WORLD ECONOMICS: MODERN FACTORS OF ECONOMIC GROWTH AND ECONOMIC DEVELOPMENT

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FACTORS THAT AFFECT ECONOMIC GROWTH

1. **Natural Resources**. The discovery of more natural resources like oil, or mineral deposits may boost economic growth as this shifts or increases the country's Production Possibility Curve. Other resources include land, water, forests and natural gas. Realistically, it is difficult, if not impossible, to increase the number of natural resources in a country. Countries must take care to balance the supply and demand of scarce natural resources to avoid depleting them. Improved land management may improve the quality of land and contribute to economic growth.

2. **Physical Capital or Infrastructure.** Increased investment in physical capital such as factories, machinery, and roads will lower the cost of economic activity. Better factories and machinery are more productive than physical labor. This higher productivity can increase output. For example, having a robust highway system can reduce inefficiencies in moving raw materials or goods across the country which can increase its GDP.

3. **Population or Labor.** A growing population means there is an increase in the availability of workers or employees, which means a higher workforce. One downside of having a large population is that it could lead to high unemployment.

FACTORS THAT AFFECT ECONOMIC GROWTH

4. **Human Capital.** An increase in investment in human capital can improve the quality of the labor force. This would result in an improvement of skills, abilities, and training. A skilled labor force has a significant effect on growth since skilled workers are more productive.
5. **Technology.** Another influential factor is the improvement of technology. Technology could increase productivity with the same levels of labor, thus accelerating growth and development. This means factories can be more productive at lower costs. Technology is most likely to lead to sustained long-run growth.
6. **Law.** An institutional framework which regulates economic activity such as rules and laws. There is no specific set of institutions that promote growth.

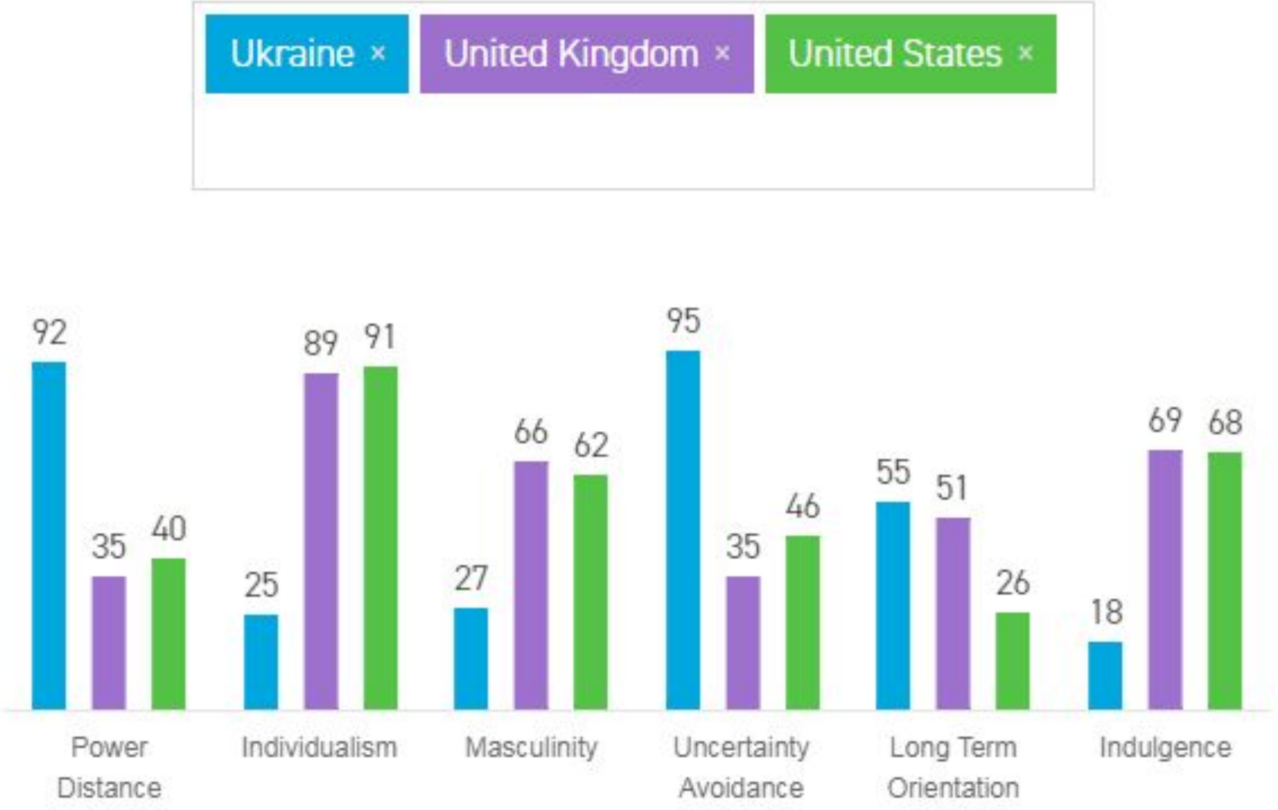
FACTORS THAT LIMIT ECONOMIC GROWTH

1. **Poor health and low levels of education**. People who don't have access to healthcare or education have lower levels of productivity. This means the labor force is not as productive as it could be. Therefore, the economy does not reach the productivity it could otherwise.
2. **Lack of necessary infrastructure**. Developing nations often suffer from inadequate infrastructures such as roads, schools, and hospitals. This lack of infrastructure makes transportation more expensive and slows the overall efficiency of the country.
3. **Flight of Capital**. If the country is not delivering the returns expected from investors, then investors will pull out their money. Money often flows out the country to seek higher rates of returns.
4. **Political Instability**. Similarly, political instability in the government scares investors and hinders investment. For example, Zimbabwe has been plagued with political uncertainty and laws favoring indigenous ownership. This has scared off many investors who prefer smaller but surer returns elsewhere.
5. **Institutional Framework**. Often local laws don't adequately protect rights. Lack of an institutional framework can severely impact progress and investment.

