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The Global Economy in the 21st Century

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Two big questions from 20 years ago look somewhat different today. First, would the long-term trend of globalization continue? Trade growth has slowed markedly since the Global Financial Crisis of 2008-09. But the feared increase in protectionism did not materialize, so one must look elsewhere for explanations. Two likely factors behind the slowdown in trade are a maturing of global supply chains and a slowdown in trade-intensive physical investment.

Second, will the rapid growth of emerging market economies (EMEs) continue, and which ones? The EMEs are already slowing down and many fear the effects on them when the Federal Reserve decides to raise interest rates. Many EMEs learned from the currency crises of the 1990s and made important reforms after 2000, which helped them to get through the Global Financial Crisis relatively lightly: more flexible exchange rates, more foreign exchange reserves, smaller current account deficits, less dollar-denominated debt and less pro-cyclical fiscal policy. But backsliding on fiscal policy and debt has left EMEs once again vulnerable, especially the commodity-exporters.

For all these issues, the role of China is crucial, since it now carries so much weight in the global economy. Breathless reports in 2014 that the Chinese economy had overtaken the US economy as the world's largest (measured by Purchasing Power Parity) were followed rapidly in 2015 by breathless reports that its economy was failing. That China is slowing down from past growth rates of 10% to a more sustainable rate of 7% or lower should not have come as a surprise. It is part of a natural process of long-term convergence and involves a "rebalancing" of the economy from manufacturing into services that is desirable, even though it means a loss of export markets for some others. The open question is whether the Chinese transition to a more moderate growth path will take the form of a hard landing or a soft landing.