Businessweek | Remarks

A Resilient Global Economy Masks Growing Debt and Inequality

The world appears to have dodged a downturn, but wars and economic nationalism are leaving many countries worse off.

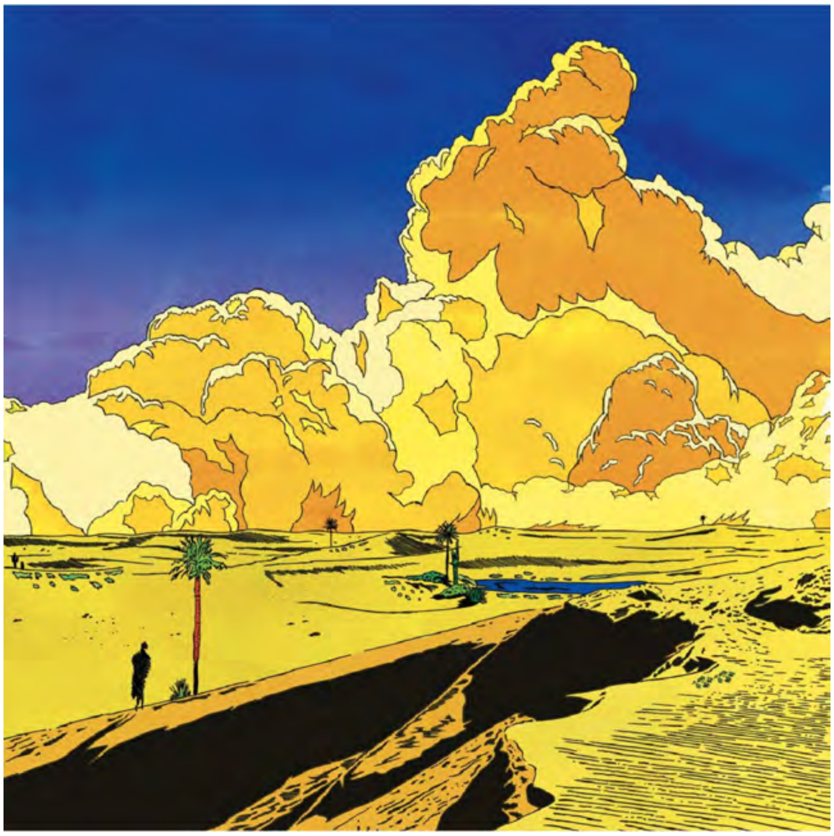

Illustration: Marie Mohanna for Bloomberg Businessweek

By Shawn Donnan, Enda Curran, Tom Orlik, and Eric Martin
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The increasingly hopeful economic story of 2024 so far is that of a world headed for a soft landing. Unfortunately that same world is also becoming more dangerous, divided, indebted and unequal.

The reasons for short-term optimism are plain. A resilient US economy has defied expectations that the Federal Reserve's barrage of interest-rate hikes would induce a recession. The UK—which dipped into a downturn at the end of last year—is already growing again, and Germany's industrial sector is showing signs of a turnaround. Even in debt-hobbled China, domestic tourists spent more per trip over the Lunar New Year holiday than in 2019 for the first time since the pandemic, and the nation's factories are humming a little more loudly.

That buoyant narrative will be reflected in what are expected to be upgrades to growth forecasts for most major economies by the International Monetary Fund during this week's spring meetings in Washington. Bloomberg Economics now expects the global economy to grow 2.9% in 2024, up from a 2.7% forecast at the end of 2023.

But look beyond the collective relief that central banks' campaign to corral inflation didn't exact higher costs, and the picture is less reassuring. What emerges is a world riddled with political and geopolitical risks, as highlighted by the escalating tensions between Israel and Iran—with economic consequences looming for all.

To Carlos Cuerpo, who took over as Spain's economy minister in December, "the picture is not that rosy" for a global economy now embarking on a grand "reconfiguration" driven by geopolitics and technological change. Spain's economy has emerged from the pandemic in good health and started to address long-term structural problems, he says. But things beyond its borders look far more uncertain. "In the short term, I would be more optimistic about Spain than what's happening at the global level, or even at the EU level, that's for sure," he says.

What worries policymakers like Cuerpo is that the reconfiguration of the global economy, as countries organize into geopolitical blocs and navigate technological disruptions such as artificial intelligence, threatens slower overall growth, with gains concentrated in a few rich-world winners. In the five years before the pandemic, global growth averaged a respectable 3.4%. But the IMF is now warning that the rate of expansion over the next five years will likely be the weakest in more than three decades.

