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Policy Brief

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The Improving Global Outlook and Morocco

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Summary

Global economic growth is likely to be a little better in 2016 than this year's lackluster outcome. The ongoing slow recovery in the United States and Europe is likely to continue. However, weakness in China as well as several large emerging markets, and sluggishness of world trade, mean that risks are weighted on the downside of this forecast. Morocco, which is reliant on European markets, is a heavy importer of oil, and whose currency has devalued in effective terms, should find the external environment more supportive than in past years. But the required adjustment in its fiscal balance will hold it back.

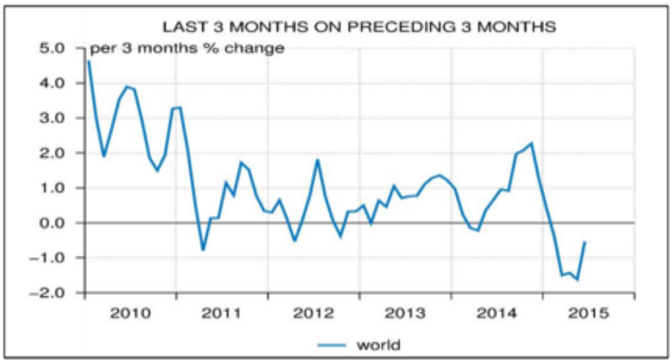
Seven years after the collapse of Lehman brothers triggered the global financial crisis, growth of the world economy remains well below its 3% average of the last 25 years. While economic recovery is ongoing and consolidating in the advanced countries, and 2016 is likely to see the world economy growing nearer its long-term average, the slowdown in China and the sharp downturn in emerging markets gives rise to significant downside risks. Though a sharp global slowdown or, worse, a recession is unlikely, the troubles in emerging markets may give way to another mediocre growth outcome in 2016, especially if the Fed's widely anticipated rise in policy interest rates from near zero results in a much sharper than currently expected hike in long-term interest rates. Taking a longer view, the most likely scenario is that advanced countries return to growth rates near 2% while developing countries see somewhat slower growth than in previous decades, while continuing to outstrip growth of advanced countries by a wide margin. This assessment carries important policy implications for Morocco, an oil-dependent economy who has a limited time window to put the windfall to good use.

The Bad News

Three problematic aspects of the recent conjuncture should be highlighted: the continued remarkably weak advance of world trade, the sharp slowdown of China, and the fragility evident in several other emerging markets. All three concerns have been with us at least as far back as the "Taper Tantrum" of the Summer of 2013, but have become even more prominent in the last six months.

World Trade, which in the pre-crisis period had grown at rates almost twice the rate of world GDP, has barely matched it over the last four years, and in recent months its quarterly momentum has moved into negative territory.

Figure 1: World Trade Weakness Continues



Source: CPB world Trade monitor, August 2015.

The most important cause of the slowdown is cyclical, but there is also a structural element. The cyclical downturn in trade reflects the weakness in Europe a region

1. Excellent research assistance was provided by Rim Berahab.

characterized by large internal trade flows, as well as the weakness of investment in advanced countries, a sector that is intensive in trade of components. More recently, the constraints placed by falling commodity prices on developing countries with a high marginal propensity to consume and to import have also contributed to slowing trade. The structural component of the slowdown reflects the end of transition, as China and several other formerly planned economies have become integrated in world trade flows over the last quarter century, their trade has reverted to more normal rates of growth. The implication is that world trade is likely to recover some of its buoyancy as the global business cycle improves and commodity prices stabilize or increase again, but the growth of world trade is unlikely to return to the high rates seen in during the 1990s and early 2000s.

«The effects of China's slowdown have been felt most keenly by other emerging markets, especially by commodity exporters.»

Worries about China go beyond the country's gradual shift towards increased reliance on domestic consumption and reduced reliance on exports, which also implies reduced imports of raw materials and components. This process has coincided with a sharp cyclical slowdown, reflected in depressed demand for housing, slower growth of investment, and large overcapacity evident in the industrial sector. The cyclical correction follows on the massive expansion of credit, local government spending, and investment by SOEs, which enabled the Chinese economy to maintain high rates of growth during the worst years of the financial crisis. These counter-cyclical policies constituted the largest stimulus in history and, as the recovery in advanced countries remained slow and drawn out, resulted in over-building and over-investment in China's large industrial export sector, and upstream activities such as construction. A large real effective exchange rate appreciation has compounded the pressure on China's manufacturing sector. Not surprisingly, China is now in the throes of a sharp growth recession, which, combined with a somewhat confused attempt at (small) devaluation in the Summer months, has caused consternation in financial markets. Although it is possible, as many are suggesting, that the slowdown in China is even sharper than the official statistics are suggesting, China's strong external balance and net investment position, its high savings rate, relatively modest tax take, moderate aggregate government indebtedness, and the significant control it can exercise over the banking sector and capital account, imply that the Chinese authorities have the tools to mitigate the downturn and its effects on the rest of the world.

