

The Global Economy at a Critical Juncture

*Some Thoughts on Trends, Developments
and Challenges*

E. Murat Ucer
October 2020

Main Points

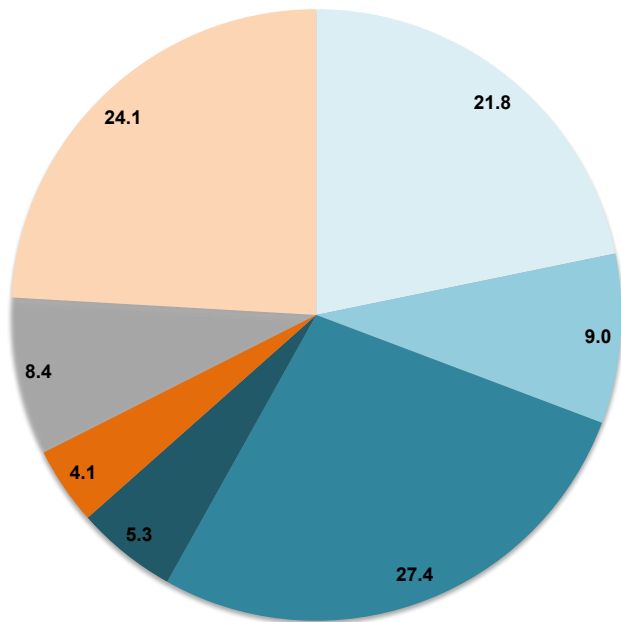


- The global economy had it good from around the late 1980s until the Global Financial Crisis... (“The End of History”, “The World Is Flat”)
- This (hyper-globalization) era is ending with two bangs now, first the GFC (2007-09), and now the COVID, both of which have exposed the weaknesses, and the dark side of globalization...
- Before COVID, the world economy was already faced with a ton of challenges: inequality, low productivity, automation, big tech, high indebtedness, great power rivalry -- and of course, global warming, and now came the COVID...
- Experts tell us two things about the COVID shock: 1) that it is highly uncertain as to how thing will play out, and 2) that this is a different kind of shock. Till a cure/vaccine is found --and reaches out to the 7.8 billion—a complete recovery especially in certain sectors (hence, the popular new letter “K”) is not possible...
- At present, economies are rebounding faster than expected, creating an illusion of “V”, but that is misleading. As markets are talking V – (and buying V), the IFIs are talking lost generations, rising poverty and potential debt crises because they, of course, operate on different time horizons, with different incentives...
- The next 3-6 months will be crucial, more so than ever because we shall know how the COVID numbers are looking in the winter, the outcome of the US elections and whether Q3 rebound in economic activity can be sustained...
- In a “good” scenario (COVID somehow under control), we could see growth pick up fast, though inflation may also become a problem in a few years’ time. In a bad-case scenario, we could see stagnation, social upheavals and debt crises.
- Either way, as we seek the “Next Normal”, we are faced with a bumpy future. Much will depend on what lessons the global community/leadership will draw from COVID, and how they respond to it...

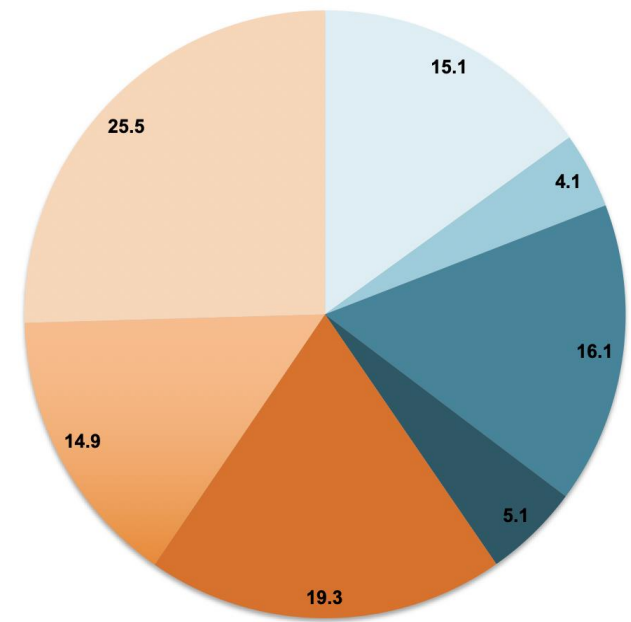
“Hyper-globalization” and the rise of Asia/China



GDP based on PPP share of world total: 1990



GDP based on PPP share of world total: 2019

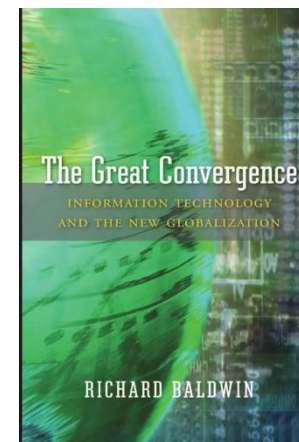
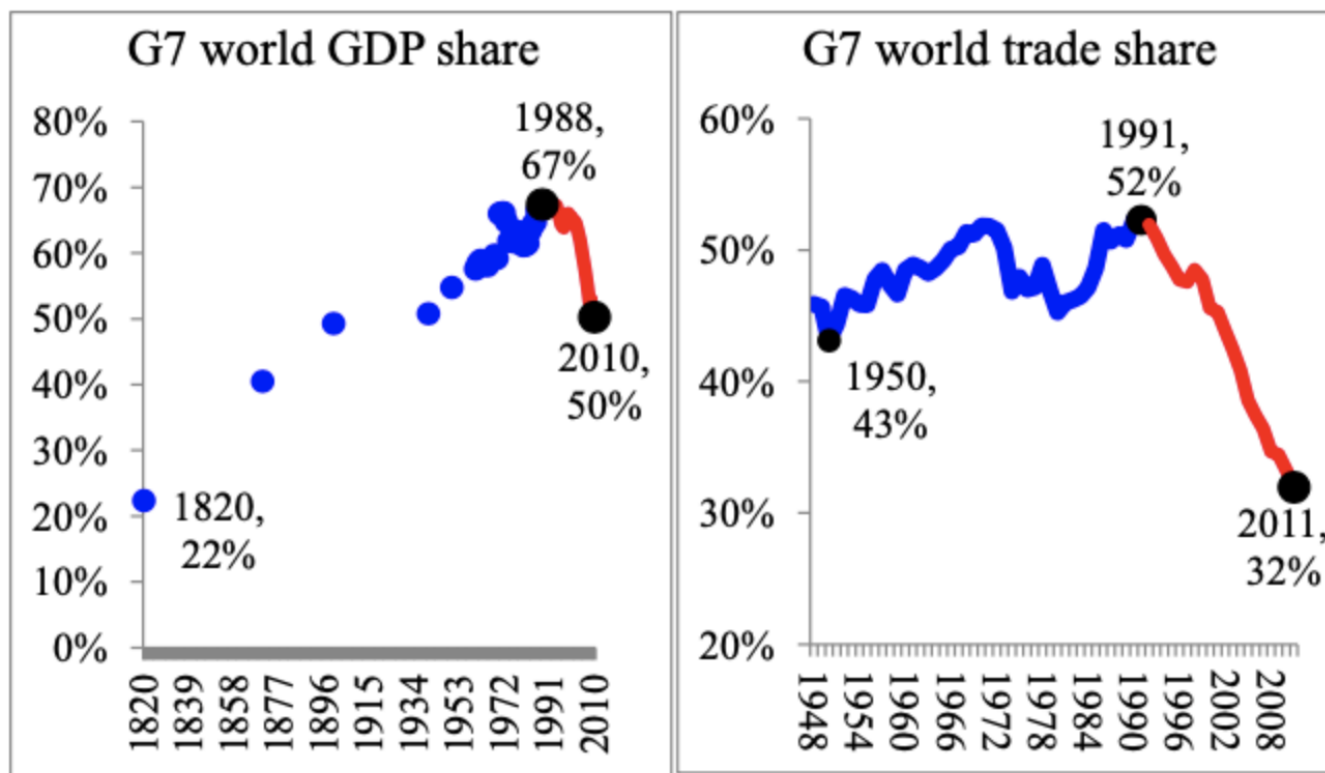


www.imf.org

ICT* + Cheap Labor => GVC* => Convergence



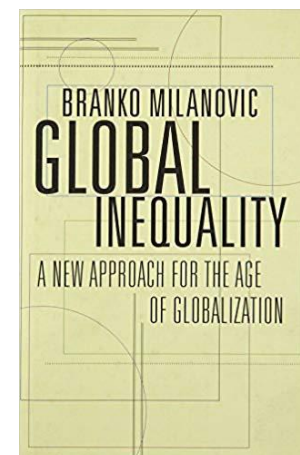
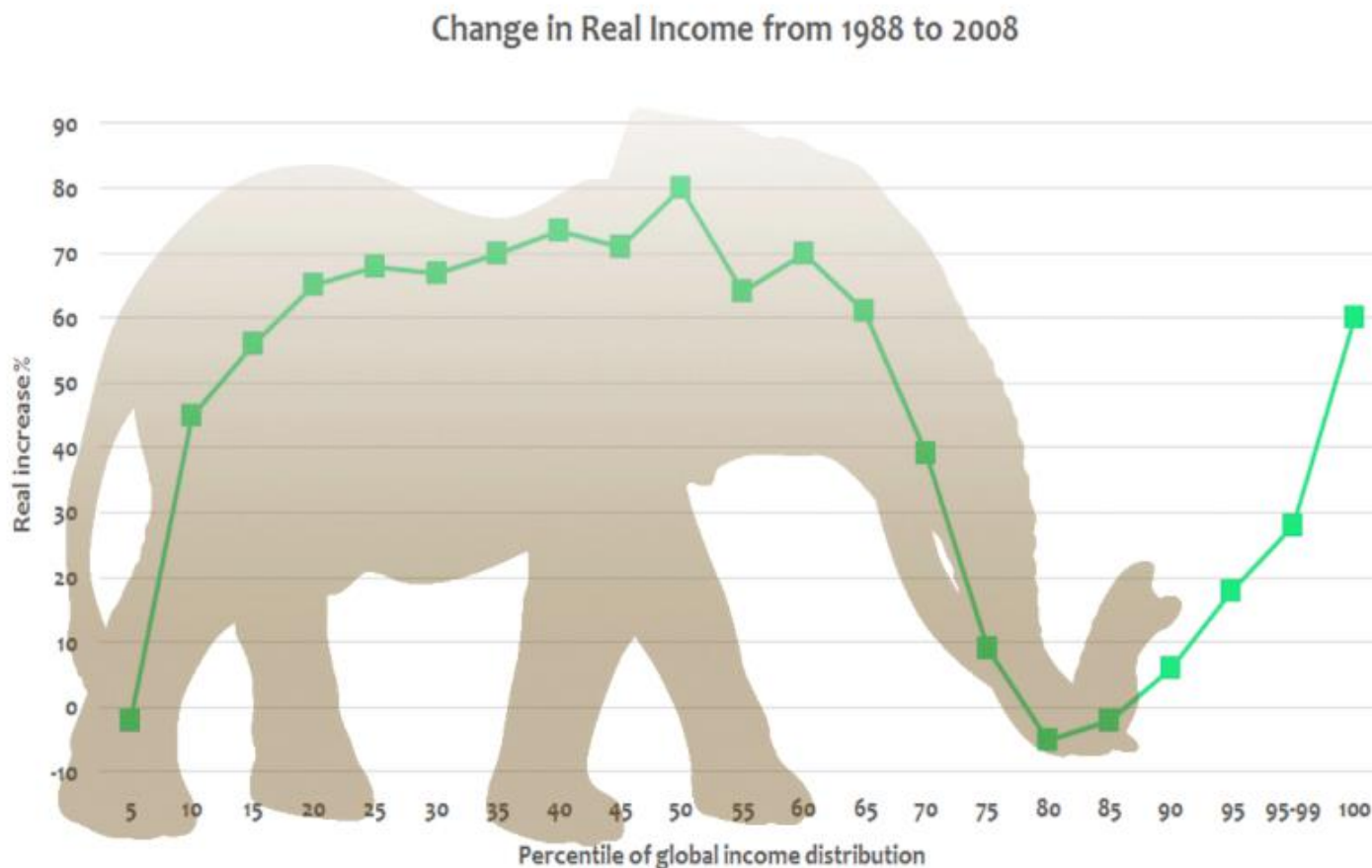
Figure 1 Spot the difference: Globalisations 1.0 and 2.0 (blue) and 3.0 (red)



