

Ralph Miliband Series on the Restructuring of World Power

# Grasshoppers, Ants and Locusts: the future of the world economy

Martin Wolf

*Associate editor and chief economics commentator, Financial Times*

Professor David Held

*Chair, LSE*

**LSE** events





FINANCIAL  
TIMES

**Ants, grasshoppers and locusts:  
prospects for the world economy**  
**Martin Wolf, Associate Editor & Chief  
Economics Commentator, *Financial Times***

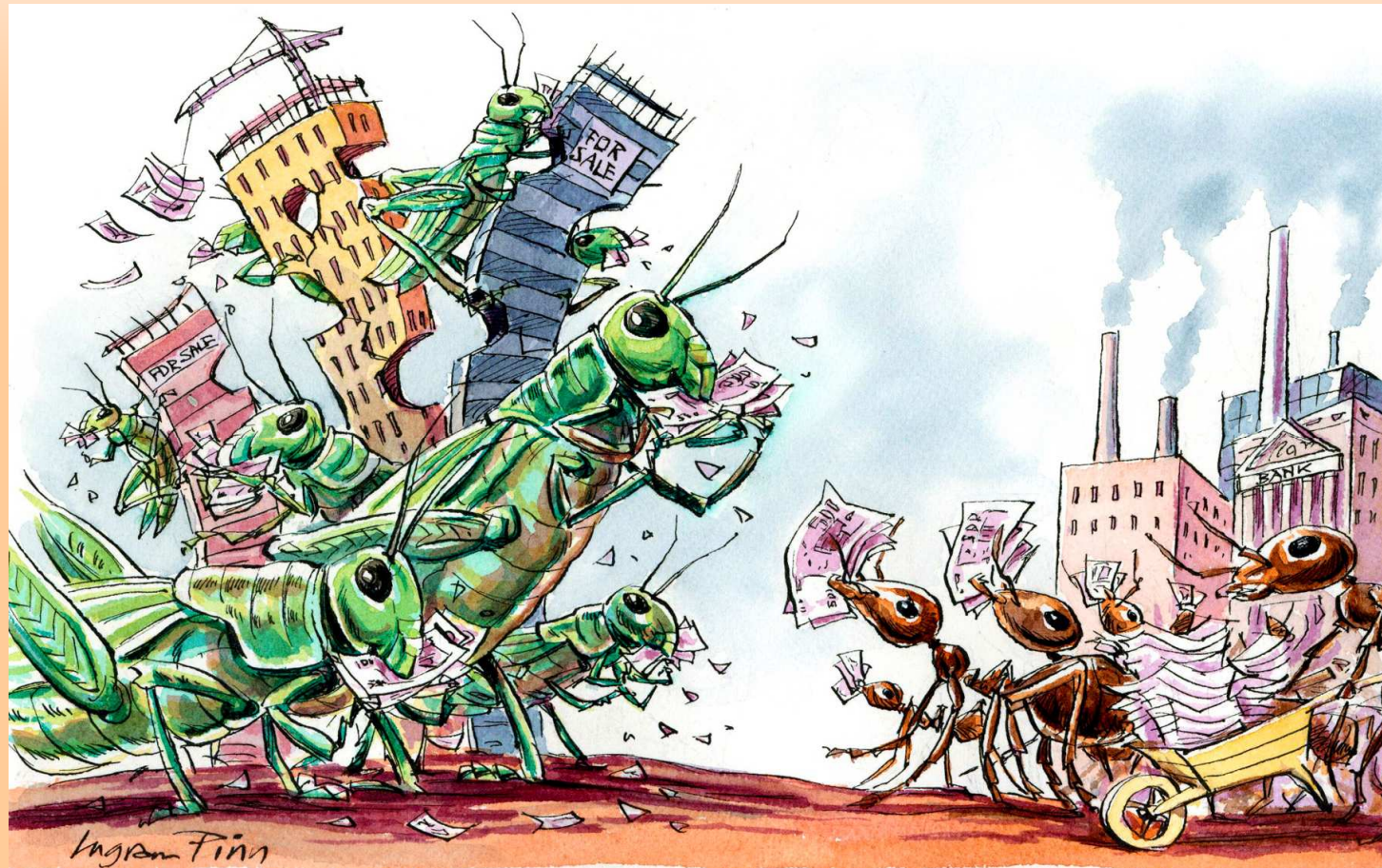
Ralph Miliband Lecture

16<sup>th</sup> March 2011

London School of Economics

# Ants, grasshoppers and locusts

---



# Ants, grasshoppers and locusts

---

1. Who are our *dramatis personae*?
2. What lay behind the crisis?
3. Where are advanced countries now?
4. Why do emerging economies matter?
5. Why does rebalancing matter?
6. Why is the eurozone the world in miniature?
7. Conclusion

# 1. Who are our *dramatis personae*?

---

- I explain where we are in terms of ants and grasshoppers and locusts:
  - Ants save:
    - Surplus countries; and
    - Western non-financial companies;
  - Grasshoppers spend:
    - Deficit countries; and
    - Households in these countries.
  - Locusts intermediate.
  - These relationships need to change if we are to have a healthy world economy.

## 2. What lay behind the crisis?

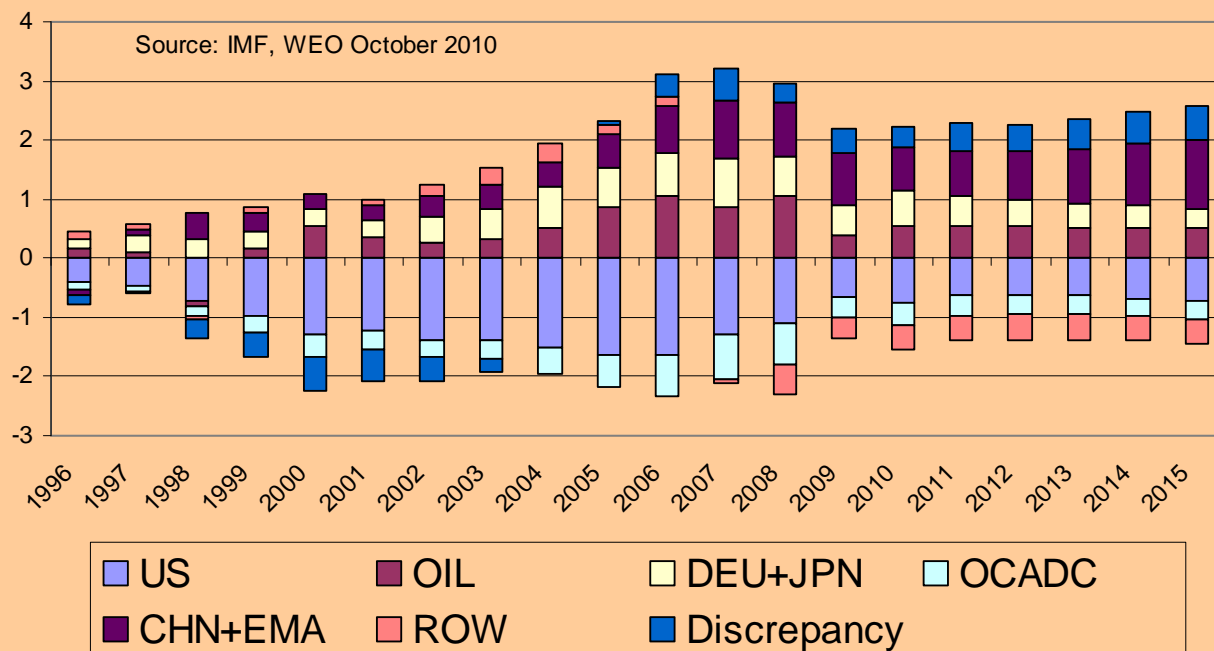
---

- What we have seen is a “developing country” crisis at the core of the world economy. Why?
  1. Undue belief in the “great moderation”;
  2. Emergence of global imbalances and extraordinary reserve accumulations in the late 1990s and early 2000s;
  3. Accommodative monetary policy aimed at targeting inflation;
  4. Low real and nominal interest rates and a “reach for yield”;
  5. Innovation in the financial sector, to provide notionally safe, high-yielding assets – 64,000 triple-A rated securities; and
  6. Failures of commission (risk-weighted capital ratios and reliance on ratings) and omission (deregulation of securities and housing markets) in financial regulation.

## 2. What lay behind the crisis? Imbalances

### THE RISE OF THE IMBALANCES

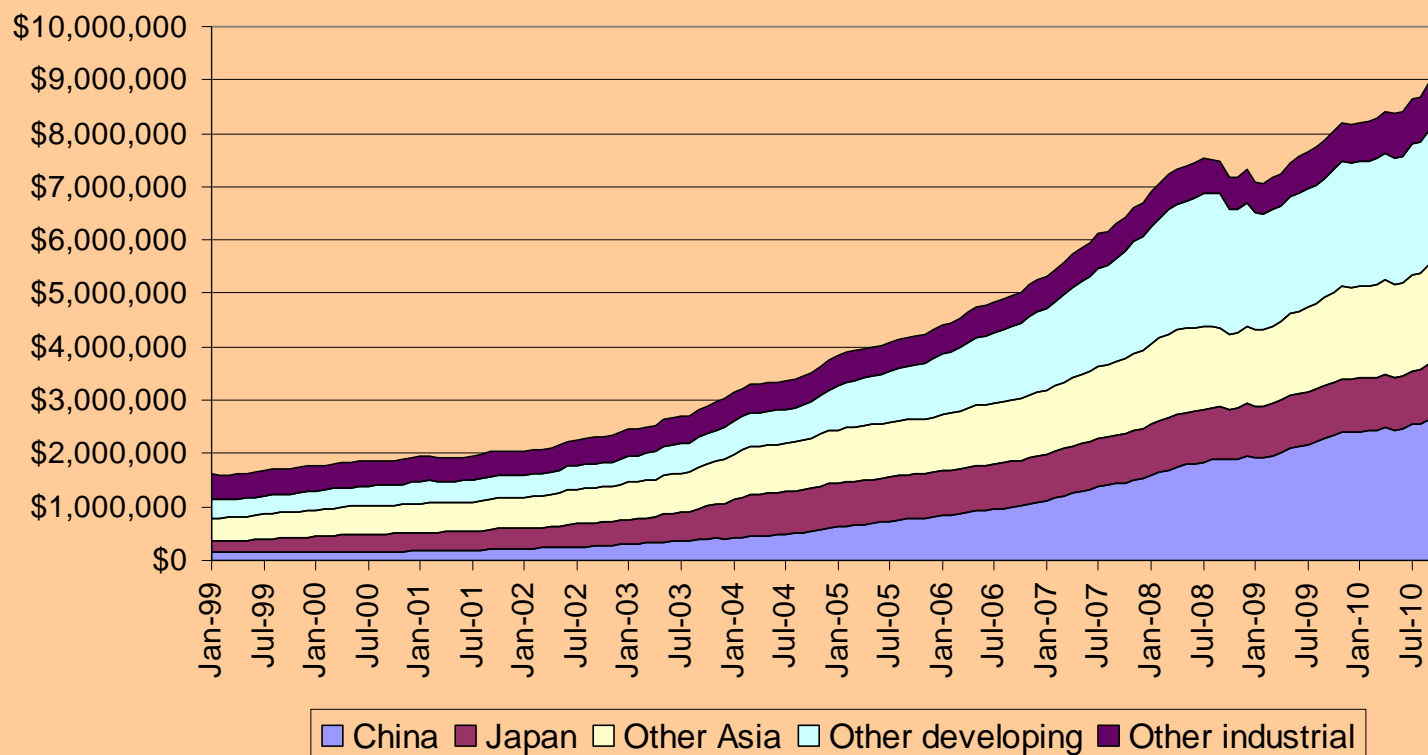
**GLOBAL CURRENT ACCOUNT IMBALANCES - PAST  
AND PROSPECT  
(share of world GDP)**



