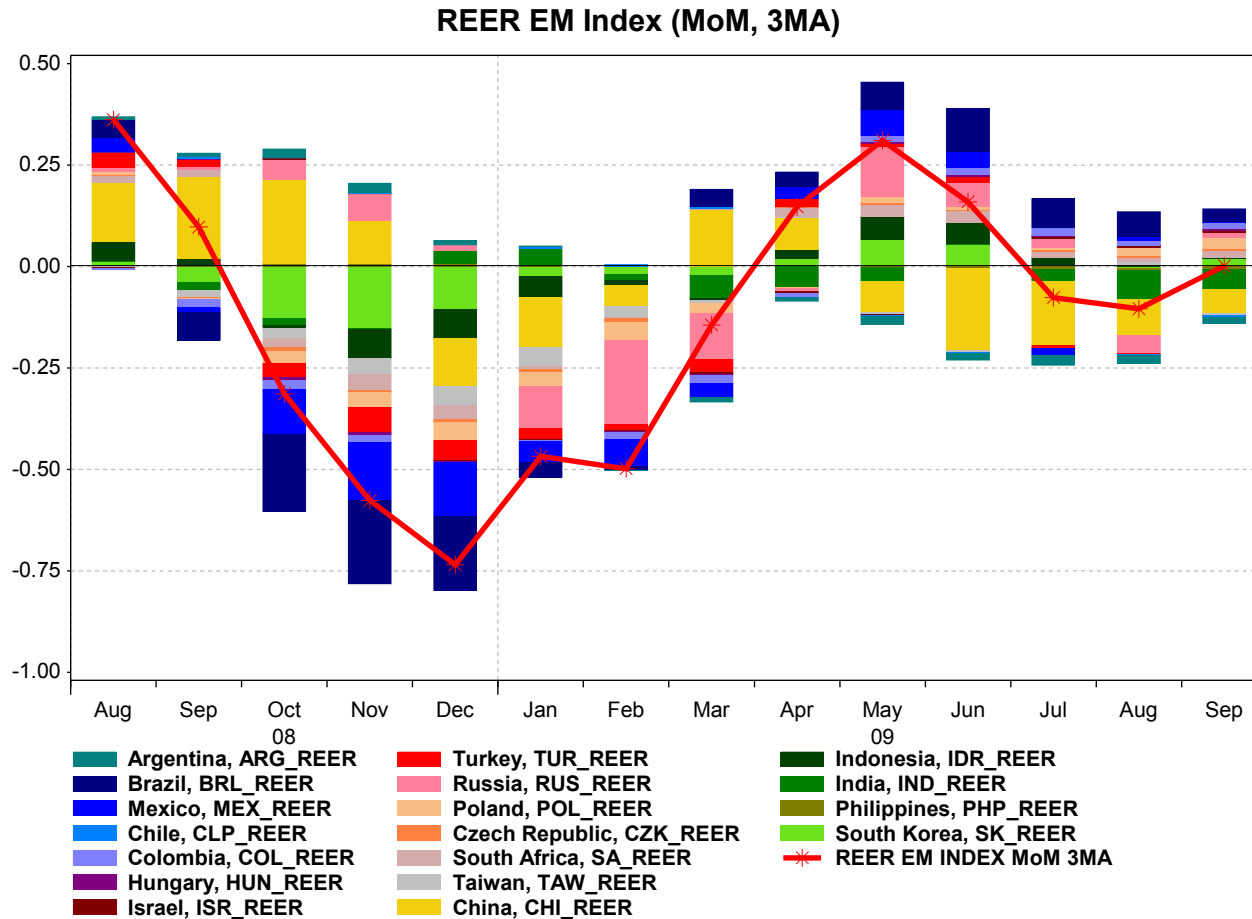


Source: Reuters EcoWin

# Risk appetite unwinds the losses and opens foreign funding at very attractive rates



# As exchange rates readjust ... but not in China

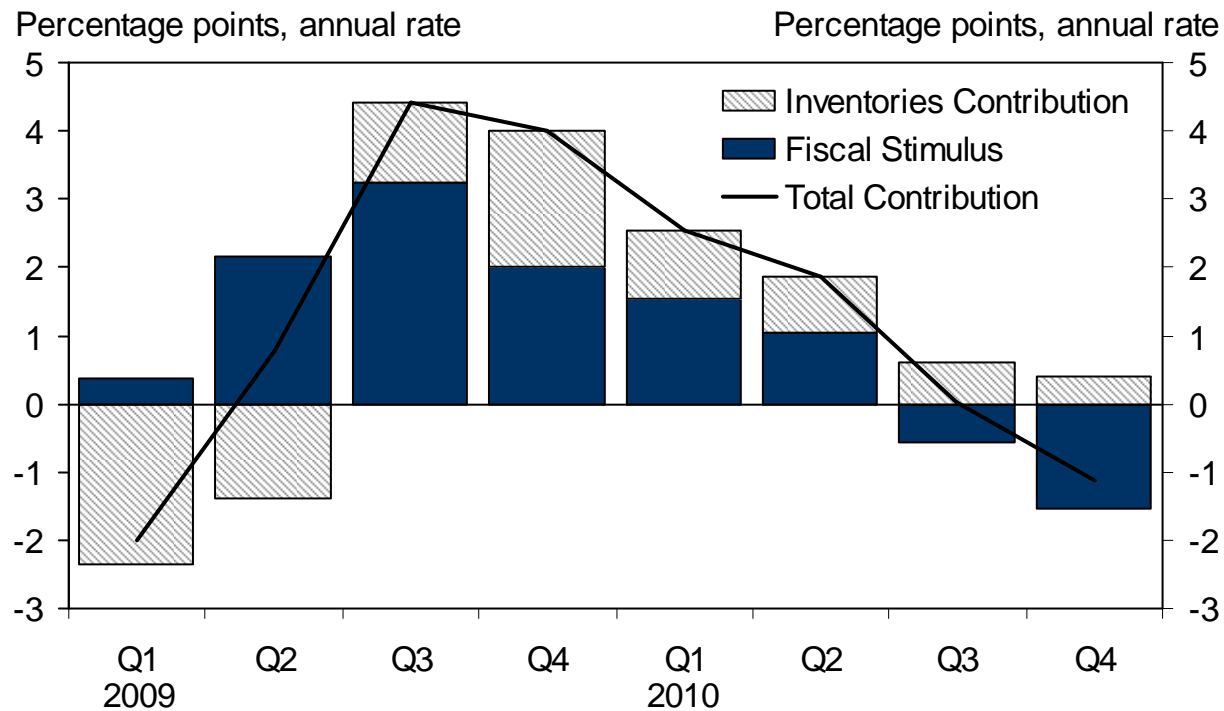


Source: Reuters EcoWin

# US: What follows the stimulus?

- Capital markets stabilized; S&P >1,000, home price decline abates, housing starts bottom out, household net worth recoups ... but still to a HUGE loss
- Consumption is stirring and net-exports expanding
- Survivor firms are holding large cash positions, profits increased (wage-squeeze)... will they invest?
- Fear is not W but a "square root" recovery

