2017
2027

FRANCE STRATÉGIE
ÉVALUER. ANTICIPER. DÉBATTRE. PROPOSER.

TAKING STOCK OF GLOBAL GROWTH OVER THE NEXT DECADE

The article below is an English adaptation of the first working paper in the series, which seeks to sketch the broad outlines of the global macroeconomic environment and gauge the prospects for growth in the decade to come. You can read the original on the "2017/2027" French-language website here.

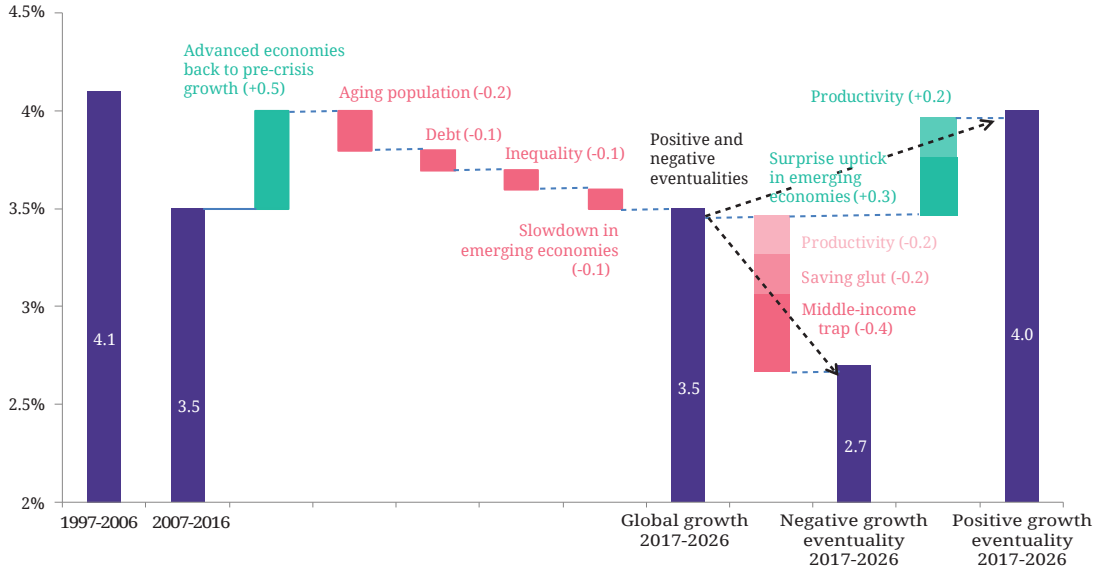
Even though the aftershocks of the 2008-2009 Great Recession are likely to fade in the decade to come, a full turnaround of the global economy is far from certain.

France Stratégie forecasts in a recent study by analyst Arthur Sode average growth of 3.5% per year from 2017 to 2026.

While this is in line with the 3.5% growth recorded for the period 2007 to 2016, it falls short of the 4.1% recorded over the period 1997 to 2006 (graph ❶).

"There's a lot of uncertainty, whether it's regarding productivity, excess savings, rising inequality or a slowdown in emerging economies," says Sode. "But growth in advanced economies doesn't look like it's set to bounce back to pre-crisis levels any time soon."

❶ POSSIBLE SCENARIOS FOR GLOBAL GROWTH FROM 2017-2026



SOURCE : France Stratégie's projections from the *World Economic Outlook*, January 2016.

