Might the pandemic signal the end of global economic convergence?

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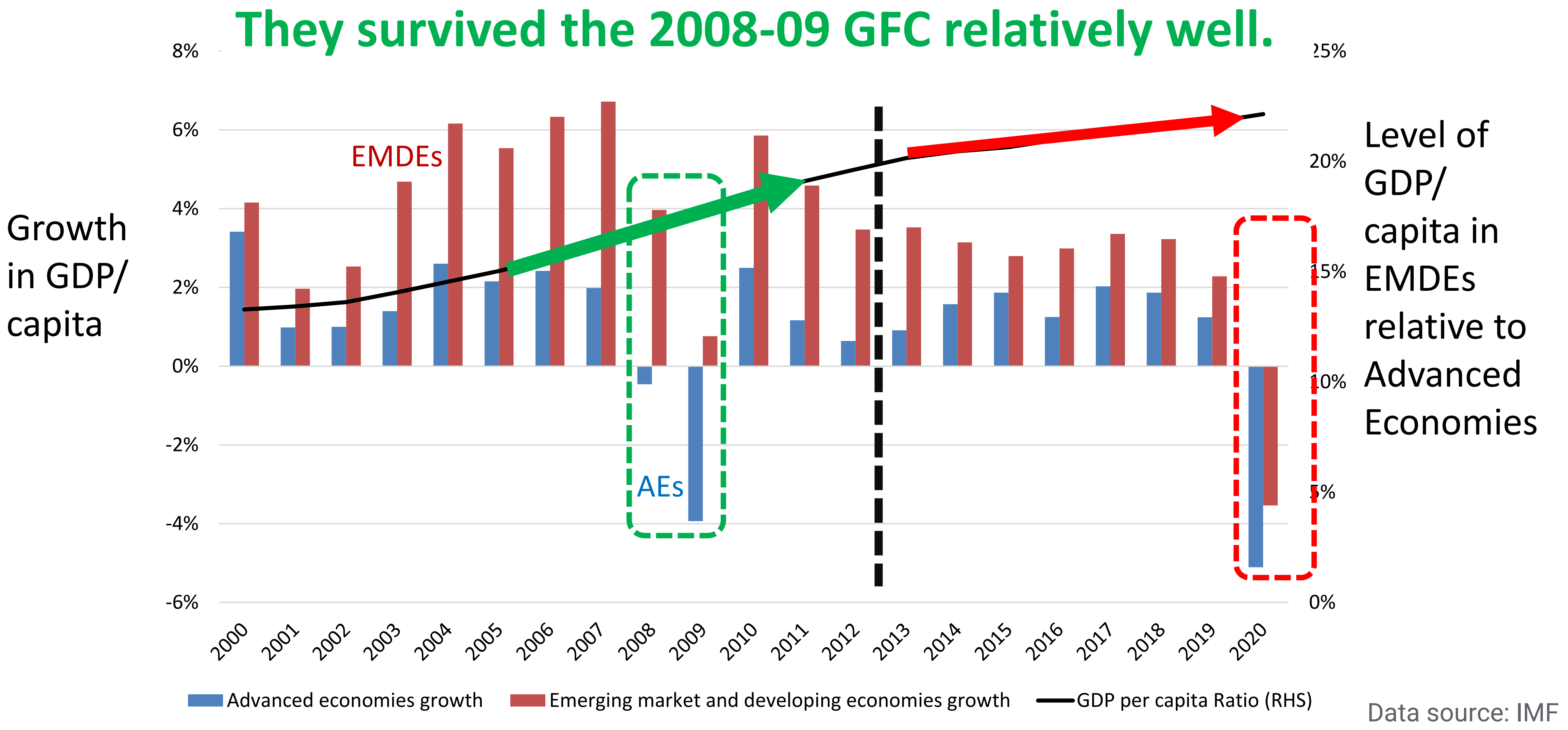
Summary of global outlook

The world economy did better than expected, in the 1st half of 2021,	But downside risks are evident:
due to monetary & fiscal stimulus	The "everything bubble" might burst;
and the miraculous scientific accomplishment of the vaccines.	and vaccination is slower than it should be.

Divergence: The downside is worse
for Emerging Market and Developing Economies (EMDEs).

Convergence: EMDEs grew faster than AEs, 2000-2013.



