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No Growth Boost from Developing Economies Says World Bank

By Nick Beams

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In the years immediately following the global financial crisis of 2008, the claim was frequently advanced that, while the major capitalist economies were severely impacted, the so-called developing economies would provide a new base for world growth.

This upbeat assessment has looked increasingly fragile in the recent period. It has now been officially buried in the latest report on the global economy released by the World Bank yesterday.

Presenting the report, World Bank president Jim Yong Kim said:

> "Developing countries were an engine of global growth following the financial crisis, but now they face a more difficult economic environment." This was not a temporary phenomenon but the result of a "structural slowdown,"

likely to last for years.

The report's lead author, Franziska Ohnsorge, commented that "after four years of disappointing performance, growth in developing countries is still struggling to gain momentum." Despite what he called "auspicious financing conditions"—the global low-interest regime—a "protracted slowdown" had been underway in many countries.

The bank cut its forecast for global growth to about 2.8 percent in 2015, down by 0.2 percentage points from its prediction in January.

The World Bank now appears to be pinning its hopes on the major economies, where it says recovery "is expected to gather momentum." Even if its forecasts for a 2 percent growth in high-income countries in 2015 and 2.3 percent in 2016-17 are met, however, they are too low to provide much of a boost for the world economy.

Moreover, as the World Bank's sister organisation, the International Monetary Fund, pointed out in its World Economic Outlook, issued two months ago, "potential growth in advanced economies is likely to remain below pre-crisis rates."

The chief reason is the stagnation of business investment spending in these economies, down on average by 20 percent since the global financial crisis, compared to 10 percent in the same period after previous recessions.

A negative feedback loop is in operation. Firms are holding back cash on the basis that there

are no profitable outlets, using it instead for speculative purposes, while the failure to invest and push forward economic growth is bringing a further contraction in profitable investment prospects.

Even if there were significant expansion in the US, this could have adverse global effects. At best, a rise in US interest rates would dampen capital flow to emerging markets. At worst, it could bring about a large withdrawal of funds. That took place in May-June 2013, when indications by the US Federal Reserve that it would ease its purchases of financial assets produced what was dubbed the “taper tantrum” in many markets.

The World Bank noted that tightening financial conditions, a reassessment of credit risks and an appreciation in the value of the US dollar, which impacts heavily on dollar-denominated debts, could amplify risks in a number of countries. It pointed out that credit rating downgrades had occurred in countries such as Brazil, Russia and South Africa since 2013.

“Rising concerns about credit downgrades in a number of larger emerging market economies could cause a general reappraisal of risk assets that spreads to other emerging and frontier markets,” the report stated. In other words, any turbulence in one or two countries could rapidly spread across the spectrum of emerging markets.

The bank also drew attention to the fact that any economic recovery in the United States is very much a two-edged sword because of its impact on the value of the US dollar. If the dollar’s rise was more than warranted by US growth prospects and if it did not “invigorate activity in US trading partners” then it “could choke off the global recovery that is still quite fragile.”

Basing itself on data compiled by the US Federal Reserve, the report said a 10 percent effective appreciation of the US dollar, back to its level of 2002, could reduce US gross domestic product by as much as three-quarters of a percentage point after two years because of its effect on exports. Such a decline would have “important repercussions” for global economic prospects, impacting heavily on Latin America.

The region’s largest economy, Brazil, is already experiencing major problems. Its economy is now predicted to contract by 1.3 percent this year, representing a 2.3 percentage point swing from the forecast made in January.

One of the surest indicators of the state of the world economy is the level of international trade. The report pointed out that global trade growth in 2014 was 3.6 percent, well below the average of 7 percent before the financial crisis. “Some recovery in global trade is projected over the next two years, but at a pace still significantly below pre-crisis averages both in absolute terms and in relation to global GDP.”

Part of the reason for this slowdown is a change in investment patterns, from the establishment of new productive capacity, in the form of global supply chains, toward government and private consumption.

The report also served to call into question claims that the fall in oil prices since the middle of last year could provide an economic boost. It noted that the price decline “had not yet been fully reflected in stronger activity in oil-importing countries.”

In what might be described as a “bright spot,” the bank reported that “recovery in the euro area has progressed more rapidly than expected since late 2014.”

The reasons for this turnaround, however, demonstrate otherwise. The “recovery” was attributed to a weakening euro, declining oil prices and an improvement in the supply of bank credit.

The report said euro area growth was expected to reach 1.5 percent this year, rising to 1.7 percent in 2016-17. At least half a percentage point of the expected increase in 2015 is a result of the euro’s depreciation over the past year. In other words, currency devaluation and the supply of ultra-cheap money by the European Central Bank are playing the major role in what limited expansion there is.

Any reading of the report underscores the turning point represented by the financial crisis of 2008, which signified a breakdown in the functioning of the global capitalist economy. As soon as there is any improvement or upturn in one area, it immediately creates new risks and problems in another.

The World Bank said the risks to its outlook remained “tilted to the downside,” though less so than in January. While deflationary dangers in the euro area had receded somewhat, “new financial stability and growth risks have emerged.”

“Deteriorating prospects in some developing countries, especially commodity exporting ones, are eroding their resilience,” the bank warned. This, together with possibility of “volatility around US monetary policy” was “increasing the risk of financial stress.” The consequences for developing country financial markets were likely to be “substantial.”

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Articles by: **Nick Beams**

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