The decoupling of the Brazilian economy: Chapter two

Many analysts believe that the enormous turbulence created by the bankruptcy of Lehman Brothers in September 2008 definitely put to rest the thesis of the "decoupling" of emerging economies. That thesis held that a substantial number of emerging economies would better resist the scenario of global slowdown — already apparent before September — than rich countries would. The idea of decoupling gained force starting in 2007 mostly because of the exceptional and simultaneous economic developments witnessed in the main emerging economies, particularly those in the BRIC group (Brazil, Russia, India, and China).

In the weeks immediately after Lehman Brothers collapsed, however, a short circuit in world credit flows struck all economies involved in globalization, without distinction. The annualized growth rate in the last quarter of 2008 of the countries in the OECD (Organization for Economic Cooperation and Development), for example, was dauntingly below normal: They practically all show a drop in GDP that in many cases reaches double digits — think of Ireland (25.7%), Japan (12.2%), Korea (18.8%), Mexico (10.35%), and Turkey (14.3%). In 19 of the 35 OECD countries, GDP fell by over 6% annualized .in the last quarter of 2008.

Obviously, the shock did not spare the emerging economies. In the BRIC countries, there is a significant change in growth rates between 2007, when growth peaked, and the projections for 2009 advanced by the International Monetary Fund (IMF). Brazil is projected to slow from +5.7% to –1.3%, Russia from + 8.1% to –6%, India from 9.3% to 4.5%, and China from 13% to 6.5%. These figures, according to many pundits, killed the idea that the main emerging economies would be able to weather the severe crisis better than the developed countries. However, there are indications that the decoupling thesis might still be valid.

Emerging economies

To find out, the first step is to determine whether the the assumption that there was some sort of decoupling before Lehman's collapse was true. Indeed, there are signs that the global boom over the past decade was to

a great extent boosted by emerging countries, whose driving force continued even after the developed world began to decelerate because of its imbalances.

In 2007 world oil consumption was broken down as follows: 56.8%, OECD (including all the major wealthy nations, and a few emerging economies); 4.7%, countries from the former Soviet Union; and 38.5%, the rest of the world (essentially major emerging countries). Those figures might lead one to defend the traditional view that, in spite of the already substantial share of the emerging countries, the global economy is still driven by wealthy nations.

However, it is important to look at the growth trends. From 2000 through 2007 emerging countries accounted for 85% of the increase in world oil consumption, while OECD consumption grew by only 12%. Even considering that many rich countries have begun to work to make their energy mix cleaner — the European Union was responsible for only 2% of the increase in consumption during this period — the data suggest that world growth dynamism has been shifting toward the emerging countries. Obviously, the most dynamic portion of the emerging world is Asia and the Pacific region, which was responsible for 50% of the increase in world oil consumption from 2000 to 2007. China alone accounts for an astonishing 37% of that increase.

As far as world trade growth is concerned, the OECD countries were responsible for 56% of total growth between 2000 and 2007. This figure, however, is inflated by the vigorous increase in trade within the European Union, which represented 26% of the growth in global trade during that period. China alone contributed 13%, and the USA 5%. OECD countries accounted for 47% of GDP growth. In other words, the world today is very different from the world a few decades ago, when the developed countries accounted for about 80% of production and trade.

It is important to underscore that the wealthy part of the world was already decelerating before the terrible fourth quarter of 2008. After their growth peaked in the third quarter of 2006 — 3% yearly compared with the same quarter of the previous year — the OECD countries began to slow down. By the third quarter of 2008, growth was 1.8% compared with the same quarter of previous year.

The growth path for the major emerging countries was different. In the case of Brazil, growth peaked at 6.9% in the third quarter of 2008 compared with the same period in 2007. China registered its best growth in 2007 — about 11.5% — and still grew 9% in the third quarter of 2008 year-on-year. India recorded growth of 9% a year in 2005–2007 and was still growing at 7.6% in the third quarter of 2008. And Russia shifted from 8.5% maximum speed in the first quarter of 2008 to 6.2% in the third quarter compared with the same quarters of 2007.

Resilience

These data make it clear that just before the great disaster of 2008 most of the emerging economies were not going through as sharp a deceleration as the OECD countries were. Somehow, the emerging economies were resilient — though not invulnerable — to the negative thrust of the developed countries. The emerging economies were sustained by the gradual increase in domestic demand and by the expansion of South-South trade. In particular, deceleration in developing countries was the consequence of tight monetary policy to fight an inflation surge. This approach contrasted dramatically with the loose monetary policy in the US. There thus seems to be little doubt that pre-Lehman there was a relative decoupling of the emerging economies from the developed countries.