<https://voxeu.org/content/globalisation-10-and-20-helped-g7-globalisation-30-helped-india-and-china-instead-what-will-globalisation-40-do>

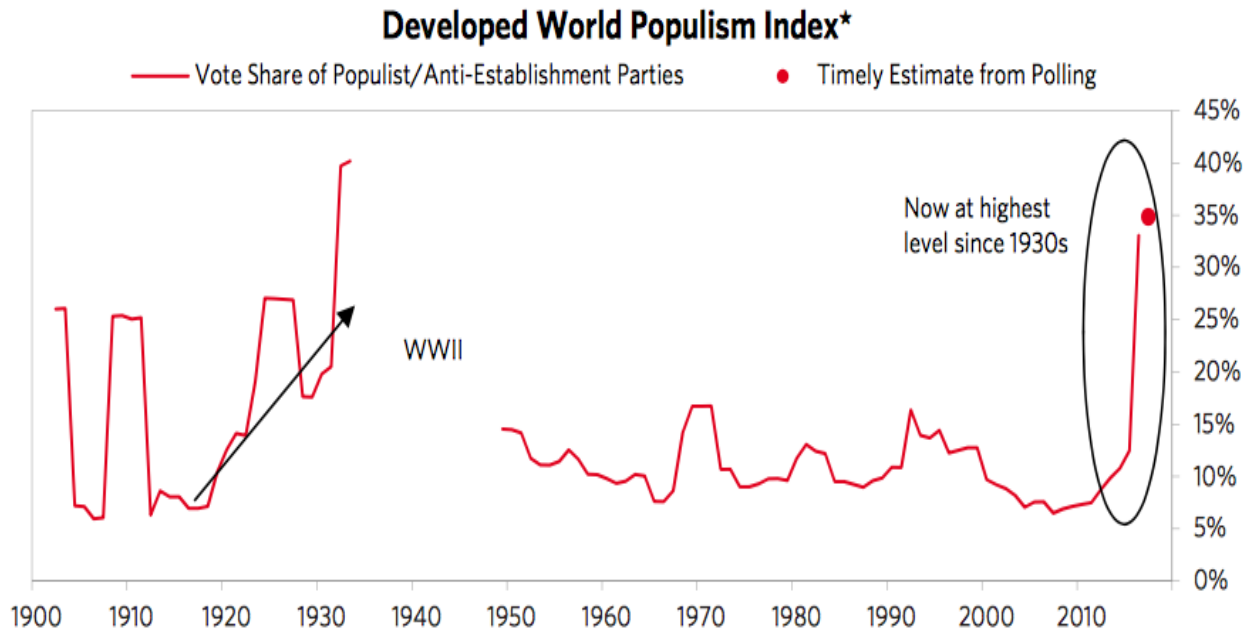
* ICT=Information and Communication Technologies; GVC=Gloval Value Chain

Globalization + Automation => Declining Middle-Class in AEs



<http://www.ozy.com/provocateurs/the-man-behind-the-most-important-chart-of-2016/74283>

Then came the rise of Populism...



**The latest point includes cases like Trump, UKIP in the UK, AfD in Germany, National Front in France, Podemos in Spain, and Five Star Movement in Italy. It doesn't include major emerging country populists, like Erdogan in Turkey or Duterte in the Philippines. In the rest of the study, we look at populists of the past rather than those now in office in order to study the phenomenon because the stories of ones in power or possibly coming to power are still being written. For example, while we consider Donald Trump to be a populist, we have more questions than answers about him and are using these other cases to assess him against by seeing if he follows a more archetypal path or if he deviates from it significantly.*

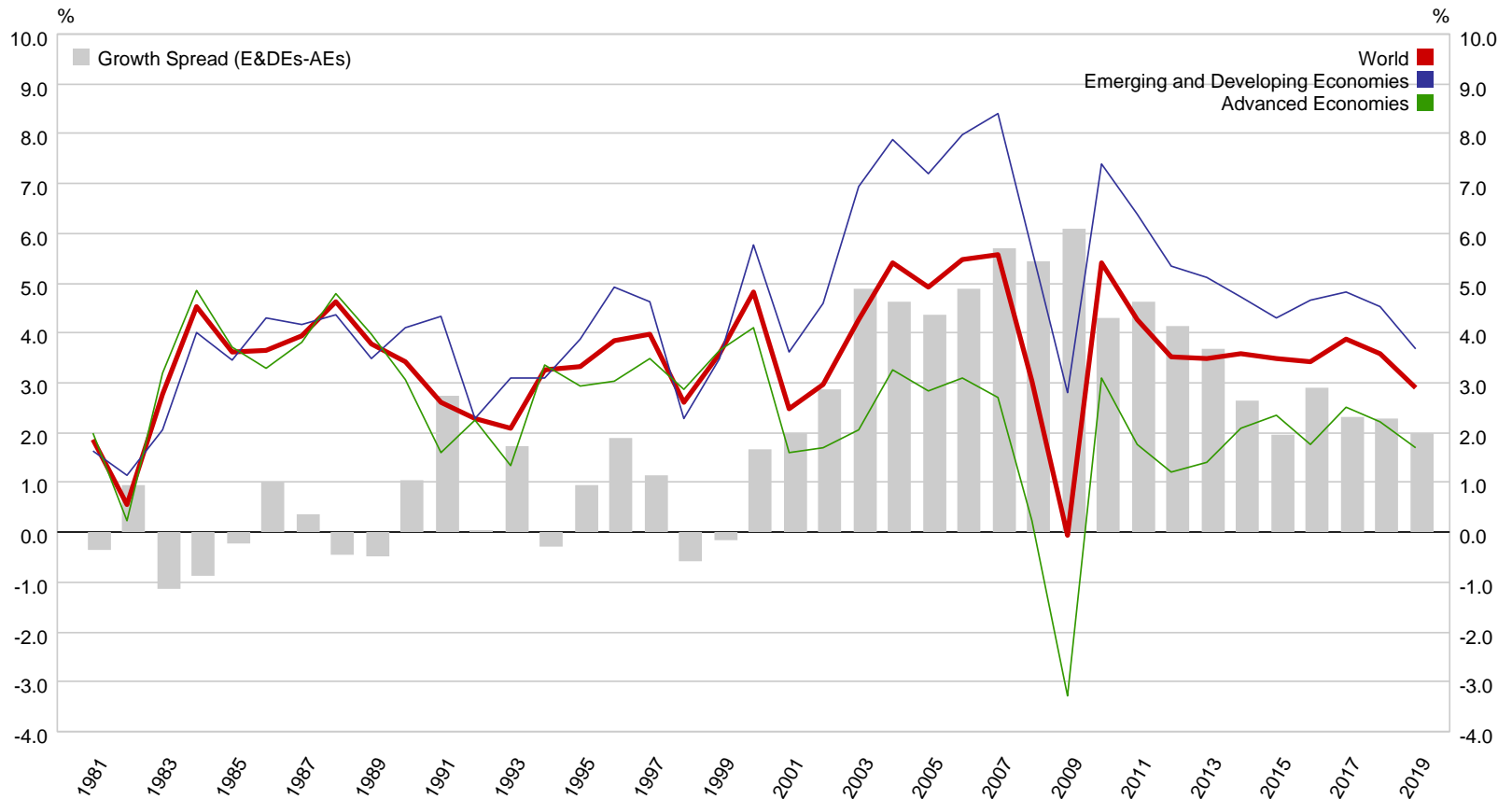
<https://www.bridgewater.com/resources/bwam032217.pdf>

Growth momentum never properly picked up after the GFC



Global Growth (%)

