WOLFENSOHN CENTER FOR DEVELOPMENT at BROOKINGS

Tracking the Global Economic Recovery:
Insights on the IMF's New World Economic Outlook

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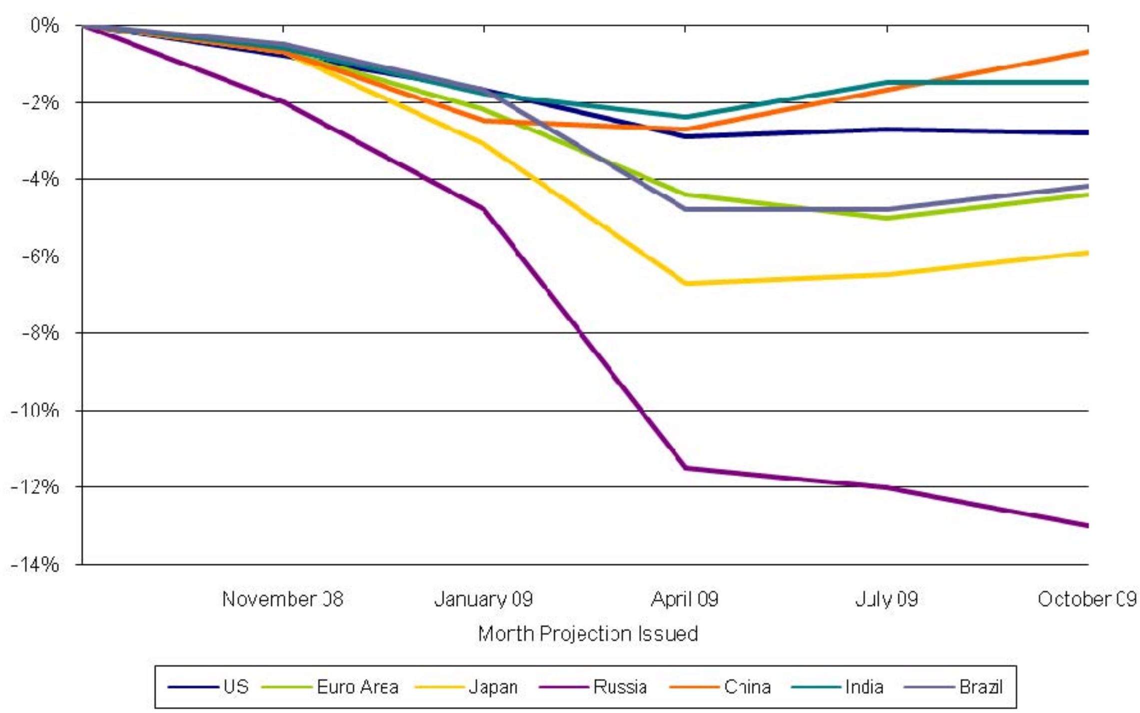
October 2009

Editor's note: In May 2009, Laurence Chandy, Geoffrey Gertz and Johannes Linn examined the global impact of the financial crisis based on data from the IMF's April World Economic Outlook (WEO). Following the release of a new WEO database released earlier this month, they appraise their previous assertions and analyze the salient features of the global economic recovery.

Turning the corner

In May, we noted how dramatically growth projections had fallen since the crisis began and the significance of sequential downward adjustments for the global economy. It appeared then that expectations might have stabilized—an important step on the road to recovery—some time between January and April, but we awaited future updates for clear evidence of this.

Chart 1: Percentage Point Change in 2009 Real GDP Growth Projection, Relative to October 2008 WEO



Source: Authors' calculations based on IMF

Chart 1, illustrating the percentage point difference between the “pre-crisis” growth projections of the October 2008 WEO[1] and the revised WEO projections to date, shows that for most countries this stabilization has indeed occurred. Projections made in July were unchanged or slightly up from those of April, a trend that continued in the most recent estimates. The ongoing downward adjustment for Russia, however, demonstrates that some countries have yet to reach an inflection point.

