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Ten Trends Shaping the International Economy

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1. Is unconventional monetary policy creating a tsunami of public debt?

The severity of the financial crisis has led major central banks and monetary authorities to introduce unconventional monetary policies, with benchmark interest rates kept at historically low levels[1] and successive rounds of quantitative easing[2]. These measures have helped prevent a short-term relapse in economic activity worldwide[3]. However, these same measures may be fuelling numerous imbalances, such as new bubbles in various asset classes, as well as creating difficulties in setting objective prices for those assets, volatile markets, fiscal imbalances, and a flood of unwieldy liquidity in certain emerging countries. Central bankers are in a difficult situation, staring down the increasingly urgent need to increase rates to avoid the abovementioned effects in a context of high unemployment and minimal economic growth in the major economies. The resolution of this dilemma is one of the key economic global challenges in the medium term.

2. Multicurrency international monetary system

The loss of economic dominance by the United States, and the inexorable progress towards a multipolar world economy will lead to a multi-currency financial system, led by the U.S. dollar, as well as the euro and the yuan[4]. The weight of the U.S. dollar in total global reserves has fallen from 71% in 2000 to 62% in 2012[5]. This trend is likely to continue in the coming years, not only with regard to reserves but also for international transactions. Up to 85% of transactions are currently made in dollars, but this weight should gradually fall as European and Chinese authorities push for their currencies to be used[6].

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[1] Zero interest floor or ZIF
[2] Benchmark interest rates currently set by the American Federal Reserve stand at 0.25%; the ECB (European Central Bank) at 0.5%; the BOJ (Bank of Japan) at 0.1%; and the Bank of England at 0.5%. Extremely lax monetary policy has been accompanied by successive monetary expansions through asset purchase programs, equivalent in some cases (such as America and Japan) to a monetary injection of over a trillion dollars.
[3] Ben Bernanke, Federal Reserve chairman, claimed that the first two rounds of QE (Quantitative Easing) created two million jobs in the United States and accelerated economic activity.
[4] See: *International Liquidity in a Multipolar World*, Barry Eichengreen, 2012.
[5] Currency Composition of Official Foreign Exchange Reserves (COFER), IMF
[6] http://www.bbc.co.uk/mundo/economia/2010/09/100908_china_economia_remimbi_mes.shtml

3. Revolution in energy and new materials

The extensive use of new technologies in energy extraction is changing the world panorama of energy production, which will have major implications for the competitiveness of world regions. At the head of these technologies is 'fracking' (hydraulic fracturing), a process that enables previously inaccessible gas reserves to be exploited. This technology is causing a revolution in the United States, where it has been extensively developed – and it is estimated that American gas prices could fall to their lowest level in decades[7]. Such low prices will generate substantial cost savings for American businesses, which will in turn strain the cost structures of their global competitors (especially Europeans).

Discovery and progress in the use of new materials and raw materials, such as graphene[8] or rare earths[9], will be crucial for the development of magnets for hard drives, halogen lamps, or magnetic resonance scanners. Advances in the industrial use of these and other materials will revolutionize many economic sectors and subsectors, create new and highly profitable niche markets, and consolidate the technological advantage of those economies that invest in R&D and industrial innovation.

4. Reshoring and the return of industry

In the last couple of years several prominent multinationals have closed factories in emerging countries and returned 'home' to continue manufacturing[10]. This trend, dubbed *reshoring,* is only just beginning, but it is likely to increase sharply over the coming years because of the confluence of several factors. These include increased labour costs in emerging or developing countries[11], an expectation that energy prices will fall in the home countries of multinationals (usually Western), and the discovery of problems in decoupling production plants from R&D and head office in the countries of origin. Moreover, high rates of unemployment in advanced countries have increased the pressure for companies to recall factories and thus help alleviate the economic and political instability resulting from mass unemployment. Companies such as General Electric, LightSaver Technologies, Offsite Networks and SolarWorld have sent some or all of their production back to the U.S. from

[7] Marie Vandendriessche (2012) Game Change? The Many Faces of Today's Energy Revolution. Part I: Technology and Economy, Cause and Consequence. ESADEgeo Position Paper. Number 28.1

[8] This is the lightest material ever made; it is 200 times stronger than steel. It will make a considerable impact in the electrical industry because of its qualities for superconduction.

