NationalBank OF BELGIUM
Eurosystem

2015-09-22

PRESS RELEASE

Factors explaining emerging economies' growth slowdown
(Article in the September 2015 Economic Review)

Over the past decade, emerging market economies have staged a period of impressive growth, boosting their share in world GDP. In recent years, however, growth in emerging markets has slowed substantially and is projected to remain sluggish for the foreseeable future. As emerging markets now account for a bigger part of the global economy, a more protracted slowdown in these economies will have more serious ramifications than in the past. Some argue that it may even contribute to a so-called “new mediocre”, a period of moderate growth rates for the world economy.

The aim of this article is to highlight several structural factors of emerging markets that can explain their synchronised slowdown as well as the more muted growth forecasts. An important element in this regard is the rebalancing of growth in China, the largest and fastest-growing emerging market economy over the last few decades. China’s impressive economic performance had relied heavily on investment and exports but, as imbalances and vulnerabilities started building up, it was considered unsustainable in the longer run. So, the Chinese authorities embarked on a comprehensive reform towards a consumption-driven growth model that relies to a greater extent on services sectors, innovative enterprises, infrastructure development and the green economy. Evidence of any progress with rebalancing the economy is mixed so far; economic growth has been slowing down since 2011 and is having a substantial impact on other emerging market as well as advanced economies.

The recent slump in commodity prices is in part the result of developments in China, which has become one of the world’s biggest consumers of metals and oil. The collapse in commodity prices and especially oil prices since mid-2014 changes the growth dynamics for both commodity importers and exporters. While lower commodity prices boost domestic demand in the former, commodity exporters are faced with a negative terms of trade shock, with a downward impact on GDP growth. As investment is scaled down accordingly, commodity exporters’ potential growth is also affected.

Leverage is another factor affecting growth in emerging market economies. The article focuses on the consequences of an excessive build-up of private sector leverage in Central and Eastern European countries in the run-up to the crisis. The financial crisis triggered a sudden stop in external financing in the region and domestic credit growth fell sharply from its pre-crisis highs. As credit supply ground to a halt, investment rates also plunged and have remained weak ever since. Notwithstanding the specificities of the credit cycle boom and bust in this region, emerging market countries in other regions which are seemingly lagging behind in the cycle might be confronted with similar challenges in future. The changing pattern in global value chains is another element contributing to the growth slowdown in emerging markets. The rapid growth and complexity of international global value chains observed since the late 1980s – and which has supported world trade growth for the last 20 years – has been facilitated by technological developments, falling transport costs and a reduction in trade barriers. However, the lengthening of global value chains seems to have ended now, something which is said to contribute to a deceleration of trade growth relative to GDP growth.

Finally, two other factors are likely to play out in the more medium term. First, the slowdown currently observed in many emerging countries is actually a recurring phenomenon in economic history. International experiences over a longer period of time indeed show that it is quite common for emerging and developing countries to undergo a sustained period of low growth after several years of strong growth. This is the so-called “middle-income trap” and it is largely attributable to a slowdown in productivity growth. Second, the gradual disappearance of the demographic dividend in some emerging market economies is also likely to affect growth in these economies in future.

The confluence of all these factors – even though they are not identical for all regions – is contributing to a more protracted slowdown in emerging market economies. Moreover, with emerging markets’ macroeconomic fundamentals no longer perceived as solid as in the immediate aftermath of the global financial crisis, market sentiment has changed. This has been reflected in recent financial market turmoil and slowing capital flows to emerging market economies.

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Stronger fundamentals and measures to speed up other reforms will be needed in order to avoid falling into the middle-income trap and a repeat of the volatile years of the 1980s and 1990s.