## 2. What lay behind the crisis? Imbalances

### FOREIGN CURRENCY INTERVENTION

#### GLOBAL CURRENCY RESERVES

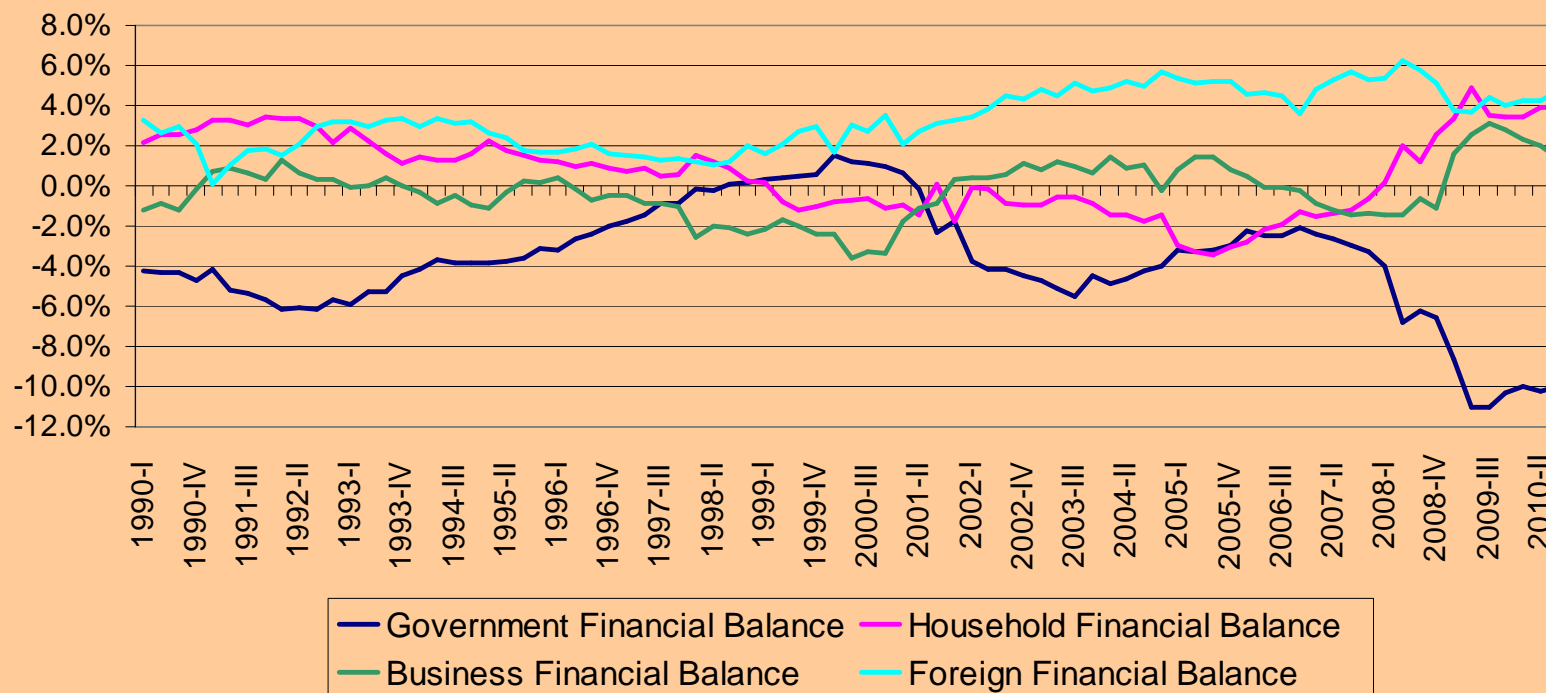




## 2. What lay behind the crisis? Imbalances

### HOW THE US IMBALANCES EMERGED

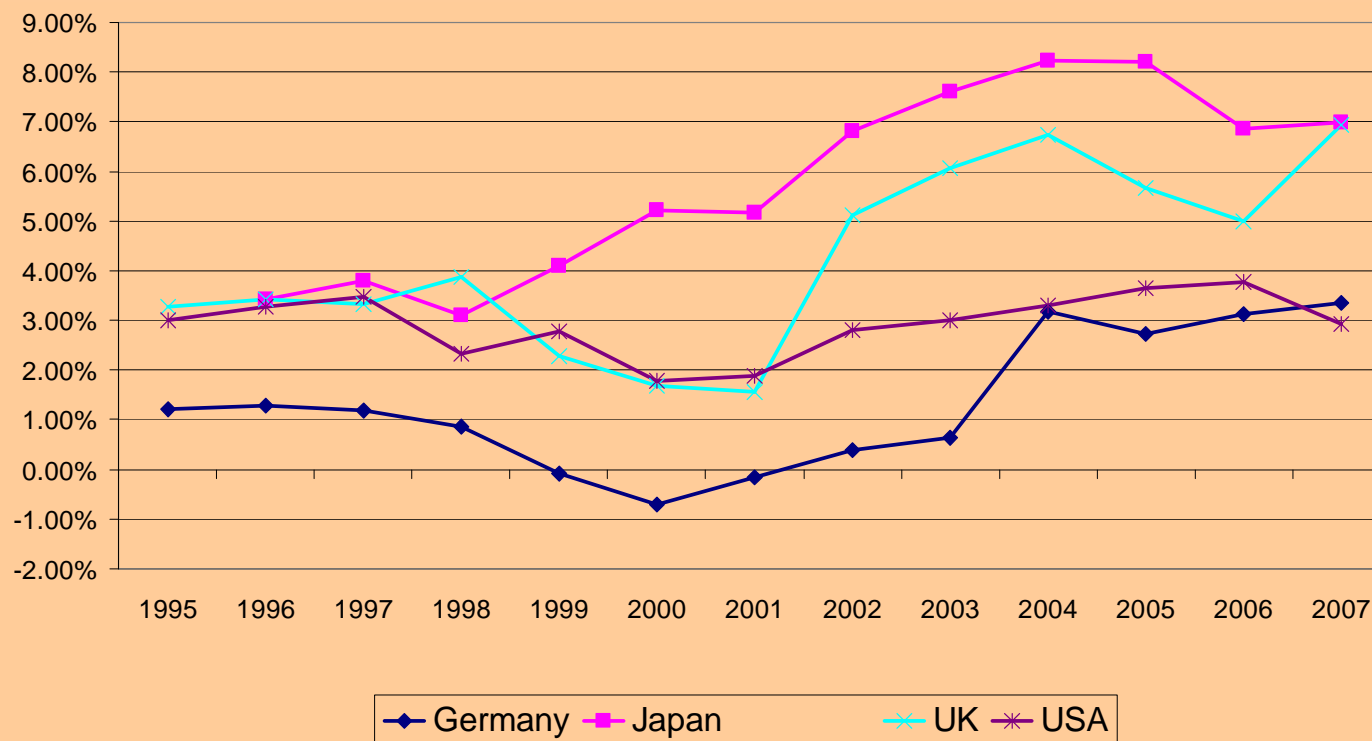
US FINANCIAL BALANCES FROM 1990  
(per cent of GDP)



