

PRESS POINTS FOR CHAPTER 2: WHERE ARE COMMODITY EXPORTERS HEADED? OUTPUT GROWTH IN THE AFTERMATH OF THE COMMODITY BOOM

World Economic Outlook, October 2015

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Key Points

- *The analysis in this chapter suggests that the weak commodity price outlook could subtract almost 1 percentage point annually from the growth rate of commodity exporters over 2015–17 as compared with 2012–14. In energy exporters, the drag is estimated to be larger—about 2¼ percentage points on average.*
- *The slowdown is not just a cyclical phenomenon; it has a structural component as well. Investment, and accordingly, potential output, tends to grow at a weaker pace in exporters during commodity price downswings.*
- *The decline in potential growth implies that the policy response should go beyond demand-side measures and include structural reforms.*
- *Exchange rate flexibility—which has increased among commodity exporters over the last decade—can help smooth the impact of the commodity price downturn. Reduced commodity-based fiscal revenues and lower potential growth limit the scope for countering the slowdown with fiscal policy.*

Commodity-exporting economies are at a difficult juncture. Global commodity prices have declined sharply over the past three years, and output growth has slowed considerably among commodity-exporting emerging market and developing economies.

The appropriate policy responses depend not only on the extent of the growth slowdown but also on whether commodity-price-related fluctuations in output are mostly structural or cyclical. This chapter uses data for more than 40 commodity-exporting economies over five decades to analyze these issues.

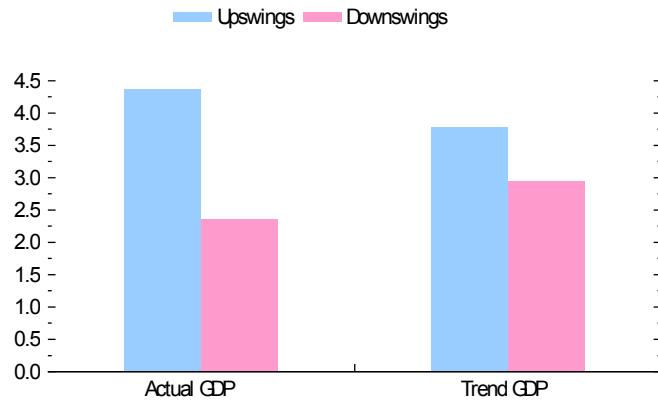
The empirical relationships estimated in the chapter suggest that the weak commodity price outlook could subtract almost 1 percentage point annually from commodity exporters' rate of economic growth over 2015–17 as compared with 2012–14. In energy exporters the drag is estimated to be larger, about 2¼ percentage points on average over the same period, reflecting a sharp downturn in oil prices over the past year.

A mix of cyclical and structural factors is likely to be at play in the current growth slowdown. The empirical analysis in this chapter suggests that commodity prices affect both the output gap and potential output in net exporters. On average, some two-thirds of the decline in output growth in commodity exporters during a commodity price downswing tends to be attributable to the cyclical component of growth. The remaining one-third tends to be attributable to the structural component, reflecting reduced investment and potential output.

Improvements in their macroeconomic policy frameworks over the past decade have put exporters in a better position to deal with a commodity price downswing. Government spending responded less to the most recent commodity price boom, enabling greater fiscal savings out of commodity-based fiscal revenues than in past boom episodes. Financial market depth and exchange rate flexibility, which in past downswings were also associated with a smaller drop in output growth, have also increased in many commodity exporters.

Nevertheless, policymakers must be realistic about growth potential in commodity-exporting economies. In countries where there is clear evidence that output has fallen below potential,

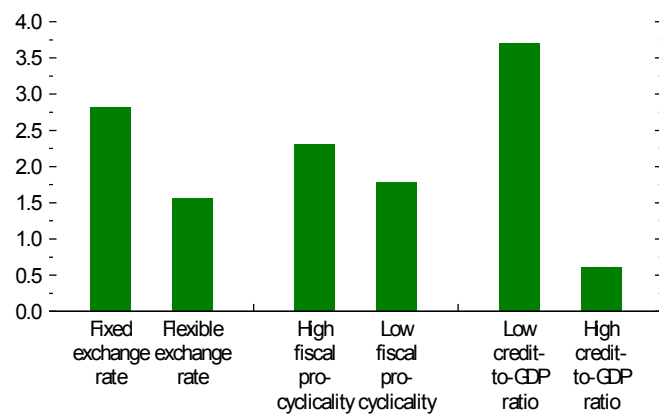
Figure 1. Median Annual Growth Rates of Actual and Trend GDP during Commodity Terms-of-Trade Upswings and Downswings (Percent)



Sources: Penn World Table 8.1; and IMF staff calculations.

