

# Fragilities in the Global Economy

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# Overview

- Global Context
- Drivers of Growth
  - Demographics
  - Productivity
  - Capital accumulation
- Policy Risks
  - End of Quantitative Easing
  - Fiscal Adjustment
  - Climate Change Commitments
- Summing Up – risks or opportunities?

# Key Points

- 7 years after the Great Recession, the world economy is in a fragile state.
- Uncertainty is large
  - Some things we know
  - Some things we think we know
  - Some things will surprise

# The Global Picture

- The world economy is being fundamentally transformed by the income growth of large emerging economies (China, India, Brazil)
- Individual economies are also going through longer term transformation (excessive debt, demographic change)
- Long term trends are impacting on short term rigidities in many economies
- Policies should be aimed at structural adjustment rather than the business cycle

# Likely Shocks

- Medium term
  - Global Demographic Adjustment
  - Global Productivity slowdown
  - Fiscal sustainability
  - Global Policies addressing Climate Change
  - Pandemics
- Shorter term
  - End of US Quantitative Easing
  - Contradictions in Europe
  - Structural adjustment in China
  - Japanese policy experiment
  - Geopolitical tensions

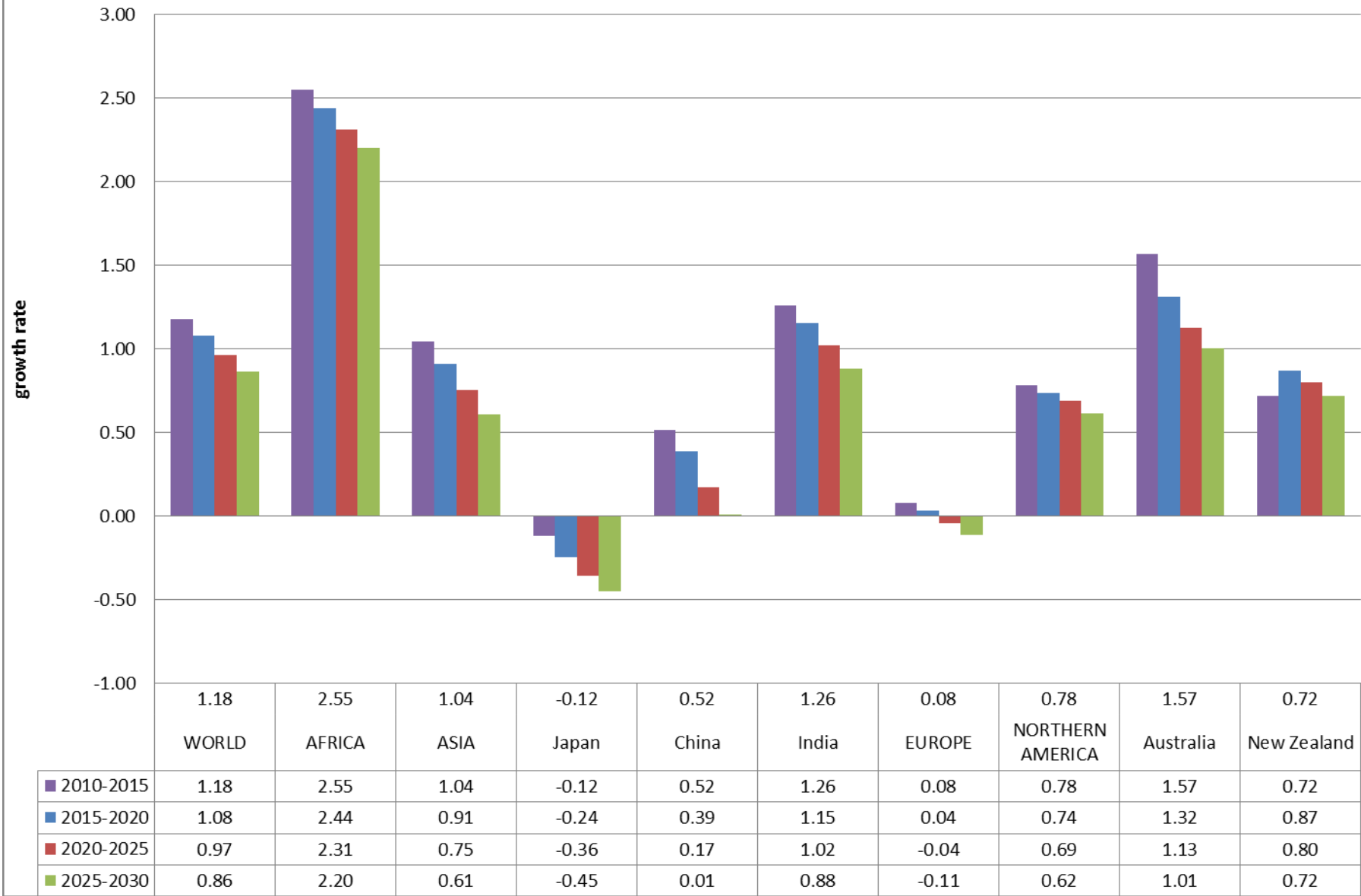
# The Drivers of Growth

- Demographics
- Productivity
- Capital
  - Physical
  - Human

# Demographic Change

Figure 1: Population Growth Rates 2010-2030

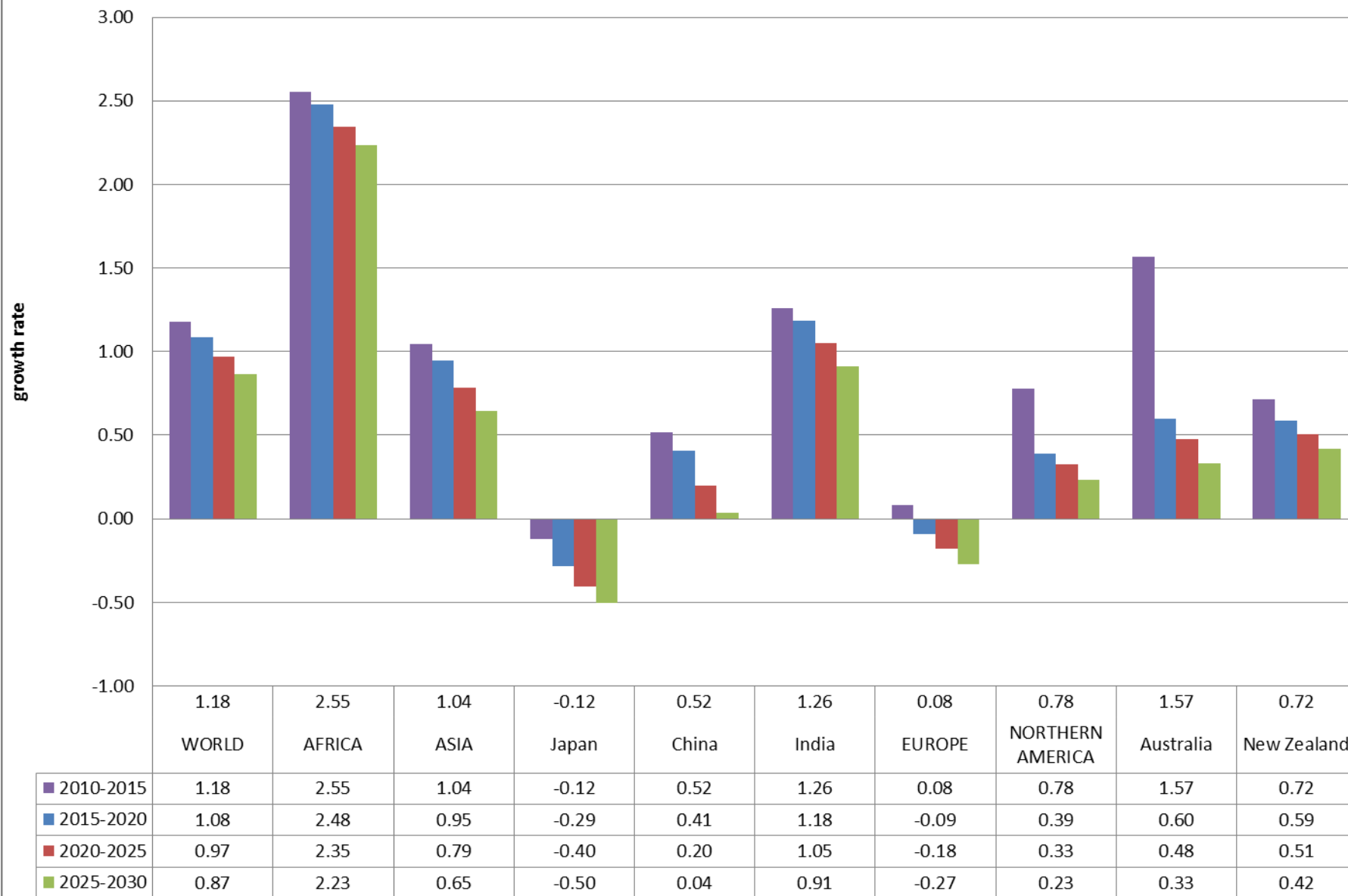
Source: UN Population Projection 2015 Revision, Medium Fertility





# Figure 2: Population Growth Rates 2010-2030 with no migration

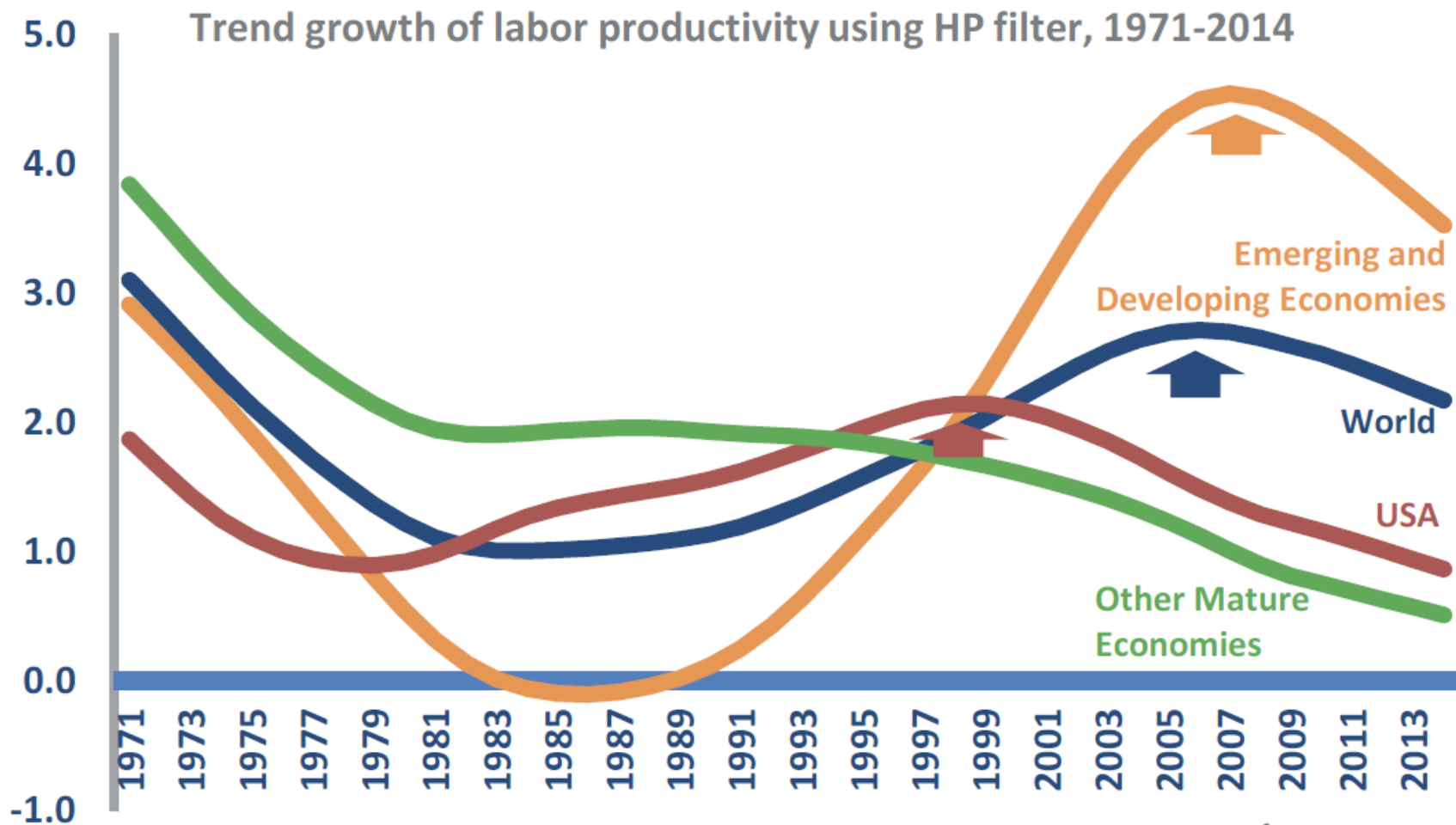
Source: UN Population Projection 2015 Revision, zero Migration