FACTORS OF ECONOMIC GROWTH

- **Boom and Bust Business Cycles.** If economic growth is high-speed and inflationary, then the level of growth will become unsustainable. This could lead to a recession like the Great Recession in 2008. However, this type of growth is typical of a business cycle.
- **Export-led.** The Japanese and Chinese economy have experienced export-led growth thanks to a high current account surplus. This is because they have significantly more exports than imports.
- **Consumer.** The US economy is dependent on consumer spending for economic growth. As a result, they also have a higher current account deficit.
- **Commodity exports**. These economies are dependent on their natural resources like oil or iron ore. For example, Saudi Arabia has a had a very prosperous economy thanks to their oil exports. However, this can cause a problem when commodity prices fall, and there aren't other industries to balance things out.

HOFSTEDE-INSIGHTS



1. Power Distance is defined as the extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally.
2. The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among its members.
3. The fundamental issue here is what motivates people, wanting to be the best (Masculine) or liking what you do (Feminine).
4. The extent to which the members of a culture feel threatened by ambiguous or unknown situations and have created beliefs and institutions that try to avoid these is reflected in the score on Uncertainty Avoidance.
5. This dimension describes how every society has to maintain some links with its own past while dealing with the challenges of the present and future, and societies prioritise these two existential goals differently.
6. This dimension is defined as the extent to which people try to control their desires and impulses, based on the way they were raised.

PATH DEPENDENCY

- Path dependency is an idea that tries to explain the continued use of a product or practice based on historical preference or use. This holds true even if newer, more efficient products or practices are available due to the previous commitment made. Path dependency occurs because it is often easier or more cost effective to simply continue along an already set path than to create an entirely new one.
  - *An example of path dependency would be a town that is built around a factory. It makes more sense for a factory to be located a distance away from residential areas for various reasons. However, it is often the case that the factory was built first, and the workers needed homes and amenities built close by for them. It would be far too costly to move the factory once it has already been established, even though it would better serve the community from the outskirts of town.*

MIDDLE CLASS

- Different, partly overlapping concepts of ‘class’
  - Statistical partitioning of distribution in discrete, partly arbitrary, groups
  - Sociological perspective (position in division of labour, occupations, education)
  - Political (capacity to forge identities and articulate common demands)

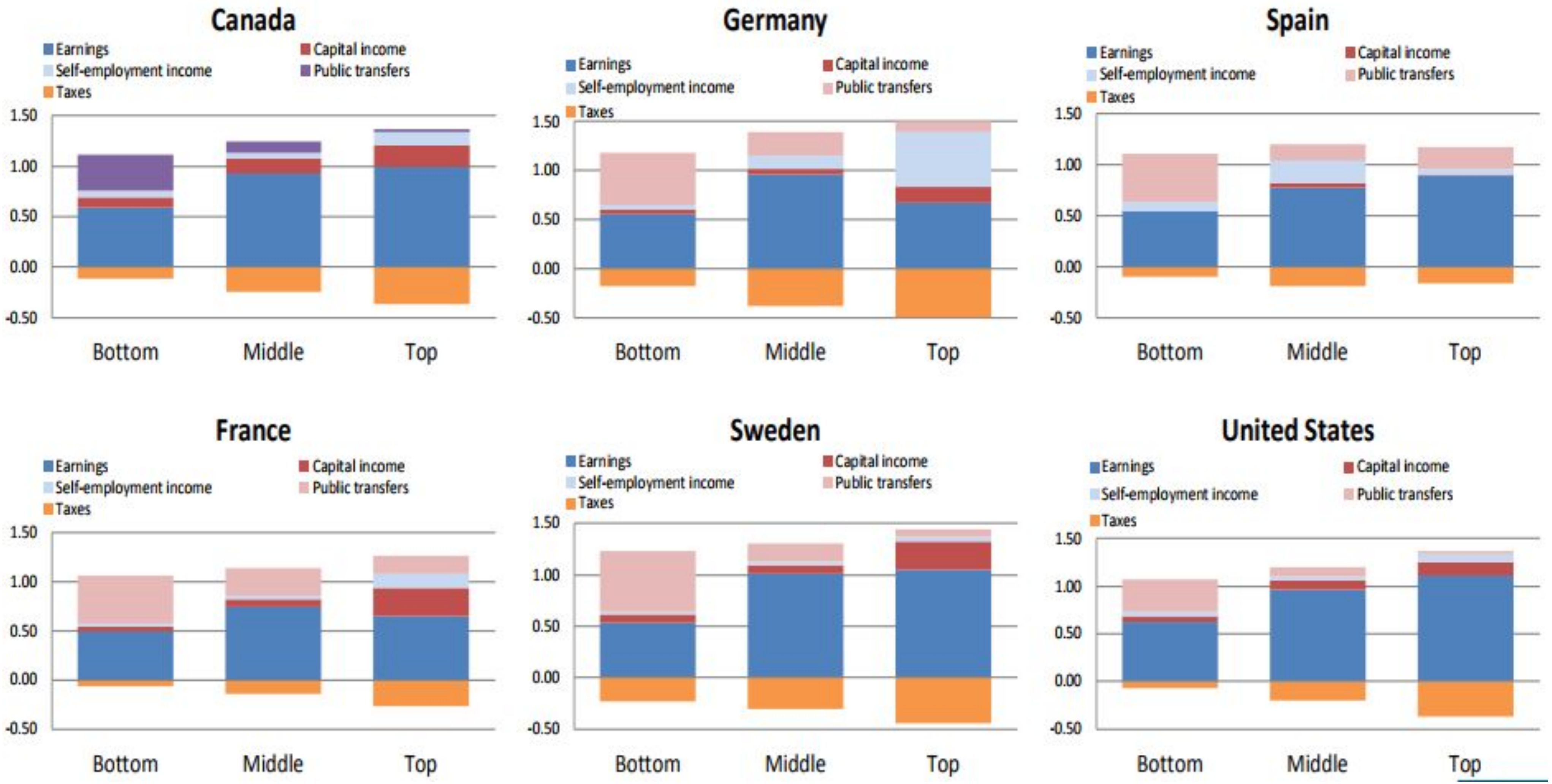
'Middle Class'

