Risk mitigation strategies: Deeper role for policy as globalization amplifies impact of world cycles?"

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World growth rates become more divergent - and more volatile?

- Great moderation ends in unexpectedly massive recession
- Turbulence may continue as recovery unlikely to be smooth and cycles will recur

Source: IMF
The unexpected depth of recession - revisions in IMF forecasts
World trade still weak – upturn mainly in Asia
Recession bigger than GDP loss suggests:

- $1 trillion drop in global GDP a poor measure of crisis
- Goods trade still down by around 20%
- $3-4 trillion loss in world trade in 2009
- $10-20 trillion in lost business worldwide?
- Peak to trough as much as $50 trillion in wealth lost - partially recouped as markets have rallied
Recovery also under par for developed world

Source: IMF
Average growth rates in BRICs

- Emergers’ growth largely on the back of China
- Brazil growth steady (above 80s and 90s rates) but not spectacular
- Russia hardest hit country among BRICs

Source: IMF
Performance since Q3-2008

Source:

Average (unweighted) GDP growth (y-on-y)
Standard Deviation

Latin America (excl. Mexico)
Asia (excl. China & India)
Emerging Europe

0.2 1.7 -2.3 4.7 5.8
-2 0 2 4 6 8
% change Q3-08 to Q2-09

Source:
• “Old” Tigers hit hard by slump in cyclical manufactures trade
• New Tigers doing relatively well particularly Indonesia and Vietnam (both over 4% growth on average during last 3 quarters)
Emerging Europe crisis vs. pre-crisis

- Worst performing region in the world: only Poland growing (1.5)
- Baltics suffering from double-digit contraction
- CIS: Ukraine collapsed, Russia doing poorly, Belarus only mild recession
Why bigger losses in some countries than others?

Source: IMF

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</thead>
<tbody>
<tr>
<td>Germany</td>
<td>1.9</td>
<td>1.5</td>
<td>1.7</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Japan</td>
<td>4.4</td>
<td>1.5</td>
<td>1.7</td>
<td>2.8</td>
<td>3.1</td>
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<tr>
<td>UK</td>
<td>2.5</td>
<td>2.2</td>
<td>2.8</td>
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<tr>
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<td>3.2</td>
<td>1.7</td>
<td>2.8</td>
<td>2.6</td>
<td>2.5</td>
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</tbody>
</table>

Source: IMF
France and Germany show varying impacts of crisis
Services quickly recover - even expand
Effect of cyclical trade in Germany and Japan

Germany

Japan

% contribution to GDP

Private consumption
Gov't consumption
Gross investment
Inventories
Net trade
GDP
US exits recession in Q3 – more convincingly than Germany and France in Q2
US wealth effects large, savings up, debt decreasing
Property losses: housing markets level off
US signs of improvement
Euro area indicators also remain weak
World trade loss worth $3-4 trillion in 2009
China grows robustly – imports picking up
Japan benefits from Asian growth
LONG-TERM FORECASTS AND RISKS FROM PREMATURE EXIT STRATEGIES
Deflation in US, EU will end

Source: St. Louis Fed, ECB
US yield curve

Source: US Federal Reserve
Impacts on long run growth potential?

- Effect of deep recessions on investment and productivity – short and medium-term damage to growth

- Long-tailed costs from governments bailing out the economy in the short term – a “spend now and let tax payers to pay later” approach to curbing recession

- More costly environment for business and finance – “the age of the regulator” - more restrictions ahead to “insure” against instability
GDP 10-year rolling averages: US, Euro area, Japan

- Rolling averages roughly corresponding with long-run potential output growth: pre-crisis roughly 3% for US, 2% for Europe
- Post-crisis drop to around 1% in Europe, Japanese level, and 2% for US

Source: IMF
3 Scenarios for potential output

a) Crisis losses recovered
b) Crisis losses not recovered, potential output growth maintained
c) Crisis losses not recovered, potential output growth permanently downgraded
Effect on policy tightening

a) Crisis losses recovered
b) Crisis losses not recovered, potential output growth maintained
c) Crisis losses not recovered, potential output growth permanently downgraded
Effect on unemployment

a) High growth, high productivity
b) Normal growth, normal productivity
c) Low growth, normal productivity
GLOBALIZATION AMPLIFIES IMPACT OF WORLD CYCLES
– raises question mark over scale and form of risk mitigation strategies
Losses in cyclical goods hurt Germany and Japan

<table>
<thead>
<tr>
<th>Category</th>
<th>Germany</th>
<th>Japan</th>
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</thead>
<tbody>
<tr>
<td>Investment goods</td>
<td>26.2</td>
<td>33.0</td>
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<tr>
<td>Durable goods</td>
<td>19.8</td>
<td>39.4</td>
</tr>
<tr>
<td>Non-Durable goods</td>
<td>5.2</td>
<td>2.5</td>
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</table>
Domestic dependence on cyclical industry

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The image shows a bar chart with various segments representing different sectors of the economy as a percentage of GDP for different countries: Germany, Japan, France, UK, and US. The sectors include Agriculture, Industry, Construction, Wholesale and retail trade, Financial and real estate, Other services, and Exports of Goods (rhs). The chart visually compares the domestic dependence of these sectors across the listed countries.
Foreign dependence on cyclical industry

- Germany
  - % of exports: 62.6
  - % of GDP: 24.1
- Japan
  - % of exports: 78.0
  - % of GDP: 11.6
- France
  - % of exports: 53.8
  - % of GDP: 11.3
- UK
  - % of exports: 55.5
  - % of GDP: 10.1
- US
  - % of exports: 60.1
  - % of GDP: 4.7

Categories:
- Plastics
- Iron and steel
- Ships, Aircraft, Rail
- Precision tools
- Vehicles
- Electronics
- Machinery
- Durable goods/GDP (rhs)
Effect of cyclical trade in Germany and Japan
German trade dependency

![Graph showing German trade dependency over time with data points for private consumption, gross investment, government consumption, exports, and imports, along with the percentage shares of 2008 GDP for each category.]
Risk mitigation strategies?

- More financial provisioning to allow for cost of failures and cyclical disasters
- More fiscal and monetary policy flexibility?
- Avoid high risk growth strategies - such as heavy external debt financing
- New industrial policies: cannot afford banks too big to fail ...
- ... and cannot afford global scale industries too big to bail?