## 2. What lay behind the crisis? Imbalances

### HOW NON-FINANCIAL CORPORATES SAVED

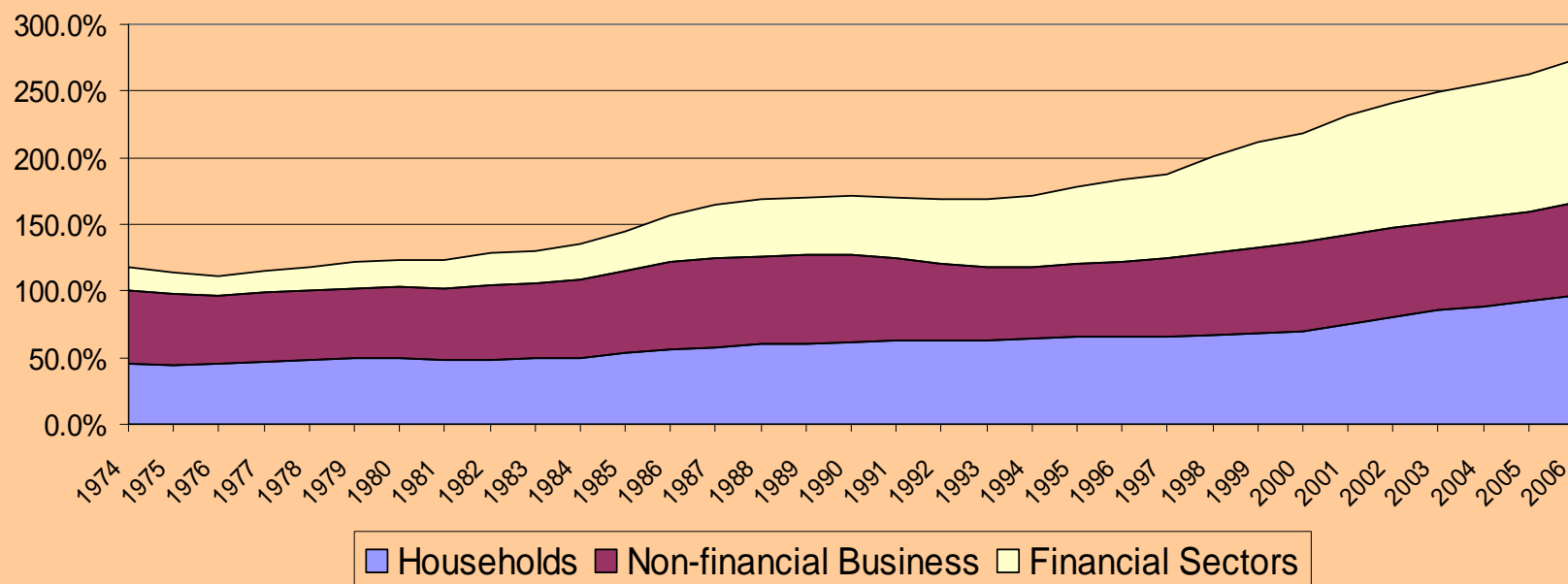
#### NET CORPORATE SAVINGS



## 2. What lay behind the crisis? Leverage

### HOW NON-FINANCIAL CORPORATES SAVED

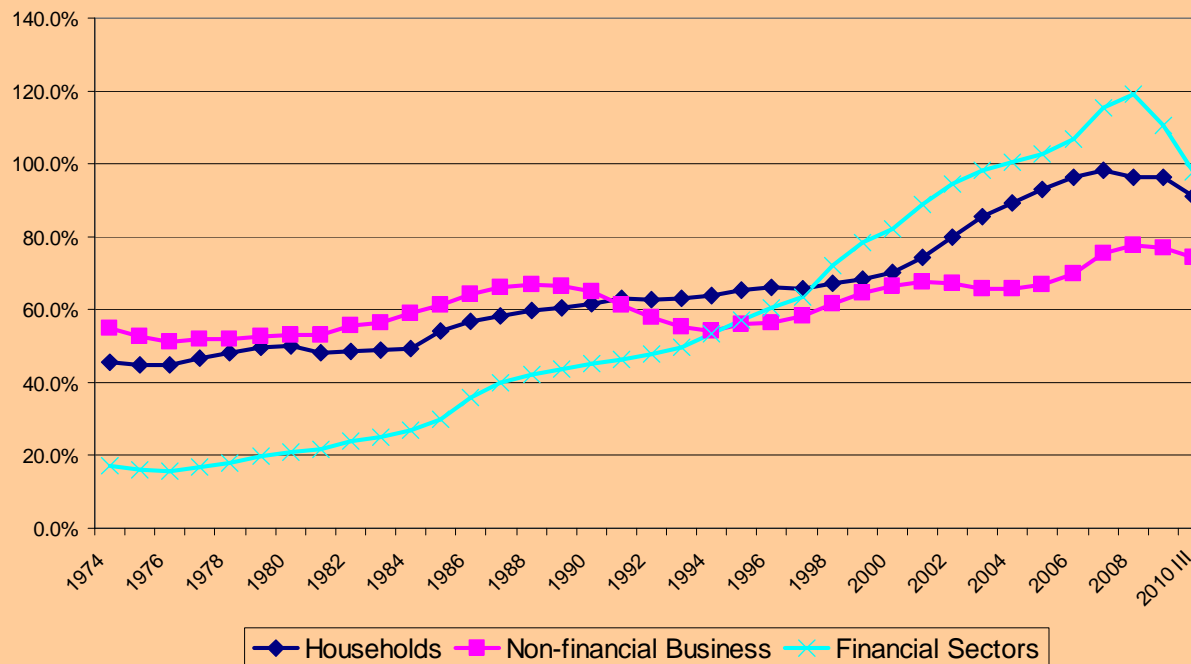
#### US PRIVATE SECTOR DEBT OVER GDP



## 2. What caused the crisis? Leverage

### HOW NON-FINANCIAL CORPORATES SAVED

**PRIVATE SECTOR DEBT  
(relative to GDP)**



### 3. Where are the advanced countries now?

---

- The economic collapse was large.
- The rescue has been dramatic:
  - Implicitly, the entire liabilities of the core financial system were nationalised;
  - Monetary policy has been unprecedented; and
  - Fiscal policy has been on a war-time footing.
- This has worked. But we are not back to normal.

### 3. Where are the advanced countries now?

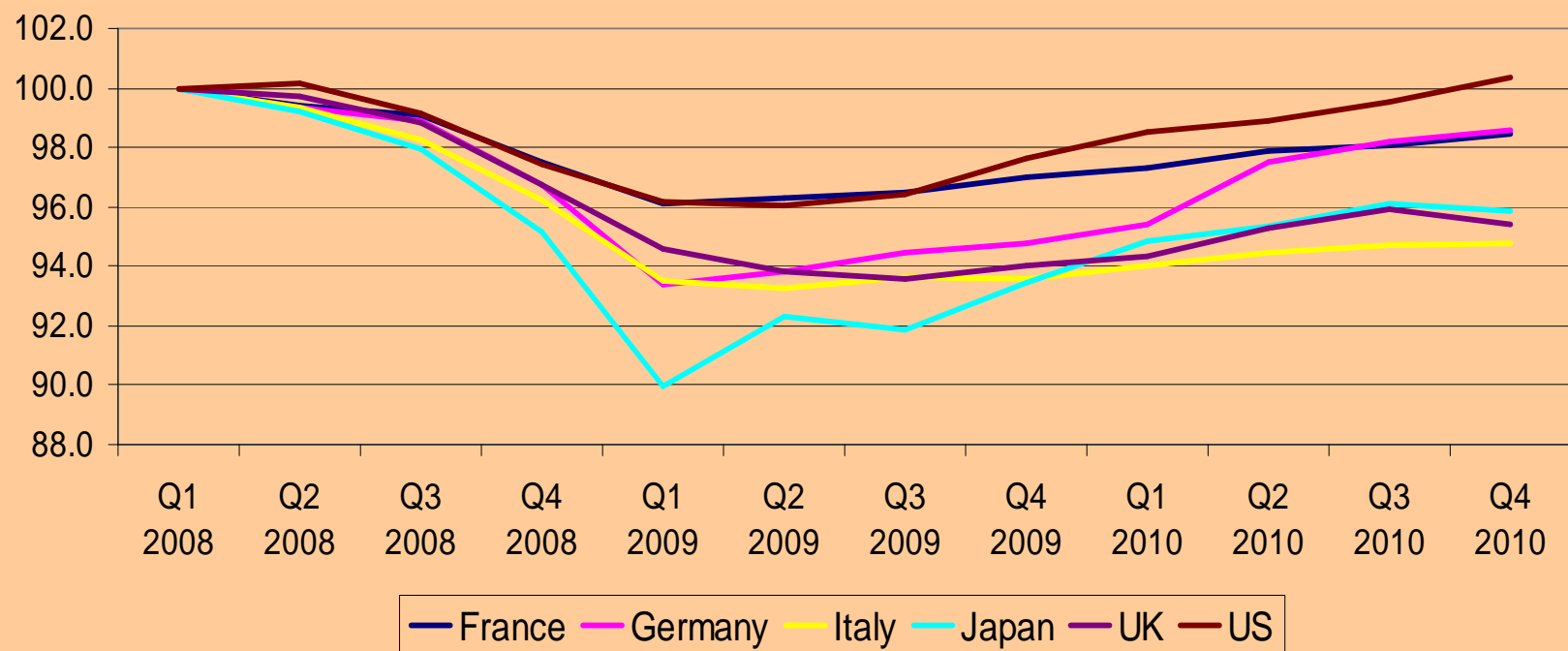
---

- Carmen Reinhart and Kenneth Rogoff, in their masterpiece, *This Time is Different*, argue that the consequences of previous financial crises in advanced countries includes:
  - Profound declines in output and employment: the unemployment rate rises an average of 7 percentage points over the down phase of the cycle, which lasts on average over four years, while output falls (from peak to trough) average over 9 percent
  - Exploding public debt: debt rises by an average of 86 percent of GDP. The main cause of debt explosions is not the widely cited costs of bailing out and recapitalizing the banking system, but the recessions.
  - By these standards, we have done quite well. Nevertheless,.....