Middle class is a description given to individuals and households who fall between the working class and the upper class within a societal hierarchy. In Western cultures, persons in the middle class tend to have a higher proportion of college degrees than those in the working class, have more income available for consumption and may own property. Those in the middle class often are employed as professionals, managers and civil servants.

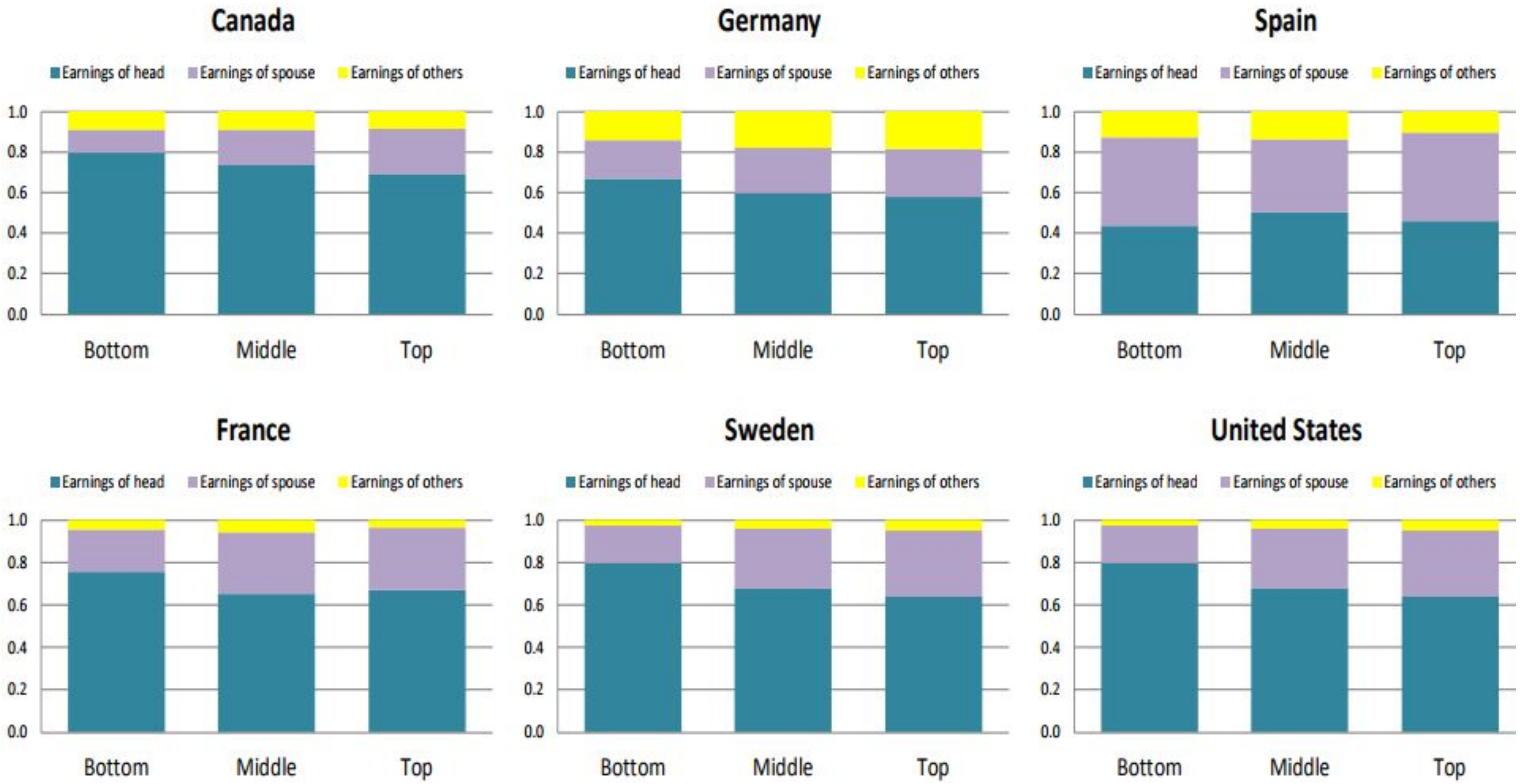
MIDDLE CLASS

- no single OECD definition of the ‘middle-class’ analogue that what we use for income poverty (40, 50, 60% of median household disposable income), i.e. various OECD studies used different definitions
- general definition of the middle class used here: people in 5th to 9th decile of the distribution (Palma ratio). At this stage, not much evidence that alternative definitions would lead to similar conclusions