MAY 2016

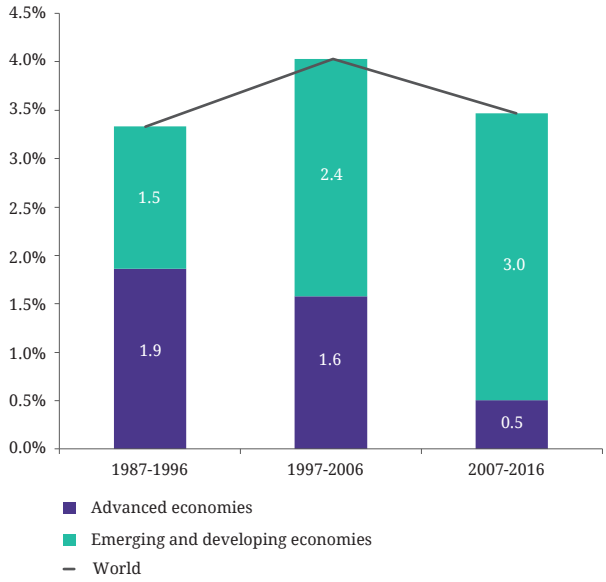
FRANCE WILL FACE IMPORTANT CHALLENGES WHEN IT GOES TO THE POLLS IN 2017 TO ELECT ITS NEXT PRESIDENT. TO BOTH FOSTER AND INFORM DEBATE AMONG CITIZENS IN THE MONTHS LEADING UP TO THE ELECTIONS, FRANCE STRATÉGIE HAS LAUNCHED ITS "2017/2027" PROJECT. IT AIMS TO ZERO IN ON WHAT IS LIKELY TO SHAPE POLICY OVER THE NEXT DECADE BY PUBLISHING A SERIES OF WORKING PAPERS ON TWELVE ISSUES VITAL TO THE FUTURE OF THE COUNTRY. MEMBERS OF THE PUBLIC WILL BE ABLE TO SUBMIT WRITTEN REACTIONS ONLINE. A DEBATE WITH THE AUTHOR(S) AND OTHER EXPERTS WILL THEN BE ORGANIZED FOR EACH ISSUE ON THE BASIS OF THE WORKING PAPER AND THE SUBMISSIONS.

THE LOST DECADE OF 2007-2016

The Great Recession cut deep into advanced economies. Unemployment in the latter surged from 6.0% on average to 8.0% in 2009 and only began to drop in 2013. The Eurozone has continued to suffer its aftershocks: It has fared the worst among developed countries, with meagre growth of 0.5% from 2007 to 2016, down from a robust 2.3% during the period 1997 to 2006.

Major emerging countries like Brazil, China and Indonesia were able to drive expansion in the wake of the 2008- 2009 crisis: They accounted for no less than 80% of worldwide growth from 2007-2016 (graph ❷). But their own momentum is expected to flag over the next decade. The IMF projects their growth to decrease from 3.1% from 2007 to 2014 to 2.5% over 2015 and 2016.

❷ AVERAGE ANNUAL GROWTH BY ZONE OVER THREE DECADES



SOURCE: IMF, *World Economic Outlook*, January 2016 (projections as of 2015).

Nevertheless, they have left their mark. "There's been a multiplication of countries that carry weight in the global economy," says Sode. "The turbulence over the past ten years has revealed an increased interdependence of economies, namely via gross capital flows and the importance of international value chains." This means economic turmoil in one country can cause a chain reaction and impact any number of economies across the globe.

THE PROSPECTS FOR 2017-2027

As for the coming decade, the economic logic would have countries bouncing back to pre-crisis conditions to make up for the growth lag in the wake of the downturn. However, that this will happen has never been more uncertain. Economists on both sides of the Atlantic are increasingly asking why this is so.

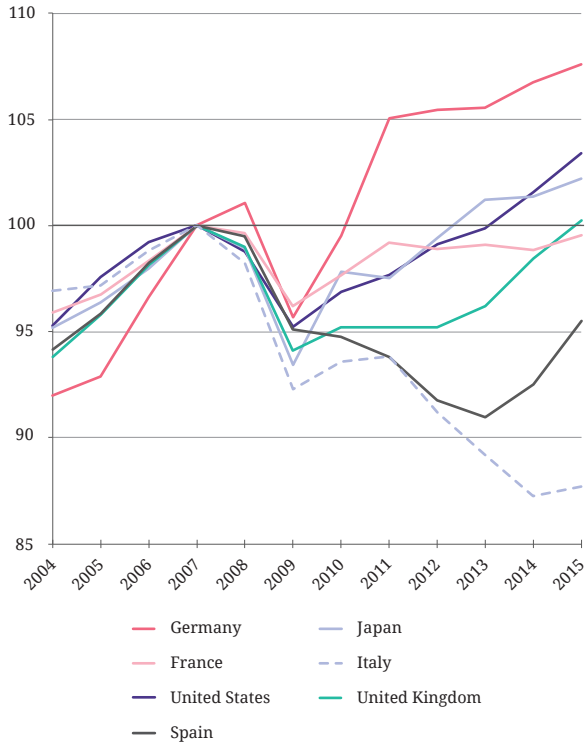
For one, the extent of the blow to advanced economies has been unprecedented in the post-World War II era: It took six years for the per capita GDPs of the US and Japan to get back to pre-crisis levels. France and the UK, for their part, only made it last year, eight years on. As for Italy and Spain, their per capita GDPs are still significantly below what they were in 2007 (graph ❸).