Note: The sample consists of commodity terms-of-trade cycles with peaks before 2000 for commodity exporting emerging and developing economies. Trend GDP is calculated using estimates of the actual capital stock and smoothed employment and total factor productivity series.

Figure 2. Variation in Average Output Growth between Commodity Terms-of-Trade Upswings and Downswings: The Role of Policy Frameworks and Financial Depth (Percentage points)



Sources: IMF, Fiscal Monitor database; IMF, International Financial Statistics database; Penn World Table 8.1; and IMF staff calculations.

Note: The bars show the difference between the median growth rates during upswings and subsequent downswings. The exchange rate regime classification is based on Reinhart and Rogoff 2004.

supportive demand policies could help avoid a costly underutilization of resources, but declining commodity-based fiscal revenues and currency depreciations—and their pass-through to inflation—often constrain the scope for easing macroeconomic policies.

The finding that potential growth declines during commodity price downswings has an important policy implication. It makes the case that the policy response to the weaker outlook should go beyond aggregate demand measures and include targeted structural reforms to alleviate the binding supply-side bottlenecks and boost productivity growth in commodity-exporting economies.

**PRESS POINTS FOR CHAPTER 3: EXCHANGE RATES AND TRADE: DISCONNECTED?
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Prepared by Daniel Leigh (team lead), Weicheng Lian, Marcos Poplawski-Ribeiro, and Viktor Tsyrennikov, with support from Olivia Ma, Rachel Szymanski, and Hong Yang.

Key Points

- Unusually large changes in the exchange rates of major currencies—in the 10–30 percent range in real effective terms—have kindled a debate on the likely effects of these changes on trade.
- Some suggest exchange rate movements are less relevant than they used to be for trade, which could complicate policymaking.
- Analysis in this chapter, based on data for advanced and emerging market and developing economies over three decades, finds that exchange rate movements still have sizable effects on exports and imports.
- A 10 percent real effective depreciation in an economy's currency raises real net exports by, on average, 1.5 percent of GDP, with substantial cross-country variation around this average.
- Little sign of disconnect between exchange rates and trade. Recent exchange rate movements imply substantial redistribution of net exports across economies. Exchange rates can still help reduce trade imbalances.

Recent currency movements have been unusually large. The U.S. dollar has appreciated by more than 10 percent in real effective terms since mid-2014, while the euro has depreciated by more than 10 percent since early 2014 and the yen by more than 30 percent since mid-2012. Large exchange rate changes have also occurred for a number of emerging market and developing economies.

There is a debate on the likely effects of these currency movements on trade. Some predict strong effects on exports and imports, based on conventional economic models. Others point to the limited changes in trade balances in some economies—in Japan, in particular—implying an apparent disconnect between exchange rates and trade. And some argue that the increasing fragmentation of production across different countries has reduced the relevance of exchange rates for trade.

Shedding light on this issue is important, as disconnect between exchange rates and trade could complicate policymaking. It could weaken a key channel for the transmission of monetary policy by reducing the boost to exports that comes with currency depreciation when monetary policy eases. It could also complicate the resolution of trade imbalances, such as when imports exceed exports, via the adjustment of relative trade prices.

The chapter's analysis suggests that exchange rate movements still have strong effects on trade (Figure 1). The analysis examines the experience of both advanced and emerging market and developing economies over the past three decades—a wider sample than is typically examined. It finds that a 10 percent real effective exchange rate depreciation comes with, on average, a rise in real net exports of 1.5 percent of GDP, with substantial variation around this average. Although it takes some years for the effects to fully materialize, much of the adjustment occurs in the first year.

There is also little sign of a trend

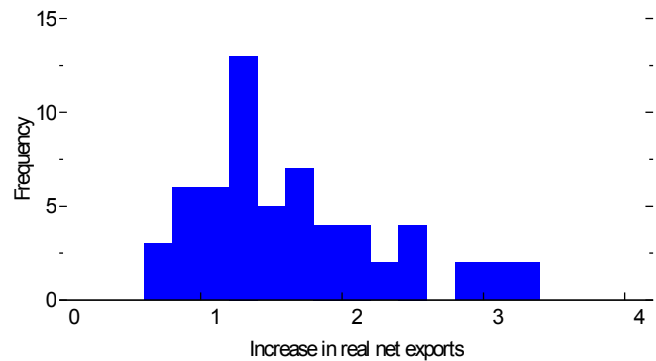
toward disconnect between exchange rates and trade. Some evidence indicates that the rise of global value chains, with different stages of production located across different countries, has weakened the relationship between exchange rates and trade in intermediate products used as inputs into other economies' exports. But global-value-chain-related trade has increased only gradually through the decades, and the bulk of global trade still consists of conventional trade. There is also little sign of a weakening in the responsiveness of exports to relative export prices, or in the effects of exchange rates on trade prices. A key exception to this pattern is Japan, which displays some evidence of disconnect, with weaker-than-expected export growth despite substantial exchange rate depreciation, although this weak export growth reflects a number of Japan-specific factors.