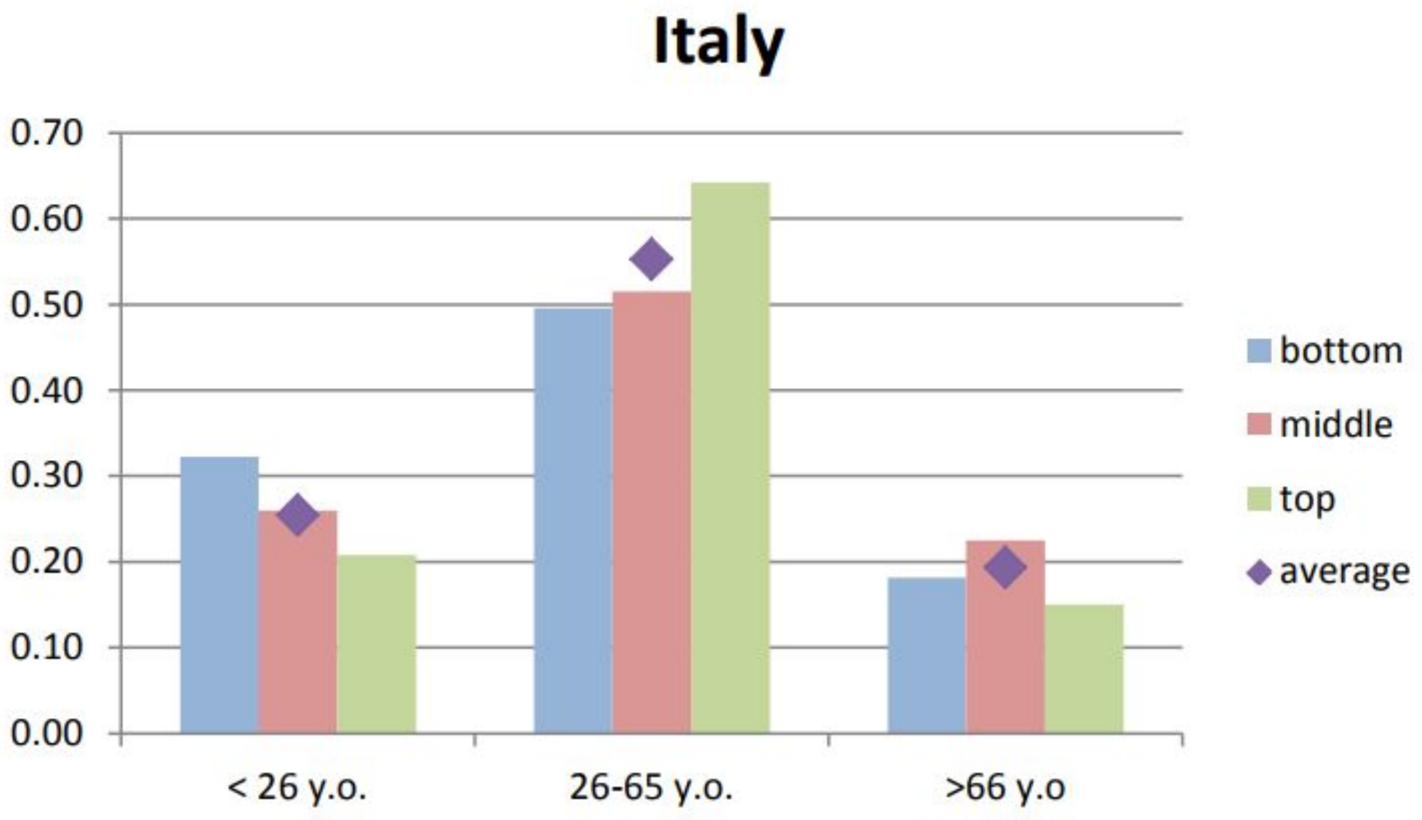
MIDDLE CLASS DEPENDS ON EARNINGS AS MAIN INCOME SOURCE



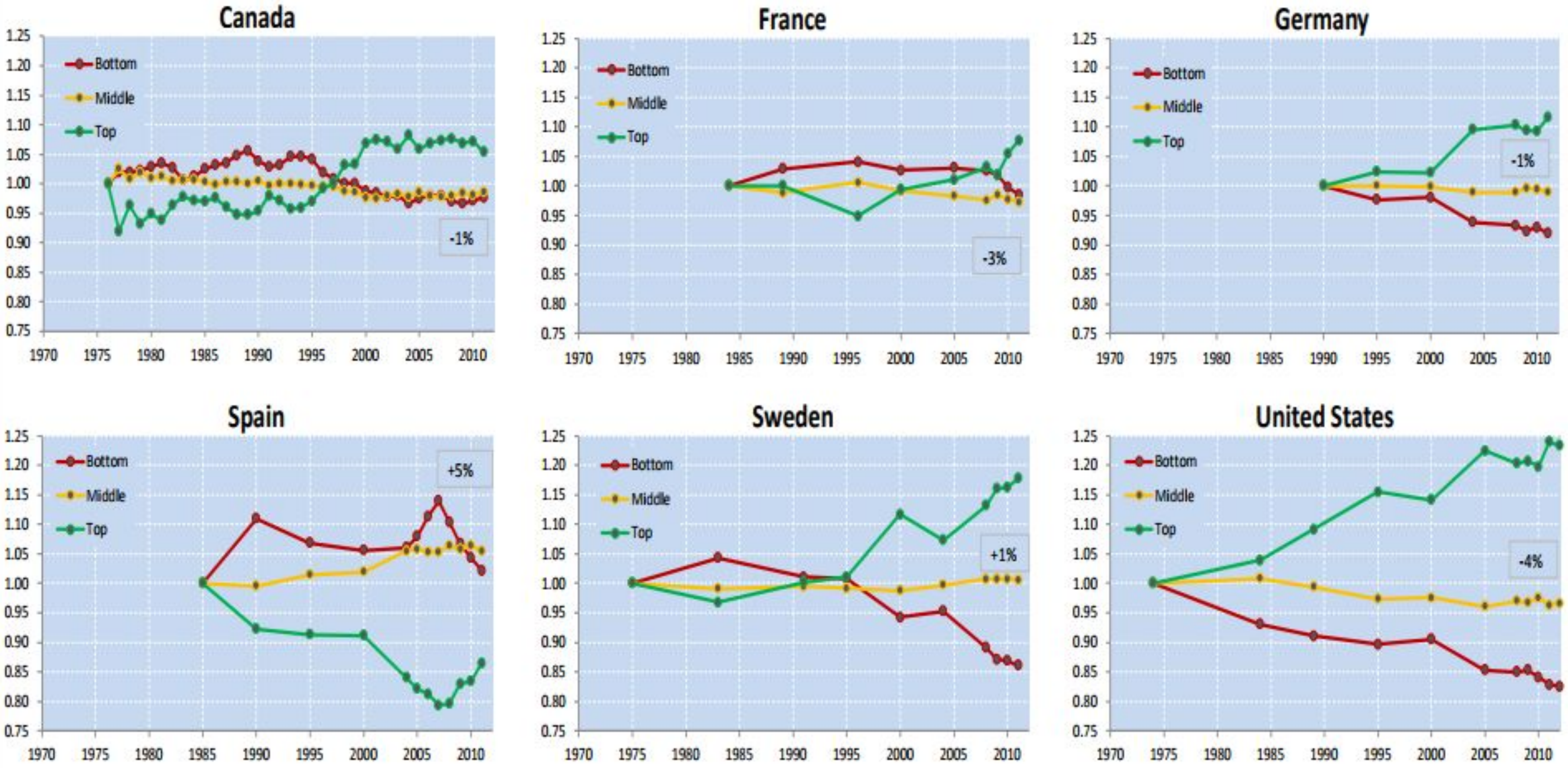
