World Economic Trends
The 2014 Spring Report
-- Risks and Potential of Emerging Economies --
(Summary)

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The global economy as a whole is recovering moderately thanks to a moderate U.S. recovery and a European pick-up in 2014, although some countries including China and other emerging countries have indicated a weakness. (The global economy is expected to score a growth rate of about 3% in 2014.) This report analyzes the current economic conditions and future outlook in each country and region.

- USA: A moderate economic recovery is continuing in line with growth mainly in private consumption.
- Europe: The economy as a whole is picking up, pulled by Germany and the United Kingdom.
- Asia: In China, the pace of economic expansion is slowing with financial market instability.

This report also reviews emerging countries' growth potential and its future linkage with the world from the viewpoint of how China's development and growth potential decline would affect the global economy.
The global economy as a whole is recovering moderately thanks to a moderate U.S. recovery and a European pick-up, despite a weakness seen in some countries including China and other emerging countries. (Figs. 1-2)

Inflation remains at low levels in developed countries while staying at high levels in emerging countries. Some developed countries see housing price hikes. (Figs. 3-4)
Global Economy: Continuing a moderate recovery

Although weakness is seen in some countries including China and other emerging countries, the global economy as a whole is recovering moderately thanks to a moderate U.S. recovery and a European pick-up.

- Forecast: A moderate recovery will continue thanks to a moderate U.S. economic recovery and a European economic pick-up. (Real economic growth in 2014: about 3%)
- Risks: (1) Impacts of U.S. monetary easing reduction, (2) too prolonged period of low inflation in the Euro area, (3) Chinese financial market developments, (4) financial market destabilization in other emerging countries, (5) geopolitical risks

USA: Sustaining a moderate economic recovery

The economy is recovering moderately due to a slow upward trend of consumption and other developments such as employment and income environment improvements and housing and stock price hikes.

- Forecast: A moderate recovery will continue. (Real economic growth in 2014: roughly in the upper 2% range)
- Downside risks: (1) A decline in housing investment accompanying an asset purchase shrinkage, (2) Prolonged deceleration of emerging economies
- Upside risks: (1) Rise of asset prices, (2) Decline of credit risk
Europe: Continuing a pick-up
While the United Kingdom is recovering, the Euro area is continuing a pick-up pulled by Germany.

- Forecast: The pick-up will continue as consumption and investment grow supported by relaxation of financial conditions and moderation of fiscal consolidation, coupled with an export increase sustained by a recovery in other economies including the USA. (Real economic growth in 2014: about 1%)
- Risks: (1) Resurgence of the sovereign debt problem, (2) An export decline affected by the deceleration of USA and Asian economies, (3) Further employment deterioration, (4) Too prolonged period of low inflation

Asia: Weakness is seen in some economies
China is slowing down its economic expansion. South Korea and Taiwan are rebounding. ASEAN economies are stalled. India has hit bottom.

- Forecast: Rather low economic growth (Real economic growth in 2014: Mid-7% in China, Mid-3% in South Korea and Taiwan, in the lower 4% range in ASEAN countries, around 5% in India)
- Risks: (1) Chinese real estate price plunges and relevant financial market instability, (2) Impact of U.S. monetary policy change, (3) Impact of China's economic deceleration
Chapter 1, Section 1. Overview of the Global Economy
-- Major Global Economic Risks and Their Trends (1) U.S. Monetary Easing Reduction, Euro Area Deflation Fears --

- It is important to avoid major market fluctuations through communications with the market based on costs (excessive risk-taking) and benefits (elimination of slack including unemployment) of quantitative monetary easing. (Figs. 5-7)
- While inflation rates are falling in the Euro area, the risk of deflation is moderate. The Euro area is expected to see a steadier pick-up. Unexpected demand-side shocks could plunge the Euro area into deflation. (Figs. 8-9)
Emerging countries' currencies have intermittently depreciated, leading to capital outflow. The impact of capital outflow remained smaller than the past one due to the background of such developments as foreign currency reserves replenishment and foreign exchange deregulation. (Figs. 10-11)

As psychological risk aversion has emerged in addition to current account deficits and other economic fundamental weaknesses in emerging countries, capital flight from emerging country currencies to developed country currencies has been seen in some cases. (Fig. 12)

The Russian currency's temporary depreciation and other developments have come in response to growing geopolitical risks involving the Ukraine situation. But their effects on international financial markets have been limited. (Figs. 13-14)
Chapter 1, Section 1. Overview of the Global Economy
-- Major Global Economic Risks and Their Trends (3) China's Financial Risks --

Factors behind the Chinese economy's deceleration include policy measures to refrain excessive credit expansion through shadow banking. They also cause the destabilization of real estate prices as well as financial markets. (Figs. 15-16)

If risk-premium hikes and reductions in lending, it may further affect economic activities, in particular for small and medium-sized manufactures, real estate firms and others that depend on shadow banking funds more heavily. It has observed that bank loans expand in total social financing, while Chinese authority regulates WMP (Wealth Management Products). (Figs. 17-18)
Current Economic Conditions in Major Countries/Regions (1)

-- U.S. Economy Continuing Moderate Recovery --

- Private consumption is sustaining a moderate increase due primarily to improvements of employment and the completion of household balance sheet adjustments. (Fig. 19)
- Business investment has recovered the level before the global financial crisis due to corporate earnings improvement, though with a slightly slower recovery tempo. (Figs. 20-21)
- Housing units started slowed in early 2014 due to cold waves and heavy snowfall. Price hikes remain below the Federal Reserve target. (Figs. 22-23)
Chapter 1, Section 2. Current Economic Conditions in Major Countries/Regions (2)