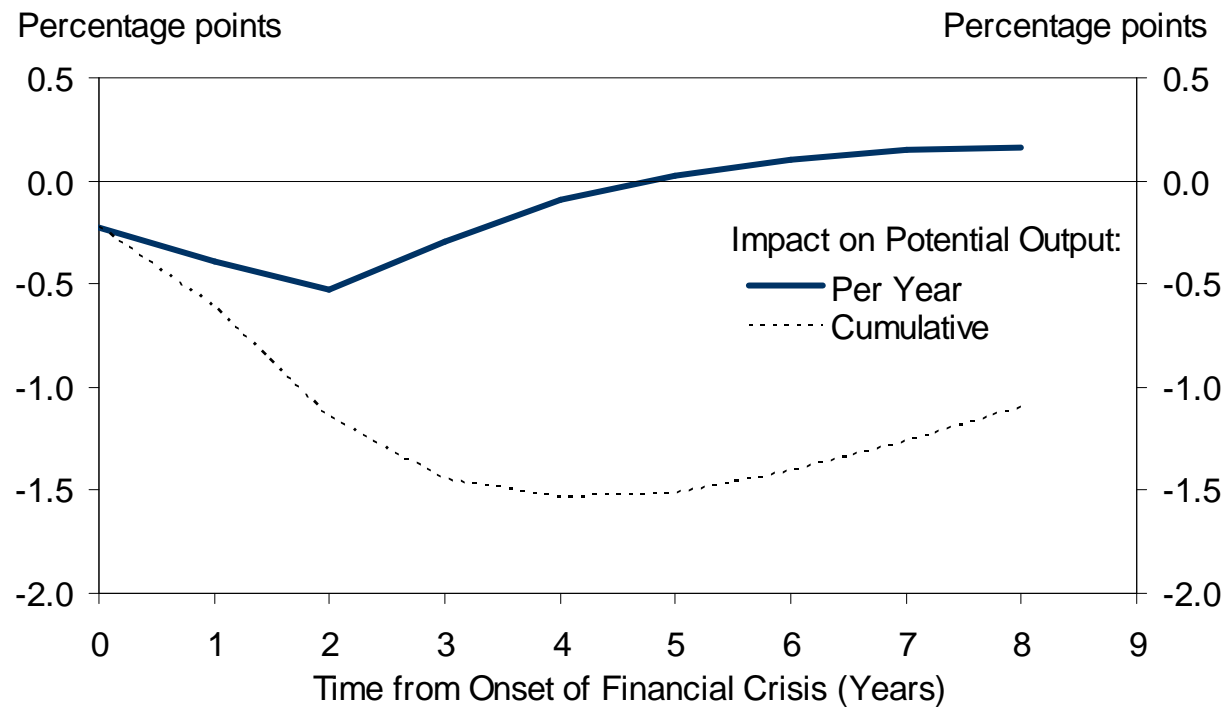
# US economy will lose four pp of GDP of temporary stimulus in 2010