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Over and beyond the China effect, and its spillover onto commodities, emerging markets have been on a slowing path because of the need to correct balance of payments or fiscal imbalances, reduce domestic overheating pressures in some cases, and remedy inappropriate or idiosyncratic policies. In turn, the slowdown in emerging markets and the financial uncertainties caused by China, have led to a sharp decline in private capital inflows and an increase of private capital outflows from emerging markets. The prospect of higher US interest rates has also played a role in this evolution. Russia, which is under sanctions, Brazil, which has been set back by massive corruption scandals, and Turkey, which is dependent on capital inflows and has seen much political uncertainty, are some of the most vulnerable countries to a further deterioration of investor sentiment.

The Good News

The most reassuring developments in recent months originate in the advanced countries and in some of the main commodity importing developing countries. At the core of these developments are the beneficial effects of lower oil prices on oil-importers and on global aggregate demand, the higher US dollar which improves the competitiveness of several countries or regions that are under pressure, and continued easing of monetary policies, especially in Europe and Japan, whose recovery is lagging that in the United States. These favorable elements have been very important in allowing the recovery to consolidate in the Eurozone, preventing the Japanese economy from lapsing into outright deflation, and sustaining aggregate demand in oil-importers such as India and Morocco.

«The countries most affected by the Euro crisis, notably Spain and Ireland, now appear to be on a solid growth path.»

Resumption of growth much nearer to long-term averages in the Eurozone is probably the best piece of news in the recent period. The countries most affected by the Euro crisis, notably Spain and Ireland, now appear to be on solid growth path, and the prospects have also brightened somewhat in Italy and Portugal, though unemployment remains very high in Spain and Italy. Though Greece has shown modest signs of growth in recent quarters, the situation there remains problematic, as the country's debt overhang is severe and cannot be resolved without some form of restructuring. Germany, which is now in full employment and has seen its competitiveness improve even further with the low Euro, and will derive a small growth boost form the influx of refugees, appears to be on a good trajectory. The UK, which continues to register growth rates which are about 1% higher than most of the other large Eurozone economies despite its ongoing fiscal consolidation, contributes to the continent's improving cycle.

The latest data on the United States is also encouraging, signaling that the economy's recovery continues to build despite disappointing headline growth numbers in the third quarter. The third quarter numbers were depressed by a large drawdown in inventories and weak exports, a reflection of the slowdown in world trade and the high dollar. However, domestic demand growth was strong. Hiring continued at a high pace and real wages are rising again, contributing to improved consumer confidence. The housing recovery, as measured by new housing starts and house prices, is continuing but construction activity still has a long way to rise before it matches estimated long-term demand induced by household formation and replacement. Although core inflation remains somewhat below the Fed target of 2% as it has been over the last 3 years, concerns about deflation have abated as the economy approaches full employment and inflationary expectation remain well anchored. This gives the green light for the Fed to raise policy interest rates gradually from their near-zero level for the first time since 2006.

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A Diverse Regional Outlook

Growth of the world economy in 2015 is estimated at near 2.5%, accelerating to near the 25-year 3% average in 2016. As the tables illustrate, the highly disparate performance of recent years among and within both the advanced and developing country groups is likely to persist.

Figure 2: GDP Growth Ranking, 2015/2016: Large countries

	2015	2016
India	7.5	7.2
China	6.9	6.3
US	2.5	2.6
UK	2.5	2.5
Euro Zone	1.5	1.6
Japan	0.7	0.7
Russia	-4	-1
Brazil	-3	-1.5

Source: Author's Forecast

India and China will remain the world's fastest growing large economies in that order, while Brazil and Russia will continue to experience sharp recessions. Among the large high-income economies, the United States and the UK will grow at rates near their estimated long-term potential of 2.5%, as will the Eurozone, near 1.5% Japan, whose demographics are among the least favorable, though growing, will lag by a significant margin.