### 3. Where are the advanced countries now?

## THE DECLINE IN HIGH-INCOME COUNTRIES

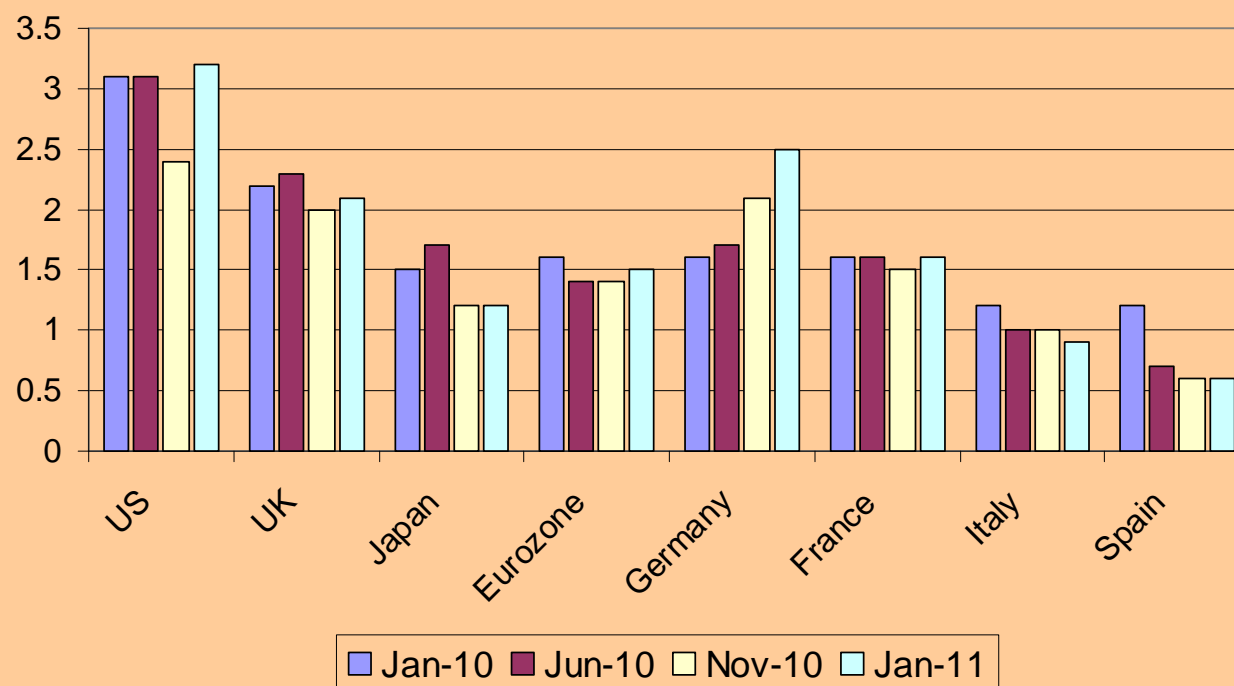
### GDP AFTER THE CRISIS



### 3. Where are the advanced countries now?

#### A WEAK RECOVERY IN 2011?

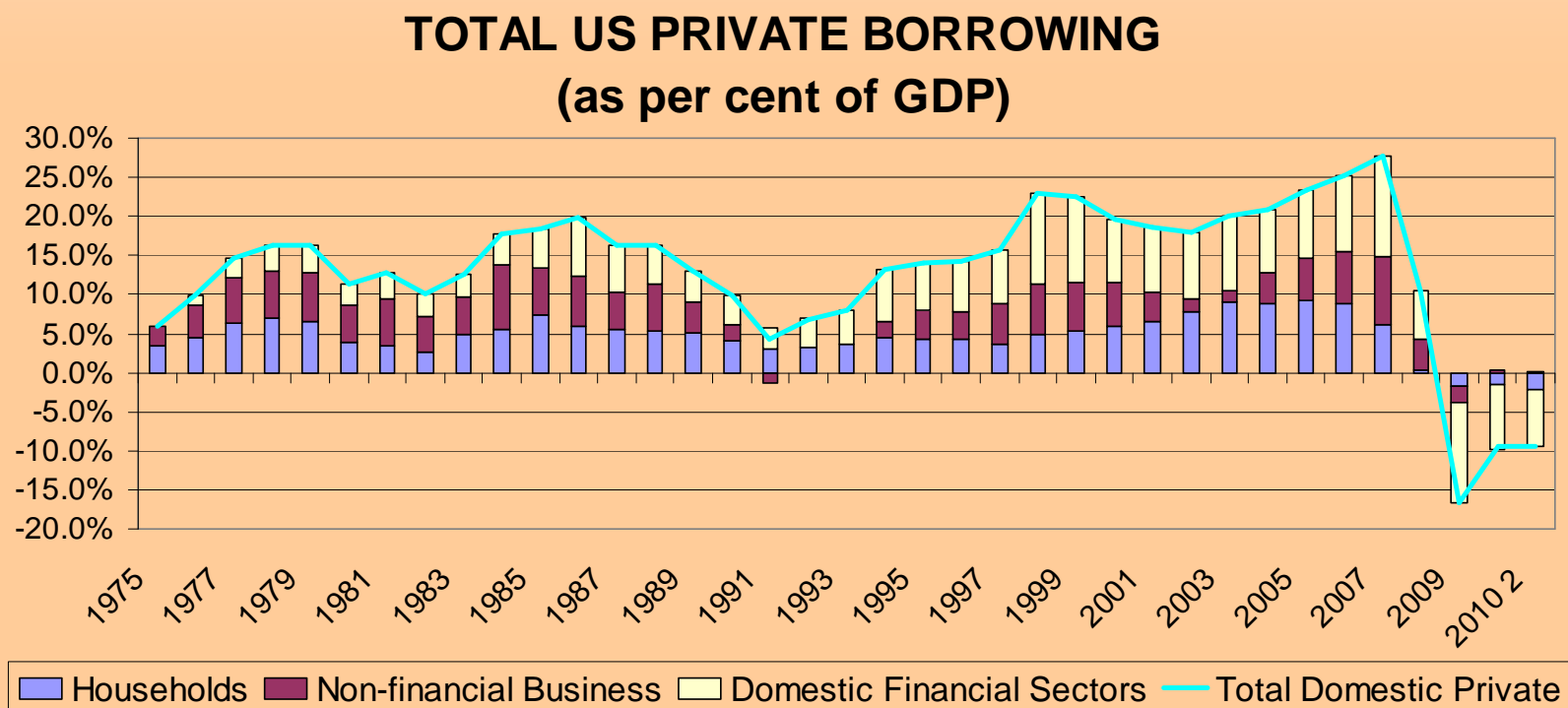
#### SUCCESSIVE CONSENSUS FORECASTS FOR 2011





### 3. Where are the advanced countries now?

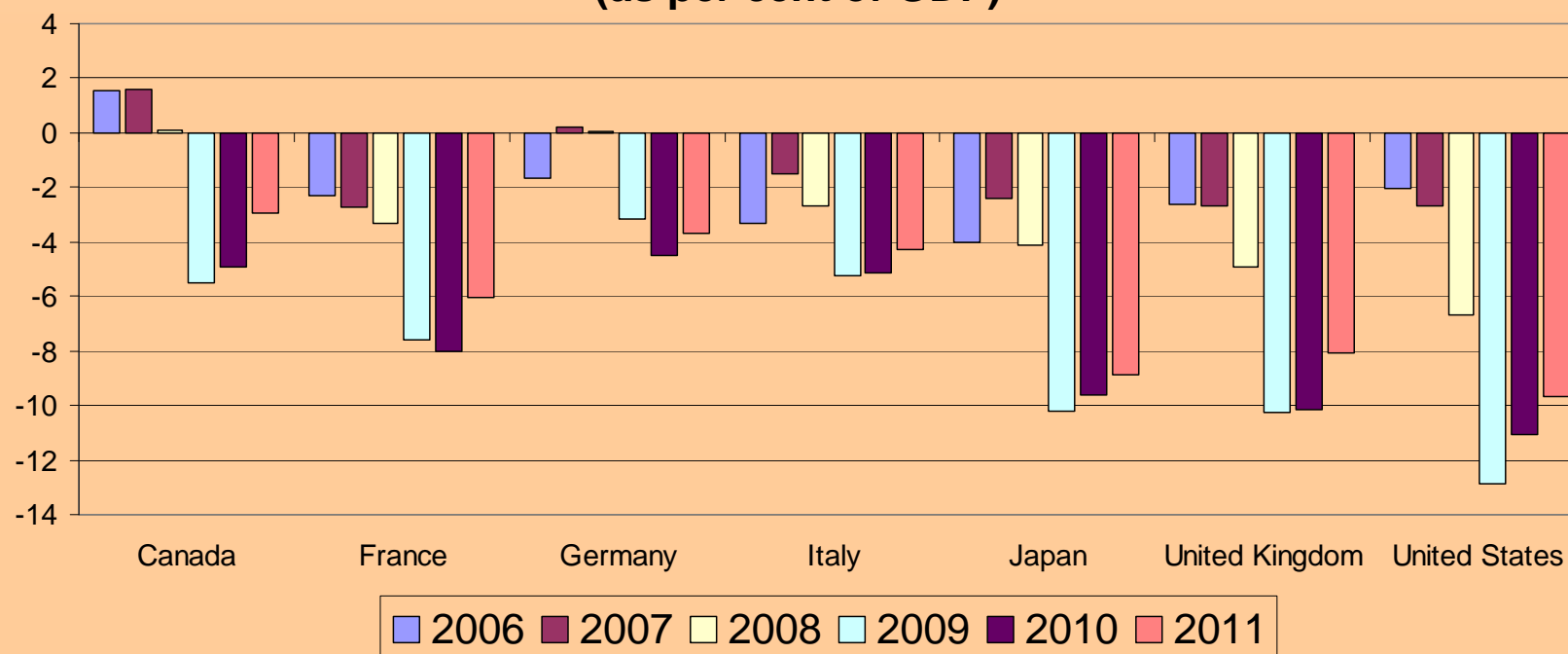
## THE US LEVERAGE CYCLE



### 3. Where are the advanced countries now?

## FISCAL FIREPOWER USED

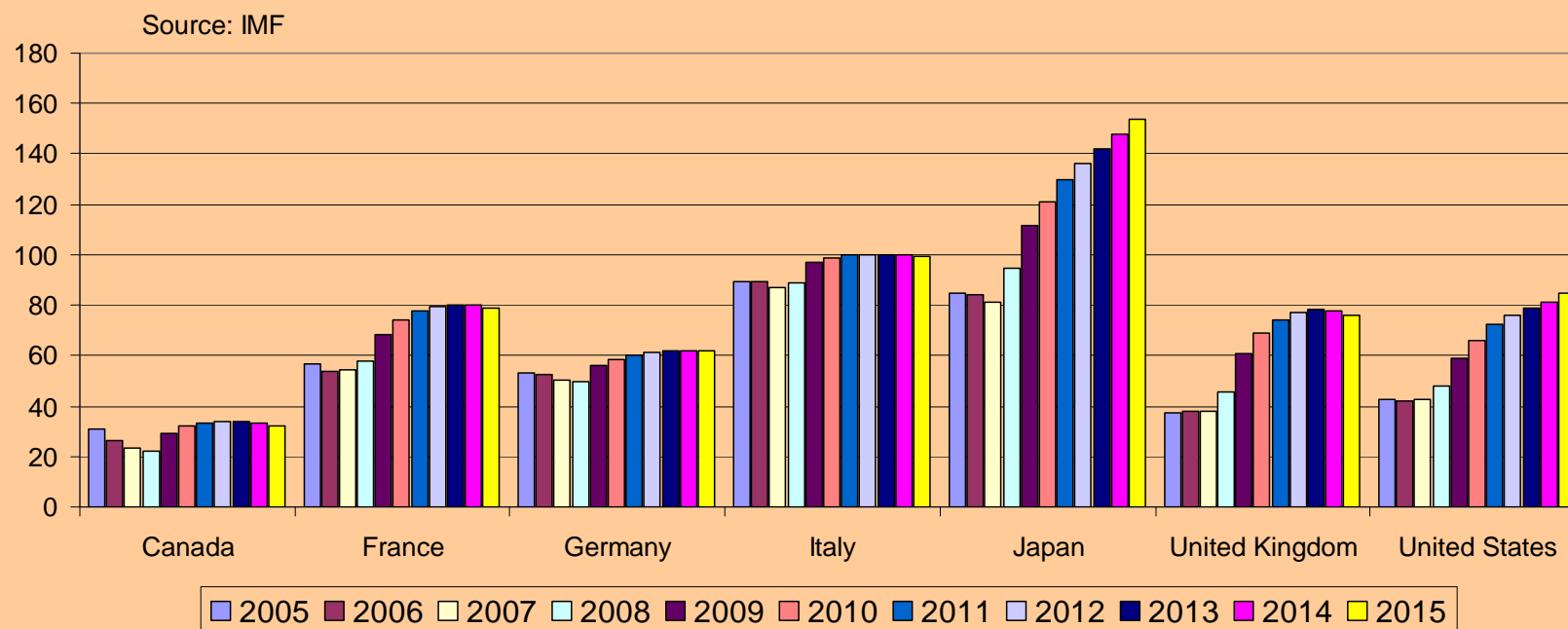
**EXPLOSION OF FISCAL DEFICITS**  
(as per cent of GDP)



### 3. Where are the advanced countries now?

## THE SOVEREIGN DEBT CRISIS

### NET PUBLIC SECTOR DEBT OVER GDP



## 4. Why do emerging economies matter?

---

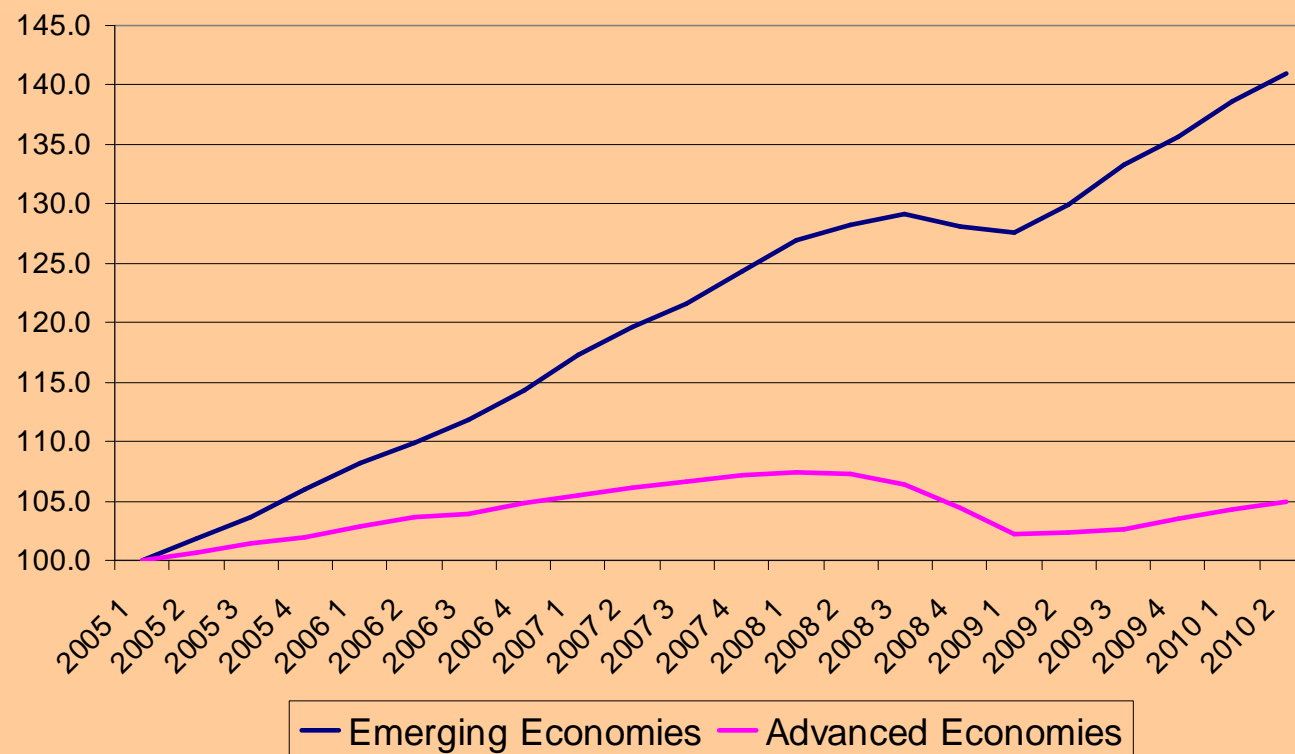
- The rapid rise of emerging countries, above all China has played a crucial role in this story
- Three aspects may be particularly important:
  - Dis-inflationary shock;
  - Real wages and the credit cycle;
  - Global imbalances
- It is particularly remarkable that China has emerged as the fastest growing country in the world and the largest capital exporter. Thus it combines the twin roles of the UK and US in the late 19<sup>th</sup> century.

