

Economic divergence in EM stays in place

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Following the rapid recovery from the 2008-2009 global financial crisis, EM have lost a lot of their shine. Moreover, the post-crisis period saw a lot of economic divergence. Whereas structural factors explain a large part of the slowdown in the BRIC's, the recent fall in food and energy prices provides an additional headwind for EM commodity exporters. Finally, the election outcomes in many important EM is another reason to expect that the divergence within EM will remain in place.

Six years after the start of the 'Great Recession', economic activity in EM has recovered relatively well. General living standards in EM are now up 26% from their 2008 levels. This figure compares to just 2.5% for DM. For the Eurozone as a whole GDP per capita levels are still 2.5% below their pre-crisis peak. That said, this general strong picture is too rosy as it hides a lot of divergence within EM. In China, where a massive stimulus program was set up soon after global economic activity nosedived, living standards are now almost 60% higher. Brazilian or Russian households, by comparison, have seen their income levels rise by much less (8% and 6% respectively). Over the last 3 years, however, EM have lost their shine. Weak demand from DM weighing on EM exports is an important reason behind the slowdown but this does not explain everything. Indeed, a big chunk of the so-called 'Great Deceleration' comes from structural factors, especially in the BRIC's which account for about half of EM economic activity. Whereas the difficult investment climate hampered growth in Brazil, Russia and India, the slowdown witnessed in China is also linked to the policy objective to rebalance the economy towards domestic consumption. In addition, the lower food and energy price levels seen since begin 2012, partially as a result of the Chinese slowdown, have marked the start of another diverging trend within EM. Lower price levels are beneficial for countries that are a net importer of commodities. The opposite is true for net commodity exporters who see their terms of trade deteriorate. The decline in commodity prices has clearly affected relative economic performance. In general, net commodity exporters like Russia, Chile, Brazil or South Africa remain in poor shape. On the other hand, net commodity importers like the Philippines, Poland, Taiwan, Korea or Hungary are doing alright at the moment. As a rapid surge of food and energy prices is not very likely in the near future, this divergence is set to remain in place for a while.

The distinction between commodity exporters and importers is only one (though admittedly important) factor at play. The fact that at least a significant part of the economic trends in recent years is structural in nature leaves a lot of room for structural measures. These measures vary from country to country and include the improvement of the general business climate, lowering the dependency on commodities or, in China's case, support domestic consumption at the expense of lower investment. Off course, all these measures require a shift in policy which makes it very difficult to pick the future winners and losers. 2014 was a big election year for EM with elections held in S. Africa, Turkey, Brazil, India and Indonesia. It's interesting to notice that no major reforms are underway in the former three countries where the incumbent politicians stay in power. Together with Russia, these are probably the countries where reforms are most needed. In Indonesia and India in particular reforms have actually started to take shape. It's too soon to tell whether they will succeed because politics in most countries are inherently unstable. In China, more stability can be expected on this front but here reforms imply that growth will actually slow down further. The upshot is that economic growth in EM will stay clearly below the pre-crisis levels and that the economic divergence seen in recent years will remain in place.