INCREASINGLY DUAL-EARNINGS HOUSEHOLDS



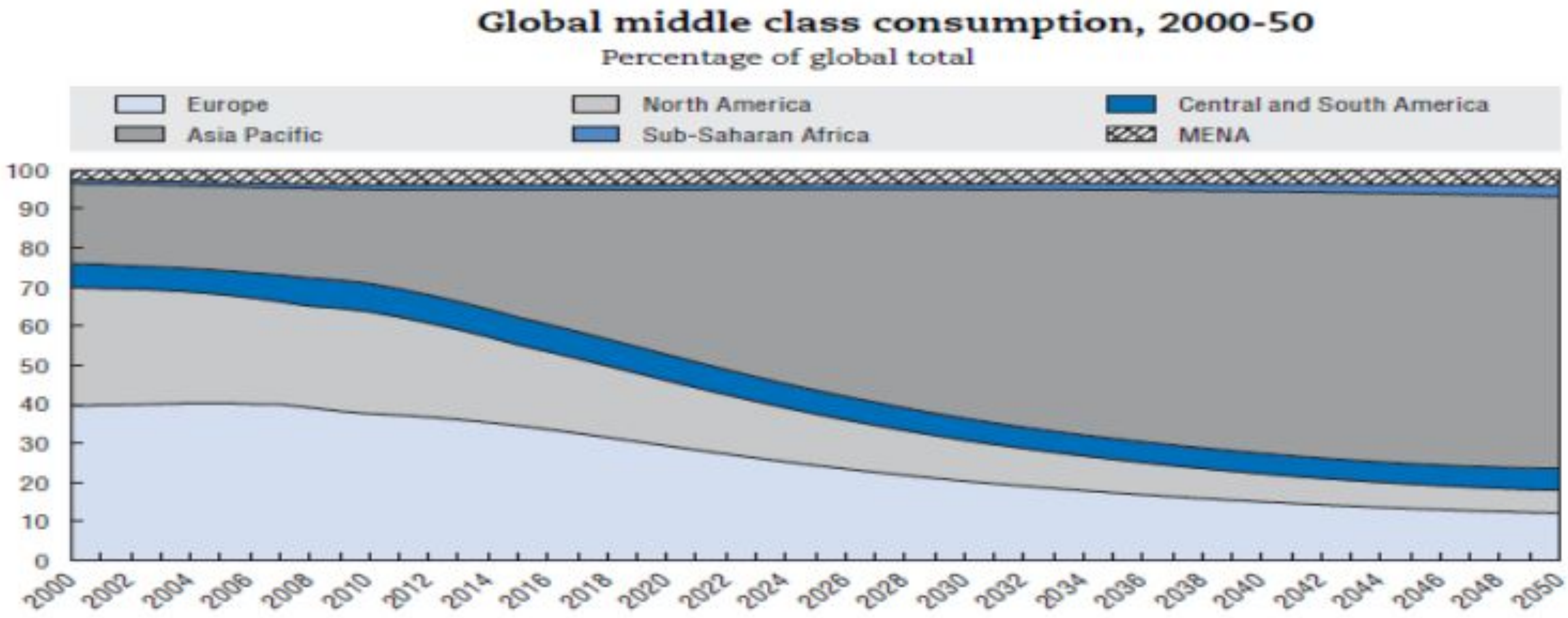
PREDOMINANTLY PRIME-AGED (WITH CHILDREN)



