Challenges and threats in the world economy

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Challenges and threats in the world economy

• Glimmering hope
• Uncertain legacy
• What can go right
• What can go wrong
• Conclusion
1. Glimmers of hope

- Forecasters imagine recovery
- Stress falls in crisis-hit regions
- Stability re-emerges
1. Glimmers of hope: house price corrections

REAL HOUSE PRICES AND REAL INDEX-LINKED YIELDS

- US real (S&P Case Shiller National)
- UK real Nationwide
- Spain real
- UK 10-year IL gilts

HOUSING CORRECTION
1. Glimmers of hope: deleveraging

DELEVERAGING APACE

US PRIVATE SECTOR DEBT OVER GDP

- Households
- Non-financial Business
- Financial Sectors
1. Glimmers of hope: end of panic

END OF THE PANIC

10-YEAR BOND YIELDS

- Germany
- Spain
- Italy
- UK
- US
- Announcement of 3-year LTRO
- Announcement of OMT
2. Uncertain legacy

- Abnormal policy
- Huge losses
- Deflationary pressure
2. Uncertain legacy: long slump

AND A WEAK RECOVERY FROM A DEEP SLUMP

GDP IN THE CRISIS
2. Uncertain legacy: long slump

PARTICULARLY IN THE EUROZONE

GDP IN THE EUROZONE CRISIS

France  Germany  Italy  Spain  Eurozone
2. Uncertain legacy: lost growth

OUTPUT IS VASTLY BELOW THE PRE-CRISIS TREND
2. Uncertain legacy: lost growth

IN THE US IT IS LOOKING LIKE A NEW ERA

US GDP
(Actual, trend and deviation from trend)
2. Uncertain legacy: lost growth

### The Productivity Divergence

#### Change in GDP per Hour Worked 2007-13

(Source: Conference Board)

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in GDP Per Hour Worked 2007-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>12.0%</td>
</tr>
<tr>
<td>US</td>
<td>7.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>4.8%</td>
</tr>
<tr>
<td>Canada</td>
<td>2.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>1.8%</td>
</tr>
<tr>
<td>France</td>
<td>1.3%</td>
</tr>
<tr>
<td>Italy</td>
<td>-1.3%</td>
</tr>
<tr>
<td>UK</td>
<td>-3.0%</td>
</tr>
</tbody>
</table>
3. What can go right

- Post-crisis healing is well under way
- Globalisation continues.
- Emerging economies still have potential.
- New technologies are unfolding.
- US energy revolution is under way.
3. What can go right

RECOVERY EXPECTED

IMF FORECASTS (January 2014)
3. What can go right

IMF FORECASTS FOR EMERGING AND DEVELOPING COUNTRIES
(January 2014)
3. What can go right: US energy

- **US energy revolution:**
  - “European gas import prices are currently around three times higher than in the US while industrial electricity prices are about twice as high, creating an energy price gap Dr Fatih Birol (chief economist of the International Energy Agency) said would last “at least 20 years”. Financial Times, 29th January 2014.
4. What can go wrong

- Secular stagnation continues.
- Technology is a squib.
- Normalisation shock worsens.
- China’s growth collapses
- Geo-political risk turns into actuality.
4. What can go wrong: secular stagnation

BUT IT IS STILL A WORLD OF FREE MONEY

CENTRAL BANK SHORT-TERM POLICY RATES
4. What can go wrong: secular stagnation
4. What can go wrong: imbalances

WHERE EXCESS SAVINGS CAME FROM

GLOBAL IMBALANCES (as per cent of world GDP)
1. Glimmers of hope: imbalances

WHERE EXCESS SAVINGS CAME FROM
EUROZONE IMBALANCES ON CURRENT ACCOUNT
(as per cent of Eurozone GDP)
4. What can go wrong: deflation

CORE INFLATION IS LOW AND FALLING

CORE CPI INFLATION (year-on-year, per cent)
4. What can go wrong: deflation

IN EUROZONE LOW INFLATION IS A HUGE THREAT

CORE CPI INFLATION RATE
(year-on-year, per cent)
4. What can go wrong: normalisation

TAPER TANTRUM

CAPITAL FLOWS TO EMERGING ECONOMIES ($bn)
(source: IMF World Economic Outlook database)
4. What can go wrong: China

THE UNBALANCED ECONOMY

STRUCTURE OF CHINA’S DEMAND

<table>
<thead>
<tr>
<th>Year</th>
<th>Household consumption</th>
<th>Govt consumption</th>
<th>Gross capital formation</th>
<th>Net exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>46.4%</td>
<td>35.3%</td>
<td>15.9%</td>
<td>2.4%</td>
</tr>
<tr>
<td>2001</td>
<td>45.3%</td>
<td>36.5%</td>
<td>16.0%</td>
<td>2.1%</td>
</tr>
<tr>
<td>2002</td>
<td>44.0%</td>
<td>37.8%</td>
<td>15.6%</td>
<td>2.6%</td>
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<tr>
<td>2003</td>
<td>42.2%</td>
<td>41.0%</td>
<td>14.7%</td>
<td>2.2%</td>
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<tr>
<td>2004</td>
<td>40.5%</td>
<td>43.0%</td>
<td>13.9%</td>
<td>2.6%</td>
</tr>
<tr>
<td>2005</td>
<td>38.9%</td>
<td>41.5%</td>
<td>14.1%</td>
<td>5.4%</td>
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<tr>
<td>2006</td>
<td>37.1%</td>
<td>41.7%</td>
<td>13.7%</td>
<td>7.5%</td>
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<tr>
<td>2007</td>
<td>36.1%</td>
<td>41.6%</td>
<td>13.5%</td>
<td>8.8%</td>
</tr>
<tr>
<td>2008</td>
<td>35.3%</td>
<td>43.8%</td>
<td>13.2%</td>
<td>7.7%</td>
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<tr>
<td>2009</td>
<td>35.4%</td>
<td>47.2%</td>
<td>13.1%</td>
<td>4.3%</td>
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<tr>
<td>2010</td>
<td>34.9%</td>
<td>48.1%</td>
<td>13.2%</td>
<td>3.7%</td>
</tr>
<tr>
<td>2011</td>
<td>35.7%</td>
<td>48.3%</td>
<td>13.4%</td>
<td>2.6%</td>
</tr>
<tr>
<td>2012</td>
<td>35.7%</td>
<td>48.1%</td>
<td>13.5%</td>
<td>2.7%</td>
</tr>
</tbody>
</table>
4. What can go wrong: China

THE UNBALANCED ECONOMY

DEMAND CONTRIBUTIONS TO CHINESE GDP GROWTH

Consumption (private & public)
Investment
Net exports
Real GDP growth
4 What can go wrong: geopolitics

• Here is a disturbing list:
  – Japan-China;
  – Iran;
  – Ukraine;
  – Middle East;
  – Terrorism.
  – Anything else
5. Conclusion

• There is room for hope:
  – The US might do quite well;
  – The eurozone might heal;
  – China might continue to grow fast;
  – And normalisation might work smoothly.

• Yet big uncertainties and risks exist:
  – Uncertainty over growth potential;
  – Risks over economics and politics.