But convergence slowed, 2013-2020; reversed for poor countries in 2020.

Growth projections: The latest IMF *WEO* update for 2021

marked up AEs, esp. US (7.0%), while marking down EMs & esp. low-income countries (3.9%).

Latest World Economic Outlook Update Growth Projections

(real GDP, annual percent change)	2020	PROJECTIONS 2021	2022
World Output	-3.2	6.0	4.9
Advanced Economies	-4.6	5.6	4.4
United States	-3.5	7.0	4.9
Euro Area	-6.5	4.6	4.3
Germany	-4.8	3.6	4.1
France	-8.0	5.8	4.2
Italy	-8.9	4.9	4.2
Spain	-10.8	6.2	5.8
Japan	-4.7	2.8	3.0
United Kingdom	-9.8	7.0	4.8
Canada	-5.3	6.3	4.5
Other Advanced Economies	-2.0	4.9	3.6

	2020	2021	2022
Emerging Market and Developing Economies	-2.1	6.3	5.2
Emerging and Developing Asia	-0.9	7.5	6.4
China	2.3	8.1	5.7
India	-7.3	9.5	8.5
ASEAN-5	-3.4	4.3	6.3
Emerging and Developing Europe	-2.0	4.9	3.6
Russia	-3.0	4.4	3.1
Latin America and the Caribbean	-7.0	5.8	3.2
Brazil	-4.1	5.3	1.9
Mexico	-8.3	6.3	4.2
Middle East and Central Asia	-2.6	4.0	3.7
Saudi Arabia	-4.1	2.4	4.8
Sub-Saharan Africa	-1.8	3.4	4.1
Nigeria	-1.8	2.5	2.6
South Africa	-7.0	4.0	2.2
Memorandum			
Emerging Market and Middle-Income Economies	-2.3	6.5	5.2
Low-Income Developing Countries	0.2	3.9	5.5

[*World Economic Outlook Update: Fault Lines Widen in the Global Recovery*, July 27, 2021]

Source: IMF, *World Economic Outlook Update*, July 2021

Note: For India, data and forecasts are presented on a fiscal year basis, with FY 2020/2021 starting in April 2020. For the July 2021 WEO, India's growth projections are 8.8 percent in 2021 and 8.3 percent in 2022 based on calendar year.

Why did EMDE growth slow, after 2013? Even before the pandemic.

Some possible explanations:

- Global trade had slowed.
- Commodity prices fell on world markets in 2014, in dollars.
- China slowed after 2010,
  - perhaps due to diminishing returns to capital
  - or the Lewis turning point in rural-urban migration.
- EMs more vulnerable to sudden stops in portfolio inflows?

Vulnerability to sudden stops of portfolio inflows

- Reforms made some EMs less vulnerable in 2000-2010.
  - Fiscal policy became less pro-cyclical.
  - Capital inflows were used to build reserves,
    - rather than to run current account deficits.
  - The $-denominated share of inflows was reduced
    - especially in the case of public debt.
- But some backsliding followed.

Dangers, looking forward,

- even leaving aside the effects of climate change,
  - which are arriving faster than was expected
  - and which will hit middle-latitude countries especially hard.
- (1) The pandemic could halt catch-up in developing countries’ incomes.
- (2) EM debt crises could return
  - especially when the Fed signals an increase in interest rates.
  - As in 1982, 1994, 1997, 2013, 2015, 2018….
- (3) The world could lose the race between vaccination & new variants,
  - due to vaccine skepticism
  - & lack of availability in lower income countries.