## 4. Why do emerging economies matter?

### CRISIS – WHAT CRISIS?

Source: Federal Reserve

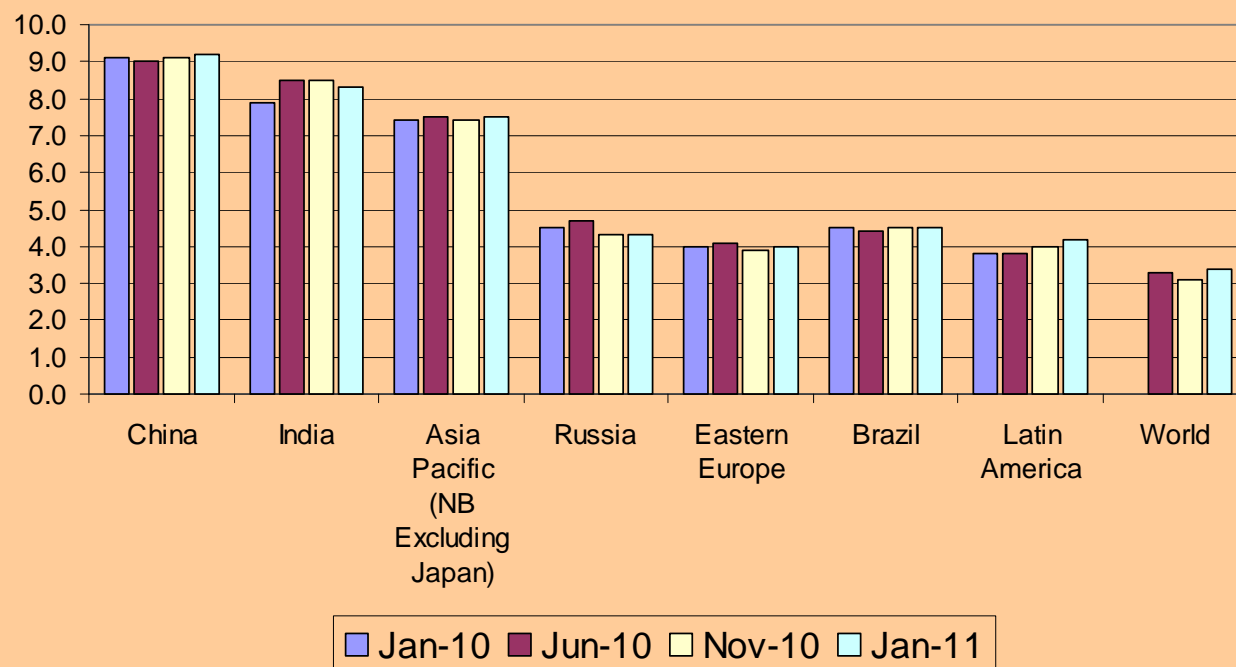
#### GDP IN THE CRISIS



## 4. Why do emerging economies matter?

### MORE STRONG GROWTH IN 2011?

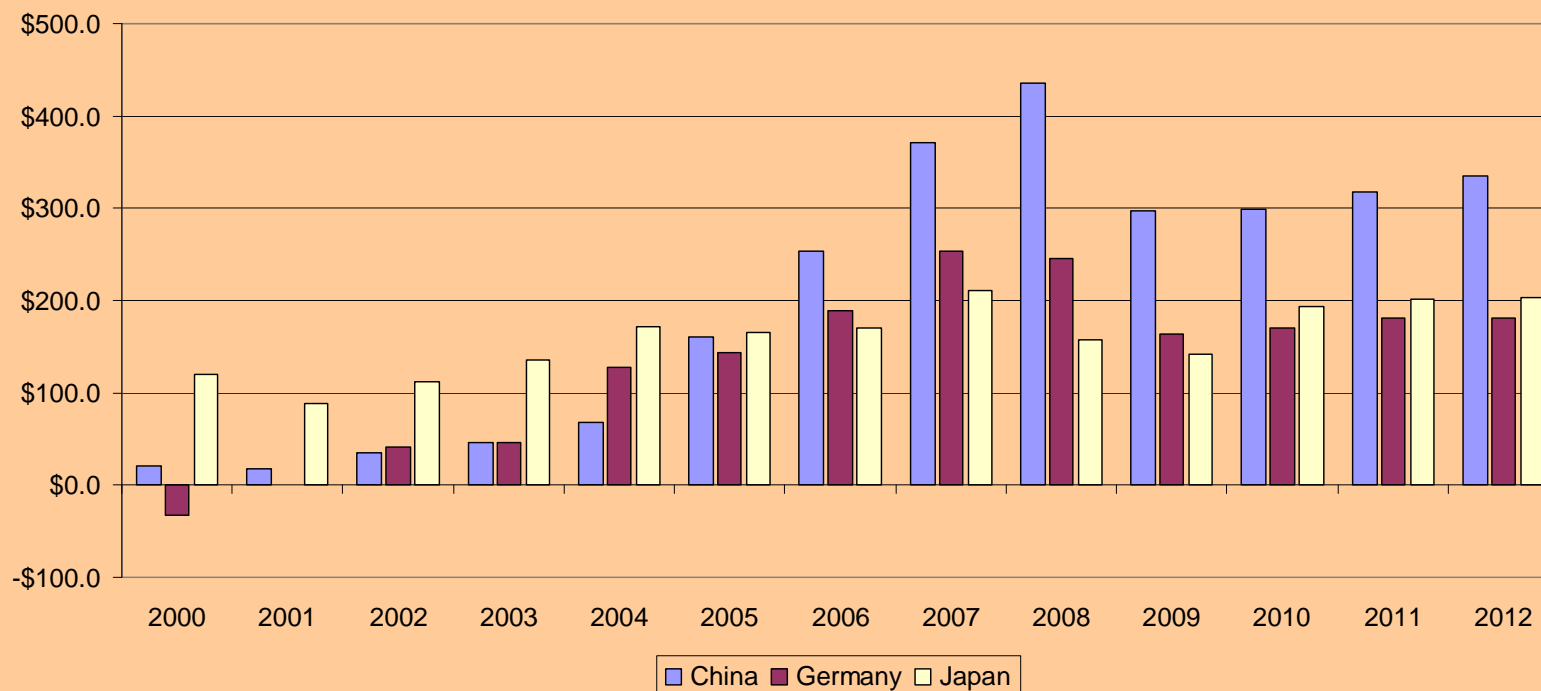
#### SUCCESSIVE CONSENSUS FORECASTS FOR 2011



## 4. Why do emerging economies matter?

### CHINA RISES TO THE TOP OF THE SURPLUS LIST

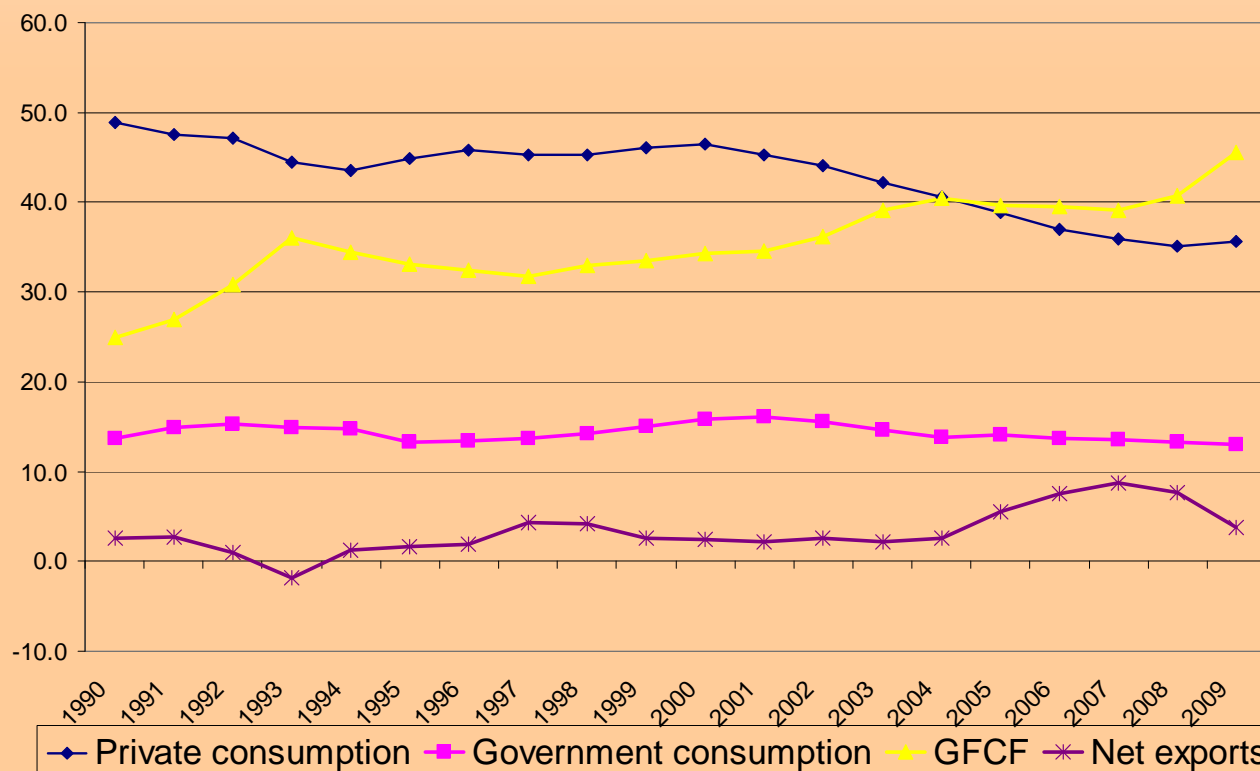
CURRENT ACCOUNT BALANCES (\$bn)