Source: Congressional Budget Office. Recovery.gov. Our Calculations

(J. Hatzius G/S), Oct/2009

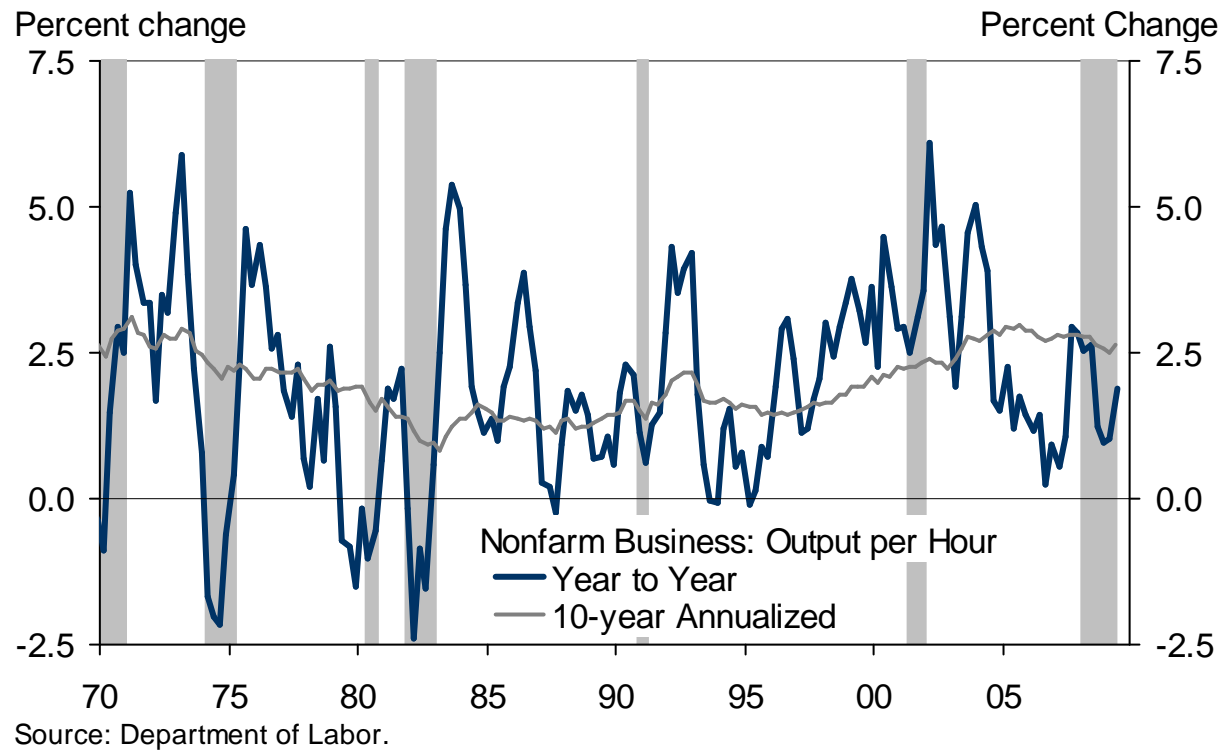
# In the past, financial crises had modest effect on potential GDP growth...



Source: OECD. Our calculations.