Recent currency movements thus imply a substantial redistribution of real net exports across economies (Figure 2).

The currency movements since January 2013 point to a redistribution of real net exports from the United States and economies whose currencies move with the dollar to the euro area, to Japan, and to economies whose currencies move with the euro and the yen. (Beyond these direct effects, changes in exports and imports also reflect shifts in the underlying fundamentals driving exchange rates themselves, such as demand growth at home and in trading partners, and movements in commodity prices.) Among economies experiencing currency depreciation, the rise in exports is likely to be greatest for those with slack in the domestic economy and with financial systems operating normally.

For policymakers, a key implication of the results is that exchange rate adjustments can still help to reduce trade imbalances. Exchange rate changes also continue to have strong effects on export and import prices, with implications for inflation dynamics and the transmission of monetary policy.

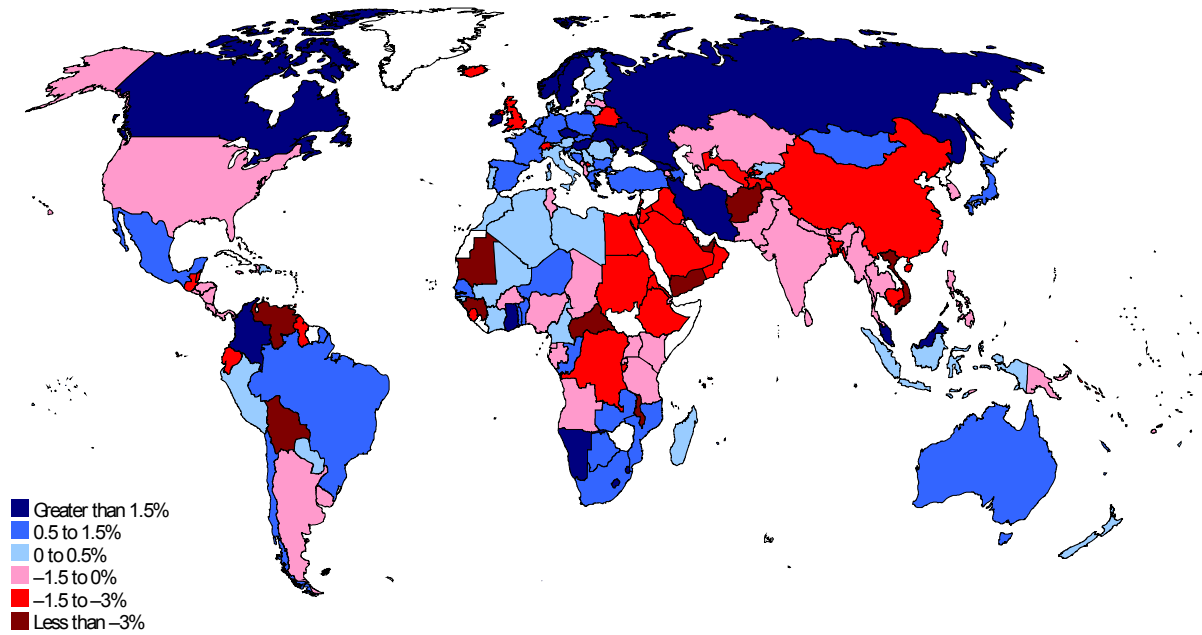
Figure 1. Effect of a 10 Percent Real Effective Depreciation on Real Net Exports (Percent of GDP)



Source: IMF staff calculations.

Note: Figure shows long-term effect on level of real net exports in percent of GDP based on country-specific import- and export-to-GDP ratios and the average producer price index-based trade elasticities reported in Table 3.1 for the 60 economies in the sample.

Figure 2. Illustrative Effect of Real Effective Exchange Rate Movements since January 2013 on Real Net Exports (Percent of GDP)



Source: IMF staff calculations.

Note: The illustrative effects of CPI-based real effective exchange rate movements from January 2013 to June 2015 on real net exports in percent of GDP are based on the average consumer price index (CPI)-based estimates of the exchange rate pass-through into export and import prices and the price elasticity of exports and imports reported in Table 3.1. These average estimates are applied to all economies. Country-specific shares of exports and imports in GDP used in the calculation are from 2012.