-- European Economy Picking Up as a Whole --

Some countries such as Spain have improved competitiveness through the implementation of structural reforms including labor market reform and are expected to pick up driven by the export growth. Corporate loan demand as a whole is recovering. (Figs. 24-26)

In the United Kingdom, private consumption has increased due primarily to income improvements and the wealth effects of housing price hikes. (Fig. 27)

After the turmoil under the sovereign debt crisis, financial markets have stabilised thanks mainly to the European Central Bank’s aggressive monetary policy and progress in fiscal consolidation in each country. (Fig. 28)
Chapter 1, Section 2. Current Economic Conditions in Major Countries/Regions (3)
-- Weakness in Asian Economies --

- In China, the pace of economic expansion is slowing down. Investment growth in the ferrous metal processing industry, which reportedly has overcapacity, is contracting. Floor space of Buildings Started in the real estate sector has also declined. (Figs. 29-31)
- South Korea and Taiwan have picked up due mainly to an upturn in global semiconductor shipments since the second half of 2013. (Fig. 32)
- ASEAN economies are generally stalling due mainly to an export slowdown. (Fig. 33)
- The Indian economy has hit bottom, while net exports are improving. (Fig. 34)
Chapter 2, Section 1. Background of Growth Deceleration in Emerging Countries (1)
-- Characteristics of Emerging Economies and Factors behind Growth Deceleration

- Emerging economies achieved high growth on the strength of progress in globalization and invigorated trade and investment from 2000, accounting for half of the global economy in 2013. (Fig. 1)
- Following the global financial crisis, mainly resource-rich countries have decelerated economic growth due to the Chinese economy’s deceleration, a slowdown of the globalization tempo and financial market turmoil from 2013. In some emerging countries, private credit expanded excessively. (Figs. 2-3)
- Population bonuses behind the high economic growth will peak in 10 to 20 years in many emerging countries. But the timings for such peaking will differ from country to country. (Fig. 4)
- Emerging countries will have to exploit their comparative advantage for developing infrastructure and institutions to sustain economic growth. (Fig. 5)
Chapter 2, Section 1. Background of Growth Deceleration in Emerging Countries (2)
-- Challenges for Resource-Rich Economies --

- Growth has decelerated remarkably in resource-rich countries. International resources markets have slackened due to China’s growth deceleration coupled with the diversification of energy supply since after the global financial crisis. (Figs. 6-7)
- For the reason that resource-rich countries are apt to see their currencies’ effective exchange rates rising during a resources boom, their currencies appreciated in the 2000s. Their future challenge is to enhance export competitiveness through the development of human and institutional resources to support industrial sophistication. (Figs. 8-9)

Fig. 6 Real Economic Growth Trend
(1) Non-resource-rich countries
(2) Resource-rich countries

Fig. 7 U.S. Shale Gas Production Outlook
Share in total natural gas supply (right scale)

Fig. 8 Effective Exchange Rate Trends
(2001=100)

Fig. 9 Employment by Industry
(1) Non-resource-rich countries
(2) Resource-rich countries

- Fig. 6
  - Economic growth trends for resource-rich and non-resource-rich countries.
  - Before and after the global financial crisis.

- Fig. 7
  - U.S. shale gas production outlook.
  - Forecast for 2011 and beyond.

- Fig. 8
  - Effective exchange rate trends.
  - Resource-rich vs. non-resource-rich countries.

- Fig. 9
  - Employment by industry for resource-rich and non-resource-rich countries.
  - Primary, secondary, and tertiary industries.

Detailed data and graphs are provided to support the analysis of growth trends and challenges faced by resource-rich economies.
China is reducing its dependence on imports of parts for its exports in the international supply chain, while India is expanding such dependence. China is shifting its role from assembling and exporting final goods to exporting intermediate goods. (Figs. 10-11)

China is expanding parts exports to India and ASEAN countries. (Figs. 12-13)

In the 2000s, India and Vietnam as well as China posted high growth in machinery exports. India’s exports sharply decelerated growth toward 2012 before picking up in the middle of 2013. (Figs. 14-15)
Direct investment has been robust not only in China but also in other emerging countries. Emerging countries’ presence is expanding. Some direct investment is shifting from China to other emerging economies including India. (Figs. 16-18)

Global companies have reflected China’s changing roles in their operations, decelerating research and development spending growth in China. (Figs. 19-20)

The presence of developed countries including European countries has been declining. But foreign direct investment trends indicate that investors are returning to developed countries such as the USA. (Fig. 21)
In the 2000s, economies accelerated in China and other emerging countries. After the global financial crisis, emerging countries have decelerated their growth tempo. Factors behind the deceleration include China’s economic slowdown, unstable international finance and slower globalization. Even under such situation, some emerging countries are following the expansion of China’s economy.

China is shifting from the international division of labor, where it imports intermediate goods from Japan and South Korea and exports final goods to Europe and North America, to the vertical division, where it exports intermediate and final consumer goods to other emerging countries. Amid the shift, India and such Southeast Asian countries as Indonesia following China are taking over China’s role.

In line with supply chain changes, global companies sell a wide range of products and expand employment in emerging countries, while shifting overseas assets and R&D spending back to developed countries. Global companies from emerging countries are increasing their presence.