TURKEY DATA MONITOR

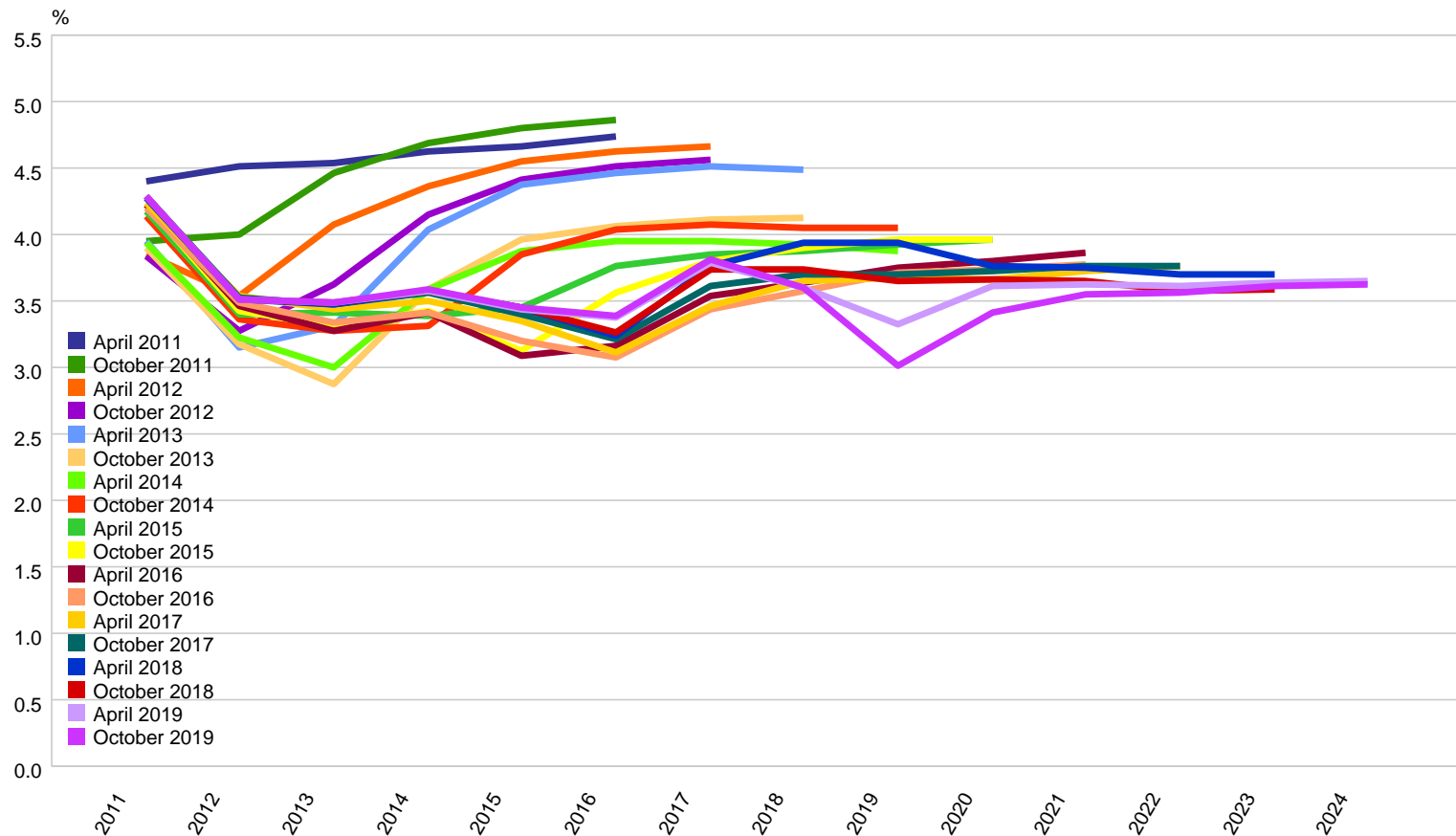


Growth forecasts have systematically gone awry...



IMF Global Growth Forecasts (%)

TURKEY DATA MONITOR



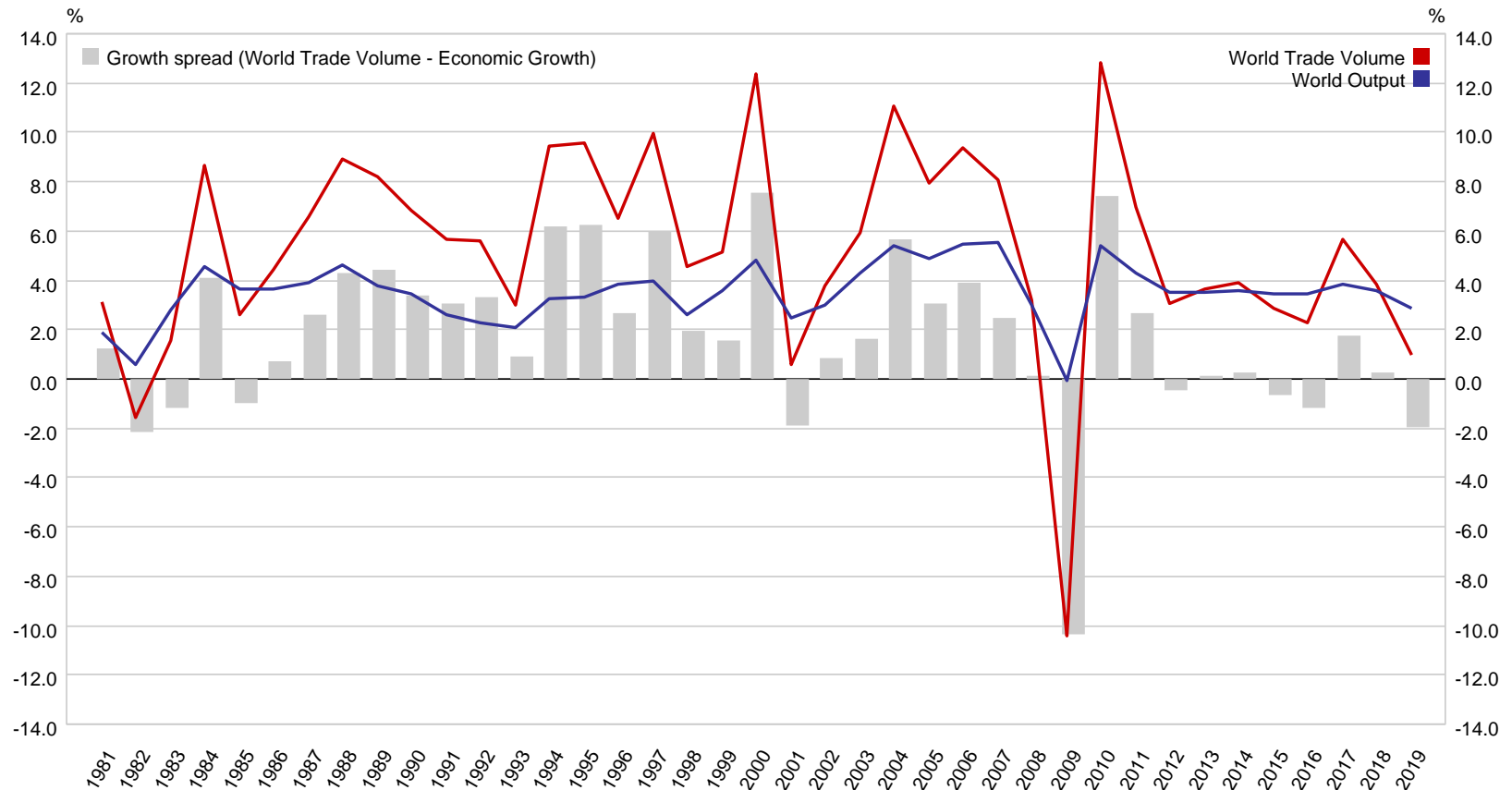
Note: Each line corresponds to a report date, with forecasts for the next 5 years formulated at that time.

Global trade has slowed since the GFC for various reasons



Output and Trade Volume Growth (%)

TURKEY DATA MONITOR

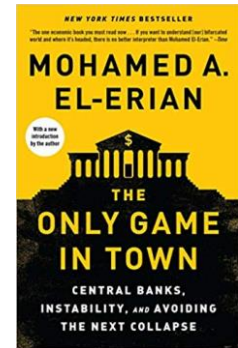
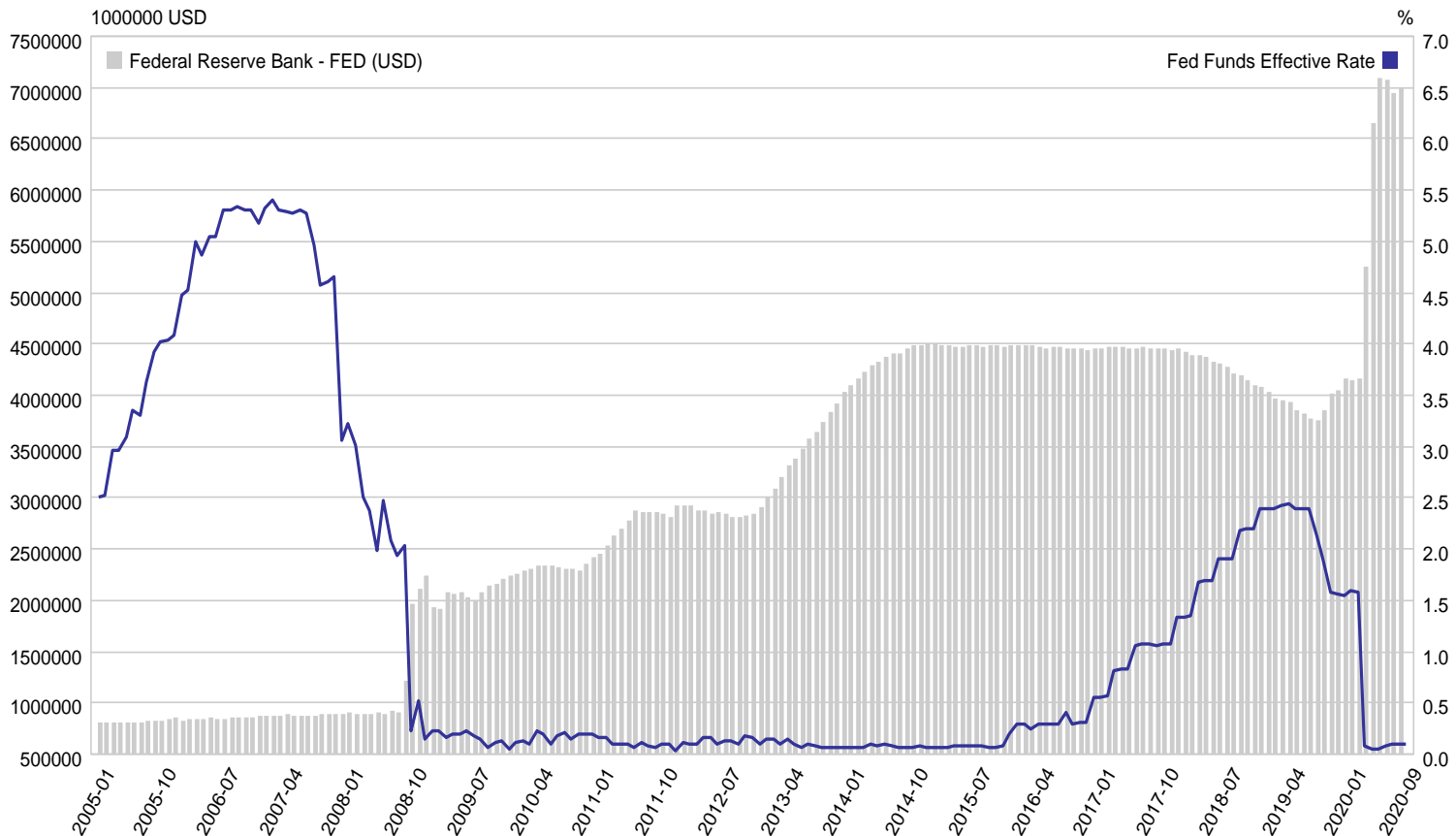