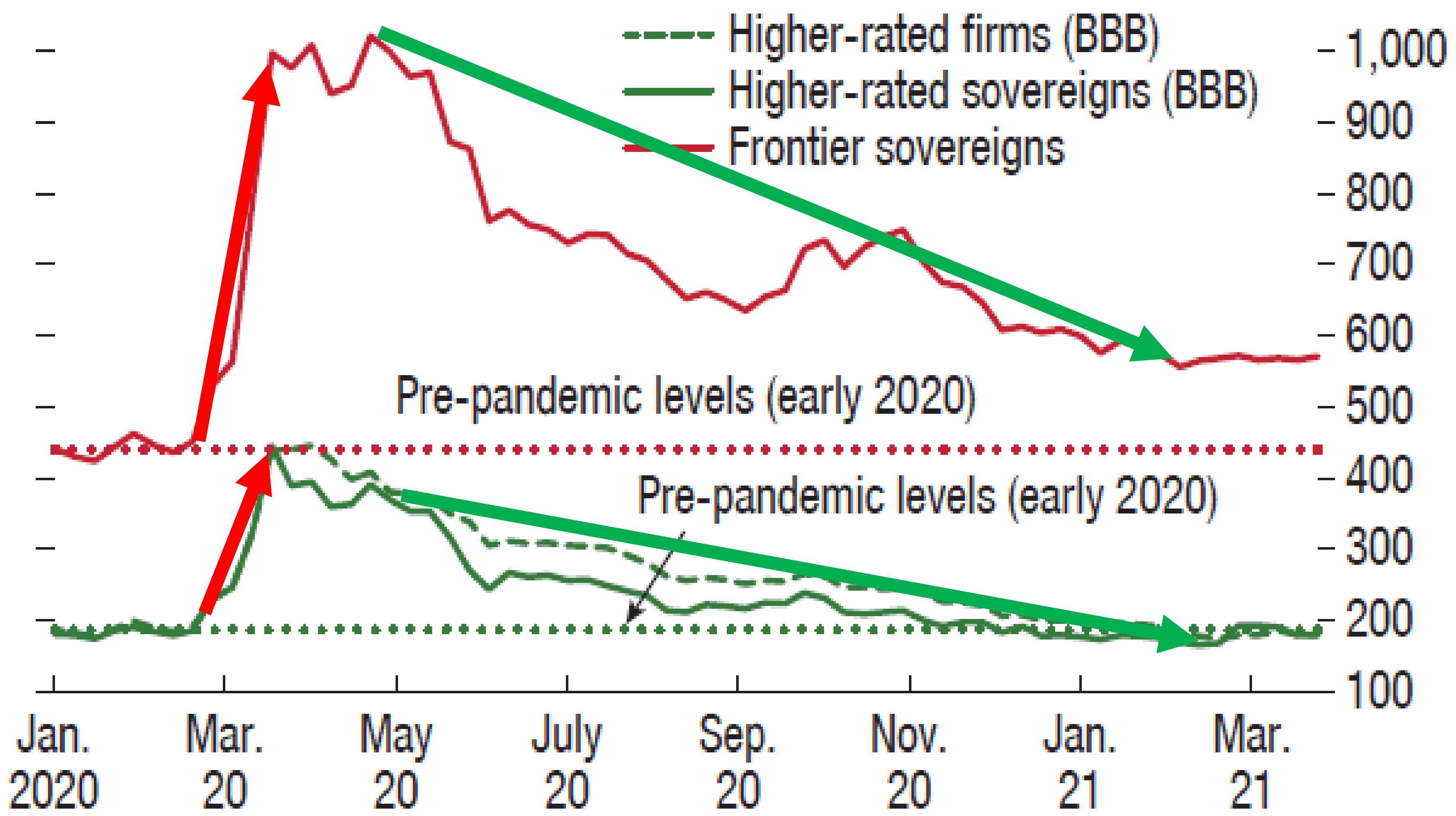
International cooperation in such bodies as the G20 is more important than ever.

- By “cooperation,” I am not referring here to coordinated setting of national monetary or fiscal policies.
  - Countries can mostly move in the right directions on their own.

- But, rather,
  - (1) initiatives to enhance **financial stability**, to reduce likelihood and severity of new EMDE financial crises.
    - Like the Debt Service Suspension Initiative,
    - And new SDR allocation by the IMF in August;
    - But much more is needed.
  - (2) Good old-fashioned **trade liberalization**.
  - (3) **Vaccination** worldwide.

(1) **Financial stability:** Despite the Covid-19 shock in March 2020, market sentiment recovered after aggressive easing by the FRB.