SIGNIFICANTLY CHANGES IN THE US (LOWER) AND SPAIN (HIGHER), SMALLER CHANGES ELSEWHERE



- 'Middle class' is a political construct, used to convey images of greater contiguity with upper classes that with 'working class': statements about the fate of the middle class immediately gain strong political attention (e.g. press debates in US, Canada, Germany, others)
- Growth of middle-classes in emerging countries, bringing with it new demands which political system are unable to answer (e.g. street protest in Israel, Brazil, Arab Spring, etc.)



FINANCIAL CRISES

The amount of subprime mortgage debt, which was *guaranteed* by **Freddie Mac** and **Fannie Mae**, continued to expand into the early 2000s, about the time the Federal Reserve Board began to cut *interest rates* drastically to fend off a **recession**. The combination of loose credit requirements and cheap money spurred a housing boom, which drove speculation, which in turn drove up housing prices.

THE GREAT RECESSION

- The Great Recession is a term that represents the sharp decline in economic activity during the late *2000s*, which is generally considered the largest downturn since the Great Depression.
- The term *Great Recession* is a play on the term *Great Depression*
- Great Recession applies to both the U.S. recession, officially lasting from *December 2007 to June 2009*, and the ensuing global recession in 2009. The economic slump began when the U.S. housing market went from boom to bust and large amounts of mortgage-backed securities and derivatives lost significant value.

BEFORE GREAT RECESSION

- The investment banks, **looking for easy profits** in the wake of the dotcom bust and 2001 recession, created collateralized debt obligations (CDOs) out of mortgages purchased on the secondary market.
- Because subprime mortgages were bundled with prime mortgages, there was no way for investors to understand the risks associated with the product.
- Around the time when the market for CDOs was heating up, the housing bubble that had been building up for several years was beginning to burst.
- As housing prices fell, subprime borrowers began to default on loans that were worth more than their homes, accelerating the decline in prices.
- When investors realized the CDOs were becoming worthless due to the toxic debt they represented, they tried to unload them, but there was no market for them.
- This caused a cascade of subprime lender failures, which created a liquidity contagion that worked its way to the upper tiers of the banking system.
- Two major investment banks, Lehman Brothers and Bear Stearns, collapsed under the weight of their exposure to the subprime debt, and more than **450 banks** failed over the next **5 years**.

DOTCOM BUBBLE

- The **dotcom bubble** occurred in the late 1990s and was characterized by a rapid rise in equity markets fueled by investments in Internet-based companies. *During the dotcom bubble, the value of equity markets grew exponentially, with the technology-dominated NASDAQ index rising from under 1,000 to more than 5,000 between 1995 and 2000.*
  - The dotcom bubble grew out of a combination of the presence of speculative or fad-based investing, the abundance of venture capital funding for startups and the failure of dotcoms to turn a profit. Investors poured money into Internet startups during the 1990s in the hope that those companies would one day become profitable, and many investors and venture capitalists abandoned a cautious approach for fear of not being able to cash in on the growing use of the Internet.

The 1990s was a period of rapid technological advancement in many areas, but it was the commercialization of the Internet that led to the greatest expansion of capital growth the country had ever seen. Although high-tech standard bearers, such as Intel, Cisco, and Oracle were driving the organic growth in the technology sector, it was the upstart dotcom companies that fueled the stock market surge that began in 1995.

From IMF

LESSONS

- Originators need to be "incentivized" to make loans to high-quality borrowers and to monitor loan performance more carefully.
- The governance structure of the risk management system needs to be improved in financial firms in which the incentives are biased toward returns rather than the risks involved in attaining them.
- The incentives to use credit rating agencies and the incentive structures within credit rating agencies themselves need to be reexamined
- Investors need to perform their own due diligence and ask the right questions about the riskiness of the securities they are purchasing

EIU GLOBAL FORECAST - HIGHER INTEREST RATES ARE COMING

- The US economy will continue to motor along; the euro area will absorb more of labour market slack; the Chinese government will manage its economic slowdown carefully; and Japan's economy will grow by 1.5%.
- Higher commodity prices will prove a fillip for emerging-market exporters, as will strong external demand from developed markets.
- However, 2018 will also be characterised by tightening monetary policy and credit conditions. On balance, the global economy is forecast to expand by 3% in 2018 and 2.9% in 2019, from an estimated 3% in 2017.

DEVELOPED WORLD

- The US economy is in good shape, and we have revised up economic growth in 2018 to 2.5%, from 2.3% previously. Wage growth is showing signs of accelerating, and the unemployment rate is at its lowest level since 2000.
- Expects the US economy to show signs of overheating in the next two years, as a result of which the Fed will quicken the pace of monetary tightening, especially given the recent tax changes. Unable to cope with this, the economy will face a downturn in early 2020.
- The recent revival of the euro zone economy is likely to be sustained, but political risk will remain high. EU leaders are currently boosting the region's resilience to shocks, in part by renewing their push for further integration of the economic and monetary union.
- A decision on reform proposals will be made at the EU summit in June 2018. Following the renewed landslide secured by the ruling Liberal Democratic Party (LDP) in Japan, Shinzo Abe is in a strong position to secure another term as LDP leader when the party votes in late 2018. This comes in the context of the country's mild economic recovery under the prime minister's recovery plan.