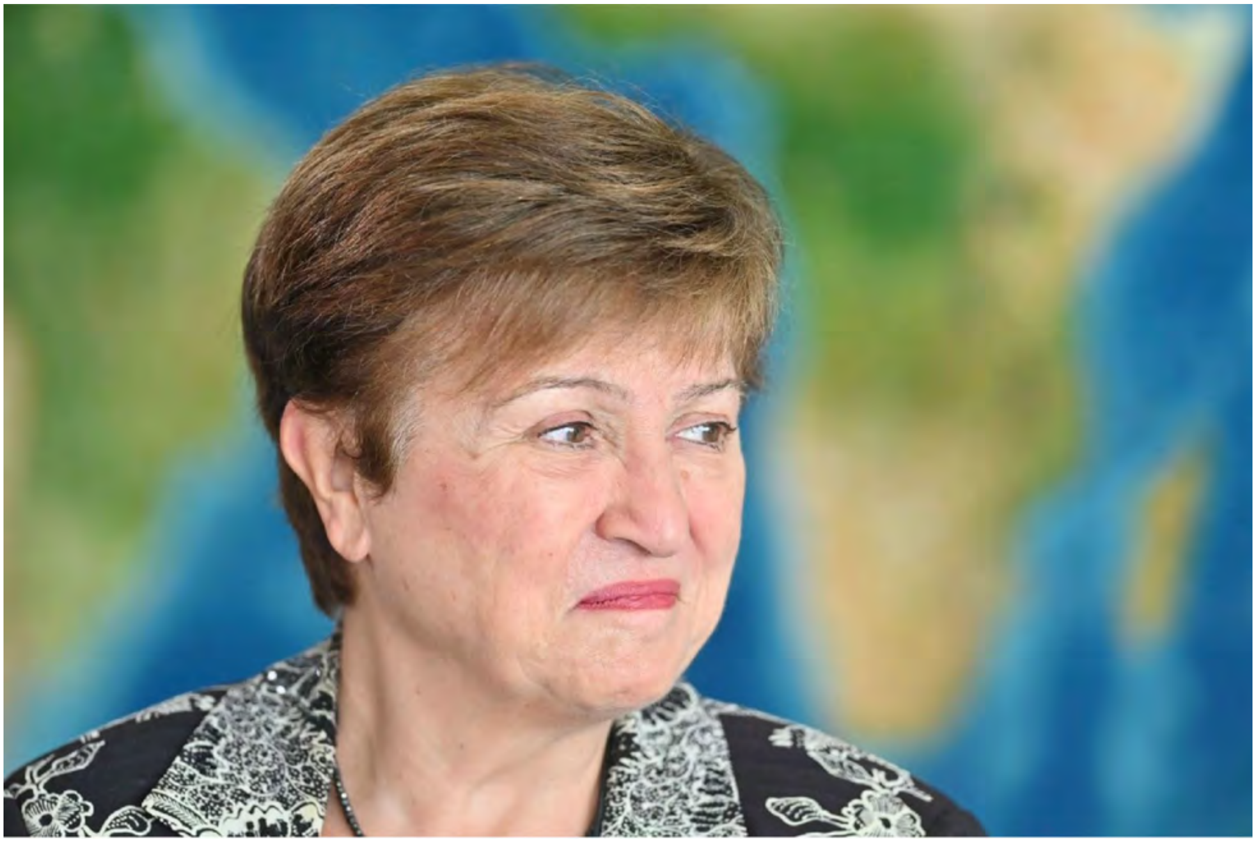
Amid wars—the shooting kind and also trade ones—business leaders and investors are confronting the end of an era in which low barriers to trade and the emergence of a new middle class in developing economies drove investment decisions. Now they're pondering a future in which production and sales may both come from markets closer to home. Poor countries have been battered by shocks from climate change, heavy debt burdens that are squeezing government spending and a sharp increase in food prices, caused in part by the war in Ukraine. The combination is fueling a surge in migration that's shaking up politics in wealthier nations.

The global economy is "in a kind of sweet spot at the moment, but not a very robust sweet spot," says Maurice Obstfeld. Formerly a chief economist at the IMF and an adviser to US President Barack Obama, he's now at the Peterson Institute for International Economics. Among the things Obstfeld frets about, aside from climate change, wars and widening geopolitical divides, is whether new technological revolutions such as AI are feeding asset bubbles that will eventually burst.

Even on Wall Street, where exuberance over the transformative possibilities of AI has lifted the S&P 500 index by more than 8% since the start of the year, some economists are cautious on the bigger picture. Citigroup Inc. analysts are forecasting an anemic 2.1% expansion for the global economy this year and remain pessimistic on the pain still to come from an extended run of high interest rates. HSBC Holdings Plc economists note there's been a pickup in world trade but caution that "this is all happening against an overlay of geopolitical conflicts and tensions which could mean further surprises ahead." The prospect of oil at $100 per barrel is looming again, while Bloomberg Economics forecasts that a direct war between Israel and Iran would thrust the world into recession.

One troubling notion making the rounds at international gatherings like the one in Washington is that the Covid-19 crisis brought a premature end to the decades-long era of economic convergence, when the gap between rich and poor nations was narrowing. In 2022 there were 712 million people in the world living in extreme poverty—getting by on less than $2.15 per day—23 million more than in 2019, according to the World Bank.

Speaking to IMF staff and board members on April 3, the fund's managing director, Kristalina Georgieva, said that the collective gross domestic product of the 69 countries categorized as low-income is now 10% smaller than it would have been without the pandemic, and that their economies are hamstrung by debt-servicing costs that are devouring government budgets. "With growth being slow, the chances to catch up are actually worsened," Georgieva said. "You have countries that are truly facing life or death, economic, social difficulties."