## 4. Why do emerging economies matter?

### HOW INVESTMENT SOARED

#### COMPOSITION OF CHINA'S FINAL DEMAND





## 5. Why does rebalancing matter?

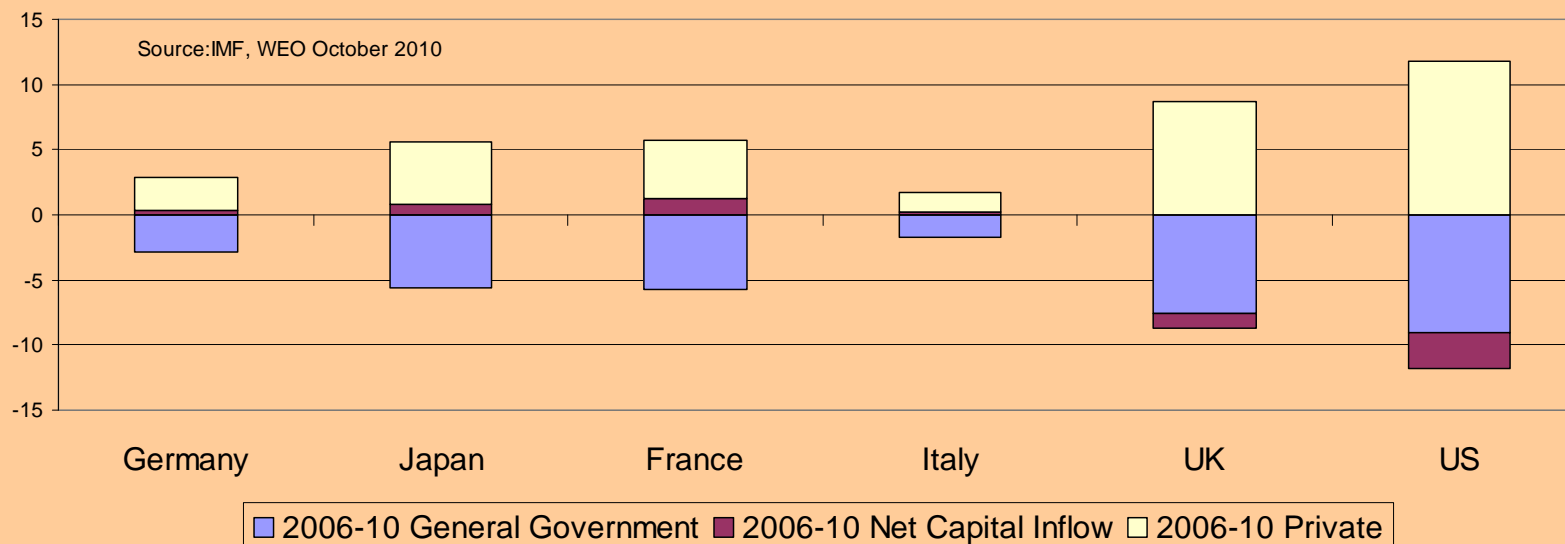
---

- The crisis has left important high-income countries with damaged financial systems, overleveraged household sectors and large fiscal deficits
- These advanced countries are no longer in a position to absorb net exports of capital from emerging economies and the chronic surplus advanced countries will not take up the slack
- If damaged advanced countries are to recover, while de-leveraging their private sectors *and* reducing fiscal deficits, they will need higher corporate investment or a large shift in net exports, or both

## 5. Why does rebalancing matter?

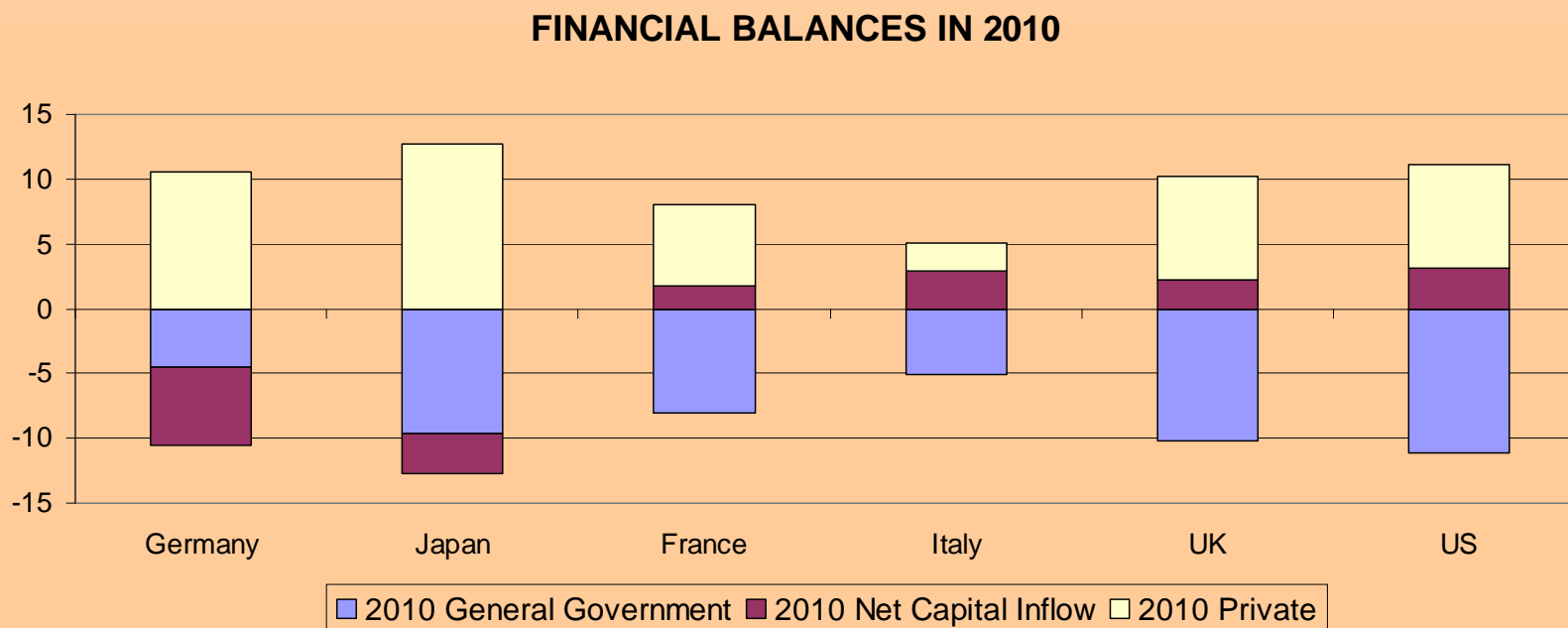
### HOW PRIVATE DEFICITS COLLAPSED

CHANGE IN SECTORAL BALANCES (per cent of GDP)



## 5. Why does rebalancing matter?

### HOW PRIVATE DEFICITS COLLAPSED

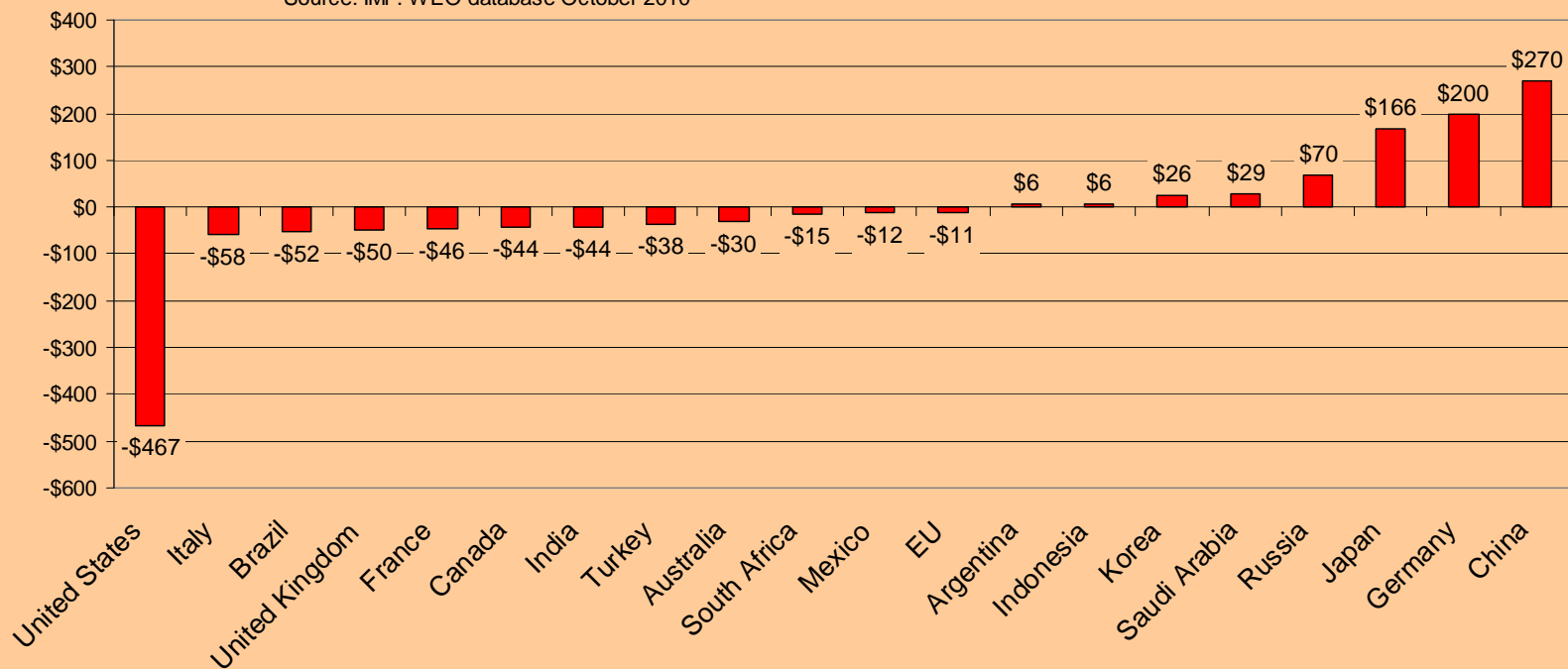


## 5. Why does rebalancing matter?

### THE CHALLENGE OF ADJUSTMENT

#### CURRENT ACCOUNT BALANCES 2010 (\$bn)

Source: IMF, WEO database October 2010

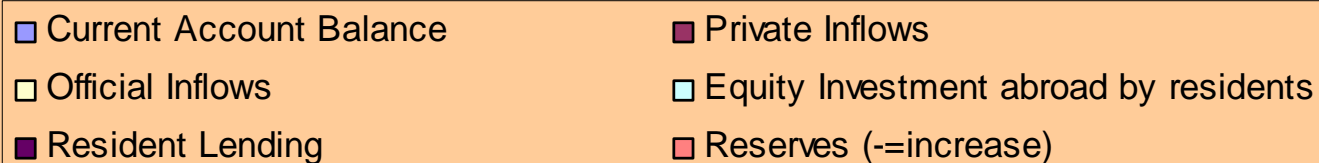
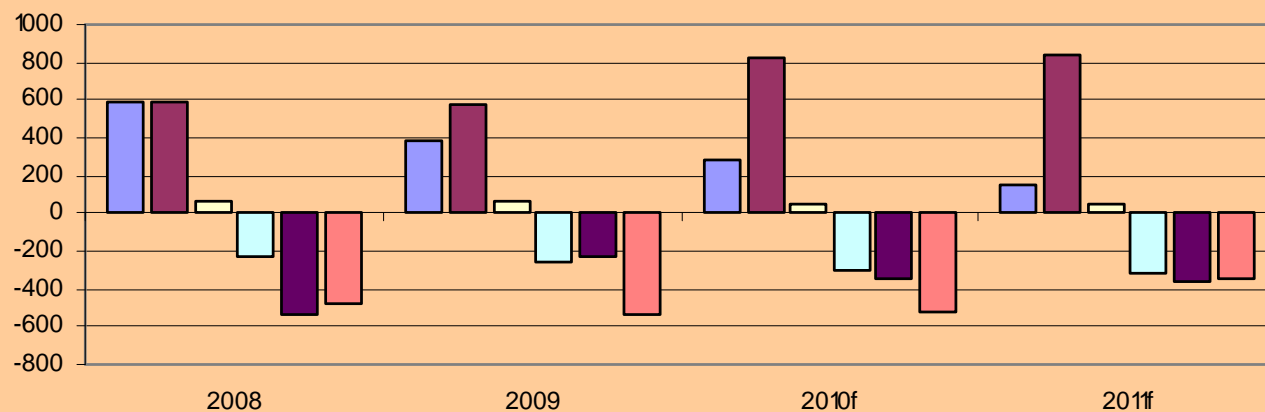