Figure 3: GDP Growth Ranking, 2015/2016: Emerging economies

	2015	2016
Asia	6.5	6.3
SSA	4.5	4.3
Middle East	3.5	3.2
East Europe (excl Russia)	3	3
LAC	-1	-0.3

Source: Author's Forecast

Developing regions (which include the aforementioned large developing economies) will also show very disparate outcomes, with Asia growing at a slower but still impressive 6.5% pace in 2016, while Latin America's aggregate GDP is likely to decline for a second year in a row. Brazil and Venezuela depress this regional average, even as moderate growth continues in large parts of the continent, including in Mexico, Peru, Colombia and the Caribbean. Sub-Saharan Africa has seen a sharp deceleration as commodity prices have declined and South-Africa, the continent's second largest economy, continues to struggle with a large current account deficit and weak investor confidence. Nevertheless, buoyed by several oil-importing rapidly growing economies such as Ethiopia, Sub-Saharan Africa is likely to remain the world's second-fastest growing region. Central and Eastern European countries are projected to grow at rates near 3%, supported by the recovery of the Eurozone and benefiting from the lower prices of oil and other imported commodities. Despite the turmoil in large parts of the region and lower oil prices which create major budgetary challenges for Algeria, Saudi Arabia, Iran and Iraq, the MENA region is expected to grow at a respectable rate near 3%. Drawing down of reserves and the improved performance of Egypt and Morocco will contribute to this outcome.

The Long View

Based on an updated analysis by the author (see Juggernaut, 2010, for a comprehensive review), as well as a recent review by the OECD, the potential growth rate of advanced countries is likely to settle near 2% over the next 20 years, a little below the pre-crisis average, while that of developing countries will settle at a rate that is more than double, near 4.5%. As in recent years, Asia and Sub-Saharan Africa are likely to remain the fastest growing regions by a wide margin. The projected growth of developing countries, if realized, would represent an outcome well below the average of the last 25 years, a reflection of slowing population growth, the end of the "transition premium" in China and other formerly planned economies, as well as ongoing governance and reform challenges in several emerging markets.

The large difference in growth rates between developing and advanced countries implies that the rapid rebalancing of the world economy towards developing countries will continue.

According to the Dutch CPB (World Trade Monitor Memo) over the last 10 years, industrial production has hardly increased in advanced countries, while it has risen by 70% in developing countries. The share of world GDP and trade accounted for by developing countries has risen by about 15% and 20% respectively.

Reflections on Morocco

Morocco, whose oil imports in 2013 amounted to near 10% of GDP, is a large beneficiary of lower oil prices, which should help support consumer demand in 2015 and 2016, and also help relieve the country's balance of payments and fiscal deficit, reflecting a partial claw-back of energy subsidies. However, while the beneficial effect of lower oil prices is likely to persist, it represents a one-off level effect – not a sustained boost to growth. Indeed, some payback depressing demand can be expected in the form of lower import demand by oil exporters and fewer job opportunities for Moroccans in the Gulf, for example. Still, other forces at work should boost Morocco's prospects. The ongoing recovery in Europe, which is by far Morocco's most important market, combined with the devaluation of the Dirham's real exchange rate due to the high dollar should lead to improved exports. Morocco's phosphate exports are also holding up, and the coming on stream of new capacity in the automobile and aerospace sector will also help.

Against this favorable background, growth of Morocco's non-agricultural output, which is expected to remain in the 3-3.5% range, appears a lackluster outcome. Ongoing and badly needed fiscal consolidation is part of the explanation. Moreover, although the security situation in Morocco has seen little spillover from the regional turmoil so far, tourism has remained weak and volatile, and investor confidence is shaky. The projected growth outcome for 2015, which is near 4.5% is flattered by a good spell in Morocco's highly volatile agricultural output.

«More systematic efforts to improve the investment climate are also needed to attract more private investment, especially from abroad.»

Lower oil prices and the recovery in Morocco's main export market provides a limited time window to accelerate the country's most pressing reforms. These should include a reorientation of exports towards the fast growing markets in Asia and Africa (which may require liberalization of trade with those regions to match that already achieved with the United States and Europe), and increased flexibility of the exchange rate regime to facilitate adjustment to external and internal shocks – a measure that most emerging market have adopted successfully in recent years. More systematic efforts to improve the investment climate are also needed to attract more private investment, especially from abroad, tapping vast savings and industrial know-how in China and in several rapidly advancing countries in Asia. In this regard, improving the effectiveness of Morocco's underperforming education system is key. As argued in a related policy paper (Dadush, Diaspora, Development and Morocco, 2015), more attention should also be paid to policies that facilitate emigration, which help relieve pressure in the labor market, and to strengthening the investment and trade links with Morocco's large diaspora.

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Uri Dadush is a senior associate in Carnegie's International Economics Program and Senior Fellow at OCP Policy Center. He focuses on trends in the global economy and is currently also tracking developments in the eurozone crisis. Dadush is interested in the impact of the rise of developing countries for financial flows, trade and migration, and the associated economic policy and governance questions. He is the co-author of four recent books and reports: Inequality in America: Facts, Trends and International Perspective (Brookings, 2012), Juggernaut: How Emerging Markets Are Reshaping Globalization (Carnegie, 2011), Currency Wars (Carnegie, 2011), and Paradigm Lost: The Euro in Crisis (Carnegie, 2010). He has published over a dozen Carnegie papers and policy briefs as well as numerous journal articles.

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