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Global Financial Crisis and Recession:

What Could Happen to Major Emerging Economies?

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Since late 2008, the financial crisis spawned in the U.S. has spread quickly across the globe, enveloping both developed and developing countries. Most of the major developed countries are now mired in recession and many export-led economies in the developing world are following suit.

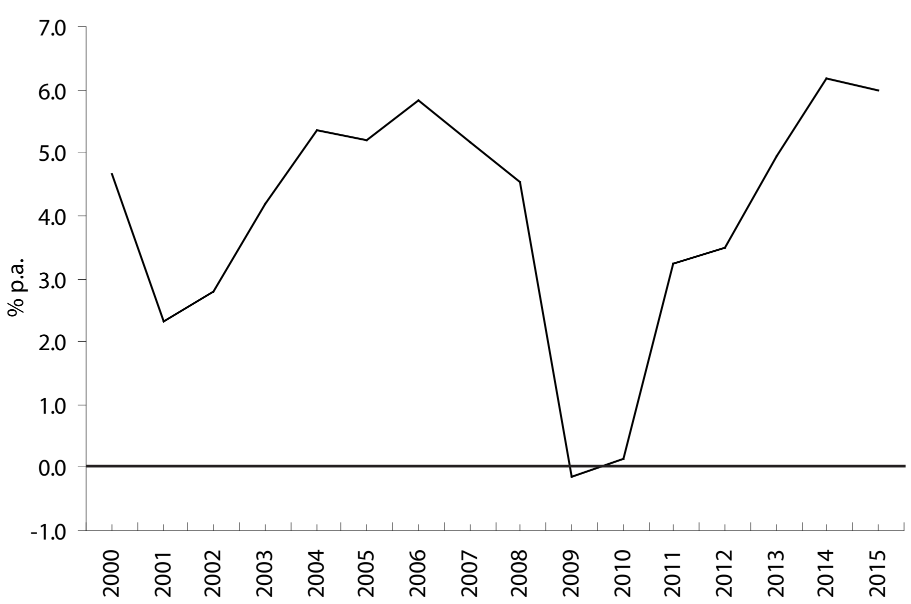
What is likely to happen to some of the major emerging economies in the coming period? This Development Viewpoint relies on a scenario of the *State of the World Economy* macroeconomic model to examine projections for 2010-2015 for Brazil, China, India and South Africa.[2]

The scenario makes specific assumptions about progressively reduced investment in the U.S., Europe, other developed countries, and China during 2010-2013. It also assumes reductions in energy supplies in 2010-2011. In addition, the scenario is made consistent with the IMF's (January 2009) growth estimates for 2008 and its corresponding projections for 2009. It is important to stress that the reported results are not predictions but projections contingent on the above assumptions.

We first report briefly on key global trends. In line with the IMF's projected contraction of -0.2% in 2009, the SOWE model suggests that world income would begin a negligible recovery in 2010, registering only 0.1% growth that year (see Figure 1). Thereafter, growth could accelerate, reaching about 6% during 2014-2015.

The global exports of manufactures are expected to drop precipitously in 2009-2010 and then recover quickly, hitting a peak of almost 12% growth in 2014.

Figure 1: World Income Growth



Source: SOWE Database

The composite price of primary commodities is projected to drop by about 30% between 2008 and 2010, hold steady thereafter, and begin a modest recovery only in 2015. The price of oil is expected to drop by about 50% between 2008 and 2010 and then recover to about three-quarters of its 2008 level by 2015.

The U.S. recession is projected to be shallower than Europe's. The U.S. economy could contract by -0.8% in 2010, after having contracted by -1.6% in 2009. Thereafter, U.S. growth is expected to bounce back, eventually approaching 5% in 2014-2015.

The corresponding projections for Europe are worse, namely, -2% for 2009 and -2.4% for 2010. Europe's recovery is expected to surpass, however, that of the U.S., with the former's growth *exceeding* 5% in 2014-2015. So, initially, Europe's recession would be a drag on the world economy but its subsequent growth should provide a push.

The Four Emerging Economies

What happens during 2010-2015 to the four major emerging economies that are the focus of our attention? We examine three aspects of their economic performance: growth, current account balance and government debt.[3]

China

On these counts, China could clearly fare the best. But its previous breakneck GDP growth rates are projected to nose-dive to about 0.4% in 2010 (see Figure 2)—in line with the global collapse of manufactured exports. Thereafter, China's growth rate would shoot back up but stay in the 8-9% range through 2015—well below the torrid 11-13% range that it achieved during 2004-2007.

Despite the oscillation in its growth, China's current account surplus remains largely unaffected. Estimated to be about 2.7% of its national income in 2008, this surplus could remain roughly between 2.7% and 2.8% until 2012, whereupon it could begin to slide, reaching a low of 2.5% in 2015.

During 2010-2015, China's government debt is projected to rise modestly. While its debt during the 2000s remained 11-12% of national income, this level is projected to drop just below 11% in 2009. Thereafter, however, it is projected to rise, reaching above 15% during 2013-2015. However, this level of debt is very manageable, especially when it is compared to the levels of the other three emerging economies.