In fact, the Eurozone had a double-dip recession, with that of 2009 followed by a downturn in 2012-2013. A turnaround only materialized in 2014.

A glimmer of a silver lining for the Eurozone lies in the severity of its economic crisis. Sode explains this could well mean that while the crisis ate into potential GDP in all countries, a large output gap – the difference between actual GDP and potential GDP – could benefit the hard-hit Eurozone. In other words, it could translate into a stronger uptick than in other advanced economies.

However, the sheer magnitude of the Great Recession may also have led to an additional loss in potential growth. This is because long-term unemployment may have dented the skills, creativity and other intangible assets – i.e. the human capital – of the labour force. What's more, as companies have been under-investing, the quality of the stock of physical capital has been deteriorating (Ball L. M., 2014).

❸ GDP PER CAPITA GROWTH AMONG DEVELOPED COUNTRIES (BASE YEAR = 2007)



SOURCE: FMI, *World Economic Outlook*, January 2016 (projections as of 2015).

A loss to potential growth notwithstanding, the advanced economies will also have to grapple with **ageing populations, ballooning indebtedness and a relentless rise in inequality** over the next ten years.

According to the UN, by 2030 a whopping 27% of their citizens will be over 60, with the ratio of young people and seniors to the working age population (20-64) rising from around 60% today to 80%.

On top of this, the level of indebtedness for governments, companies and households has climbed to historic highs across advanced economies over the past quarter century. Both private and public debt have been shown to hinder growth, especially when indebtedness is spread across sectors. Japan and the

Eurozone are particularly vulnerable, given the high levels of debt present in their non-financial companies (both have gross debt of just over 100% of GDP). The final drag on the possible economic expansion of advanced economies is the unremitting rise of inequality. In the wake of the crisis, much has been written on the issue, especially in the US, which has levels of inequality unseen in other developed countries. But inequality has also risen sharply in countries with a much more egalitarian tradition like Sweden, Finland or Germany.

Taken together, Sode estimates ageing, indebtedness and inequality could knock 0.4 percentage points off of global growth.

THE SOUTH SLOWS DOWN

A sign of things to come may be seen in the precipitous drop in the price of oil: Since mid-2014 crude oil has plummeted from around USD 110 a barrel to under USD 40 as of early March of this year.

Granted, the development of alternative energy sources such as shale gas and renewables has played a role in this. But a major factor has been the slowdown in emerging economies, which may offset any boon cheap oil can provide to developed economies.

Sode cites a Bank of France working paper, which estimated in 2015 that **potential Chinese growth should drop to 5.5% by 2017, dipping to 4.5% by 2027**. For an economy that will represent more than 20% of global GDP on average over 2017-2026, this could shave off 0.3 percentage points from worldwide growth.

The question is will other developing countries be able to pick up China's slack. This is far from given. The IMF posited in its 2015 WEO that countries like Mexico, Brazil and Turkey will be faced with a lower participation rate – i.e. the ratio of those working or looking for work to the working age population – and capital stock.

That said, the number of people in the world earning more than USD 10 000 in purchasing power parity (PPP) has been projected to increase from a little over 1 billion in 2017 to almost 2 billion in 2027 (Sode, 2014). More than four-fifths of this increase will come from emerging economies, namely in Asia. This may translate into a significant boon for companies in advanced economies, who are well positioned to provide goods and services for the relatively affluent.