EM interest rate spreads

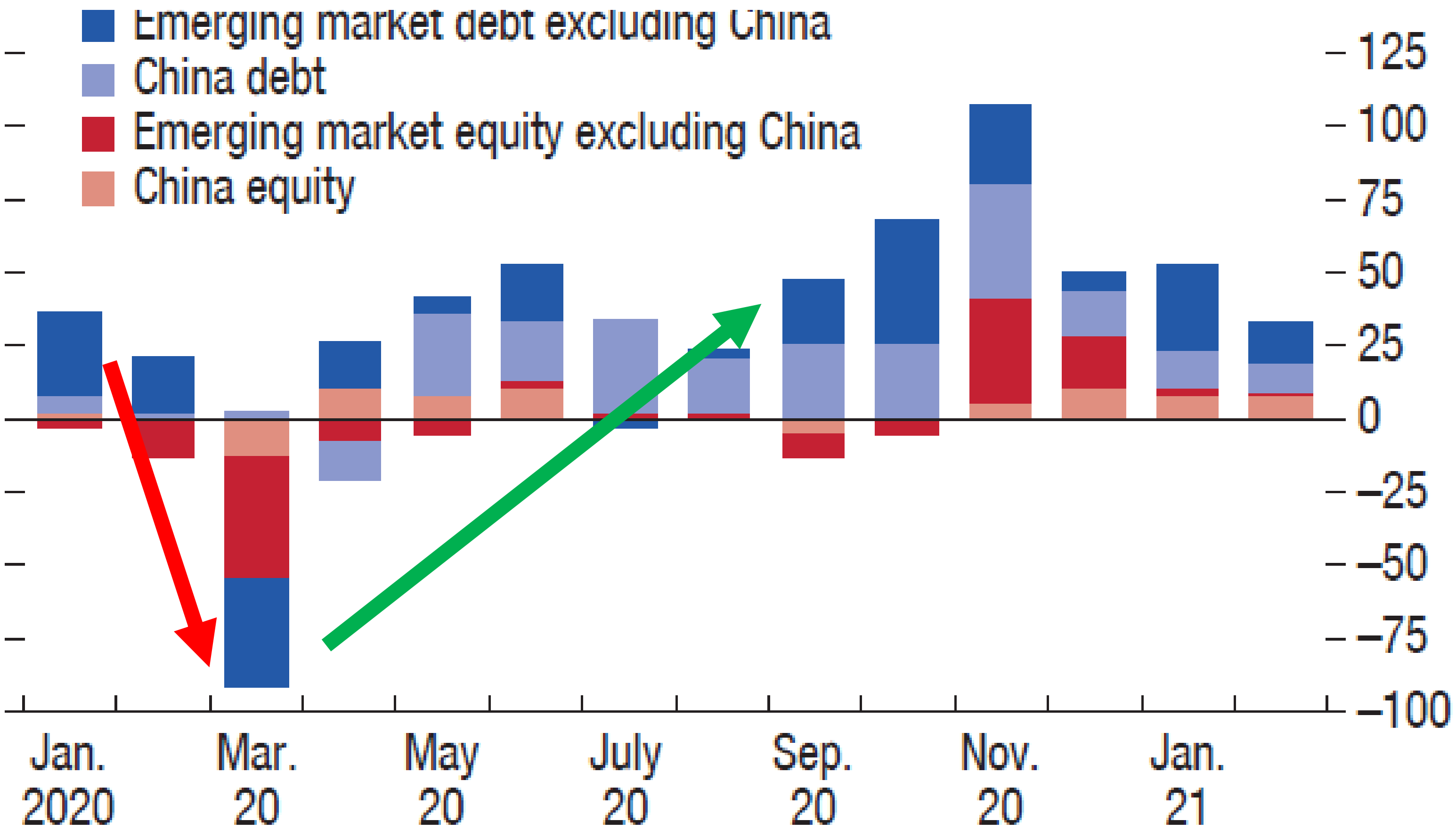


Emerging Market Hard Currency Credit Spreads (Basis points)