[9] Group of 17 chemical elements essential for modern technology.

[10] http://www.economist.com/news/special-report/21569570-growing-number-american-companies-are-moving-their-manufacturing-back-united

[11] The Economic Commission for Latin America (ECLAC) estimates that unit labour costs (ULCs) in China grew by 2.4 between 2002 and 2010; and the Boston Consulting Group (BCG) estimates that China's labour costs may have exceeded Mexico's in 2012.

China. Others such as Farouk Systems, NCR Corporation, and ACE Clearwater have returned from South Korea, India, and Hungary[12].

5. Openness and integration vs. protectionism

Over the coming years we will see an increase in bilateral trade and investment, as well as progress in the implementation and deepening of economic integration areas[13]. New sovereign economic liberalisation initiatives are revealing the reduced ability of supranational organisations, such as the World Trade Organisation, to draft agreements and function as the meeting point for such initiatives. Three prominent examples under negotiation include the *Transatlantic Trade and Investment Partnership* (TTIP) (a transatlantic liberalisation of trade and investment between the US and the European Union)[14]; the *Pacific Partnership* (a free trade area led by those Latin American countries (and their business lobbies) closest to Washington – such as Chile, Colombia, Mexico and Peru); and the *Trans-Pacific Partnership* (a free trade agreement for the Asia-Pacific area).

In contrast, mass unemployment in many world economies and the shifting of economic power to the south could encourage protectionist policies in the United States and European Union. According to UNCTAD, the percentage of measures restricting FDI (foreign direct investment) as a percentage of all trade measures has increased from 6% in 2000 to 25% in 2012[15]. Prominent examples include possible blocking operations in the United States (on the recommendation of CIFIUS[16]) against Chinese technology giants ZTE and Huawei, and the continued blockage of transactions such as the acquisition of UNOCAL by CNOOC.

6. State capitalism

The shift in north-south economic power, and the multipolarity we have witnessed in recent years, has launched a particular group of countries in which the state remains extremely influential in economic terms – China, Russia, Brazil, Mexico, United Arab Emirates, and Saudi Arabia. The economic system in these nations has been described as state capitalism. This hybrid economic model is halfway between the state and the market and varies greatly – from the tight economic control of the Chinese Communist Party to the congressional approvals required for actions by Mexican oil company Pemex. A striking demonstration of this model is the development of large publicly owned companies (state owned enterprises or SOEs), and investment funds (sovereign wealth funds or SWFs) that act as overseas

[12] *World Investment Report 2013, UNCTAD*
[13] There are currently 3,196 bilateral treaties in the world and 20 bilateral trade agreements. Ten international investment agreements were agreed in 2012.
[14] http://cincodias.com/cincodias/2013/06/24/economia/1372058249_047577.html
[15] *World Investment Report 2013, UNCTAD*
[16] *Committee on Foreign Investment in the United States*

investment bodies. Providing tax revenues in these countries hold steady, both SOEs and SWFs will increase in economic power over the coming years and become highly influential in the areas where they operate.

7. Demographic pressures and sustainability

There are currently 7.2 billion people on the planet, but this figure will increase to 9.6 billion by 2050, according to United Nations[17]. Growth will be uneven and by 2050 developing countries will contain 85% of the world population. Among developed countries, only the United States will accompany India, Indonesia, Pakistan, and sub-Saharan Africa as net population generators, but in any case, the Nigeria's population will surpass the population of the US by the middle of the century[18].

This considerable increase in the world population will generate profound political, social, and economic changes. Of critical importance is the pressure that the world population and improved living standards will inflict on natural and food resources. In the case of water, for example, it is estimated that demand will considerably exceed supply by 2030[19]. The supply of commodities must increase accordingly, either through a boost in productive capacity or through technological improvements. In any case, growth in demand will generate major volatility in the price of resources such as gas, oil or water – and increased international investment in the extractive sector could ultimately lead to serious internal and external conflicts.

8. Strengthening south-south relations

The economic awakening of the southern hemisphere has altered global economic and trade patterns. South-south trade flows have taken leading roles in international commerce – rising from just 6% of total volume of international trade in the eighties to 15% today[20]. South-south investment flows follow a similar trend[21]. The *World Investment Report*, recently published by UNCTAD, confirmed an economic power shift to the south, and revealed that in 2012, for the first time in history, developing nations received more FDI than developed nations[22].