# Key points

- Population growth is slowing globally
- Labor force growth is slowing globally
  - In some countries population is shrinking
- Immigration is a key source of growth in economies like New Zealand, Australia and the US
- Australia & New Zealand's relative demographic position is good.

Productivity



Note: Trend growth rates are obtained using HP filter, assuming a  $\lambda=100$ .

Source: Source: The Conference Board Total Economy Database™, May 2015

- Productivity growth is slowing everywhere
- Will it continue?

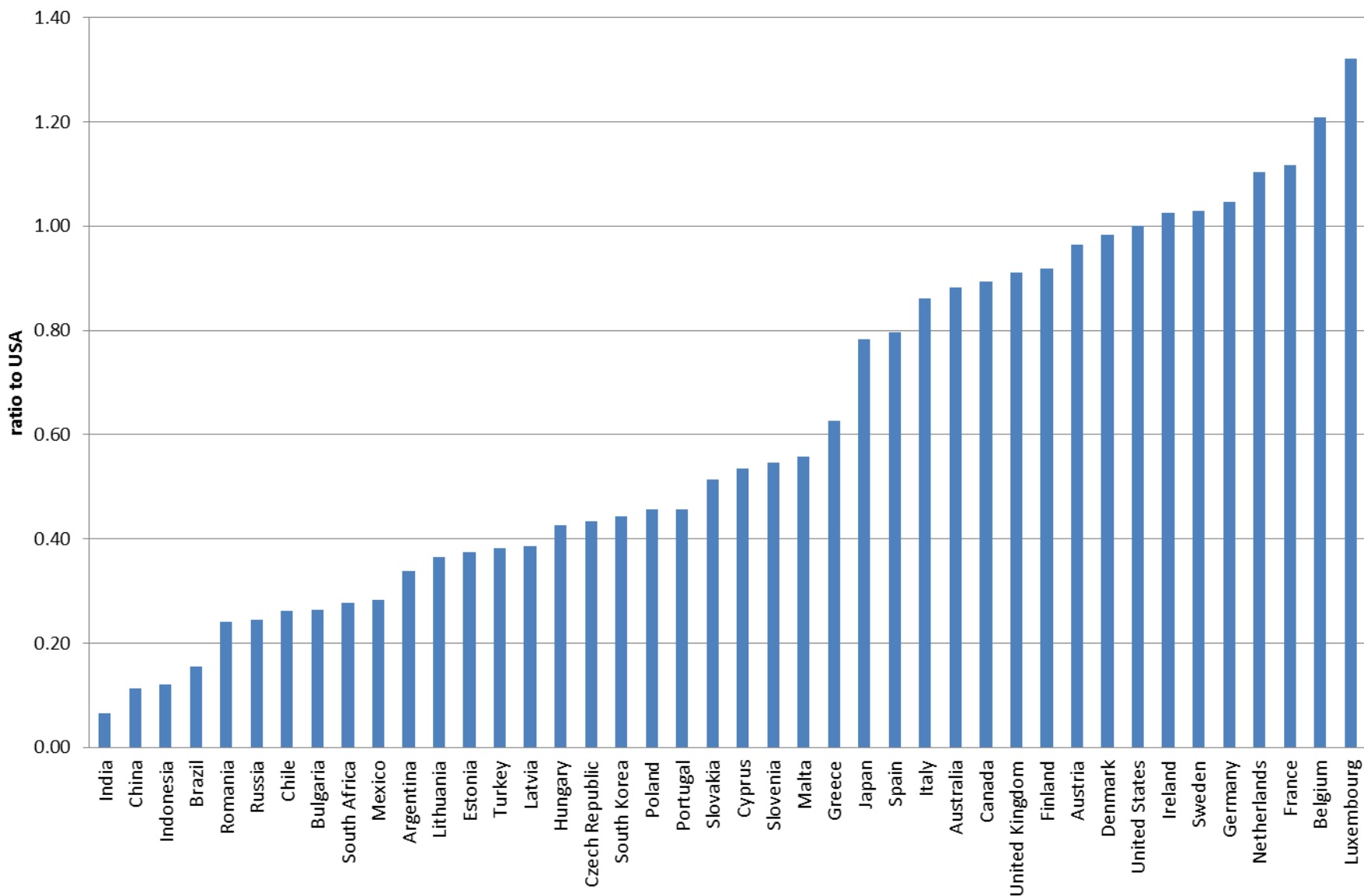
# What does a global productivity slowdown imply?

- Depends if it is temporary or permanent
- If permanent then current capital stocks probably too high in many sectors/countries
  - Investment rates need to fall
  - Real interest rates will fall (savings glut)

# Will Productivity growth continue to Slow?

- Distinguish between the frontier sectors where growth is driven by innovation versus growth that is driven by “catching up”
- Even if the frontier slows – catchup need not slow.

