April 2018

Field Notes: Observing the International Bureaucrat

by Vincent Reinhart
Chief Economist & Macro Strategist

Evolution has made international bureaucrats more skittish over time, as practiced as they have become in avoiding the opprobrium after crisis. They have had many crises to manage, or was it that they managed to have many crises? Part of their natural response has been to change their plumage, showing the colors of concern for equality and inclusion, as well as sustainability.

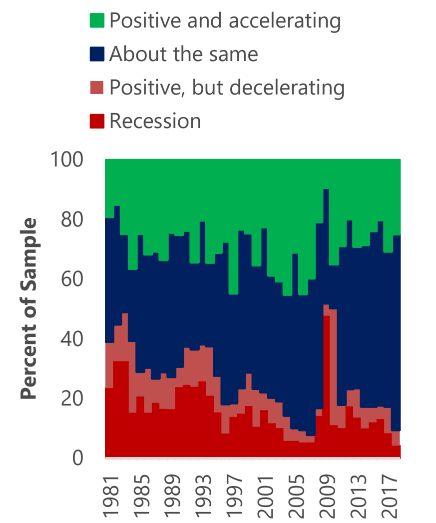
Twice a year, however, they are seen in their natural habitat, when sufficient numbers roost in one place to show their real behaviors. This opportunity comes as policy makers and their attendants flock to Washington, DC, for the 2018 Spring Meetings of the International Monetary Fund (IMF) and the World Bank. To put matters into perspective, this is a venue where catching a glimpse of US Treasury Secretary Mnuchin ranks a star in anyone's birding journal.

What is it like when they are all together? Imagine a colony of seagulls, and one starts cawing. Relatively soon, they all caw the same note. In the current context, officials concerned about economics go to rounds of similar meetings in different capacities, read the same talking points, hear their colleagues not vary from their scripts, and convince themselves that repetition proves the story true.

Hear the first caw. The International Monetary Fund just published its World Economic Outlook (WEO), providing forecasts for 193 economies out to 2023. For each economy, there are 45 time series to report since 1980, totaling 382,140 potential entries in the global worksheet. Luckily, the IMF staff starts early and does it only two times a year. A grueling, thoroughly component, operation, the WEO gives the best snapshot of the wisdom of the official crowd.

The cawing sounds like "synchronicity." For the second meeting running, the common feature of economic growth has been its commonness. The chart to the right conveys the idea, plotting plausible ranges for describing real GDP growth across the 193 economies forecasted by the IMF staff. The chart categorizes the year-over-year changes in real GDP in a manner best understood from the middle outward. The cool, blue, widening river counts the share of economies where real GDP growth in a given year was positive and about the same as the prior year (within 1 percentage point). The light red represents places where growth, while still positive, is slowing. Below that is falling behind; economies in red are contracting. The summer outcomes are in green at the top, which counts the economies where the level of activity is accelerating.

Real GDP Growth Across 193 Economies



Note: Requires valid observations in both current and previous year and "about the same" is defined as +/1 0.5% relative to prior year. Source: International Monetary Fund, World Economic Outlook (April 2018).

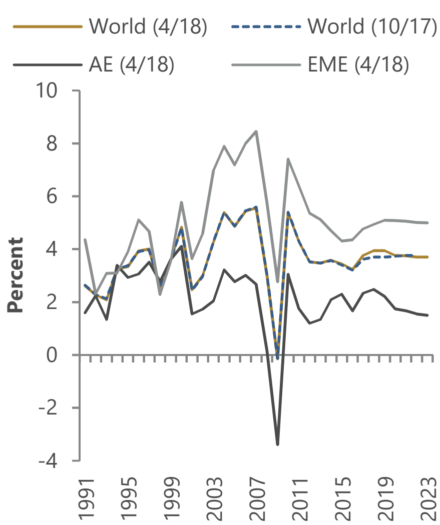
STANDISH
BNY MELLON AMNA

The broadening blue river is the message of the moment, synchronicity. Worrisome slowdowns and recessions are rarer than the norm, giving way to more economies expanding at a similar, relatively steady pace. If we stopped here, the reader might think we are no longer trying. Have no fear. Another half-dozen charts unpack the meaning of this single one. A long trip, but a rewarding one, similar to that of the annual migration Franklin's Gulls from Canada to South America.

The explanation for the broadening blue swath can partly be discerned in the chart below, which plots the growth of real GDP for the world, advanced economies and emerging market ones. Three features are evident about the cyclicality, volatility, and long-run properties of real GDP growth.

The near-term path of growth slopes up from 2017 through 2019 for the whole and the parts. Monetary policy remains accommodative in advanced economies, and China is expected to stay on plan, keeping commodity prices firm and supporting growth in other emerging market economies. The recent revisions look small, but the cumulative change adds 1 percent to the level of global GDP in international purchasing power terms by 2019.