Central Banks became “the only game in town”



Fed Balance Sheet Size and Fed Funds Rate

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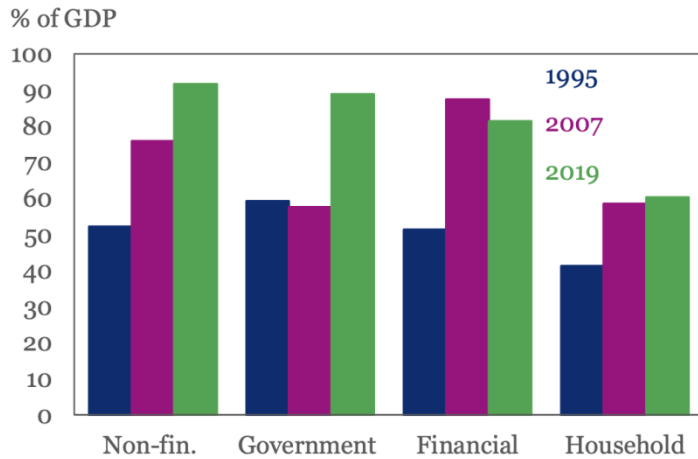


<https://www.americanactionforum.org/insight/timeline-the-federal-reserve-responds-to-the-threat-of-coronavirus/>
<https://www.brookings.edu/research/fed-response-to-covid19/>

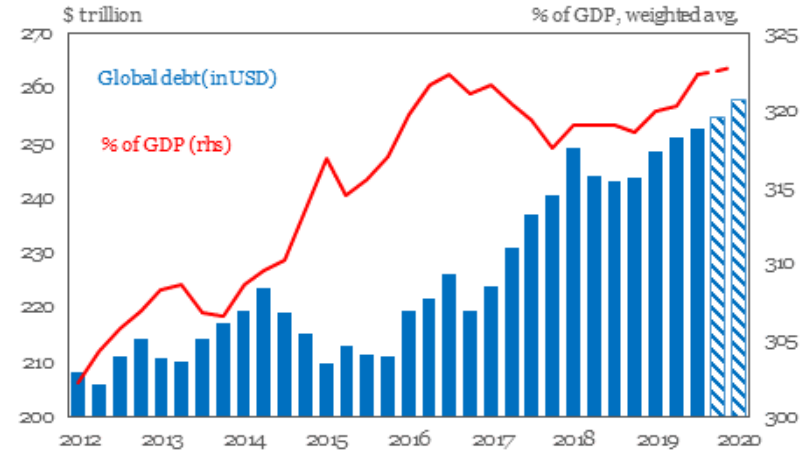
Indebtedness, which was a problem, became a bigger one



Chart 1: Government debt has doubled to \$70T since the 2008 crisis; pandemic response will drive that higher still



Global debt hits a fresh record of 322% of GDP



Source: IIF, BIS, IMF

Chart 4: EM FX debt (ex-financials) tops \$5.3 trillion

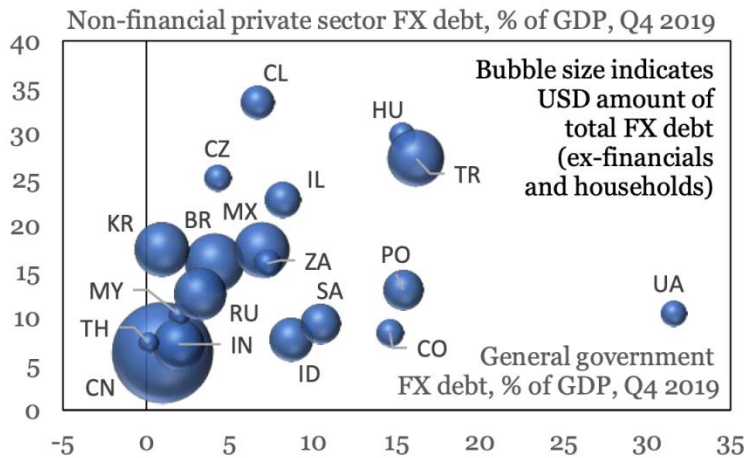
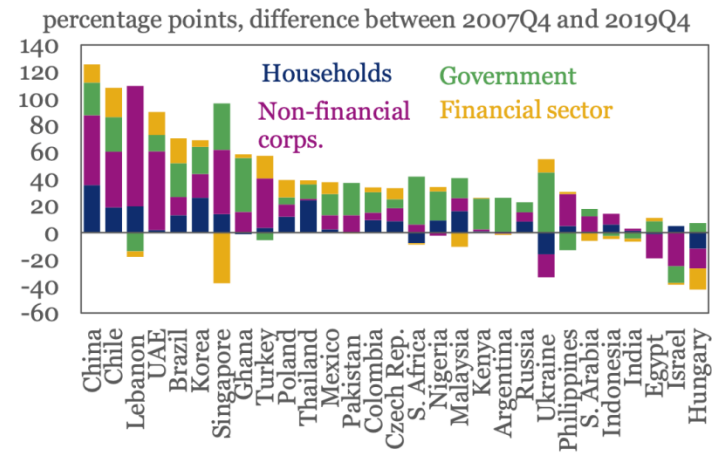


Chart 6: Change in emerging market debt/GDP since 2007



https://www.iif.com/Portals/0/Files/content/Research/Global%20Debt%20Monitor_April2020.pdf

And then the COVID hit...



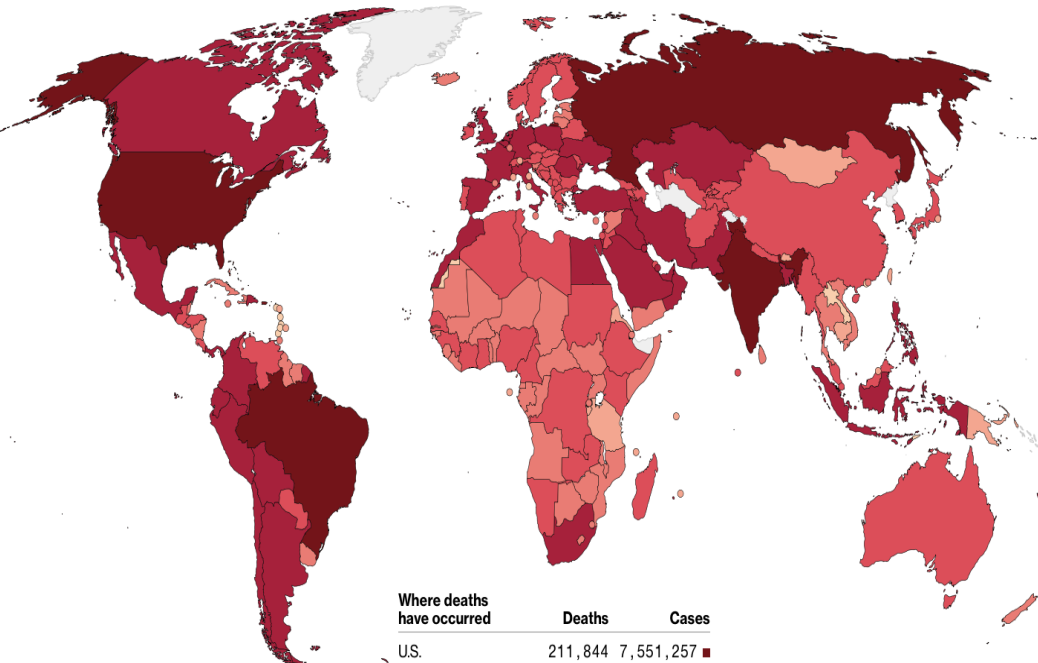
A Global Crisis Like No Other Needs a Global Response Like No Other

APRIL 20, 2020

36,200,813 / 1,056,493

Confirmed cases worldwide / Deaths worldwide

Jurisdictions with cases confirmed as of October 8, 2020, 1:23 PM GMT+3
 1-9 10-99 100-999 1,000-9,999 10,000-99,999 100,000-999,999 1 million or more



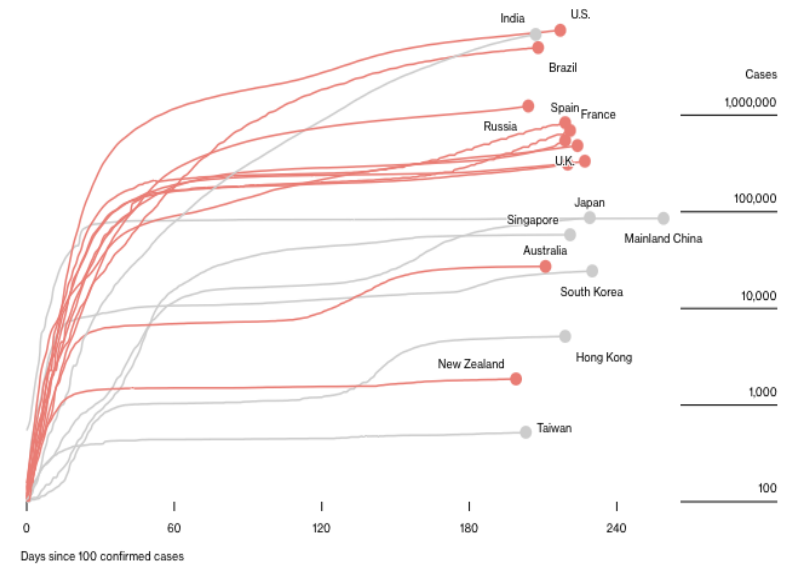
Where deaths have occurred	Deaths	Cases
U.S.	211,844	7,551,257
Brazil	148,228	5,000,694
India	105,526	6,835,655