South-south cooperation, regional banks[23], and Arab funds have changed the traditional architecture of development programs in the southern economies, helping to improve the

[17] http://esa.un.org/unpd/wpp/Documentation/pdf/WPP2012_Press_Release.pdf
[18] http://esa.un.org/unpd/wpp/Documentation/pdf/WPP2012_Press_Release.pdf
[19] The Water Resources Group. Background, Impact and the Way Forward. 2012
[20] According to BBVA Research, north-north trade flows decreased from 61% to 40% for the same period.
[21] According to Ocampo (2010) between 1996 and 2009 flows of south-south FDI grew by 20% per annum.
[22] Developing countries received more than $700 billion in 2012; and the developed nations received $561 billion, almost a third less than in 2007 UNDP Human Development Report 2013
[23] Regional development banks accounted for 18.5% of all aid provided by multilateral agencies in 2009. UNDP Human Development Report 2013

social conditions of these countries, and forcing the advanced economies to pay closer attention to developing countries' needs. It is expected that economic relations between the nations of the south will further intensify[24], which will lead to profound changes in the multi-location of the value chain, further specialisation, and the emergence of hitherto unexplored niche markets. Within ten years many economic business sectors will be utterly different from today. Moreover, this emerging consolidation will play a key role in pushing the reforms (educational, technological, fiscal, and infrastructure) that will move emerging nations away from the middle-income trap and bring them closer to convergence with rich countries, as has happened in South Korea.

9. Booming frontier markets

Beyond the BRICs, a group of heterogeneous countries that includes some of the world's fastest growing economies has attracted a considerable chunk of international investment despite the current economic crisis. These are the *frontier markets* – economies driven by a combination of abundant natural resources and low labour costs. An increasing number of investors are injecting capital into these economies. These investors usually have two objectives: earn high returns (until recently these high returns were available in BRIC nations), and hedge investments made in advanced and emerging economies. While the economic cycles of the BRICs and emerging economies draw ever closer to the fluctuations of advanced economies, *frontier markets* or pre-emerging economies show little correlation with the other countries' cyclical trends[25], which represents a significant benefit in the current environment.

As a result, frontier market equity funds reached a new record in May 2013: $2.27 billion[26]. Similarly, the MSCI Frontier Market Index gained 13.31% in the first five months of the year, its best start since the index was created five years ago; while the MSCI Emerging Markets Index fell 4.4% for the same period. Currently, there are seven frontier markets – UAE, Bulgaria, Kenya, Sri Lanka, Nigeria, Pakistan and Vietnam. These are among the ten most profitable markets in the world – and indications are that they will continue to be profitable over the coming years.

[24] The Economic Commission for Latin America and the Caribbean (ECLAC) predicts that by 2018, south-south trade will exceed north-north trade. The WTO predicts that by 2020, south-south trade will constitute more than a third of world trade.
[25] Emerging markets have a higher correlation (0.74) with advanced economies than frontier markets (.48). Thomson Reuters Datastream (2013).
[26] EPFR Global (2013).

10. Mismatches between saving and investment

Before the current crisis, China and Germany implemented counter-cyclical policies that lowered consumer expectations. As a result, both countries increased their already high saving rates[27] and the resulting trade surpluses were used to finance the U.S. and southern European countries. Encouraged by low interest rates, America became more reliant on consumer borrowing and began to accumulate large balance of payment deficits. This development fuelled a strong interdependence: saver nations provided the consumer finance to spending nations. However, economic transition in China began to shift from a model based on government spending and exportation to a model based on domestic consumption – the result being that the Chinese now save less. This transition to lower saving rates requires the introduction of a public system of pensions and health coverage for most Chinese citizens. Overall, this trend implies a risk for the world economy – and America in particular – namely, a reduction in the availability of international funding[28]. In addition, the eurozone crisis has made Germany less enthusiastic about funding consumption by its southern neighbours. So who will provide the necessary liquidity for economies such as America and Spain to keep on spending? Worryingly, the changes we are seeing in the saver nations could lead to a general reduction in international funding levels.

[27] The savings rate in China exceeded 50% of GDP in 2010. Ma and Tao (2013)
[28] American debt with China exceeds one trillion dollars. China is the largest foreign holder of US Treasury bonds.

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