IMF *Financial Stability Report*, April 2021, Fig.2

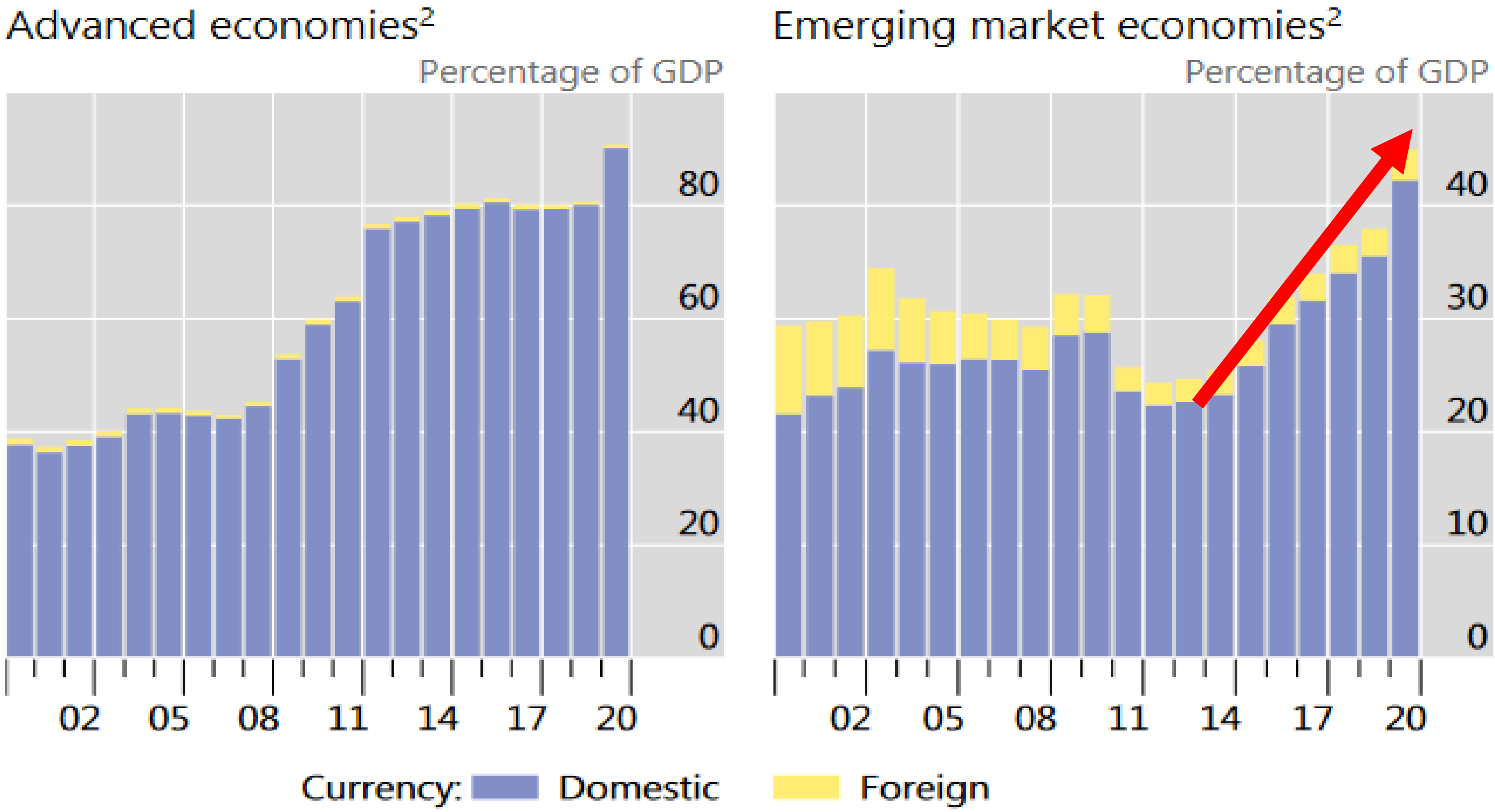
Emerging Market portfolio flows rebounded too.

(Billions of $US)



IMF *Financial Stability Report*, April 2021

But government debt/GDP rose sharply in 2020, in both AEs & EMs.