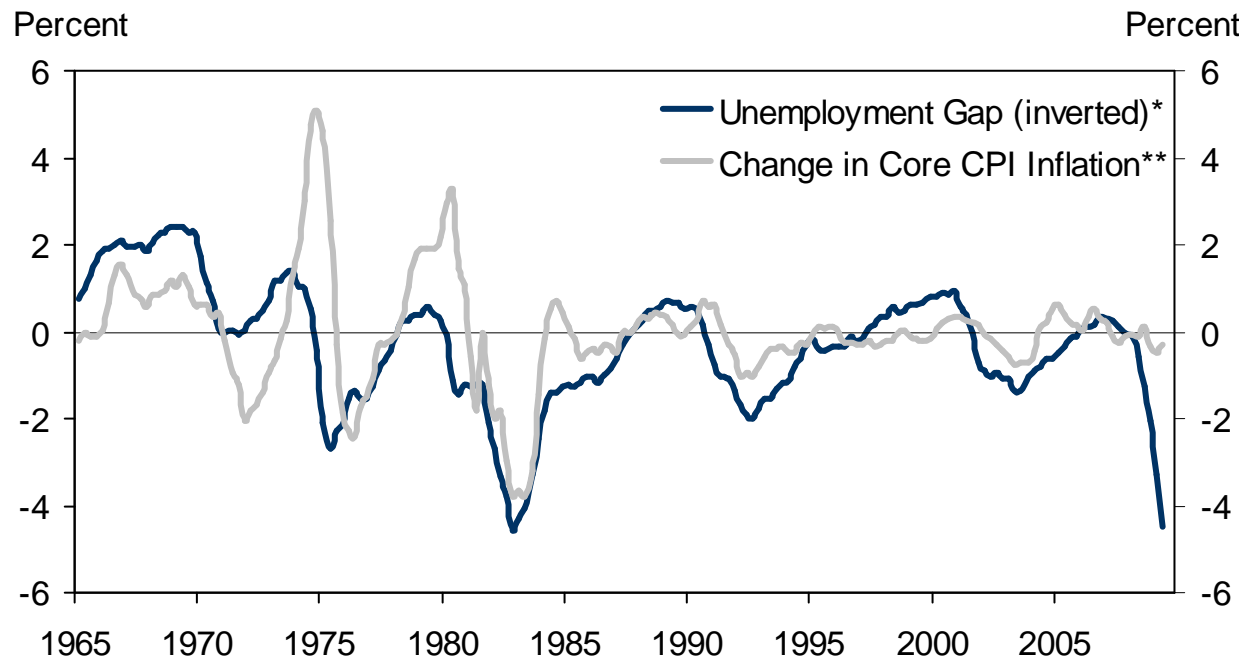
(J. Hatzius G/S), Oct/2009

# Strong productivity growth but TFP could trend down with higher taxes & NAIRU



(J. Hatzius G/S), Oct/2009

# What happens if the NAIRU increases 200bp to 6.50-6.80%?



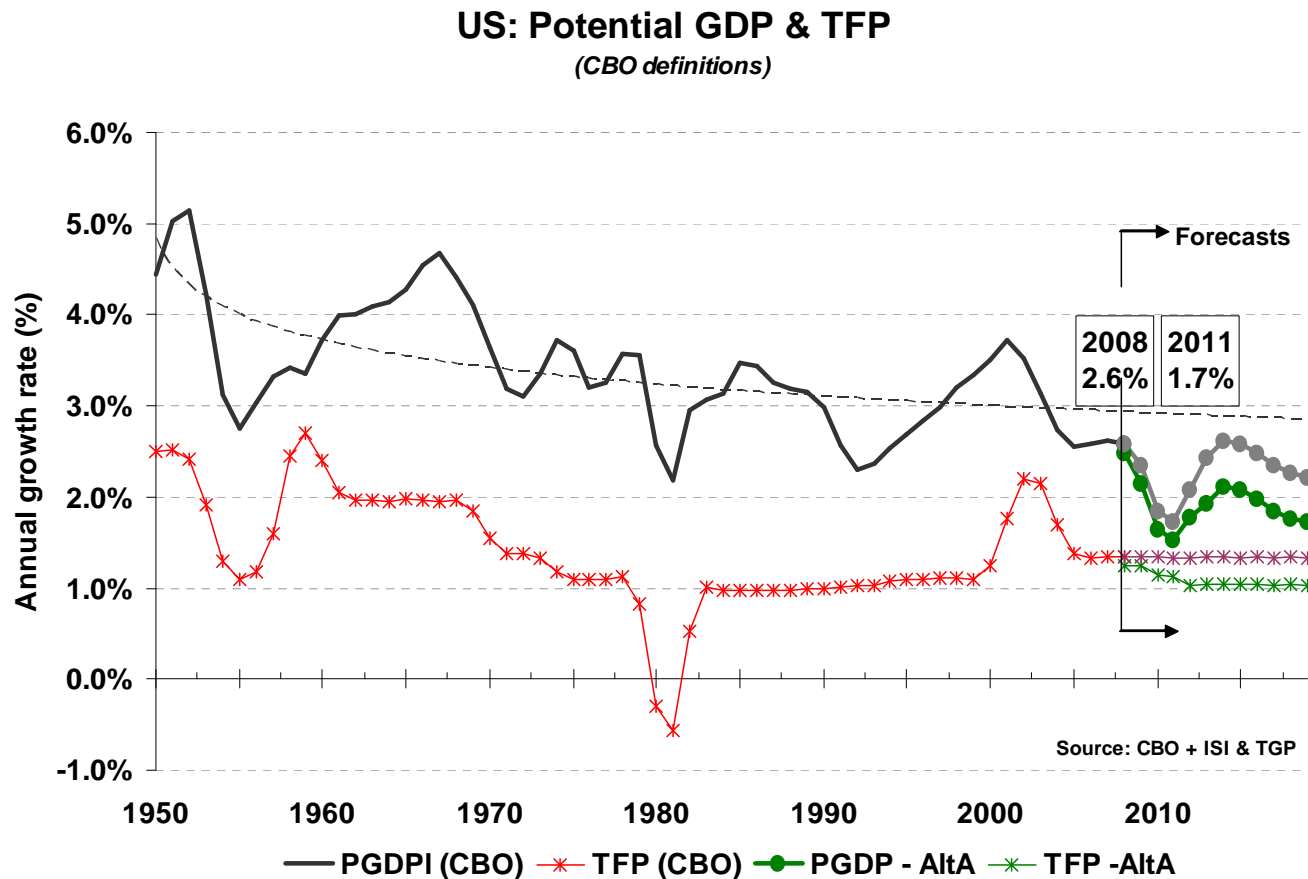
\* Unemployment rate minus CBO "natural" rate.