We also wrote in May about the prospect of a Chinese-led recovery, which has been borne out in more recent WEO updates. In January, days after the IMF reduced China’s 2009 growth forecast to 6 percent, Chinese Premier Wen Jiabao took to the stage at the World Economic Forum, insisting that the country could still make its growth target of 8 percent. Wen admitted that given the global economic climate, meeting this target would “be a tall order” and could only “be attained with hard work.” Eight months later, the IMF now believes China will exceed this 8 percent target after all. Remarkably, the IMF’s latest 2009 growth projection for China is only 0.7 percentage points below the forecast from the outset of the crisis.

If these were normal times with the U.S. and Eurozone growing at about 3 percent, China’s 8.5 percent growth this year would contribute as much to global growth as that of the U.S. or Eurozone. But with the U.S. and Eurozone far below 3 percent growth for the year, China’s robust growth takes on special significance in this recovery period. In recent weeks, renewed Chinese demand has been credited with everything from boosting machinery exports from Germany and Korea to renewed commodity sales in Brazil and Australia.

When President Bush invited the G-20 heads of state to Washington, DC, last November in a desperate bid to save the global economy from collapse, the implicit rationale was that the G7 judged itself incapable of tackling the crisis on its own. China’s success in leading the global economy into recovery suggests that this judgment was well-founded. The recent decision to, in effect, replace the G8 with the G-20 is further evidence that the changing balance in the global economy, as power shifts gradually eastward, is finally being acknowledged. Nevertheless, more needs to be done in reforming the governance of the international financial institutions to ensure that emerging powers, like China, are given an appropriate voice and vote. At the same time, these countries will have to play a more active role in these forums and be willing to take on greater responsibility for co-managing the world economy.

Adjusting to a new normal

While the recent uptick in 2009 and 2010 growth projections is welcome news, we should be careful not to view the new WEO as especially sanguine. Indeed the IMF’s view of the global economy’s longer-term prospects remains bleak, with risks pointing mostly to the downside.

Average real GDP growth of the world economy over the next five years is expected to be less than that of the five years before the crisis, 2003-07. This suggests that in the pre-crisis period, the global economy may have been operating at above potential GDP and at risk of overheating, a supposition supported by sharp spikes in commodity prices and widening global imbalances. It also suggests that in the post-crisis era we will need to adjust to a “new normal,” one where economic expansion is less rapid. This is true for all regions of the world but is especially the case for Central and Eastern Europe, and for the Commonwealth of Independent States (CIS) (see Table 1). According to the IMF, annual growth in the next five years will average only 3.6 percent in Central and Eastern Europe, down from 6 percent during the 2003-07 boom period. In CIS countries, 2010-14 annual growth will average just 3.9 percent, half that

[1] As explained in our earlier paper, the October 2008 WEO serves as a conservative, but nevertheless practical, approximation of the pre-crisis outlook. The projections are conservative since the event which marked the crisis’ unofficial inception—the collapse of Lehman Brothers on September 15—had already taken place at the time of its release. Nevertheless, the October 2008 figures have the advantage of isolating the effect of the crisis, whereas earlier forecasts were strongly influenced by commodity prices, which fluctuated dramatically in the months leading up to September.

of the 2003-07 era. Overall, only 44 economies are expected to fare better in 2010-14 than they did in 2003-07, with 138 doing worse.

Table 1: Percentage Point Difference in Average Annual Growth Rates: 2010-14 Forecasts vs 2003-07 Actuals - Regions

World	-0.5%
Advanced economies	-0.4%
G7	-0.3%
European Union	-0.7%
Emerging and developing economies	-1.3%
Developing Asia	-1.1%
Middle East	-1.5%
Sub-Sahara Africa	-1.2%
Central and Eastern Europe	-2.4%
Commonwealth of Independent States	-4.0%
Latin America and Caribbean	-1.1%

Source: Authors' calculations based on IMF

For a subset of the world's countries, this new normal will represent a wholesale change from the economic climate of the 2003-07 boom period. There are 56 countries for which average forecast growth rates for the 2010-14 period are at least 2 percentage points a year below those for the 2003-07 period. They are primarily oil exporters and former Soviet countries, though some small Asian exporters and Western European economies with particularly bleak prospects also make the list. Table 2 provides a selection of those we consider the most politically and economically important of the worst hit economies.