Bank for International Settlements *Quarterly Review*, June 2021, p.21

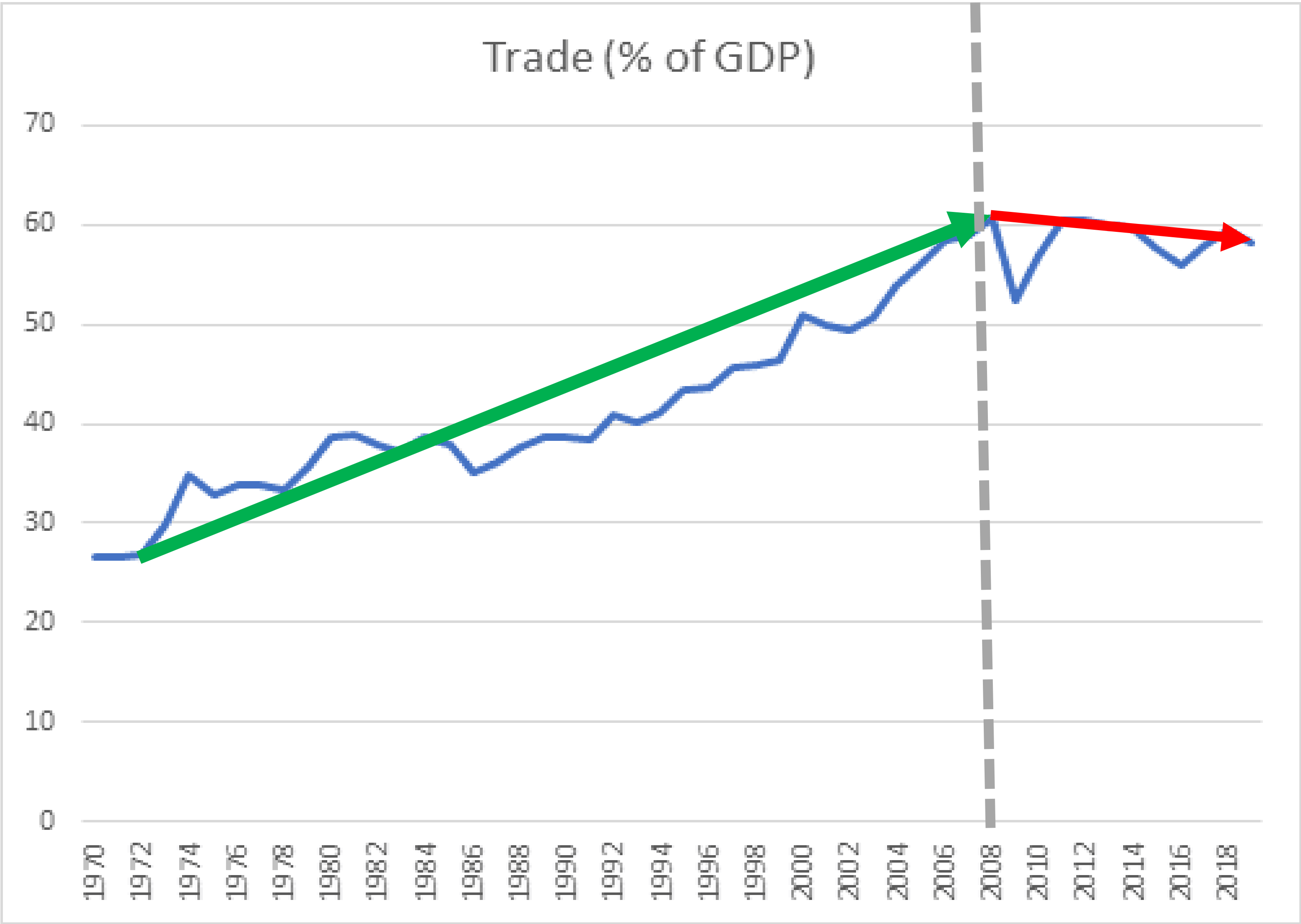
Data sources: ECB Securities Issues Statistics (SEC); Dealogic; Euroclear; Thomson Reuters; Xtrakter ltd; natl data; IMF WEO; BIS calculations.

[2] General government bonds outstanding aggregated across countries, as a ratio to their combined GDP.

EM debt sustainability is vulnerable to a future rise interest rates.

- Governments were able to finance spending in response to pandemic.
  - Good.
- But I worry that high Debt/GDP now leaves EMDEs vulnerable.
  - Why, if interest is low?
  - Because debt sustainability is vulnerable to a rise in interest rates,
    - whether from US interest rates, local risk premia, or both.
    - Why, then, do I downplay monetary cooperation, as Rajan urged in 2014?
- The financial situation must be judged particularly fragile if one sees a bubble component to today’s high prices for risky assets.
  - The Fed has the difficult job of letting some air out of the bubble,
    - without precipitating a financial crash.

(2) Trade: The upward global trend in trade/GDP stalled from 2008, even before Trump's tariffs or the pandemic.