\*\* Deviation in year-on-year core CPI inflation from prior two-year average.

Source: Department of Labor. CBO. Our calculations.

(J. Hatzius G/S), Oct/2009

# Could the US long-term growth rate drop to close to 2%pa?



# The way down and the ways out

- Down: Debt & inflation
  - Possible but unlikely, unless there is a 2<sup>nd</sup> stimulus package
  - Exit strategy manageable: Private sector pullback finances public debt; debt ratio is rising but eminently sustainable
  - "Collapse" of the USD??? monetized inflation???
- Up: Schumpeterian shock – "creative destruction"
  - Recession purges
  - Health + energy reform = impetus to productivity
  - Financial intermediation is "healthy" (FED will stay with the \$1.3tr of "toxic assets")
- Up: Export your way to growth (positive net-exports)
  - Who buys? Who can compete?

# China: Can it go alone? Can it transform the US into a net export economy?

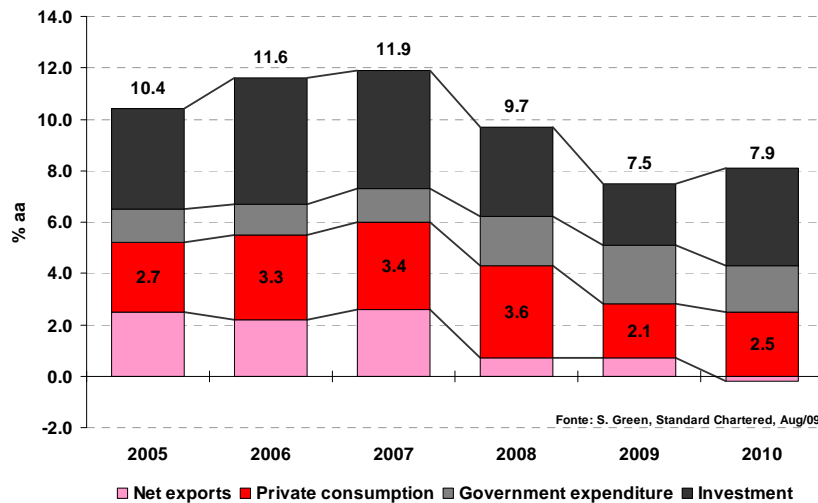
- Post- Asia crisis growth linked to strong exports to & investments in US (B-W-II???)
- Strong link between US retail sales (ex food & autos) and imports from China
- Break in the relation at end-2007
  - Prior (2005-2007): Rapid growth in US retail sales with "long tailed" and rising impulse response in Chinese imports, tending to near unitary elasticity
  - Post (2008-2009): Decelerating and slumping US retail sales with "short tailed" and falling impulse response, tending to twice the speed in the contraction/recovery