## 5. Why does rebalancing matter?

### THE GLIMMERINGS OF ADJUSTMENT

#### BALANCE OF PAYMENTS OF EMERGING ECONOMIES (\$bn)

Source: IIF



## 6. Why is the eurozone the world in miniature?

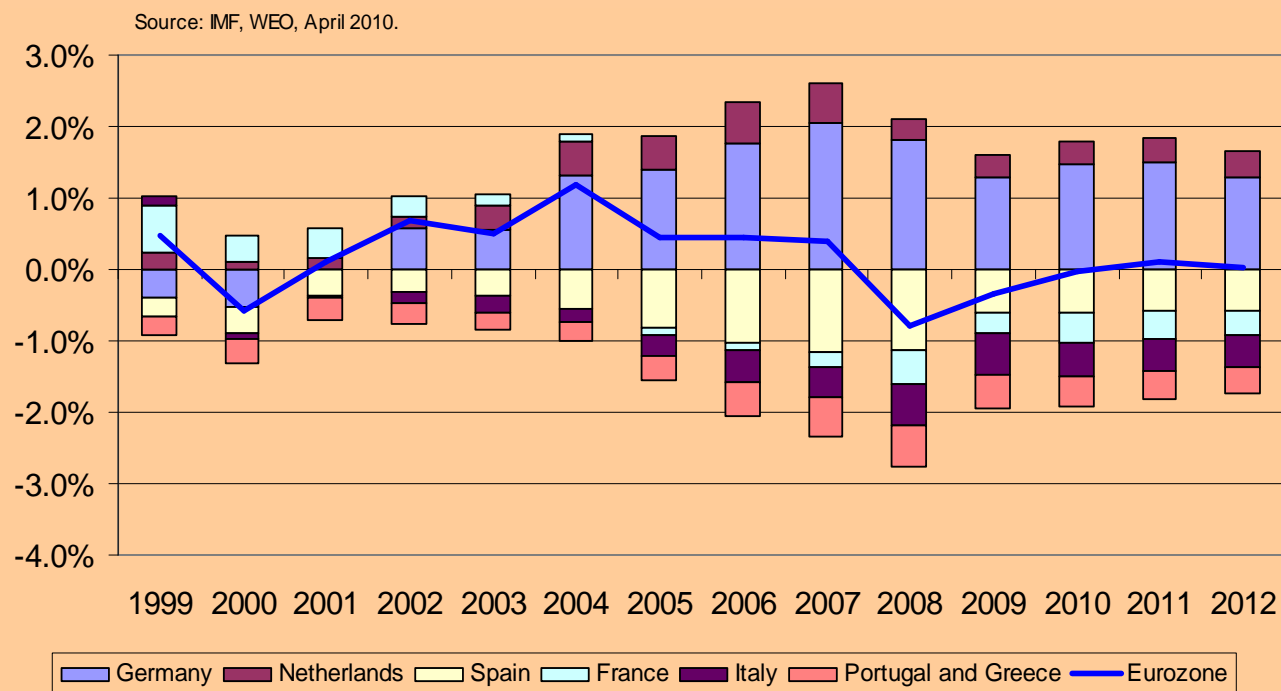
---

- The eurozone is the world in miniature
- The eurozone is facing a long-running crisis
- It needs to restructure debt
- But it also needs to rebalance
- Can it do so?