# Economy wide Labour Productivity Relative to the United States in 2005



Source: GGDC Productivity Level database . Measure as GDP in PPP units per hour worked

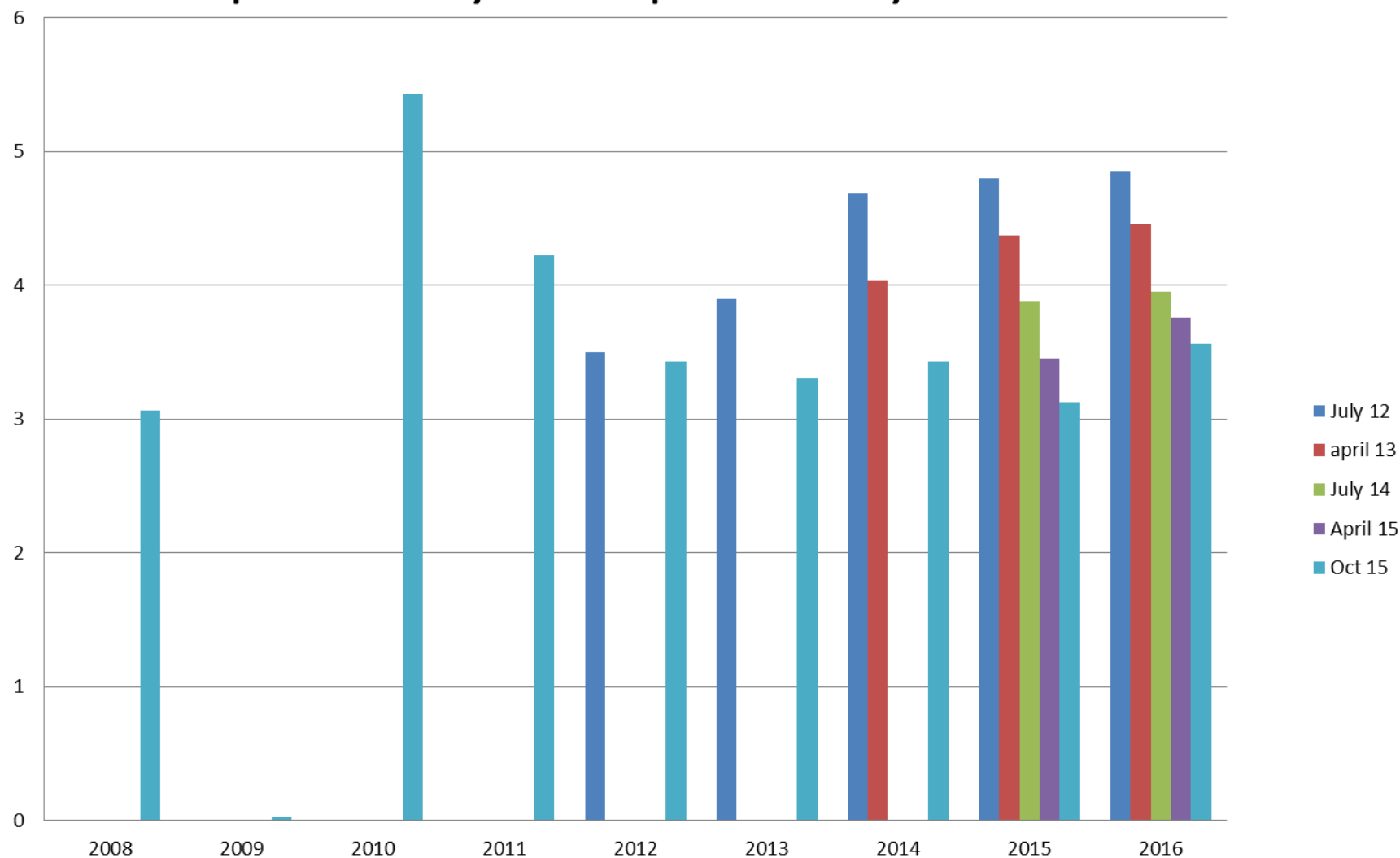


- There is still plenty of capacity for countries and sectors to catch up to the frontier
- Will this happen?

# The Global Economic Outlook

# World GDP Growth

## April 2015 vs July 2014 vs April 2013 vs July 2012 Forecasts



Source: IMF World Economic Outlook October 2015, April 2015, July, 2014, April 2013 and July 2012

# Near Term Growth Outlook

- Asymmetric and sluggish recovery
  - US likely to continue to grow
  - Japan will slow unless major structural reforms undertaken (FTA with Australia is important)
  - GFC increased risk which hurt investment and slowed potential growth substantially - similar to the aftermath for crisis economies of 1997/98
  - Global monetary relaxation pushed funds into existing assets pushing up asset prices but not investment

# Policy Risks

# Short Term Issues for Policymakers

- US
  - How to unwind QE and guide expectations
- Europe
  - How to avoid a Euro collapse from a banking crisis or a sovereign debt crisis
- Japan
  - Implementing the 3 arrows policy
    - Massive monetary expansion
    - Fiscal expansion with long term fiscal contraction
    - Major structural reform to raise long run growth

# Short Term Issues for Policymakers

- Emerging Economies
  - Rise is risk associated with the end QE
  - China dealing with major structural issues

End of Quantitative Easing (QE)