South Africa

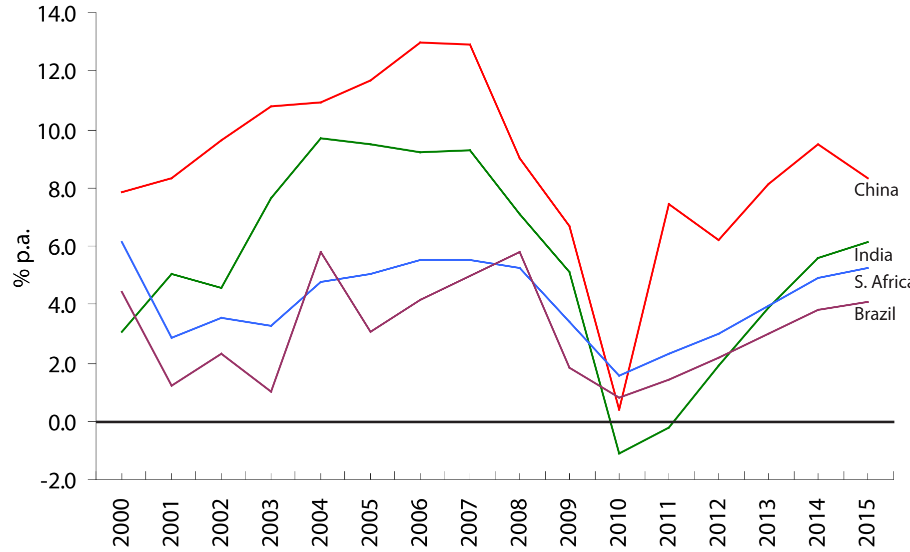
South Africa's growth performance is projected to be credible, but not impressive. Expected to drop from 5.2% in 2008 to 3.4% in 2009, its growth rate should decline further to about 1.5% in 2010.

Thereafter, it could begin a slow, steady climb, reaching about 5% again in 2014-2015.

South Africa's current account deficit has been growing in recent years, already reaching -3.5% of national income in 2008. It is projected to increase further, to almost -3.8% in 2010. Then the deficit begins to decline, reaching again its 2006 level of about -2.5% in 2015, due in part to improved terms of trade. Though such a reduction is a hopeful sign, South Africa will still be dependent on attracting capital inflows.

During 2002-2007, South Africa's government debt remained within 42-43% of national income. But by 2008 it was estimated to have declined just below 42%. From 2009 onwards, the country's government debt should continue declining at a steady rate, reaching almost 32% in 2015. Occurring alongside economic recovery, this trend is encouraging.

Figure 2: Income Growth in Emerging Economies



Source: SOWE Database

Brazil

Brazil's growth performance is projected to be similar to South Africa's, but somewhat slower. Projected to dive from 5.8% in 2008 to 1.8% in 2009, its growth rate is expected to drop even further, to 0.8% in 2010, and only then to begin a slow recovery, reaching about 4% in 2015.

Already having gone into a small deficit in 2007, Brazil's current account is estimated to have reached -1.8% of national income in 2008. Despite declining growth and then slow economic recovery, Brazil's deficit is projected to steadily widen, eventually reaching about -3.3% in 2015. This could represent a major concern, signalling perhaps a lack of competitiveness of its exports (or its exchange rate)—and implying that the country would remain heavily reliant on receiving capital inflows.

During 2002-2007, Brazil's government debt ranged within 40-41% of GDP. However, this ratio started to drop in 2008, and is projected to continue a steady downward decline. By 2015, Brazil's ratio of government debt to national income is projected to dip just below 30%. This is certainly a positive sign, particularly in contrast to the deterioration in Brazil's current account.

India

Of the four emerging economies, India is slated to experience the most wrenching transition. While the IMF projects its growth to slow from about 7% in 2008 to about 5% in 2009, the *State of the World Economy* model projects India's rate to then plummet to -1% in 2010 and remain at -0.2% in 2011. Thereafter, however, its economy is expected to rebound, recovering quickly to a 6% growth rate in 2015.

Already almost -1% in 2007, India's current account deficit widened to -1.3% of national income in 2008 and is projected to stay there for 2009. Thereafter, it is expected to decline just below -1% and then edge back up eventually to -1% in 2014-2015. This represents a positive development given its projected rapid growth in the later years.

While India's government debt rose to over 66% of national income during 2004-2006, it began to drop appreciably thereafter, and is projected to reach about 55% in 2009. Nevertheless, it is expected to progressively worsen thereafter, eventually reaching over 65% in 2015, i.e., basically its level in the mid 2000s. Such a debt ratio would approach the U.S.'s in 2015, namely, 72% of national income. However, while the U.S. could manage to finance such debt, India is likely to confront increasing problems.

Summary

In summary, China is projected by our scenario to end up in the strongest position in the wake of the global crisis and recession. Its growth rate would continue to be relatively rapid, its current account would remain in surplus, and its government debt would stay relatively low.

Although the other three emerging economies will also be able to resume growth, they will not be immune to problems afflicting their current account or government debt.

South Africa is projected to achieve a credible rate of growth by 2015 and reduce its government debt, but experience problematic—though declining—current-account deficits.

After suffering recession, India is projected to eventually bounce back to a moderately rapid rate of growth without worsening its current account deficit but it could still be saddled with an onerous government debt.

Brazil is projected to attain a moderate economic recovery and appreciably reduce its government debt but it could still confront an ominously widening current-account deficit.

1. The conceptual work on this scenario was contributed by Francis Cripps, who has developed the *State of the World Economy* model.

2. For related material, see www.soas.ac.uk/cdpr/researchareas/worldmodel.

3 Note that the scenario assumes no policy response by these economies.