EMERGING / ADVANCED / A changing economic hierarchy

While battered Western heavyweights continue to suffer the effects of the financial crisis, newcomers are benefiting from low debt, high savings and a shrinking reliance on foreign money. As the two worlds head down dramatically different economic paths, Brian Milner writes, 2011 will be a year in which fast-growing countries like Brazil must prove they can sustain their hard-won economic gains in the face of some serious obstacles

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When the advanced economies plunged into the worst slump since the Great Depression in late 2008, much of the developing world slid down the same slippery slope. But in a dramatic departure from previous patterns, emerging countries quickly dusted themselves off and climbed back on to the growth track while most of the industrial economies were still stumbling around in the dark.

This startling divergence is certain to become an even more prominent feature of the global economic landscape - and of investment choices - in 2011. But some of the former have-nots will fare far better than others. Some success stories will turn out to be ephemeral. And the question remains to be settled of whether what we have been witnessing marks the beginning of a permanent transfer of power and wealth to the brash newcomers from the sclerotic old guard.

The seismic shift does not mean all of the advanced economies are condemned to remain mired in the muck left by the meltdown. The United States is showing signs that it may be ready to limp out of the chronic-care ward. Germany is benefiting mightily from its export muscle and a battered euro; and Canada and Australia will continue reaping the rewards from China's vast appetite for resources, regardless of price. But for most, 2011 will again be marked by subpar growth, hefty imbalances and dim employment prospects, as they dig their way out from under a mountain of debt.

By contrast, governments in the emerging world typically carry low debt and boast strong surpluses, hefty foreign exchange reserves and high savings rates. They also rely less than ever on foreign capital, which nevertheless is pouring in from investors attracted to the growth prospects, higher interest rates and healthier public finances. It is no small irony that countries like Thailand, Malaysia and South Korea absorbed the lessons of orthodox economics after their own brushes with disaster during the Asian financial crisis of 1997. Vowing to never again leave themselves at the mercy of international bond investors, bankers and currency speculators, they repaired their balance sheets, kept deficits in check and boosted reserves.

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As a result, when the global credit crunch hit, they had the financial capacity to cushion their battered economies from external shocks. If only the West had been so prudent.

The industrial countries also responded to the crisis with aggressive fiscal and monetary stimulus. But they had to pile up record amounts of debt to finance it. The pump-priming almost certainly prevented a devastating depression, but growth remains elusive. During the next five years, the industrial countries will account for a steadily declining share of the world economy - less than half by 2012, compared with about three-quarters in 1985, according to International Monetary Fund projections. The emerging country share climbed to nearly 40 per cent during the global turmoil of 2008-09.

Meanwhile, the rich countries will contribute far more to the global debt burden than to growth in the next five years. Their share of total debt will amount to about 85 per cent by 2015, says Eswar Prasad of the Brookings Institution in Washington and a former IMF official. So it should come as no surprise that while China and other fast-growing economies in Asia and Latin America hog the main line, the United States, Japan and most of Europe will remain largely idle on the spur tracks.

"There is a structural decoupling, in terms of growth rates, between the emerging markets and the advanced economies," says Prof. Prasad, co-author of a new book titled *Emerging Markets: Resilience and Growth Amid Global Turmoil.* "If anything, the global recession has reinforced the notion that the emerging markets are on a completely different trajectory altogether."

Signs of this shift are popping up everywhere. Vast amounts of cash have poured into emerging stocks, bonds and other assets, boosting currency values, causing potentially dangerous bubbles and leading some nervous governments to impose restrictions on certain types of short-term investments.

Meanwhile, business is booming. Asian-based airlines will finish 2010 with the fattest profits of any region - an estimated $7.7-billion (U.S.), compared with $5.1-billion for their North American counterparts and $400-million for European carriers, according to the International Air Transport Association. Even at the pay window, top executives in Brazil now fare considerably better, on average, than their counterparts in the U.S. or Europe.

If the advanced and emerging groups continue on their respective economic and fiscal routes, political power will also gradually shift to the new kids in the bloc. But before we can call this a permanent sea change, China, Brazil and the other growth stars will have to prove they can sustain their hard-won economic gains in the face of serious obstacles. These range from weak public institutions and poorly developed financial systems to growing income disparities, which feed social unrest in countries with vast numbers of people still living in abject poverty.

There is also a rising risk of currency and trade conflicts as divisions widen, not only between developing and advanced heavyweights but within their respective camps, as they pursue vastly different recovery strategies. While the U.S. has opted for looser monetary and fiscal policies, Europe is on an austerity kick. China and a handful of other key emerging countries fear doing anything that could derail the growth train, despite the darkening spectre of inflation.

Some global economy watchers remain unconvinced that we are witnessing a permanent transfer of economic power, let alone political influence. "Of the BRIC states, Brazil is the only one that might emerge as a major regional or even international power. But you're talking 30 to 50 years from now," says Peter Zeihan, vice-president of analysis with Stratfor, a global intelligence firm based in Austin, Tex. "India's a storm in a box. China is praying it won't collapse, but fearing that it will. And Russia is in a long, slow twilight."

Well, leaving out Russia, that is a distinctly minority view as 2011 beckons.

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