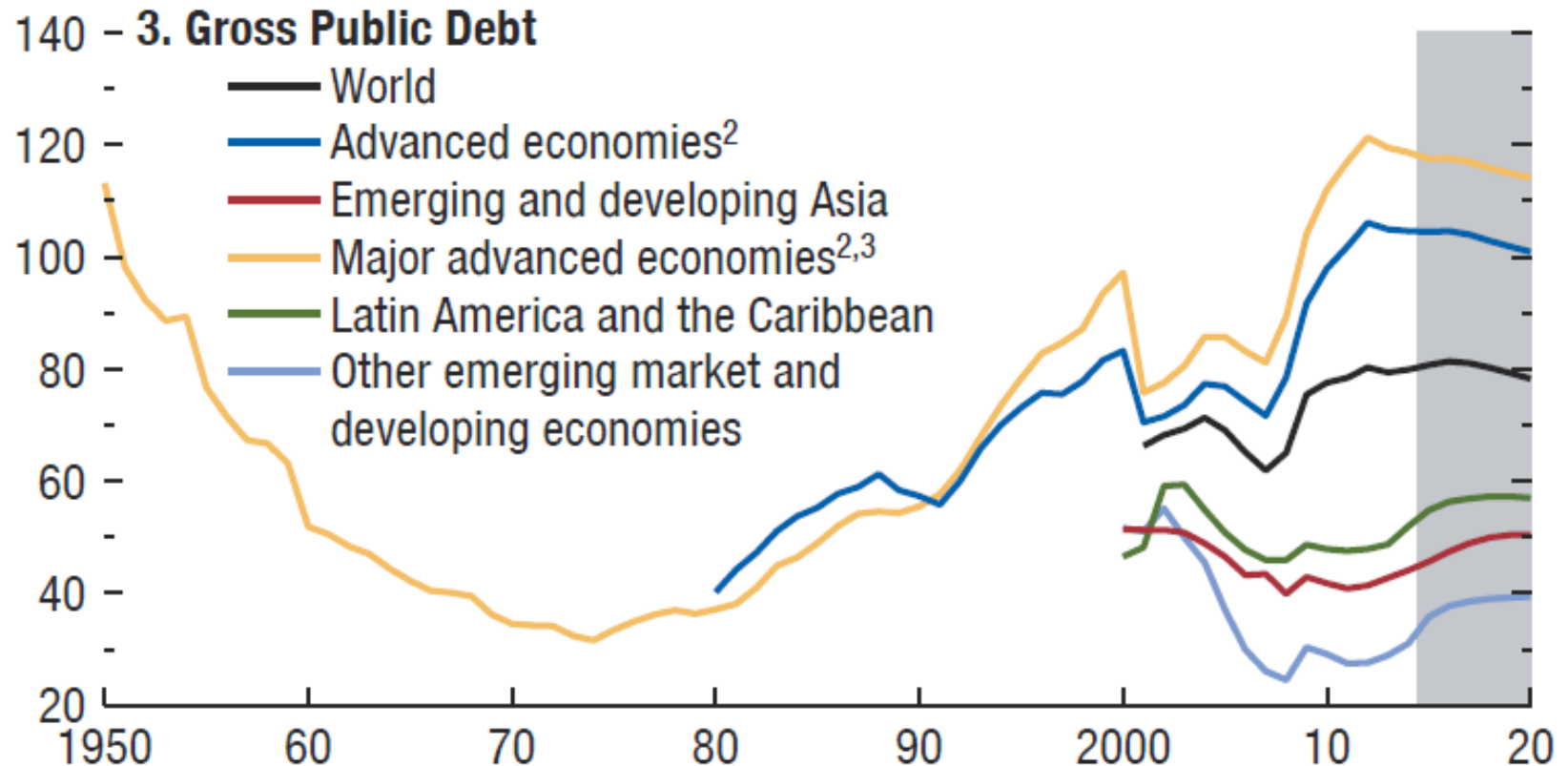


# End of QE

- US economy is recovering
- Expect interest rates to rise in the US (question of how much)
- Good news for global demand through trade
- Bad news for poorly performing economies as capital flows out of these economies towards the US (and into other well performing economies like Australia)
- Bad news for economies with large sovereign and private debt exposures