Such drastic changes in economic outlooks are likely to have substantial political economy repercussions in these countries. Their current leaders will compare unfavorably—rightly or wrongly—to those who ruled over the boom period, and may face instability and/or electoral losses.

Some of these countries, such as Greece, Latvia and Iceland, have already removed incumbent governments. Others, like Estonia and Lithuania, are feeling the pressure from the severity of their economic contraction. For Georgia and Ukraine, long-standing political challenges will only be exacerbated.

Three countries on the list in which the transition to a new normal may be particularly significant are strategic regional powers: Russia, Iran and Venezuela.

In Russia, the fallout of the downturn could have intriguing political consequences. When Vladimir Putin first became Russia's president in 2000, the country was on the cusp of an economic rebound following a decade of chaos. Assisted by rising oil prices, Putin oversaw the re-emergence of Russia as an economic powerhouse—an accomplishment that secured his widespread support from the Russian public. Today, with the Russian economy back in troubled waters, rumors are swirling that Putin may attempt another run for president in 2012, perhaps hoping to once again be credited with turning the economy around. The IMF's outlook, however, suggests that this will not be an easy task. If Putin does return to the presidency but fails to right the ship, his political reputation will suffer.

Table 2: Percentage Point Difference in Average Annual Growth Rates: 2010-14 Forecasts vs 2003-07 Actuals - Select Countries

Latvia	-7.9%
Venezuela	-7.7%
Estonia	-6.4%
Lithuania	-6.3%
Georgia	-5.5%
United Arab Emirates	-5.1%
Kuwait	-4.8%
Kazakhstan	-4.3%
Ireland	-4.1%
Iceland	-3.9%
Russia	-3.9%
Turkmenistan	-3.8%
Greece	-3.4%
Ukraine	-3.3%
Iran	-3.1%
Singapore	-2.9%
Spain	-2.4%
Hong Kong	-2.3%

Source: Authors' calculations based on IMF

Both Venezuela and Iran face similar political economy challenges. Their respective leaders, Hugo Chavez and Mahmoud Ahmadinejad, built their successes in past years through populist redistributive economic policies, courtesy of government coffers overflowing with petrodollars. But these good times may be coming to an end. Remarkably, having averaged almost 8 percent growth between 2003 and 2007, the IMF does not expect Venezuela's annual growth to exceed 0.5 percent between now and 2014. It would be difficult for any politician to rule over a period of such stagnation; for one who has staked his reputation on delivering economic relief for the poor, it could prove to be unmanageable. In Iran, plans are already underway to significantly scale back the country's generous subsidies program, which equals almost a third of national GDP. Though welcomed by economists, the move may be a difficult sell to the Iranian people; a fuel rationing policy implemented two years ago sparked riots in which a dozen gas stations were set on fire.

Over the past five years, Putin, Chavez, and Ahmadinejad all used their resurgent economies as a foundation for bolder and more audacious actions abroad. Whether or not the reverse—waning global influence in the face of a weakening economy—will hold depends on how these leaders respond to the need for austerity. Economic pressures could compel these regional powers to turn inward and focus on domestic needs rather than asserting their ideologies abroad. Conversely, if they perceive themselves to be under threat, the appeal of distracting foreign (mis)adventures may become impossible to resist.

The IMF forecasts are, of course, not set in stone. Indeed, a focus of our analysis has been how these forecasts have changed over time. Neither Russia, Iran, nor Venezuela's fate is sealed; there are many factors that could recast their economic outlooks over the coming five years, most notably another run up in oil prices. Nevertheless, the disconnect between the 2003-07 boom—when these countries, along with the global economy as a whole, enjoyed above average growth—with the present forecast, does raise interesting political economy questions for these regional powers and others.