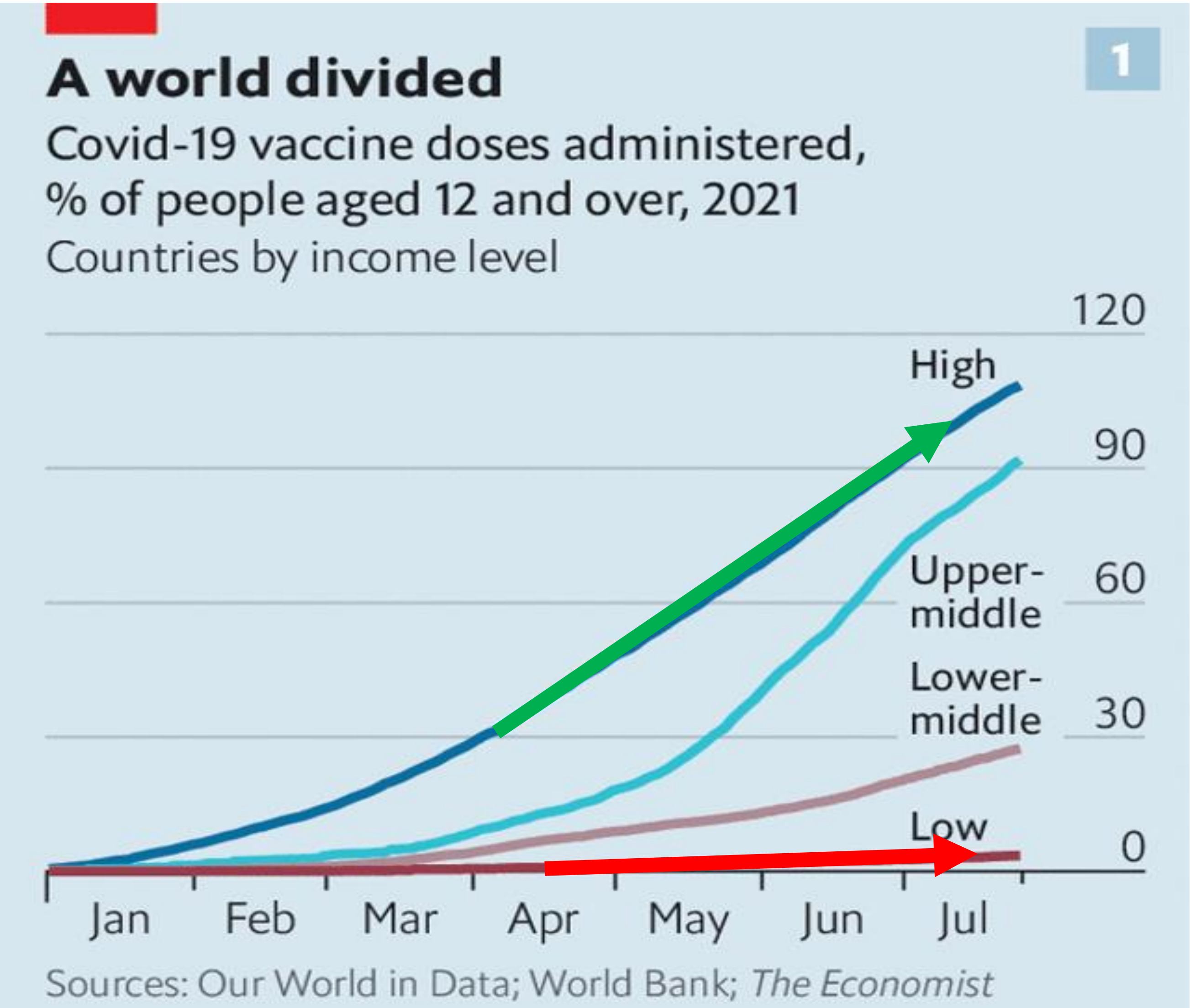
Data source:
World Bank, 2021

Four trade liberalization ideas

1. E.g., US & China should roll back trade barriers,
   - which they raised over the last four years.
2. Liberalize, in particular, trade in environmental goods
   - such as equipment for wind & solar power.
3. Agree international rules guiding Carbon Border-Adjustment Taxes,
   - so that they can be used, but not mis-used,
   - working with the WTO.
4. Complete progress toward a global regime for corporate taxation
   - working with the OECD.