On the other hand, it is unquestionable that the emerging countries have not maintained that decoupling in the quasi-catastrophic period since September 2008. Comparing the fourth quarter of 2008 with the same period in 2007, Brazil grew by 0.8%, China by 6.8%, Russia by 1.1%, and India by 5.3%. Those growth rates are far inferior to the rates registered in the previous quarter. The important question now is whether, after riding out the current severe turbulence, the emerging countries will go back to the previous pattern of relative decoupling or, following the shock at the end of last year, they will become more dependent on the performance of the OECD countries.

It is too early to give a definitive answer to the question, but there are signs that suggest that the decoupling thesis, at least as far as Brazil is concerned, is justifiable. In addition to monitoring indicators of activity and employment, which have longer cycles, it is important to monitor what is happening in foreign trade, one of the most important channels of transmission of the crisis.

Up to the bankruptcy of Lehman Brothers, the emerging countries showed resilience to — but were not invulnerable to — the negative thrust of the developed countries

In the first four months of 2009 Brazil's daily average exports declined by 16.5% compared with the same period in 2008; imports fell by 22.8%. Thus, the trade balance surplus grew by 51.3%. However comforting they may seem, at first glance those figures indicate that the country is still suffering the full impact of the brutal reduction in foreign trade that started last September. Indeed, in the first four months of 2009 trade fell by 19.5% compared with the same period in 2008.

On more careful examination, however, the signs are more promising. While the decline in manufactured (28.7%) and semimanufactured (21.5%) exports for the first four months of 2009 compared with the same period in 2008 is certainly significant, basic product exports increased by 8.7%.

What is most promising is that the good performance of basic products, sustained in both prices and quantities, is caused by Asian, especially Chinese, demand. This becomes obvious from a consideration of trading partners' shares in total trade with Brazil. Comparing the first four months of 2008 and of 2009, the share of Brazilian exports to the European Union declined from 25.1% to 23.1%, to Latin America from 26.6% to 21.3%, and to the United States from 14.4% to 11.3%. Performance of the Asian market was the opposite: the share of Brazilian exports to Asia increased from 16.1% to 24.8%. Brazilian exports to China rose by 66.7%, and the share of our exports to the communist giant rose from 6.5% to 12.9%.

At the outset of the international financial crisis, marked by Lehman's bankruptcy, the doubt was whether Asia could stand on its own feet by stimulating internal demand. Because the US and the rich countries were struck by a structural crisis from which they will take a long time to recover, China could not count on the buoyant foreign demand of pre-Lehman days. The success, or lack thereof, of the gigantic fiscal stimulus package launched by China is thus fundamental to assessing global dynamics after

the most dramatic moments of turbulence had been overcome. What the figures on Brazilian foreign trade and even the Chinese indicators seem to suggest is that Asia is indeed breathing again.

Advantage

If it continues, this breath of life should also be able to gradually pump up economic activity in large suppliers of raw materials and basic products to the Asian markets like Brazil and other Latin American countries. Another advantage is that the Latin American economic fabric has not been devastated or even contaminated by the financial bubble of the rich countries, as was the case in Eastern Europe. In other words, a new demand for commodities will find Latin American producers with governments, businesses, and families that have acceptable levels of debt.

This scenario suggests that Latin America and Brazil have a chance to come out of this recession fairly quickly, though the recovery is still not likely to be strong. There is also an indication that the major consumers of Brazilian manufactured products — Latin America and the Caribbean — will come back to buy in a not-too-distant future. Thus, we can expect more encouraging volumes of exports of manufactured and semimanufactured goods. If that happens, of course, it is obvious that Brazil will run up against increasing competition from Chinese manufactured goods. But this is a long-term structural challenge not directly associated with the post-crisis cyclical recovery.

Recent economic history has another encouraging lesson specifically for Brazil. By mid-2008, when commodity prices peaked, Brazil's terms of trade had increased by no more than 10% compared with the average in early 2006. That is further evidence that Brazilian import and export activity is diversified to the point that the country is not too vulnerable to drastic changes in relative prices. Thus, unlike what happens in Chile, which is heavily dependent on the price of copper, and in Venezuela, a hostage to oil prices, the Brazilian economy is not at the mercy of a specific product or service.

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Despite having been brutally affected in the last quarter of 2008 by the global crisis, which will inflict a heavy toll on growth in 2009, Brazil's economic structure, which is behind the country's very positive economic performance since 2004, has not been fundamentally destabilized. This suggests that Brazil is likely to come out of the crisis more rapidly than the rich countries. This could be the start of the second chapter of decoupling.