Getting to a Flatter Curve

The first 264 days with more than 100 confirmed cases

Asia / Other

Show



Note: JHU CSSE reporting began on Jan. 22, when mainland China had already surpassed 500 cases.
 Source: Johns Hopkins University Center for Systems Science and Engineering

https://www.bloomberg.com/graphics/2020-wuhan-novel-coronavirus-outbreak/?itm_source=inline

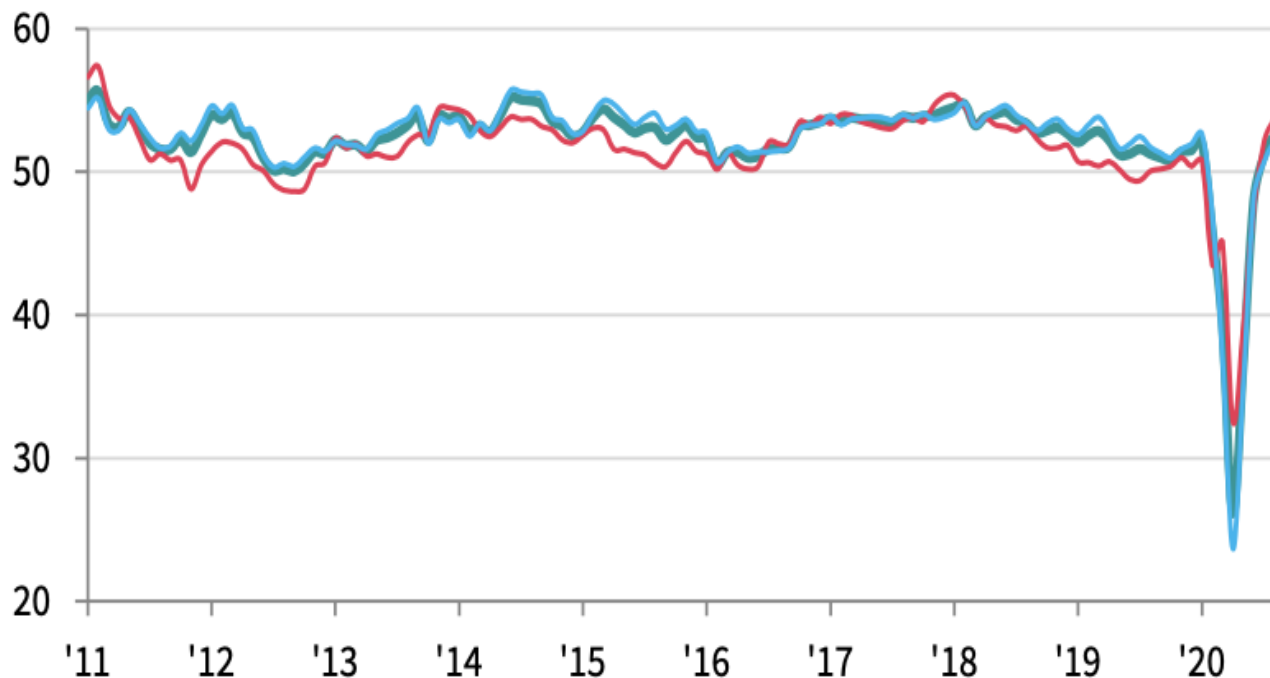
Global PMIs collapsed but then rebounded very sharply...



Global Output Index

Composite / Manufacturing / Services (Business Activity)

sa, >50 = growth since previous month



Sources: J.P.Morgan, IHS Markit.

<https://www.markiteconomics.com/Public/Home/PressRelease/14f2c7f343524934b4f8f4ce62206bfb>

But the shape of the recovery is still a matter of debate...

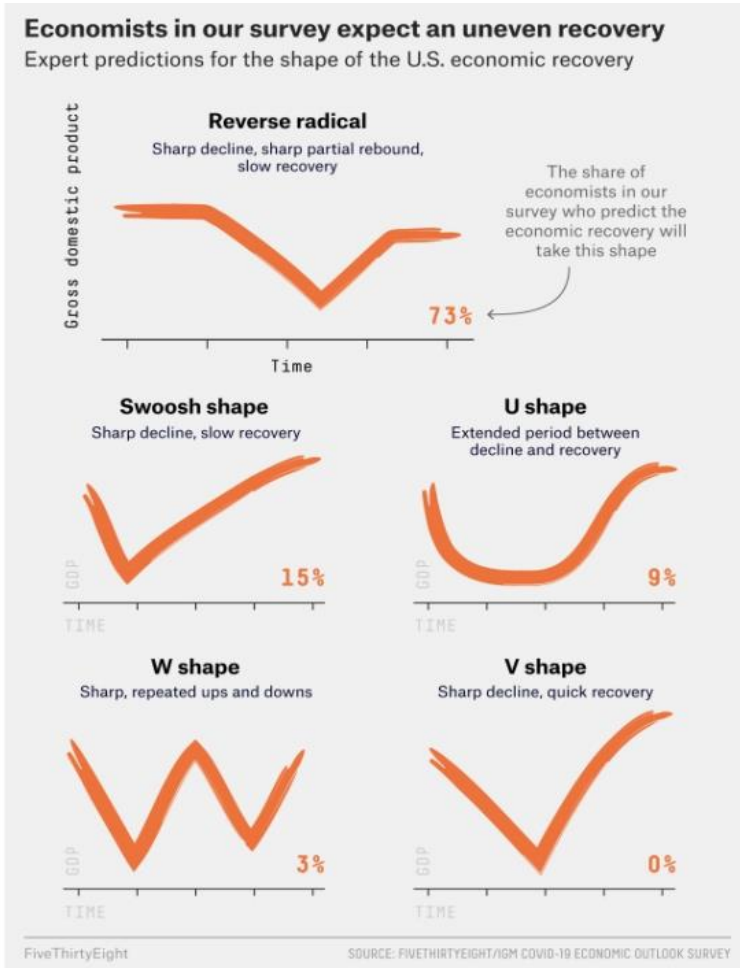
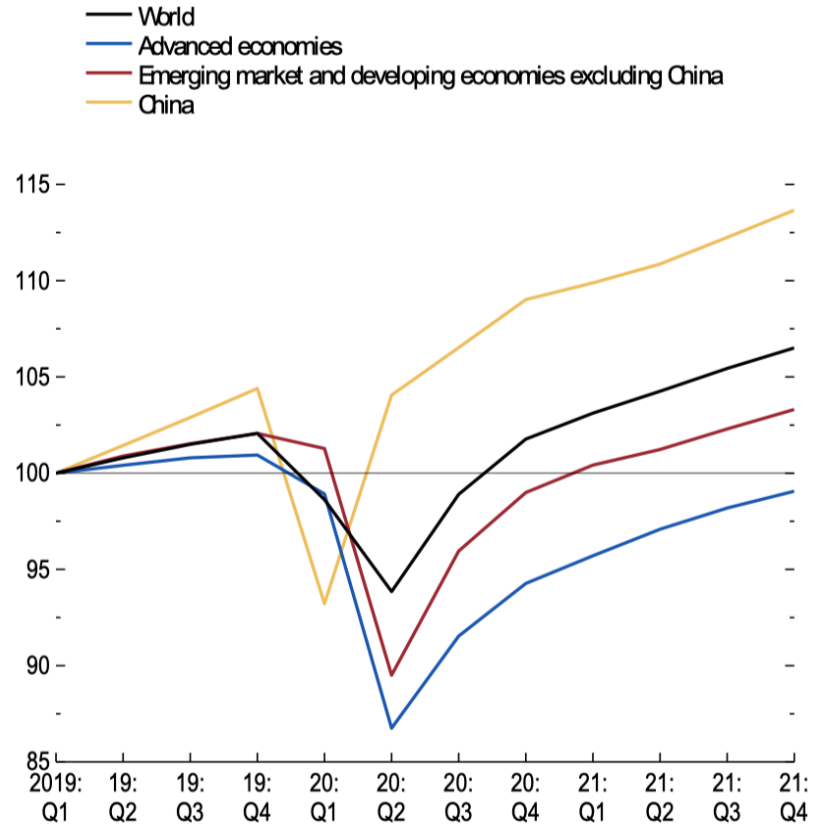


Figure 1. Quarterly World GDP
(2019:Q1 = 100)



Kaynak: *World Economic Outlook Update, June 2020, IMF*

<https://macromon.files.wordpress.com/2020/06/five-shades-of-recovery.png?w=560>

Meanwhile, a new letter “K” gained currency...



“This description of the economy fairly captures the two separate paths of the recovery. The line heading upward symbolizes those parts of the economy that have benefited from pandemic: Technology (Apple Inc., Alphabet Inc., Microsoft Corp.), general merchandise retailers (Target, Walmart), entertainment (Netflix Inc., Walt Disney Co., YouTube), Biotech and Pharmaceuticals (Moderna Inc., Johnson & Johnson & Johnson, Merck & Co., Pfizer Inc., AstraZeneca PLC) work from home firms (Slack Technologies Inc., Zoom Video Communications Inc.) and online retailers (Amazon.com Inc., Shopify Inc.). [...] The line heading downward symbolizes, well, pretty much everyone else.

<https://www.bloomberg.com/opinion/articles/2020-09-02/the-k-shaped-recovery-is-real-and-it-perfectly-captures-the-economy>

“The American economy is recovering. That's not up for debate. But the manner in which the economy is bouncing back is very much disputed by economists and politicians.

“Joe Biden says it's a "K-shaped" recovery. Donald Trump said the bounce-back is "V-shaped."

“In a K-shaped recovery, the economic bounce-back is bifurcated like a "K": The wealthiest Americans are quickly rebounding, even thriving, while the middle- and lower-income set are not.

<https://edition.cnn.com/2020/09/30/economy/k-shaped-economic-recovery-trnd/index.html>

Let's listen to OECD, IMF, Pimco on the outlook...