UNCERTAINTY AHEAD

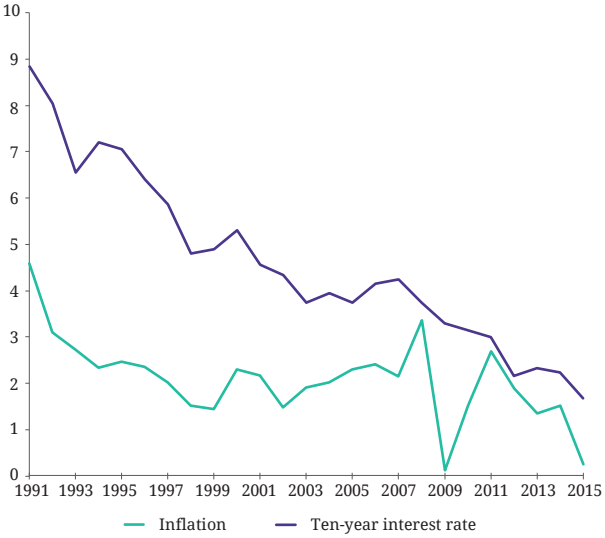
A fall in productivity, which is the main engine of growth over the long term, could further hurt advanced economies. Sode points out there has been a slowdown in productivity since 2008 across almost all developed countries. Granted, the US, Germany and Spain have fared better than the UK, Italy, France and Japan. The so-called techno-optimists see current technological innovations as likely to boost productivity. The fact remains that substantial technical progress over the past two decades has failed to spur aggregate growth.

The advanced economies are also grappling with the spectre of deflation. Despite years of expansionary monetary policy (the US Federal Reserve, for example, kept interest rates close to zero from December 2008 until December 2015) and billions of dollars and euros pumped into North American and European economies to stimulate demand and consequently growth, inflation has continued to fall across advanced economies.

The US economist and former Obama advisor Larry Summers believes the culprit lies in secular stagnation, a concept developed during the Great Depression in the 1930s. It posits that reduced demand results from an excess of savings and lack of investment. This imbalance drives down real interest rates (graph 4).

As for emerging economies, they, too, are far from in the clear. More than a few may be facing the prospect of getting stuck in the so-called **middle income trap**, where they can neither compete for exports against less developed countries nor vie with advanced economies for high value-added markets. China, Indonesia, Brazil, Egypt and South Africa could all see their robust growth grind almost to a halt.

4 INFLATION AND TEN-YEAR INTEREST RATE IN ADVANCED ECONOMIES



SOURCE: OECD.

GEOPOLITICAL RISKS

The world stage today looks a lot less stable than was projected when the Soviet Union collapsed a quarter-century ago. From the vantage point of 2016, conflicts look set to become less localized and contained than they have been in the recent past. The civil wars in Syria and Sudan are but two examples.

Geopolitical risks will certainly be a major factor for global economic prospects in the years ahead. On top of the conflagration in the Middle East sparked by the US invasion of Iraq in 2003, China is asserting its power more broadly. Russia, for its part, has been seeking to project its military might farther afield. This is not to mention the havoc terrorist groups such as Daesh (ISIS) have been wrecking in the Middle East and Europe.

Sode stresses that the **multiplication of national and international conflicts is a human tragedy with very real economic costs**. The countries and regions themselves are obviously hit hardest. But the international community also loses out in terms of lost trade, refugees (witness the current crisis in Europe), the need for investing in security and, lastly, increased uncertainty and lack of confidence in the future.

Adapted by Richard Venturi, based on *"La croissance mondiale d'une décennie à l'autre"* by Arthur Sode

WHITHER GLOBALIZATION?

The 2008-2009 crisis will perhaps be remembered as a crucial turning point in economic globalization. For the first time in almost three decades, world trade has stopped progressing faster than global GDP, and cross-border financial transactions have gone down substantially.

Sode points out world trade may have dropped due to an increasing fragmentation of production chains and China's entry into the global economy. And financial flows may have decreased to more normal levels after a period of excess.

Nevertheless, **the consensus on open international markets appears is increasingly being questioned**. The current political debates in developed countries such as the US, the UK, France and Italy attest to this. In short, many political parties are calling into question the free flow of goods, capital and people.

The very political and institutional bedrock on which economic growth has been founded since World War II seems less stable than ever before. But this lack of stability could conversely be an opportunity for governments and central banks to come up with innovative economic policies.

Indeed, it could encourage them to tackle such vital issues as the insufficient spread of innovation and productivity gains, weak inflation and real interest rates, persistently high public and private indebtedness and the imbalance between saving and investing.

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