# Fiscal Sustainability

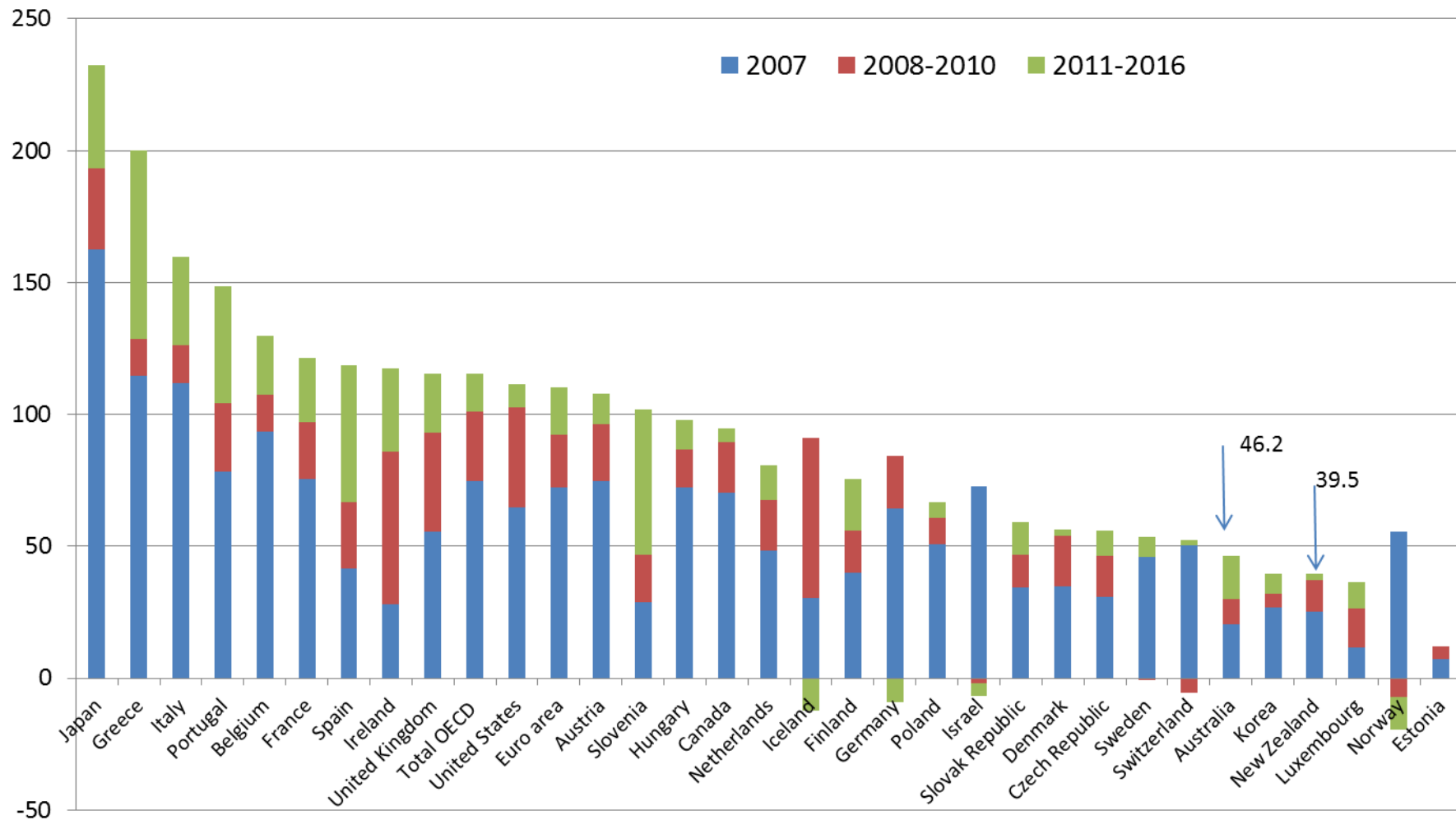
# Global Government Debt



Source: IMF World Economic Outlook October 2015

# Figure 7: Government Gross Financial Liabilities

(Per cent of nominal GDP)



Source OECD Economic Outlook November 2015, Annex Table 32

# Key Issues

- Fiscal problems accentuated by
  - Rising interest rates
  - Low rates of economic growth
- Countries will need to cut deficits substantially over coming years
  - Very different adjustment across countries
  - Fiscal Deficit reduction raises national savings and if private investment does not rise, savings will flow overseas depreciating the exchange rate and improving the trade balance

# Fiscal Adjustment

- Potentially a rise in global savings pushing down world interest rates
- Countries not cutting likely to see large capital inflows, a strong exchange rate and a decline in competitiveness

# Climate Policy

# Paris Climate Negotiations

- Countries met in Paris in December 2015 to negotiate climate policies with a post 2020 agreement for action in focus
- Countries have announced “Intended Nationally Determined Contributions” (INDCs)



# Australia and NZ commitments

- Australia will reduce emissions to 26-28 per cent on 2005 levels by 2030
- New Zealand will reduce greenhouse gas emissions to 30 per cent below 2005 levels by 2030.

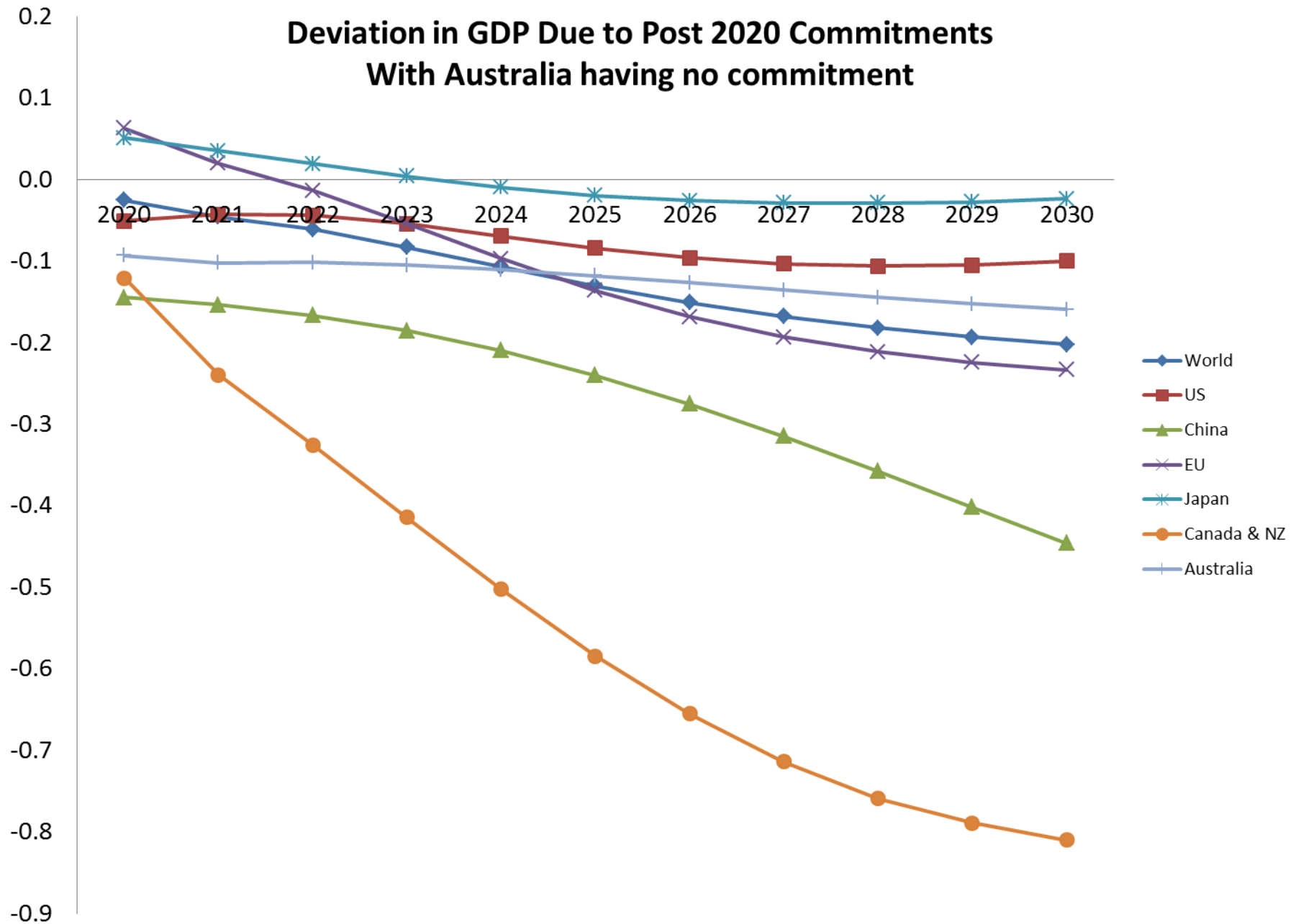
REPORT 1: 2015 ECONOMIC MODELLING OF INTERNATIONAL  
ACTION UNDER A NEW GLOBAL CLIMATE CHANGE AGREEMENT