“As economies began to reopen, activities that could operate with physical distancing rebounded strongly. But it would be imprudent to infer from this that the recovery is V-shaped and global income can rapidly return to pre-crisis levels. In some industries a rapid recovery will occur; those linked to digital activity for example, but others will not be able to fully recover for some time.”

https://www.oecd-ilibrary.org/economics/oecd-economic-outlook/volume-2020/issue-1_34ffc900-en

“The IMF has issued a rallying call to rich countries around the world to increase public investment as the best way to encourage a strong economic recovery from the pandemic. Advanced economies should not worry about debt, but take advantage of historically low borrowing costs to increase spending on infrastructure maintenance immediately, it said.

<https://www.ft.com/content/fc7ad858-0fdd-401e-bce5-796a8353ba30>

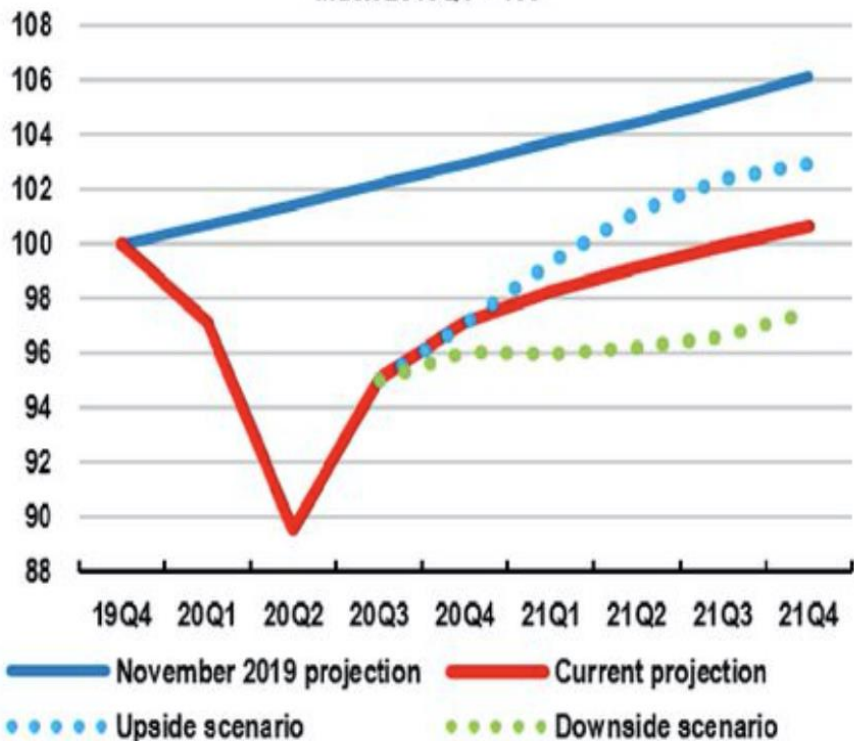
“While a continuation of the cyclical recovery over the next year or two is very likely, we think the concerns [...] about “economic scarring” that will weigh on steady-state potential output growth are warranted. Longer spells of unemployment typically imply an erosion of individuals’ skills and thus labor productivity. Also, higher uncertainty will likely depress business investment for a long time to come. Together with an increasing “zombification” of the corporate sector due to massive government and central bank support, this will likely weigh on longer-term productivity growth.

<https://europe.pimco.com/en-eu/insights/economic-and-market-commentary/secular-outlook/escalating-disruption-2020>

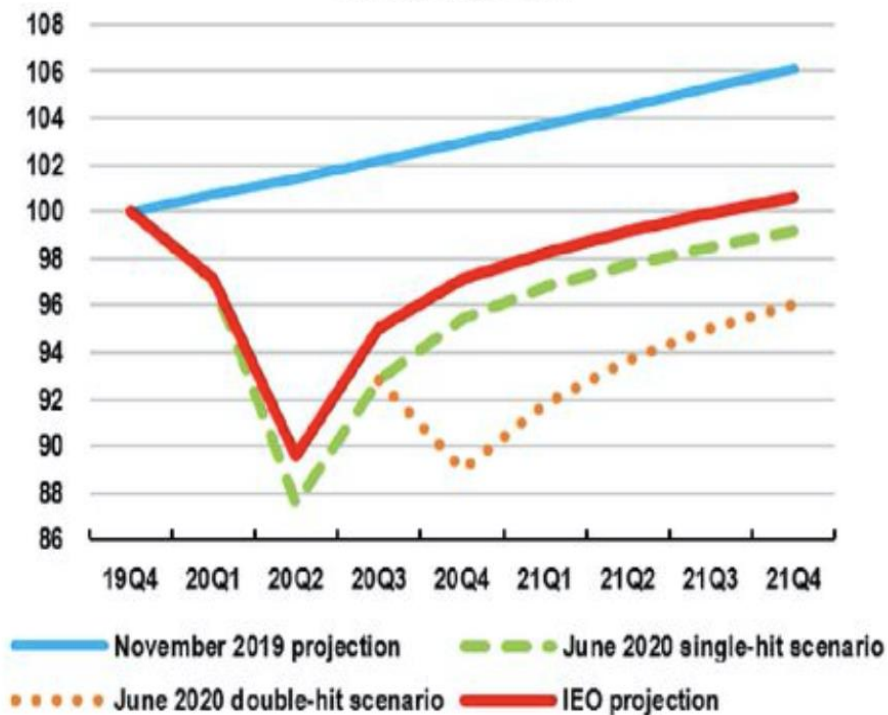
OECD forecasts two scenarios based on confidence...



A. World GDP
Index 2019Q4 = 100



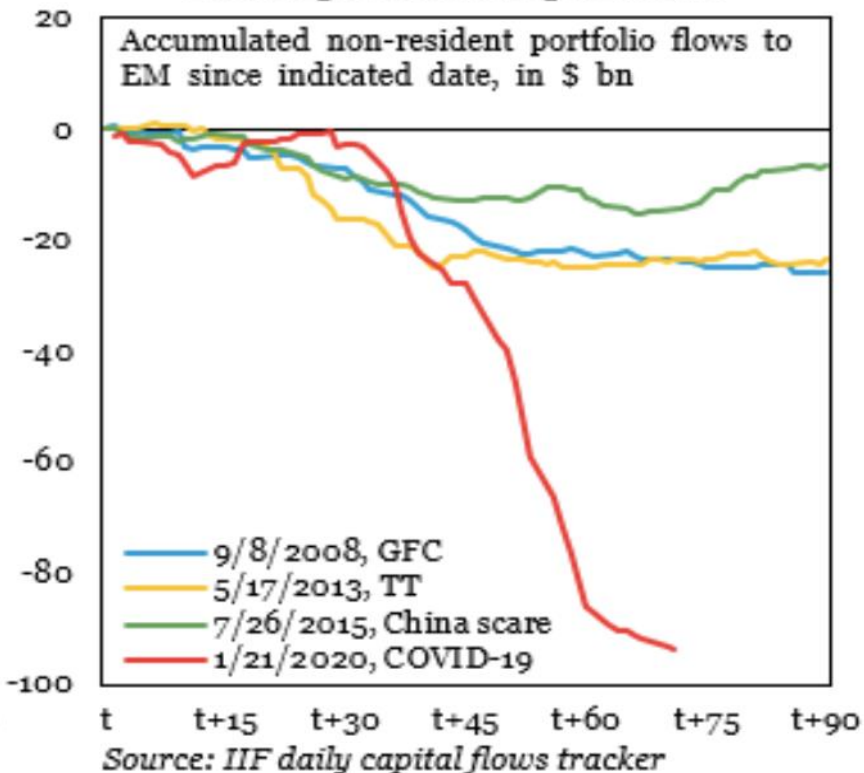
A. World GDP
Index 2019Q4 = 100



There have been massive capital outflows from EMs...



Stress Episodes for Capital Flows

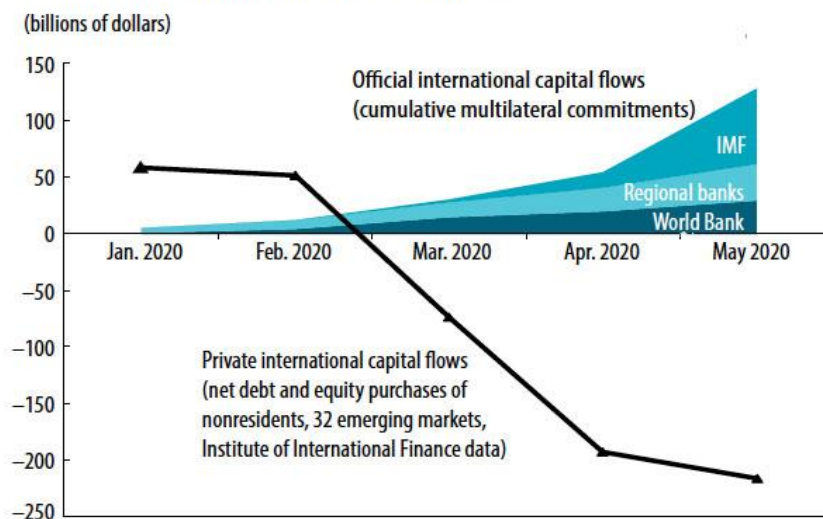


<https://www.iif.com/Publications/ID/3829/IIF-Capital-Flows-Tracker-The-COVID-19-Cliff>

Chart 1

Multilateral lifeline

Quick funding by multilaterals helped offset a collapse of government revenues and the withdrawal of private capital.



Source: Horn, Sebastian, Carmen M. Reinhart, and Christian Trebesch. 2020. "Coping with Disasters: Two Centuries of International Official Lending," NBER Working Paper 27343, National Bureau of Economic Research, Cambridge, MA.