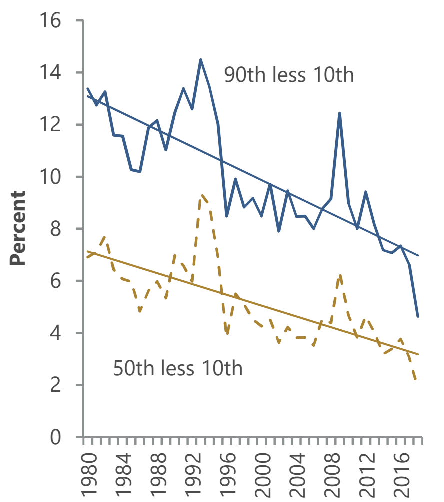
Real GDP Growth



Source: International Monetary Fund, World Economic Outlook (10/17 and 4/18).

Notably, the spread between growth rates narrows. This is true in this broad sample, above, and across the full set of 193 economies, below, extending the convergence observed over the past 35 years. More specifically, the spread between the 90th percentile growth rate relative to the 10th percentile rate has shrunk over time. Moreover, the adverse tail—the bottom 40th percentage point spread relative to the median—contributes an outsized portion of this decline. Real GDP growth around the world is getting more similar and bad outcomes relatively rarer. Admittedly, part of the narrowing owes to the receding sight of the Great Recession in the rearview mirror. Still, the distinct downtrend suggests that a Great Convergence hid in plain sight all along.

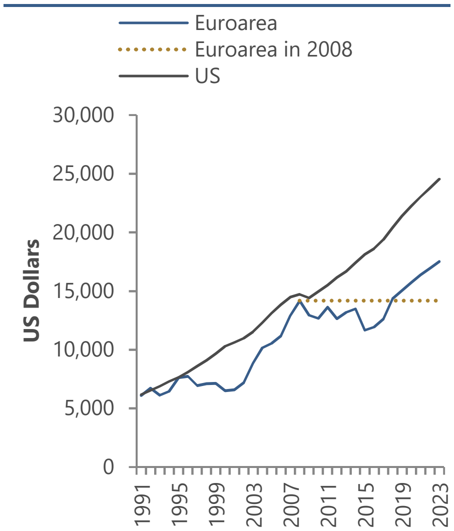
Dispersion of Real GDP Growth Across 193 Economies



Source: IMF. World Economic Outlook (April 2018) and BNYM AMNA calculations

There is a remarkable nugget buried in the WEO wilderness that speaks to the benefit of being distant in time from a financial crisis. Unfortunately, the journey may be lengthy. As shown below, the level of nominal GDP in the Euro area in US dollars is projected finally to crest above that posted in 2008, before the fall. Ten years of treading water owed to a large initial decline in real GDP and its subsequent subpar growth, persistently below-goal inflation, and significant currency depreciation vis-à-vis the numeraire (the US dollar) partly in light of the monetary response of the European Central Bank. Essential to this was the slowness in acknowledging the scale and scope of the problems on bank and national balance sheets. True, domestic purchasing power rose over this period, on net, but the footprint of the Euro area in global markets shrank, presumably acting as a sea anchor on the demand for goods and commodities denominated in dollars.

Nominal GDP

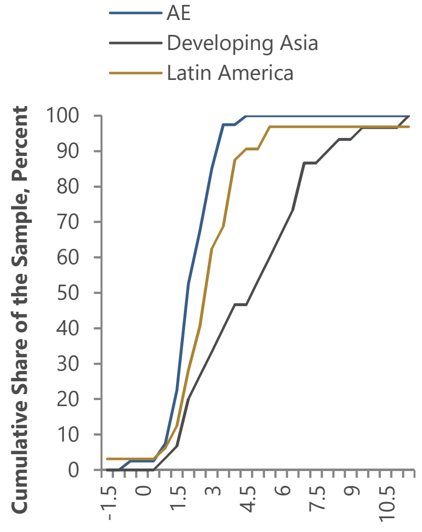


Source: International Monetary Fund, World Economic Outlook (4/18).

The third salient figure of the IMF's growth forecast is seen in the points at the far right of the chart. Real GDP in advanced economies is expected to grow 3½ percentage points slower than emerging market economies. Aging populations in the former are increasing slowly (if at all) and adding less extra output per extra hour worked (productivity is at a standstill). The remarkable difference is evident below, which sorts the sample of long-run GDP growth into advanced economies, emerging market economies in Latin America, and emerging and developing economies in Asia.[1] More than one-half of Asian economies grow faster than 90 percent of advanced and Latin American economies. The problem for Latin America is that it seems more similar to sclerotic advanced economies than high-saving, fast-moving Asian ones. Considering that among the fastest-growing economies in the Asian group is now the second-largest economy on earth, China, the difference is economically meaningful.

