

OPENING REMARKS

Pilar L'Hotellerie-Fallois 9.15-9.30

- Let me welcome you to the Banco de España and the XIth Emerging Markets Workshop, which - for the second time- is held in our premises in Madrid.
- As many of you know, this workshop is an annual research meeting, which was initially promoted by the BOFIT of Bank of Finland. Then, other central banks of the euro area, starting with Banco de España and then followed by the Central Bank of Austria and the ECB have supported and hosted this nice initiative. So, a special welcome goes to the representatives of these institutions.
- The previous edition of the Workshop in Madrid was in October 2009. At that time the global economy was enduring the Great Recession, but something was becoming clear: while the advanced economies faced a dramatic fall in output (-3,4% in the year) the emerging economies, as a group, –albeit not spared from a severe shock- held relatively well (growing 3%). With the exception of emerging economies in Eastern Europe, the emerging markets had a good crisis.
- These diverting paths set the trend for the next years: the recovery in the advanced economies is feeble and uncertain and the euro area economies are facing a daunting economic and institutional crisis, which has even threatened the integrity of the monetary union. Meanwhile, the meantime, the emerging economies have performed a strong recovery, pulled by the emerging locomotive role of China and, in general, South-South interlinkages.

- The policy paths have also tended to diverge. The advanced economies have engineered an arsenal of unconventional monetary policies of massive proportions which is still on display, and, in the first instance, fiscal authorities embarked on intense fiscal expansions, followed by protracted fiscal consolidations.
- A remarkable achievement for most emerging economies, relative to the past is that they were able to respond to the crisis with countercyclical policies. Fiscal expansions were large in several cases, and monetary policies also stepped into the unconventional sphere, but to a much lesser extent than in advanced economies.
- Rather, they took a defensive attitude towards the unconventional journey in the North. In fact, the issue which dominated economic policymaking in emerging economies most of the time was the management of the flood of capital inflows from advanced economies.
- These inflows were, on the one hand, influenced by the monetary policies of advanced economies and the corresponding environment of persistent very low interest rates. But, on the other hand, they were also boosted by the key shift in the perception of relative risk and relative return between emerging and advanced economies, in favour of the former.
- Moreover, this shift has been perceived as permanent, shaping a new economic and financial landscape in the aftermath of the crisis –as the title of the workshops reflects. There is evidence of this shift in very different areas.
- For instance, according to the data by the IMF and our own calculations, a day of February 2009 –around the 14th, Saint Valentine-, the emerging

economies surpassed the advanced economies in terms of economic weight, measured by PPP. Of course, this is a symbolic milestone, but it reflects well the change of fortunes in the world economy. We should not forget that during the final part of the last century there was hardly any progress in real convergence of emerging to advanced economies. The intense process of globalization and the ascent of China –and the lower recurrence of crisis- boosted convergence in the first years of this century. After the crisis, the lacklustre performance of the advanced economies, coupled with the resilience of emerging economies, have greatly intensified this convergence: the emerging economies will represent 55% of global GDP by the end of this year and 58% in 2018.

- This progress has also been reflected in other areas: emerging markets represent now close to 60% of world trade, and 20% of global trade is already South-South. In terms of global financial flows, emerging markets economies remain quite far from the advanced economies, whose financial development is much larger. Notwithstanding this, the share of global capital inflows into emerging markets has increased from 10% in the years before the crisis to more than a third. Also capital outflows by residents are expanding as national savings –public and private- are channeled abroad.
- This expansion has been also reflected in the global governance, which has gone through a substantial transformation in the last years. The more clear example is the relevance of the G-20 group of countries – comprising emerging and advanced economies representing more than 75% of world GDP. This higher relevance is not only relative to the G-7 group of main advanced economies, but also in absolute terms, since the G-20 is at the center of the revamped efforts of international coordination in the aftermath of the crisis. [Admittedly, with the overcoming of the worst of the crisis and the diverging evolution of the economies, the appetite for coordination has also ebbed, but the

progress in global governance, relative to the previous situation, is here to stay].

- Therefore, there is a widespread feeling that emerging market economies have come of age, and that they are leaving behind the problems that plagued them in the past. Some factors have contributed to strengthen this view: first the improvement of their macroeconomic fundamentals –inflation, fiscal accounts, financial vulnerability, and so on; second, the remarkable resilience to the crisis and their capacity to keep on growing while the advanced economies have stagnated –that is, the theory of decoupling between these two groups of countries-; and third, that emerging economies have become much more vocal and autonomous in global fora, even forming coalitions.
- These are welcome developments for the global economy, since it makes global growth more balanced and equitable. But this has also led to a certain euphoria on the part of analysts and markets and a certain complacency on the part of policymakers. It seemed that the economic progress of emerging economies was strong and sustainable.
- If this workshop had taken place last year, I would have pointed out to certain risks of this situation and the caution required. But this event takes place after those bright prospects have been tarnished for two main reasons, related to the reversal in the factors of support mentioned above: first, a broad slowdown in emerging economies led –again- by China after a period of overheating; Second, the prospects of medium-term withdrawal of the monetary stimulus in the United States.
- It has been remarkable, even worrying, the market reaction to these events and the correction of emerging financial markets, much more acute in those countries with larger economic imbalances –such as Brazil, Turkey, India or Indonesia. Indeed, this shift in sentiment has resurfaced the vulnerabilities that the phase of eupheria had concealed.

- The postponement of the tapering in the United States, plus some stabilization in the economic data in several key countries, have partially reversed the market correction. The timing has been fortunate for two reasons: first, because in some cases the markets were spiraling out of control and some country could have got into deep trouble; second, because it has been a useful reminder of the dangers of complacency and the overshooting by markets.
- Does it mean that the period of strength in emerging economies has been a mirage? Not really. Economic fundamentals in many countries are stronger than in the past, so that vulnerabilities are lower. But there was an excess complacency in the authorities of several countries, which prevented the progress of economic reforms and, even, justified a drift towards higher state interventionism. Also, the perception of the potential or sustainable growth in these economies was probably a bit overstated, since there were some obvious limits to growth in some of them.
- So, it is welcome that this sort of 'stress test' has happened that there have been no real casualties. This warning will make the authorities more conscious of the need to advance with reforms and solid macro management and the markets more cautious and less procyclical.
- This workshop is a good opportunity to discuss on these issues. Looking at the programme, however, you can see that most of the paper are related to financial market issues and macro finance. Perhaps, going forward, the research agenda in the area should be more focused on identifying the sources and limits of growth in the region. Maybe this could be a good topic for next year.
- Anyway, now it is time for the presentations to start. Let me welcome you again and have a nice stay in Madrid.