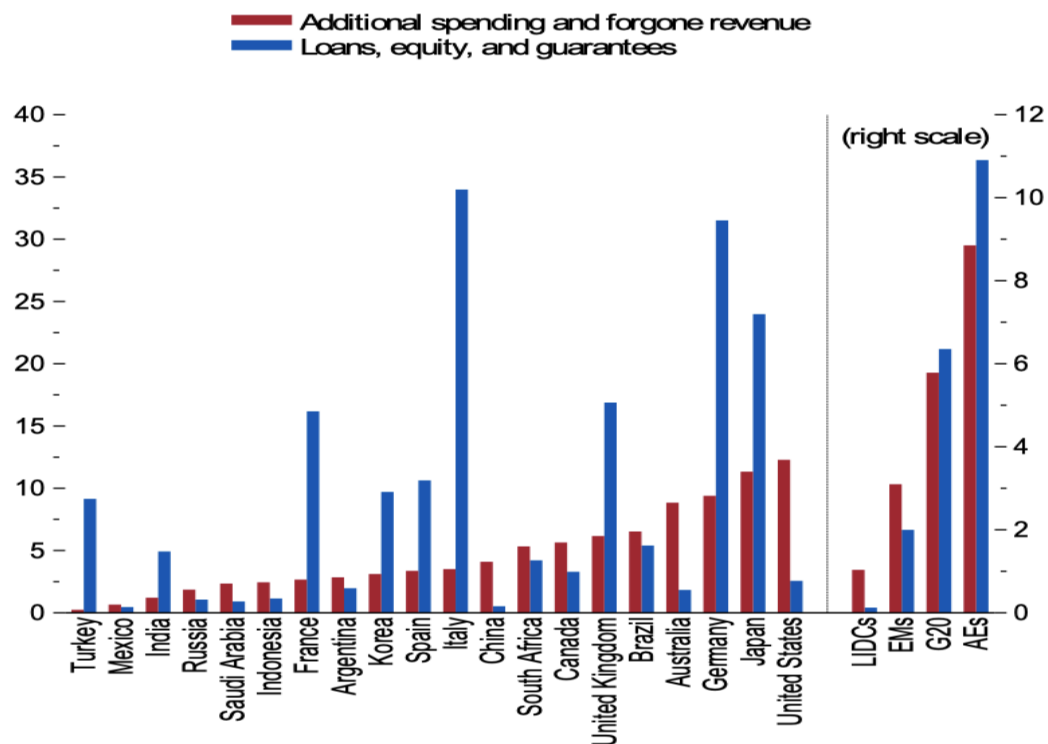
<https://www.imf.org/external/pubs/ft/fandd/2020/09/debt-pandemic-reinhart-rogoff-bulow-trebesch.htm>

This time fiscal response was forceful, but varied...



Annex Figure 1. Country Fiscal Measures in Response to the COVID-19 Pandemic
(Percent of GDP)

Countries are providing sizable fiscal support through budgetary measures, as well as off-budget liquidity.

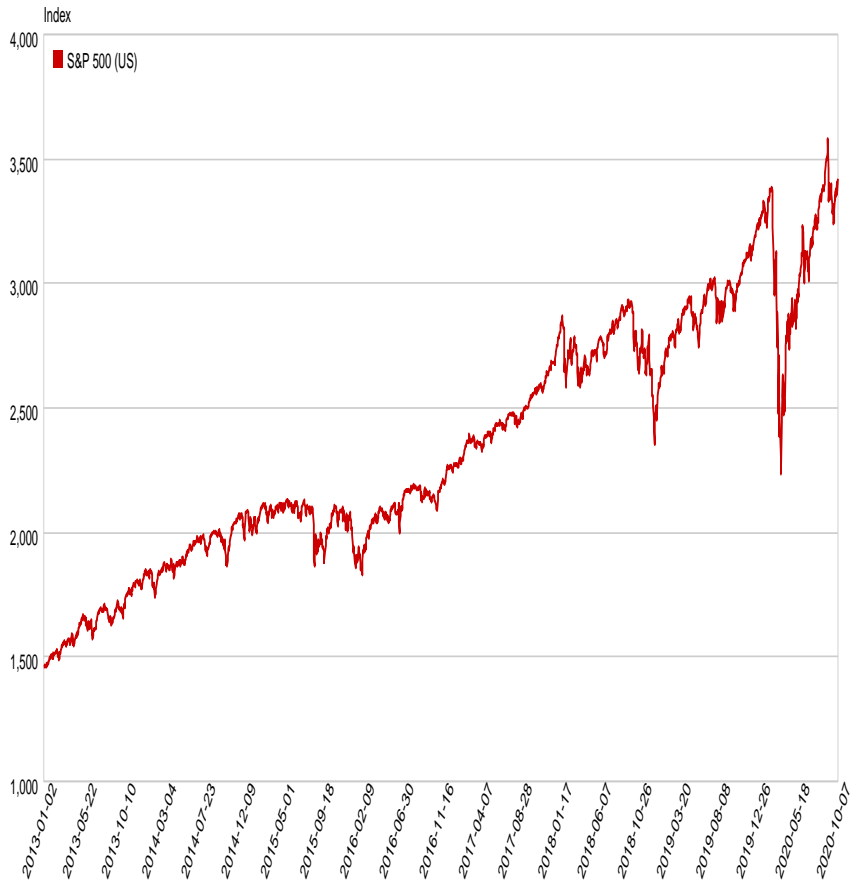


Source: *World Economic Outlook Update, June 2020, IMF.*

Markets (mostly) rallied, shrugging off the real economy



S&P 500



Gold Price



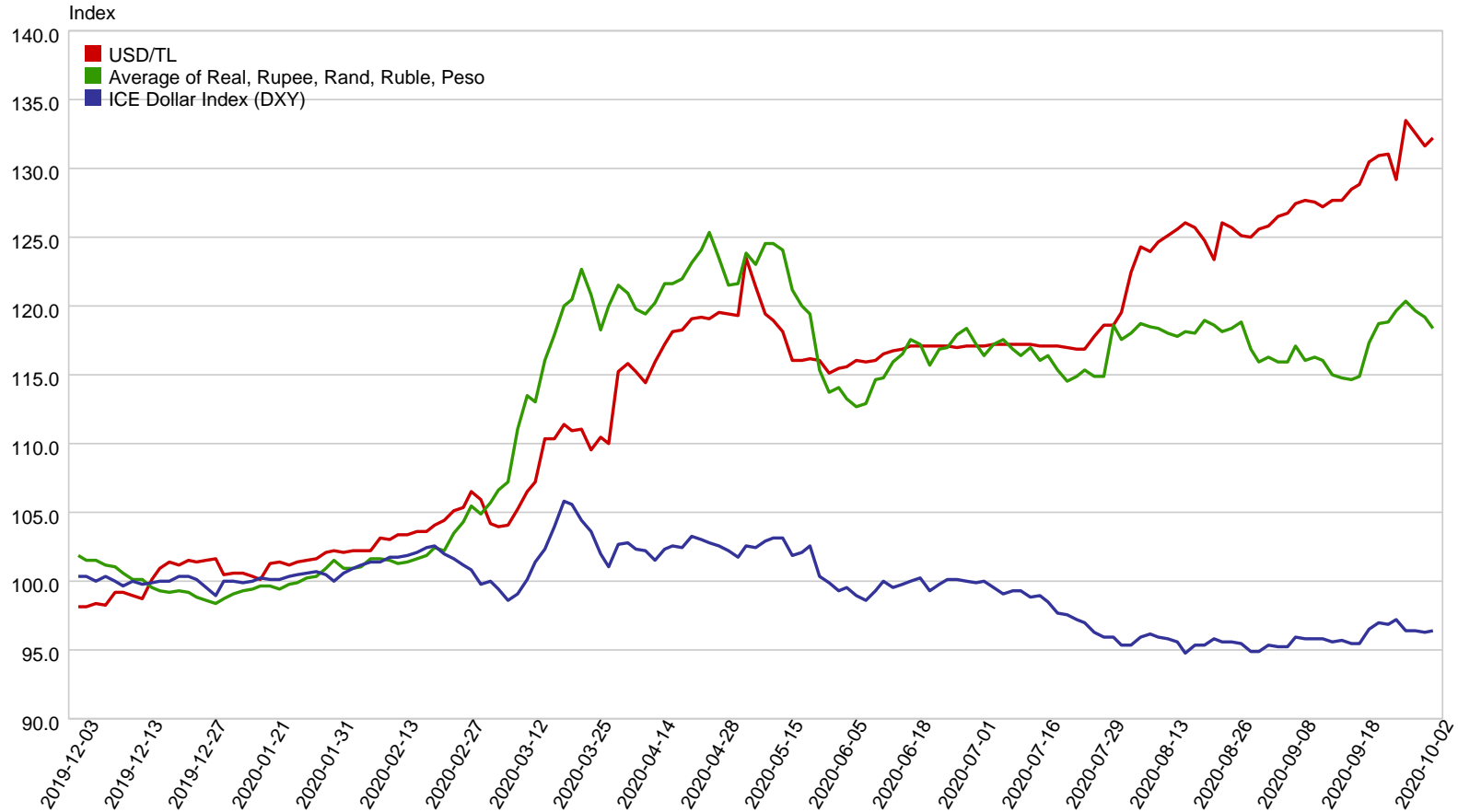
Dollar weakened, but this time not against the EMs...



Dollar vs EM and AE Currencies



(2019 December =100)