# External vs domestic-led growth: Does it add up?

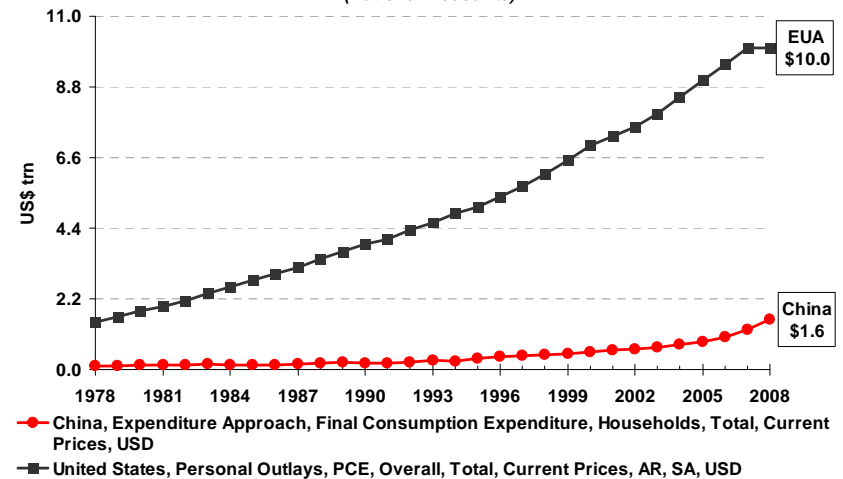
- Implications for China's growth (PMI)
  - Prior (2005-2007): Near unitary positive response of (log change) PMI to impulse from (log change) in imports to the US
  - Post (2008-2009): Inelastic (0.5) response but in *negative direction*. Quite clearly an unstable result (short sample dominated by cyclical turn) – disturbing nonetheless
- China is set to grow rapidly in 2009-10 w/o strong pickup in US retail consumption
  - Complementarities in trade & strong competitive edge (helped by exchange rate rule) + indication (TIC data) to continue to invest in USD securities
  - Dynamics has change and would argue for lower global growth

# Rebalancing growth in China: A slow start with a long way to go

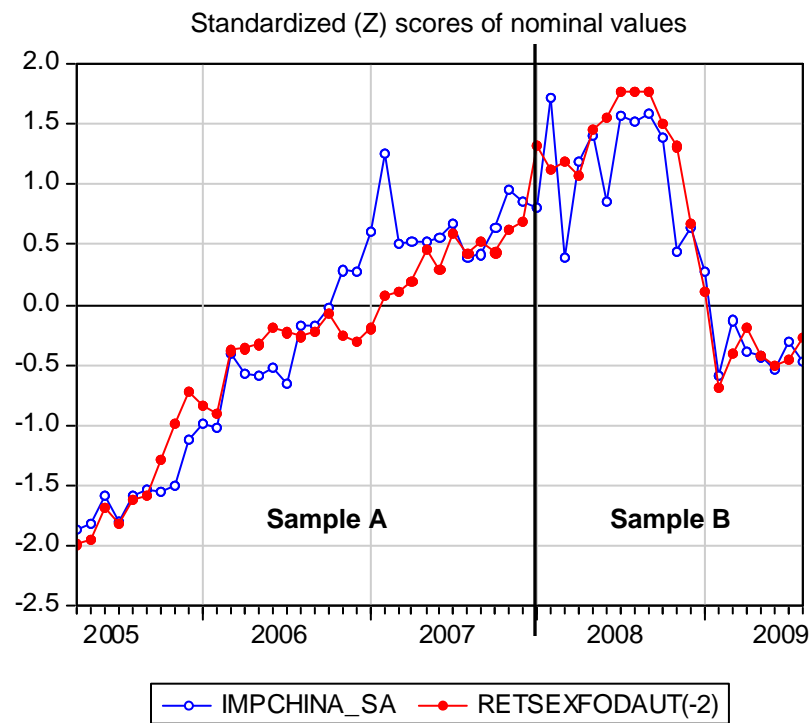
China: Contributions to GDP growth



Private consumption: China vs. EUA  
(National Accounts)