(3) **Vaccination** in low-income & lower-middle countries lags far behind the rich.

- The US & other rich countries should make vaccines more extensively available to lower-income countries.
- It is ridiculous to chase after vaccine skeptics at home, trying to coax them into accepting the benefits of this scientific miracle, without also doing more to bring vaccines where most needed.
- Agarwal & Gopinath of the IMF have proposed a plan of action:
    - Estimated cost/benefit ≈$50b/$9,000b.



The Economist, July 31, 2021.

"The pandemic has exacerbated existing political discontent"

So long as this coronavirus runs wild anywhere,
it is a danger to everyone everywhere.

That is international interdependence.

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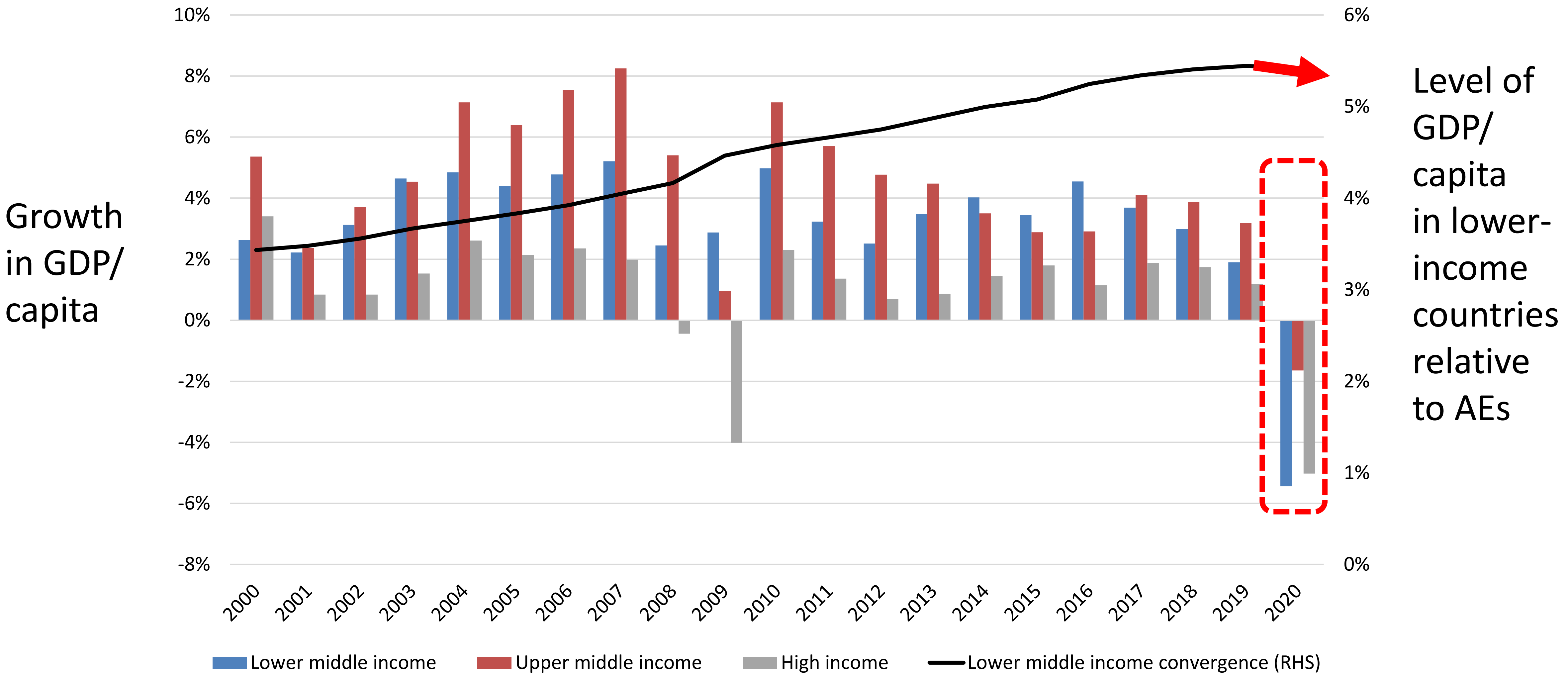
Appendix graph

For low-income countries, convergence went into reverse in 2020.



Data source: World Bank