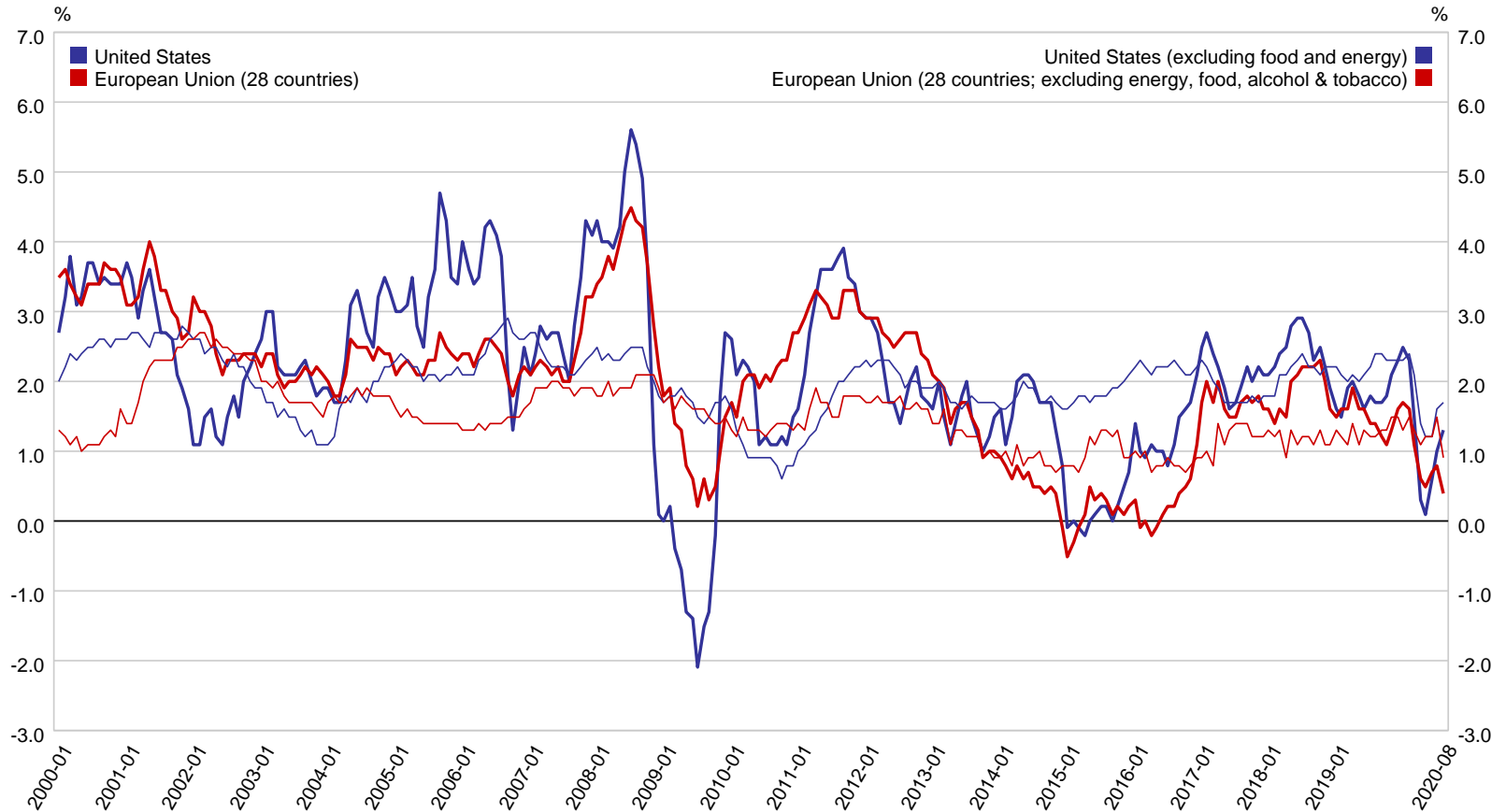


Below-target inflation/deflation remains a risk in AEs



Inflation in the US and EU (% y/y)

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Two particularly pressing concerns: poverty and debt...



“Overall, the pandemic will push between 88m and 115m people into extreme poverty this year, which the bank defines as living on less than \$1.90 a day, according to a report it published on Wednesday. According to the report, more than 80 per cent of those who will fall into extreme poverty this year are in middle-income countries, with south Asia the worst-hit region, followed by sub-Saharan Africa.

<https://www.ft.com/content/2a41fa8b-e5d1-4102-b14f-7ec5820a5d7d>

“Without aggressive policy action, the COVID-19 pandemic could turn into a protracted debt crisis for many developing countries. Debt risks in developing countries were already high prior to the pandemic. These risks are now materializing. High debt servicing hamstrings developing countries’ immediate response to COVID-19 and rule out needed investment in the United Nations Sustainable Development Goals (SDGs). A debt crisis would dramatically set back sustainable development. [...] The global community has responded. [...] But actions taken so far will not suffice to avoid defaults.

<https://www.un.org/development/desa/dpad/publication/un-desa-policy-brief-72-covid-19-and-sovereign-debt/>

“Amid massive and synchronous financing needs across a broad swath of countries, there is brewing in the background a growing need for debt restructurings in numbers not seen since the debt crisis of the 1980s. Official creditors should be prepared to act as needed.

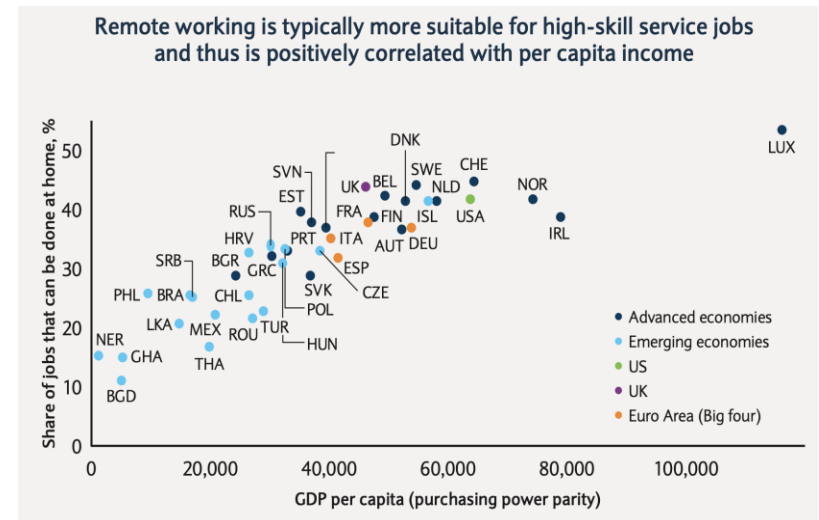
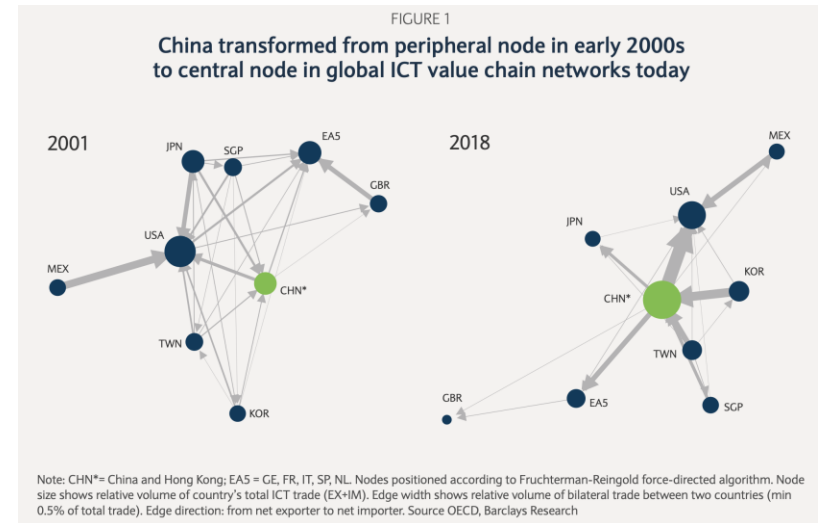
<https://www.imf.org/external/pubs/ft/fandd/2020/09/debt-pandemic-reinhart-rogooff-bulow-trebesch.htm>

Some speculations on a post-COVID world...



- **GVC Realignments:** The pandemic has revealed the risk of overdependence on China, and how without the timely arrival of intermediate goods, GVCs can grind to a halt. Diversification of supply chains away from China and re-shoring will likely follow, together with more government involvement.
- **Less Mobility:** The international mobility of people rose dramatically leading to rising tourism revenues and migrant numbers. The pandemic will likely reduce these sharply until at least a vaccine is found. This means additional challenges for countries dependent on these flows.
- **Accelerated Automation and Digitization:** Partly follows from one and two above. Faced with the prospect of increased production costs, reduced availability of migrant workers, etc. businesses are likely to turn to automation and digitization. Working from home (WFH) accelerated the use of technologies that were previously feasible, which should now progress further, though there are stark differences across countries in terms of WFH schemes (25% in Turkey vs. 40% in UK, Sweden), with adverse consequences on income inequalities.
- **Demand for Green Policies:** With the shock of the pandemic, green policies came to limelight by affecting public perception of humanity's exposure to 'natural' events, and how air quality and the like improve, when activity is reduced. Policy makers' emphasis on investing in 'green' policies and infrastructure has also risen visibly.

Source: Barclays Capital (link [here](#))

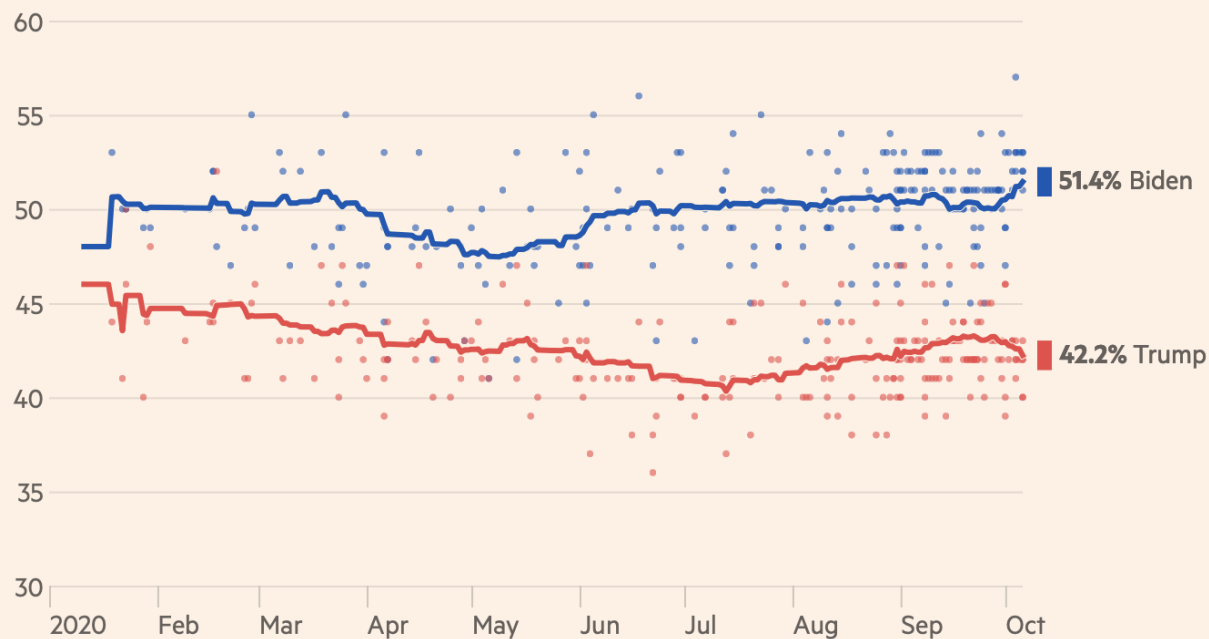


US elections, along with COVID, will define Q4 and beyond...



How Trump and Biden are doing in the US national polls

Lines represent weighted averages, points represent polls (%)



Source: RealClearPolitics, updated as of October 8 2020

© FT

RealClearPolitics

Source: <https://ig.ft.com/us-election-2020/> On US elections and market implications, see:

<https://www.goldmansachs.com/insights/pages/beyond-2020-post-election-policies.html>

On the key issues to watch in Q4, see: <https://worldview.stratfor.com/article/2020-fourth-quarter-forecast>

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