[1] Long-run growth is taken to be the IMF forecast for 2023, far enough in the future to have any cyclical element.

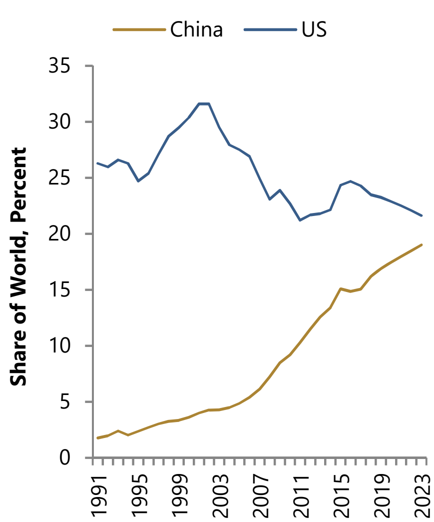
Long-run Real GDP Growth



Source: International Monetary Fund, World Economic Outlook (4/18).

How does this add up? By adding up. Over time, the growth gap cumulates, seen in the chart below, which shows that the share of the US and China in global GDP are in motion to converge sometime soon. The same pattern emerges with the two clubs they belong to—advanced economies and emerging and developing economies in Asia.

Nominal GDP



Source: International Monetary Fund, World Economic Outlook (4/18).

Average and Standard Deviation of Real GDP Growth Across Regions, 1991 to 2018 (Percent)

	Average (1)	Standard Deviation (2)	Sharpe Ratio (3)
Advanced economies	2.81	3.68	0.76
Emerging and developing Europe	2.83	4.85	0.58
Commonwealth of independed states	3.74	7.94	0.47
Emerging and developing Asia	4.69	4.87	0.96
Latin American and the Caribbean	3.11	3.75	0.83
Middle east, North Africa, Afghanistan, and Pakistan	4.37	10.44	0.42
Sub-Saharan Africa	4.19	8.22	0.51

Source: IMF, World Economic Outlook (April 2018) and BNYM AMNA Calculations

The latter is not just growing quickly; it is growing steadily. As shown in the first column of the table, the economies in Asia delivered the fastest average real GDP from 1991 to 2018, especially compared with the standard deviation of that growth. Across the regimes, a growth diagnostic akin to the Sharpe ratio—the difference of the average growth of a region with that of the world relative to the standard deviation of that growth—is highest for Asia. The convergence seen earlier is simply the shifting of activity to the relatively more stable pole of the global economy.

International bureaucrats probably do not arrive at the mixed message that the world is more stable partly because the US economy is getting relatively less important. They definitely do not opine that, by mishandling its serial, sometimes silenced, crises, the Euro area marginalized itself quicker. Even if unvoiced, the shifting throw-weight of regional GDP must have consequences for inflation dynamics and the clearing of global commodity markets (as well as on other spheres of influence, including the one that also particularly cares about throw-weights).

Before writing off market economies completely, recognize that Asian ones have been using their balance sheets, often in an opaque manner, to absorb shocks and deliver growth. This compounds, too. For the largest one of them, officials may have found a better way to manage an economy. However, the claim, when made elsewhere before, fell short in the fullness of time. The job gets more complicated as an economy gets bigger and its citizenry demands more. If so, avoiding repetitive small- and medium-sized tremors stores up the kinetic energy for a big one. Perhaps, the Great Convergence has less in its favor than at first glance.

BNY Mellon Asset Management North America Corporation
Boston • Pittsburgh • San Francisco

Standish Mellon Asset Management (UK) Limited
London

www.bnymellonamna.com
info@standish.com

This commentary is provided for general information only and should not be construed as investment advice or a recommendation. You should consult with your advisor to determine whether any particular investment strategy is appropriate. These views are current as of the date of this communication and are subject to change as economic and market conditions dictate. Though these views may be informed by information from publicly available sources that we believe to be accurate, we can make no representation as to the accuracy of such sources nor the completeness of such information. Please contact BNY Mellon Asset Management North America Corporation ("BNYM AMNA") for current information about our views of the economy and the markets. Portfolio composition is subject to change, and past performance is no indication of future performance.

BNY Mellon is one of the world's leading asset management organizations, encompassing BNY Mellon's affiliated investment management firms, wealth management services and global distribution companies. BNY Mellon is the corporate brand for The Bank of New York Mellon Corporation. BNYM AMNA is a registered investment adviser and BNY Mellon subsidiary.

Effective on January 31, 2018, The Boston Company Asset Management, LLC (TBCAM) and Standish Mellon Asset Management Company LLC (Standish) merged into Mellon Capital Management Corporation (Mellon Capital), which immediately changed its name to BNY Mellon Asset Management North America Corporation.