Economics

U.S. As Global Growth Engine Risks Igniting Some Old Tensions

By Ben Holland and Enda Curran
February 25, 2021, 10:00 PM EST

Watch: Mark Grant, chief global strategist at B. Riley FBR Inc., discusses the market selloff and strategy.

LISTEN TO ARTICLE

4:53

In this article

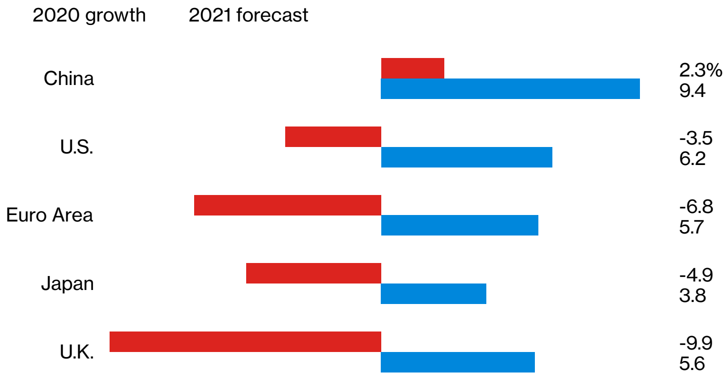
The U.S. economy appears primed to recover from the Covid-19 slump much faster than others, causing havoc on bond markets this week and potentially exacerbating the kind of imbalances that caused trouble after the last crisis.

The prospect that the U.S. recovery could decouple from developed-world peers and the implication of that for global currencies and trade is likely to figure high on the agenda when finance ministers and central bankers from the Group of 20 major economies meet online later today.

"A multi-speed rebound in the global economy continues with a strong U.S., a moderating China and a choppy euro-area," said Catherine Mann, chief economist at Citigroup Inc. "For 2021 at least, the U.S. as global locomotive is back on track."

Fast Lane, Slow Lane

China and the U.S. have been fastest to recover among major economies



Source: JPMorgan Chase & Co

The speed differences are the result of economic policy choices as well as variance in the severity of virus outbreaks, rules for containing them and rollout of vaccination programs. If the gaps persist for too long, it could stir up tensions over trade and currencies like the ones that followed the financial crisis -- as well as deepening inequality between countries.

The U.S., where President Joe Biden is pushing another $1.9 trillion in pandemic relief measures through Congress, appears most committed to running its economy hot. U.S. officials are calling on others to keep their foot on the gas too.

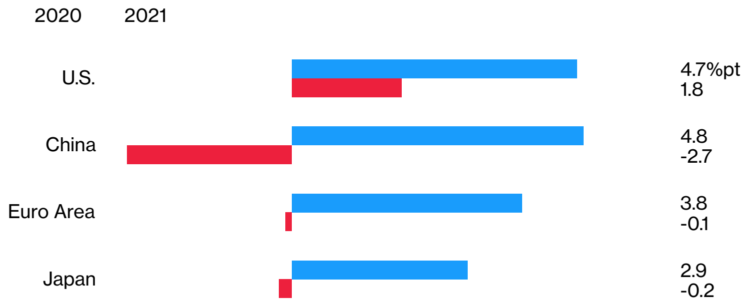
“I urge G-20 countries to continue to take significant fiscal and financial policy actions and avoid withdrawing support too early,” Treasury Secretary Janet Yellen wrote to fellow attendees before today’s meeting. “Together, our efforts will be greater than the sum of our individual responses.”

The U.S. will expand 6.2% this year, recouping all its 2020 losses and then some, JPMorgan economists forecast. By contrast, the euro area, Japan and the U.K. aren’t expected to reach their pre-Covid GDP until 2022.

While all major economies boosted government spending to shore up growth in 2020, hardly any except the U.S. will be running expansionary fiscal policy this year, according to JPMorgan's calculations.

Still Stimulating?

Impact of discretionary fiscal policy on GDP growth



Source: JPMorgan Chase & Co

In the near term, everyone gets a lift out of rapid growth in the U.S. -- because it's the world's biggest importer.

For countries that have weaker economies or are less willing to stimulate them, "it basically means more external demand," said Alicia Garcia Herrero, chief Asia-Pacific economist at Natixis SA in Hong Kong.

She sees no problem for the rest of the world if the U.S. embarks on a big stimulus, provided it doesn't trigger the kind of inflation that would lead investors in dollar assets rushing for the exit. "That is the big if," she says.

In the longer run, the perception that other economies were taking advantage of the U.S. role as consumer of last resort can fuel trade conflicts, like it did with China under President Donald Trump. Even before that, in the early 2010s, U.S. officials would complain that Europe was running too-tight policy and not contributing enough to global growth.

The same kind of tensions could await in a post-Covid world if policy support is withdrawn "in an uncoordinated or haphazard manner," wrote Neil Shearing, chief economist at Capital Economics, in a Chatham House paper published last week.

“Countries that under-stimulate their economies must rely on demand from the rest of the world,” he wrote. “There are already ominous signs that the recovery has become unbalanced,” like growing current-account surpluses in China, Vietnam and Taiwan, and deficits in the U.S.

Mind the Gap
Actual/forecast current-account balance
Source: Official data / forecasts compiled by Bloomberg

Currencies may be another cause of contention. The dollar has been declining steadily after a spike early in the pandemic, causing anxiety among countries that don’t want their exports to become less competitive. Yellen has said the U.S. will let markets determine the greenback’s value.

“The U.S. is likely to push back against other countries’ intervention in foreign exchange markets to weaken their currencies, despite other major advanced economies being in worse economic straits,” said Eswar Prasad, a professor at Cornell University.

Australia’s central bank has argued the local dollar would be stronger if it weren’t for its latest stimulus measures. In Japan, Prime Minister Yoshihide Suga said he’s watching foreign exchange rates more closely than any other financial or economic indicator.

China’s yuan has gained about 10% against the dollar since June, spurring the government to consider relaxing restrictions on taking money out of the country in order to take the pressure off. Bloomberg Economics’ yuan stress indicators suggest the currency’s strength is set to continue in the near term.

As well as addressing the uneven recovery in their own economies, G-20 leaders are also under pressure to prevent the gap with the world’s poorest nations from widening further. Those countries haven’t been able to ramp up government spending to fight the virus like their wealthier peers did, and they struggle to obtain vaccines.

The G-20 has been working on a debt forgiveness plan that would involve private creditors. Yellen praised the effort in her letter, though she said implementation would be the real test. She also signaled support for boosting the International Monetary Fund's lending power.

"Without further international action to support low-income countries, we risk a dangerous and permanent divergence in the global economy," Yellen said.