EMERGING MARKETS

- Conditions for emerging markets to become more challenging in the first half of the forecast period as US interest rates continue to rise. India will be Asia's fastest-growing large economy in 2018-22, expanding at an average annual rate of 7.9%. Growth will also remain on track in the Association of South-East Asian Nations (ASEAN) member states, with an average annual expansion of 4.8%. Vietnam, Cambodia and Myanmar, in particular, will continue to record growth rates above 6%, owing to relatively low wage costs and advantageous geographic locations.
- the Chinese economy to slowly slightly in 2018, to 6.4%, from an estimated 6.9% in 2017. The government's long-held target of doubling real GDP between 2010 and 2020 is within its grasp; it requires annual average GDP growth of 6.3% in 2018-20. We believe that it will meet this target without requiring significant economic stimulus. We expect China to move away from GDP targeting in the next decade. This is ideologically consistent with the call of the president, Xi Jinping, for more inclusive growth in his landmark speech at the party congress at the end of 2017. As such, we expect growth to continue to slow steadily in the forecast period, reaching 5.2% in 2022.

EMERGING MARKETS

- The ongoing economic recovery in Latin America is forecast to gather momentum in 2018-19, after several years dominated by macroeconomic policy adjustments to the end of the commodities boom of the previous decade. Sustained Chinese growth will continue to provide a favourable external environment for the region, particularly for commodity exporters such as Brazil and Argentina. This, combined with a rise in global risk appetite, as reflected in lower sovereign credit default swap rates (except for Venezuela, which defaulted on some external debt obligations in late 2017, taking the country further into economic and financial crisis), has generated strong growth in local stockmarkets.
- At present, seven countries in the Middle East that collectively account for a quarter of the regional population are either torn by civil war or destabilised by Shia-Sunni rivalry. Geopolitical risk has also risen rapidly within the Gulf Co-operation Council (GCC). We expect the boycott of Qatar by some of the GCC countries and Egypt to continue until at least 2021. In this period divisions will harden between Qatar, Turkey and Iran on one side, and Saudi Arabia, the UAE and Egypt on the other. The long-term rivalry between Saudi Arabia and Iran is likely to destabilise a group of other countries in the Middle East, including Iraq, Syria, Lebanon and Yemen. Tensions are likely to increase rather than diminish in the region in the coming months.
- Following a dismal performance in Sub-Saharan Africa over 2016-17, we expect a lacklustre recovery to take hold from 2018. This will be driven by a favourable external environment as export prices strengthen and trade gathers pace. However, policy mismanagement, unsupportive political dynamics and gradual tightening of credit conditions in developed economies will weigh on future prospects. On balance, the region is forecast to grow by 3.3% a year in 2018-22.

EXCHANGE RATES

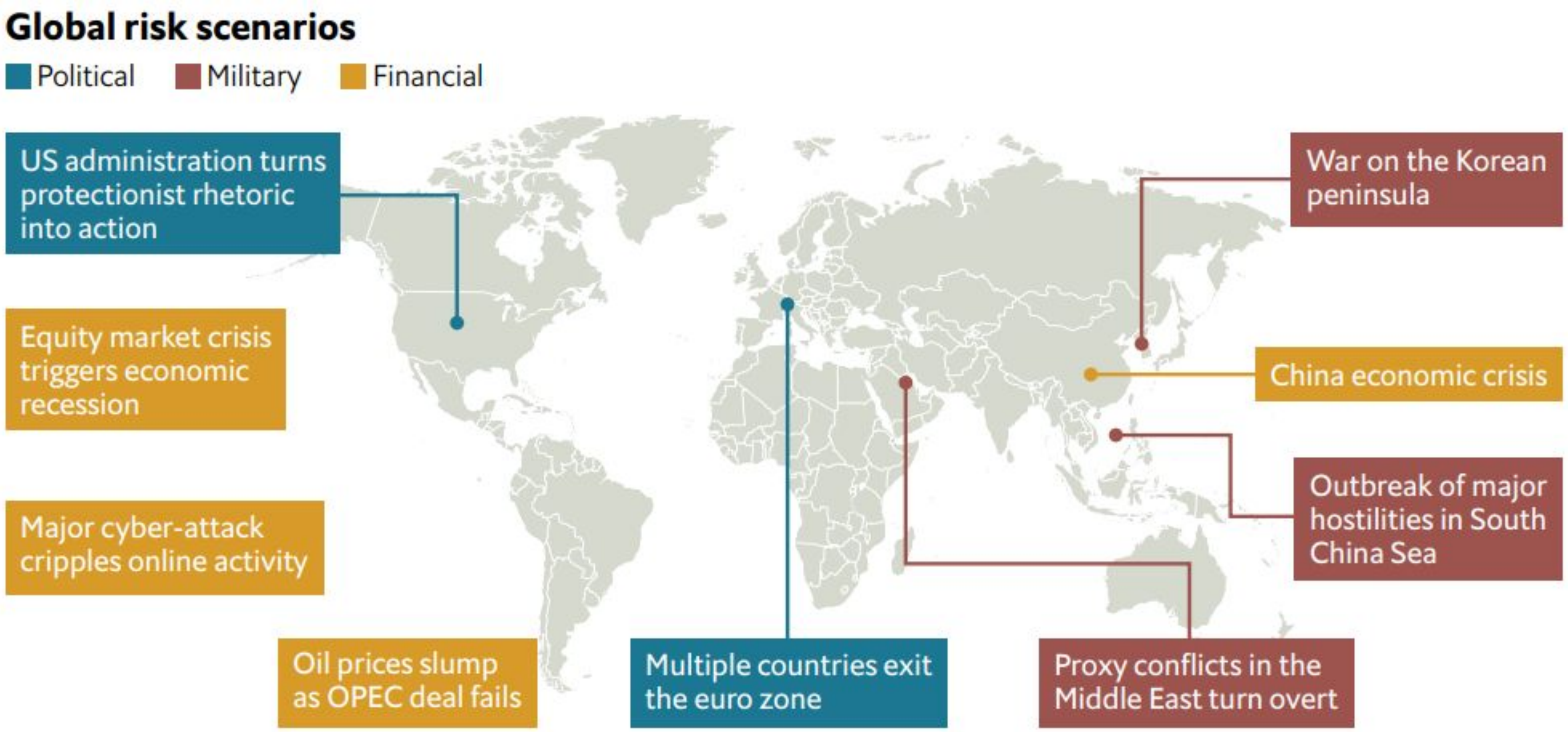
- The US dollar has continued to depreciate in early 2018, in spite of solid economic data, major tax reform and a clear commitment by the Fed to raising interest rates. Previously, markets did not believe monetary tightening by the Fed to be credible.
- However, this changed in early February when global stockmarkets fell sharply in response to suggestions of faster US wage growth. Regular interest-rate increases should provide the dollar with fresh support over the next two years, but any rally in 2018-19 will be modest at most. Among G10 currencies, the euro made the biggest gains against the dollar in 2017 as economic data went from strength to strength and some political risk receded. Further supporting the currency, the ECB is slowly becoming more upbeat in its communication.
- However, we believe that the first interest-rate rise is still two years away, and the euro zone continues to face considerable political challenges, which will limit economic momentum. On balance, we expect the euro to hold steady against the dollar in 2018-19. The yen is expected to appreciate further against the dollar in 2018-19 owing to its safe-haven appeal, and as the BOJ slows the pace of its asset purchases over dwindling bond-market liquidity concerns