## 6. Why is the eurozone the world in miniature?

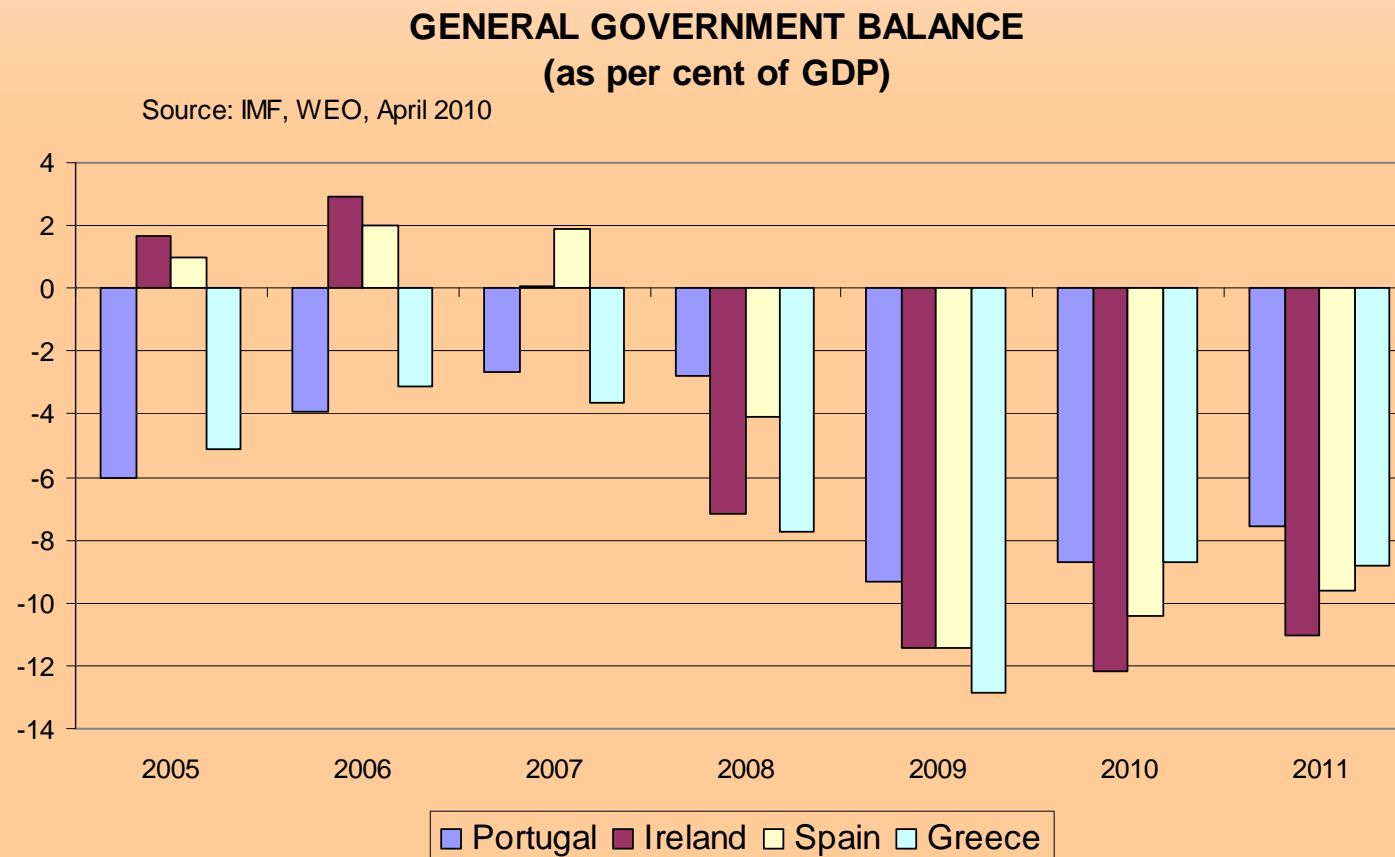
### THE GOOD, THE BAD AND THE UGLY

**CURRENT ACCOUNT IMBALANCES IN THE EUROZONE**  
(as a share of eurozone GDP)



## 6. Why is the eurozone the world in miniature?

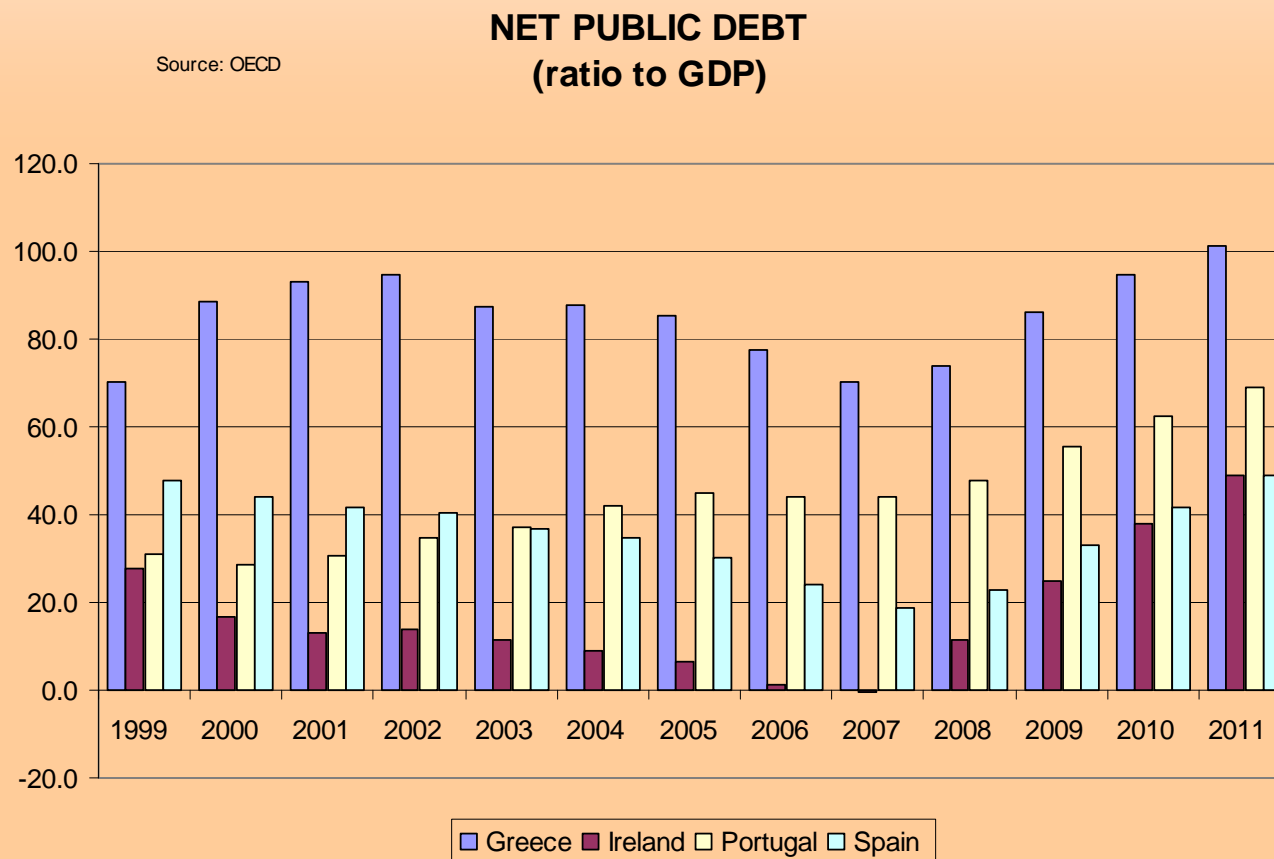
### ROAD TO THE FISCAL DEFICITS





## 6. Why is the eurozone the world in miniature?

### ROAD TO THE FISCAL DEFICITS

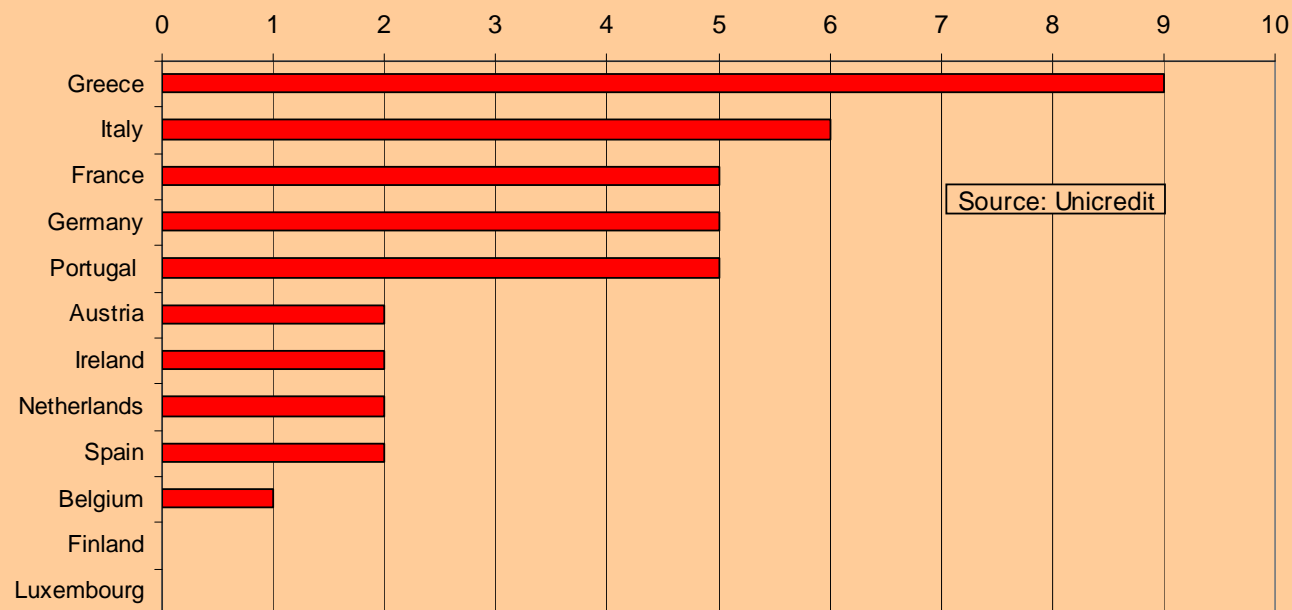


## 6. Why is the eurozone the world in miniature?

---

### THE GOOD, THE BAD AND THE UGLY

#### NUMBER OF BREACHES OF THE 3 PER CENT DEFICIT RULE

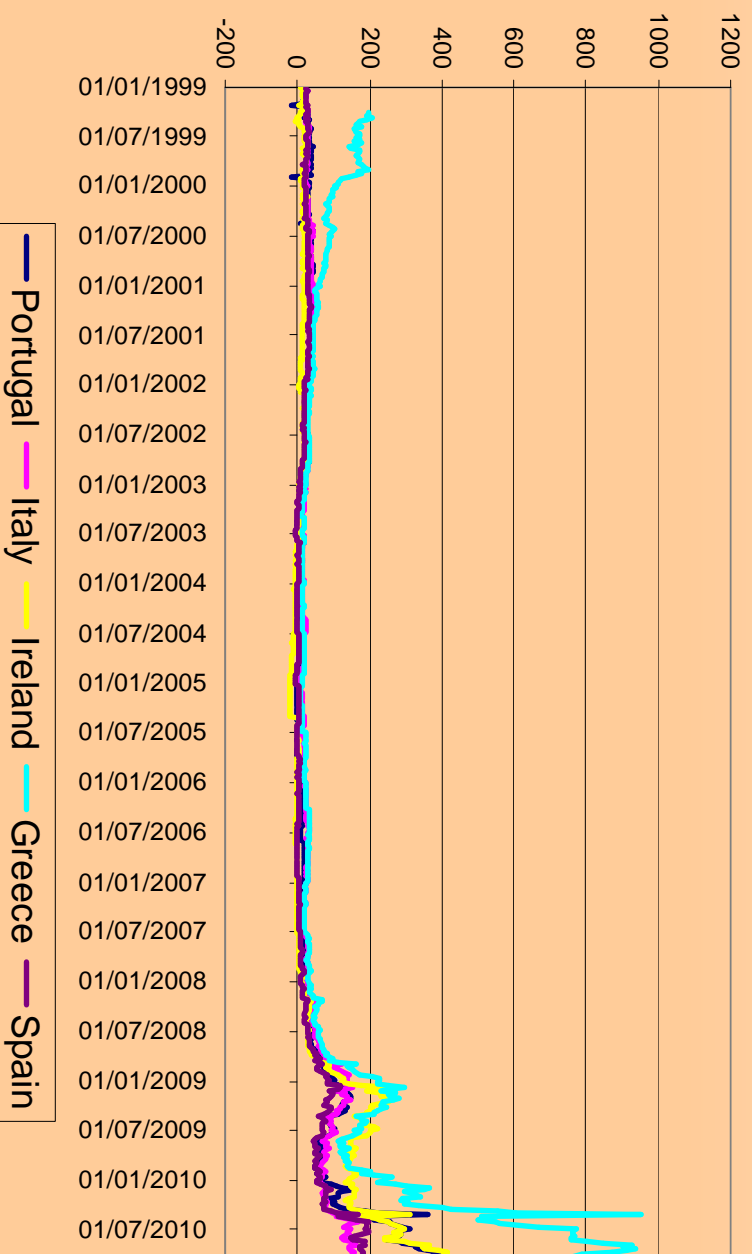


## 6. Why is the eurozone the world in miniature?

---

### THE GOOD, THE BAD AND THE UGLY

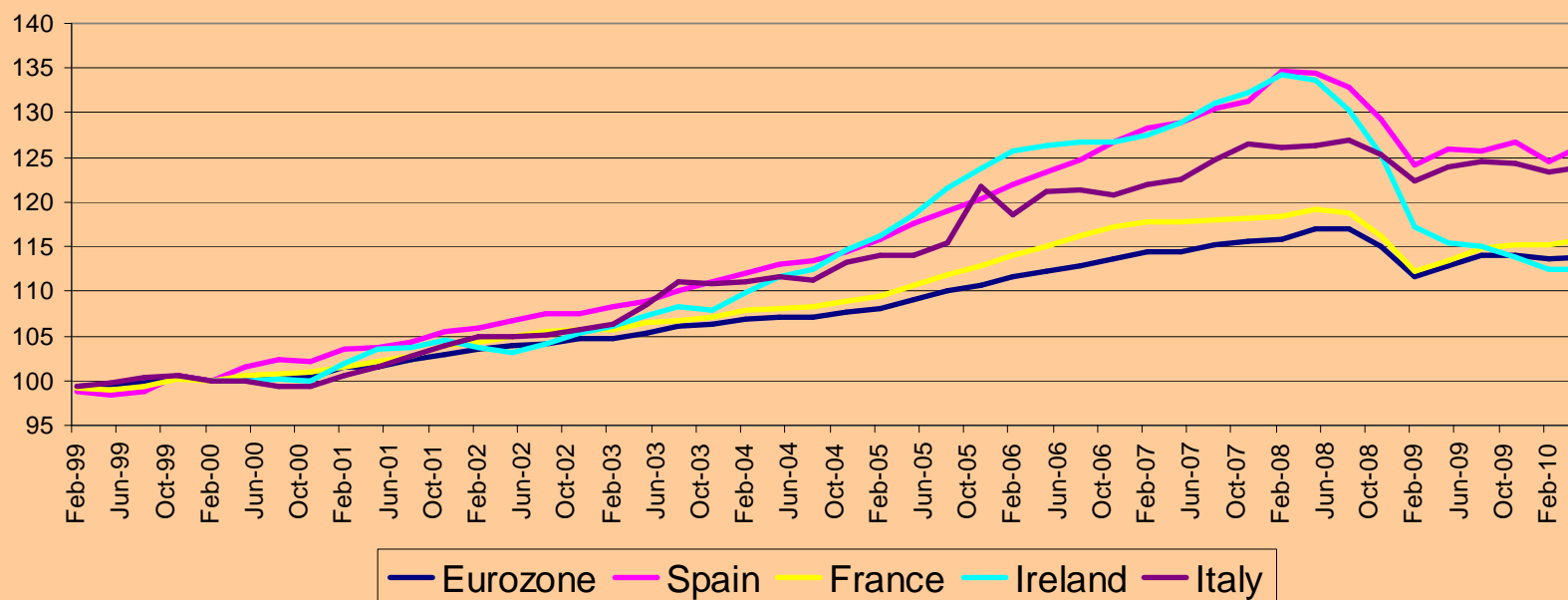
#### SPREADS OVER BUNDS



## 6. Why is the eurozone the world in miniature?

### LOST COMPETITIVENESS IN THE PERIPHERY

**UNIT LABOUR COSTS**  
(Total economy relative to Germany (Q1 2000 = 100))



## 7. Conclusion

---

- The world economy has changed in big ways:
  - End of private leverage cycle in high-income countries;
  - End of reliance on US as borrower and spender of last resort;
  - Emergence of huge developed country sovereign debt problems;
  - Big challenge of global rebalancing and returning to stable global growth.
  - Grasshoppers become antlike and ants become grasshopperlike – and locusts behave themselves!
  - Is this too much to hope for? Perhaps

Ralph Miliband Series on the Restructuring of World Power

# Grasshoppers, Ants and Locusts: the future of the world economy

Martin Wolf

*Associate editor and chief economics commentator, Financial Times*

Professor David Held

*Chair, LSE*

**LSE** events