REPORT 2: 2015 ECONOMIC MODELLING OF AUSTRALIAN ACTION  
UNDER A NEW GLOBAL CLIMATE CHANGE AGREEMENT

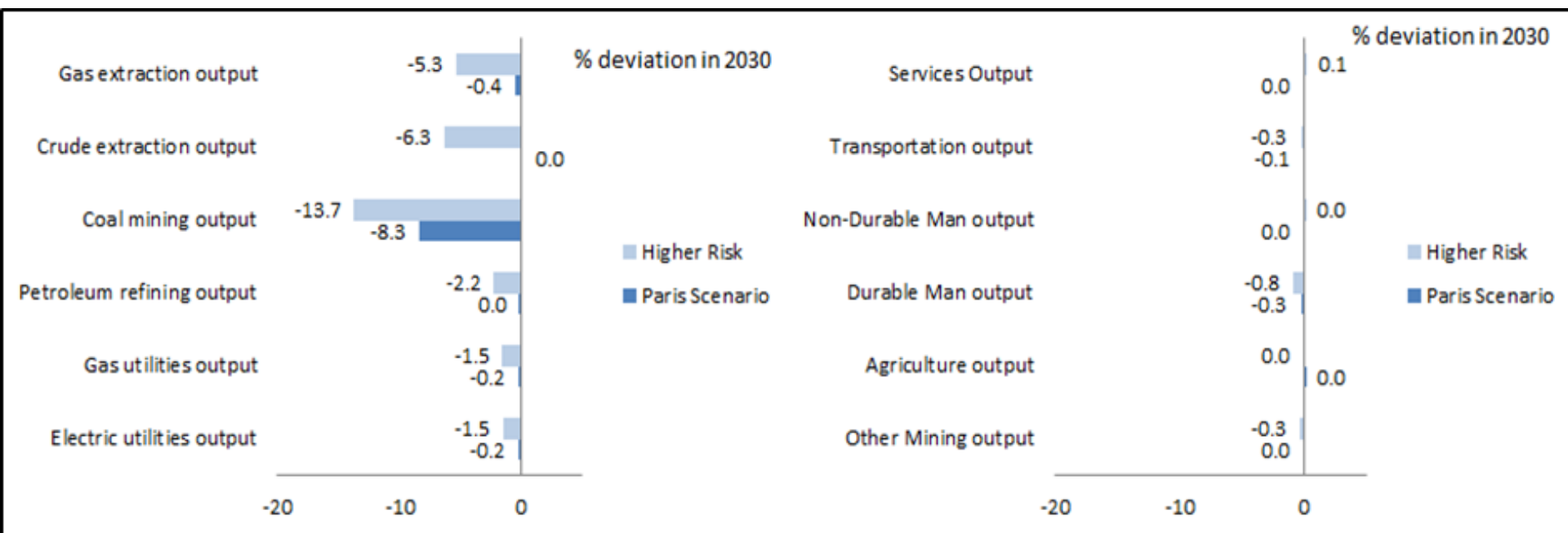
(Modeling feeding into the Paris negotiations)

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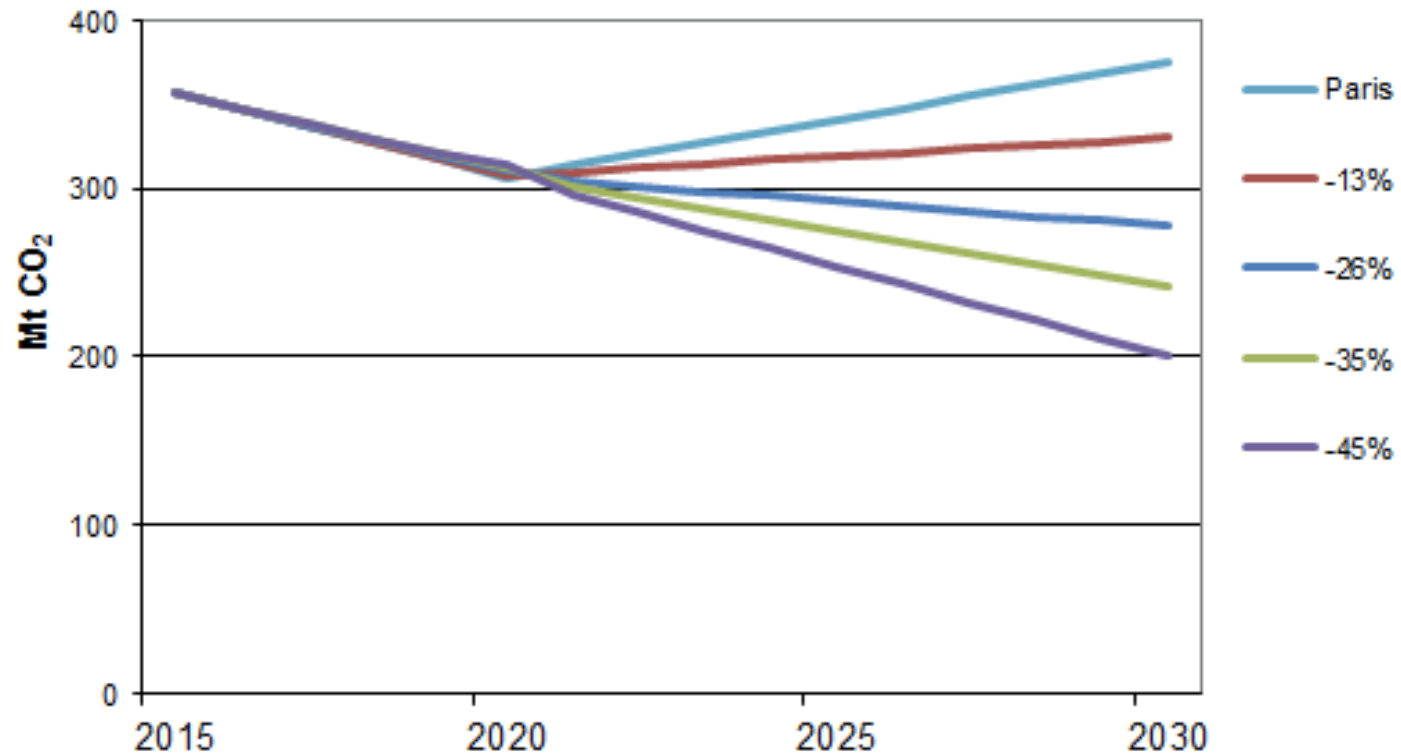
## Deviation in GDP Due to Post 2020 Commitments With Australia having no commitment