COMMODITIES

- The price of crude oil is likely to remain range-bound, at US$60-70/barrel in 2018-19 for dated Brent Blend, despite the efforts of OPEC and its partners, notably Russia, to constrain global supply by extending the existing production-cut deal until the end of 2018. These efforts will be largely offset by US shale, which will provide both a price ceiling and a floor.
- Industrial raw materials prices are set to rise for a second successive year in 2018 on the back of strong growth in China and strict environmental controls restricting supply. We expect marginal growth in food, feedstuffs and beverages prices, reflecting rising population, incomes and rapid urbanisation.

WORLD ECONOMY: FORECAST SUMMARY

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (%)										
World (PPP* exchange rates)	**3.4**	**3.6**	**3.4**	**3.2**	**3.7**	**3.8**	**3.8**	**3.5**	**3.8**	**3.8**
World (market exchange rates)	**2.4**	**2.8**	**2.8**	**2.3**	**3.0**	**3.0**	**2.9**	**2.4**	**2.8**	**2.8**
US	1.7	2.6	2.9	1.5	2.3	2.5	2.3	0.8	1.9	1.8
Euro area	-0.2	1.4	2.0	1.8	2.5	2.2	1.9	1.7	1.7	1.7
Europe	0.8	1.9	2.0	1.8	2.6	2.3	2.0	1.8	1.9	1.9
China	7.8	7.3	6.9	6.7	6.9	6.4	6.3	6.2	5.5	5.2
Asia & Australasia	4.6	4.1	4.3	4.1	4.5	4.3	4.4	4.0	4.2	4.2
Latin America	2.8	1.4	0.5	-0.5	1.2	2.1	2.3	2.4	2.8	2.8
Middle East & Africa	2.2	2.7	2.4	4.2	2.2	2.8	3.3	3.5	3.9	4.1
Sub-Saharan Africa	4.8	4.5	3.0	1.0	2.3	2.9	2.9	2.9	3.6	4.0
World inflation (%; av)	**3.8**	**3.5**	**3.2**	**3.8**	**4.5**	**5.3**	**4.4**	**3.1**	**3.1**	**3.1**
World trade growth (%)	**3.3**	**3.1**	**2.3**	**2.3**	**4.6**	**4.3**	**3.9**	**2.8**	**3.8**	**3.7**
Commodities										
Oil (US$/barrel; Brent)	108.9	98.9	52.4	44.0	54.4	63.0	60.0	57.8	60.6	63.3
Industrial raw materials (US$; % change)	-6.8	-5.1	-15.2	-2.2	20.2	5.7	-0.2	-4.7	1.0	-1.7
Food, feedstuffs & beverages (US$; % change)	-7.4	-5.2	-18.7	-3.5	-0.9	0.9	2.8	1.8	0.7	1.6
Exchange rates (av)										
¥:US$	97.56	105.86	121.02	108.76	112.14	111.26	109.06	104.00	100.00	100.20
US$:€	1.33	1.33	1.11	1.11	1.13	1.20	1.18	1.21	1.21	1.24



Global risk scenarios
Political
Military
Financial
US administration turns protectionist rhetoric into action
Equity market crisis triggers economic recession
Major cyber-attack cripples online activity
Oil prices slump as OPEC deal fails
Multiple countries exit the euro zone
Proxy conflicts in the Middle East turn overt
War on the Korean peninsula
China economic crisis
Outbreak of major hostilities in South China Sea