IMF chief Georgieva. *Photographer: Ton Molina/Fotoarena/Zuma Press*

Economist Branko Milanovic, a former World Bank official who's an expert on global inequality, says it's too early to conclude the convergence is over. But it's become much harder to close the disparity between advanced and developing economies, he says. The rise of China accounted for many of the gains on that front over the past 30 to 40 years. Now that China is categorized as an upper-middle-income nation, continued improvement in living standards there increases inequality worldwide, Milanovic says.

To be optimistic about the state of the global economy today, he says, requires believing that the wars in Gaza and Ukraine are nearing an end, that the US and China have put tensions behind them and that Russia is about to become less aggressive on the world stage. Any of those would be "heroic" assumptions, Milanovic says.

If anything, the signs suggest new trade wars are brewing. Beijing is using all the levers at its disposal to support production and exports of electric vehicles and solar panels, and to catch up to the leading edge of technology on semiconductors. This is causing consternation in the US and other industrialized countries, which are plowing billions of dollars into programs geared at reducing their dependence on China.

"China is too large to export its way to rapid growth," US Treasury Secretary Janet Yellen warned during a visit to the country earlier this month. "If policies are oriented only at generating supply and not also at generating demand, global spillovers will result." At least in public, Yellen didn't brandish any sticks to incentivize a change in behavior in China. The next Treasury secretary, if Donald Trump gets back into the White House, might not be as polite. The ex-president has floated the idea of imposing a 60% tariff on Chinese goods—enough to effectively end bilateral trade, according to Bloomberg Economics calculations.

Treasury Secretary Yellen. *Photographer: Tingshu Wang/ Reuters*

The European Union has launched investigations into China's exports of EVs, even as politicians there continue to grumble about the Biden administration's own efforts to ramp up US production of plug-in cars. In Washington there are also concerns that Chinese automakers and other manufacturers are opening plants in Mexico as a way to circumvent US barriers to Chinese-made products.

Industrial policies motivated in part by increased skepticism about the benefits of globalization have taken hold in rich countries, and there are likely to be consequences for poor nations, many of which benefited greatly from the proliferation of cross-border supply chains. Those rich-world subsidies to encourage investment at home could mean less investment in sub-Saharan Africa and other places hoping to attract manufacturing and growth. "Poorer and less-developed countries could be deprived of the benefits of globalization as the major economies turn inward and as trade and financial flows fragment and fall in line with deepening geopolitical fissures," says Eswar Prasad, a Cornell University and Brookings Institution expert on trade.

One of the major forces spurring immigration to Europe and the US is the widening gap between the economic opportunity offered in parts of sub-Saharan Africa, Central America and Asia and that at hand in the world's richest economies. "For poor people around the world, it is becoming more difficult and difficult and difficult. That will lead to immigration. That will lead to social unrest," Iraqi Deputy Prime Minister Fuad Hussein told reporters during a visit to Washington on March 26.

Another worry for governments, businesses and investors: This was supposed to be the year of interest-rate cuts. Instead some central banks in advanced economies are taking a more cautious approach in light of reports showing lingering price pressures. A recent uptick in inflation in the US, for example, has some Fed officials suggesting they may wait until next year to cut rates.

Central banks' reticence will have consequences for a world awash with debt. Some low-income countries are spending 13% of their GDP on debt-servicing costs, according to the IMF, or four times the share of GDP (3.1%) that will go to interest on US federal government debt this year. The United Nations estimates that 3.3 billion people live in countries where governments spend more on interest than on education or health.

The debt keeps piling up. The Organization for Economic Cooperation and Development projects total government debt issued by its 38 rich member countries alone will rise by $2 trillion, to a higher-than-ever $56 trillion this year. "We are still cruising along on this mindset that everything is for free, and so you can do everything at the same time, and that consciousness that there are trade-offs that are needed has not yet hit home," says Harold James, a historian at Princeton University.

A recent paper from the IMF argued the emergence of connector economies such as Mexico, Morocco and Vietnam, which act as links between superpower nations, has brought some resilience to trade networks. In the 20th century Cold War, nonaligned countries just minded their own business. In the 21st century version, they're more likely to be arbitraging geopolitics for economic advantage and connecting the blocs, the IMF researchers found.

Spain's Cuerpo says that even a world reorganizing into blocs can keep trading and investing, as long as countries like his avoid the lure of "simple protectionist views." He's keen to expand ties with Latin America and finally conclude an EU trade deal with the Mercosur bloc nations led by Argentina and Brazil. "We have to be very strategic in terms of how to position ourselves as a country or as a continent."

But finding a new equilibrium may be impossible if governments double down on economic nationalism. With Trump leading in the polls heading into the US presidential election, and other populists gaining ground in Europe, the future looks more uncertain and potentially chaotic than hopeful for anyone wishing a broader peace were at hand. "The geopolitics of the moment, combined with the terrible political situation in the US, have really frightening potential," says Anne Krueger, a former World Bank chief economist who's now at Johns Hopkins University.