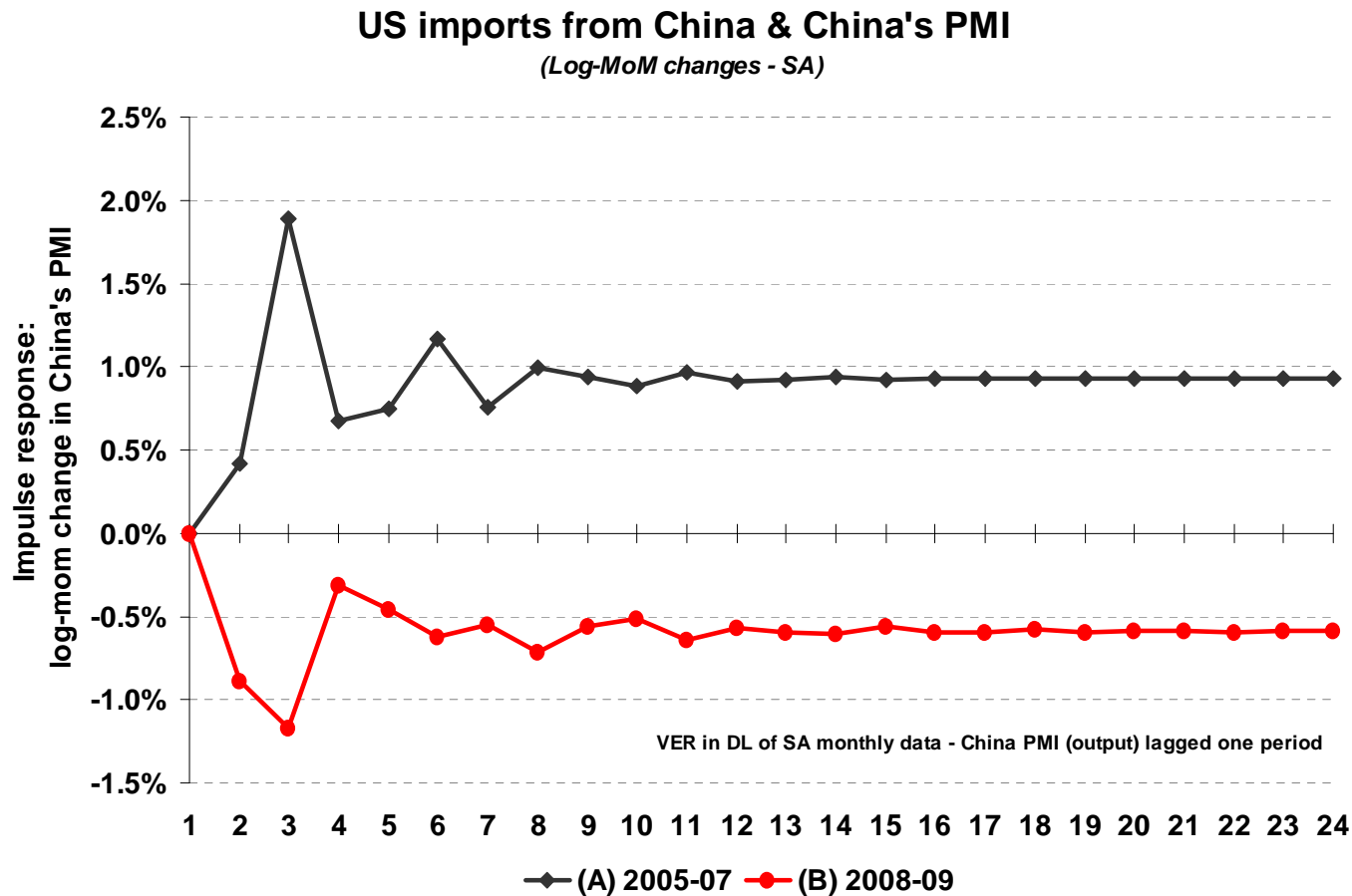
# Partners in growth and in injury: US retail sales (ex-food and autos) & imports from China



# Two periods, two measures: impulse reactions from vector auto regressions



# Two periods, two measures: impulse reactions from vector auto regressions



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