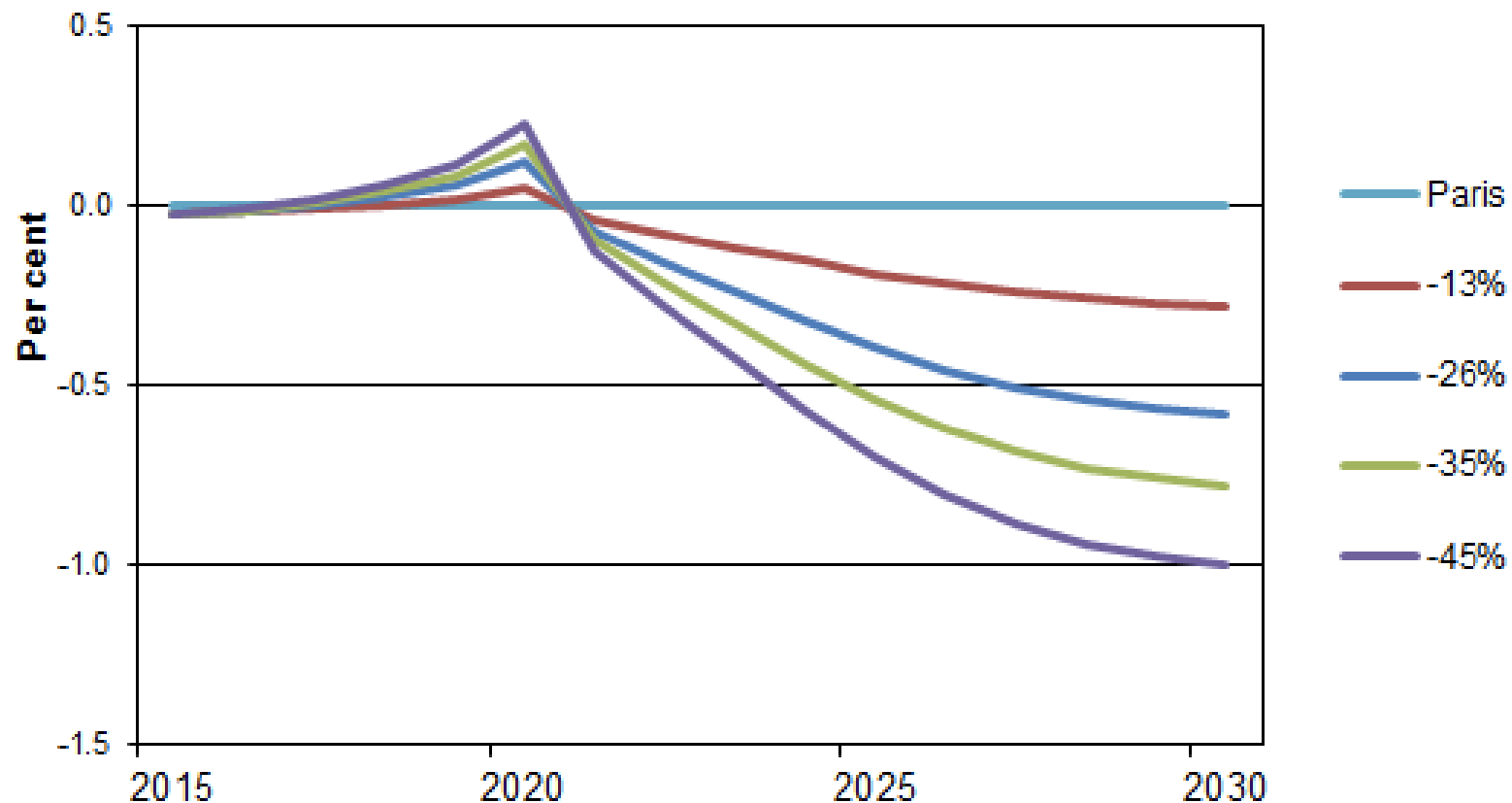
**Table: Change in output in Australia if all countries except Australia meet their targets**



**Figure 1: Australian Target paths for emissions from energy, 2015 to 2030 (Mt CO<sub>2</sub>)**



**Figure 4:** Australian real GDP, core target scenarios, 2020 to 2030  
*Deviation from Paris scenario (per cent)*



**Table 2: Paris Target impacts on GDP, Australia and key countries, 2030 (% deviation)**

Modelled emissions pathway (2005-2030)		Change in GDP (per cent)	
US	-37%	-0.1	
Japan	-22%	-0.02	
Europe	-34%	-0.2	
Canada	-22%	-0.8	
China	Peaking in 2030	-0.4	
Australia scenarios - costs		Core target scenarios	Sensitivity technology
	-13%	-0.3	-0.2
	-26%	-0.6	-0.4
	-35%	-0.8	-0.5
	-45%	-1.0	-0.7

# Key points

- The size of the emission reduction target is a not a measure of the extent of action
- The overall reduction pledges so far made for Paris are less than many scientists believe is needed
- But Australia is making a reasonable contribution relative to other countries and the size of commitment will have significant effects on Australia.



# Summing Up

- Near terms risks are large
- Medium term risk are also large
- But medium term opportunities are also large
- Australia & New Zealand are well placed to take advantage of opportunities as emerging countries grow

# Summing Up

- The key to adapting to the changing global situation is to increase flexibility in the economy as “enabling technologies” (or disruptive technologies) break down old ways of doing things.

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