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Subir Gokarn: Global divergences

Challenges will emerge from the unevenness of the global recovery

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During her visit to India last week, Christine Lagarde, managing director of the International Monetary Fund (IMF), characterised India as one of the few bright spots in the global economy. The IMF's January 2015 update of its quarterly *World Economic Review* provides a backdrop for this description. The next update will be published in time for the spring meetings of the IMF and the World Bank next month, but it is unlikely to present a different picture from the last one. And that picture is a rather mixed one.

The positive side of the story that emerges from country and regional forecasts for 2015 and 2016 is that the global economy will continue to grow at a steady pace. Growth during the past two years is estimated to have been at 3.3 per cent each year; the pace is expected to accelerate slightly to 3.5 per cent and 3.7 per cent over the next two. Even though this is relatively small, its impact on world trade is projected to be quite significant. Imports by advanced economies, which grew at two and three per cent respectively over the past two years, will accelerate to 3.7 per cent and 4.8 per cent over the next two. Imports by emerging and developing economies, which decelerated sharply in 2014, will recover and accelerate to 6.1 per cent growth in 2016. Trade buoyancy is clearly a dividend of steady and persistent economic growth.

Underlying this relatively favourable outlook is the persistence of soft commodity prices. Oil prices are expected to decline by over 40 per cent in 2015 from their average levels in 2014. Although they are projected to rise by 12 per cent in 2016, they will remain significantly below their peaks, providing sustained relief to oil importers. The prices of other commodities are expected to continue declining over this year and the next. These projections build into a relatively positive inflation trajectory, with consumer inflation expected to be in the 1-1.5 per cent range in advanced economies and in the five-six per cent range in emerging and developing economies.

The negatives emerge when we look at the forecasts for individual countries and regions. Within the advanced economies, the United States is expected to power on ahead of the pack, accelerating from an average growth of 2.3 per cent during 2013-14 to about 3.5 per cent during 2015-16. The United Kingdom will also do reasonably well, growing at a little less than three per cent.The euro area will recover from its almost zero growth during 2013-14 to around 1.3 per cent during 2015-16. Even within Europe, the gap between Germany and the rest of the larger economies is expected to widen. Notwithstanding its rather ambitious policy initiatives, Japan is expected to grow by less than one per cent a year this year and the next. Clearly, the gap between the major advanced economies will widen.

Amongst the emerging and developing economies, India's "bright spot" status arises from its acceleration from about 5.4 per cent growth during 2013-14 to 6.4 per cent over the next two years. In contrast, China is expected to decelerate from 7.6 per cent during 2013-14 to 6.8 per cent in 2015 and a further 6.3 per cent in 2016. Much was made of this cross-over between India and China in the media; the specific numbers apart, the significance of the forecasts is that they show India accelerating while China decelerates against the same global backdrop.

The other three BRICS countries - Brazil, Russia and South Africa - all being commodity exporters, are expected to bear the brunt of the commodity price cycle. Russia, after growing at around one per cent during 2013-14, is expected to decline by over two per cent over the next two years. Brazil will see a meagre 0.3 per cent growth in 2015 and climb back to a still disappointing 1.5 per cent a year later, even as it hosts the Olympic games. South Africa will do somewhat better, clocking around 2.3 per cent during 2015-16, not very different from its performance over the previous two years.

There are implications of these patterns for domestic policies, trade, capital flows and international co-operation. First, on the domestic policy front, even though the baseline forecasts suggest that trade volumes will expand, there is no guarantee against overt and covert protectionist measures being put in place by slower growing countries and regions. The imperative on the faster-growing economies to buttress their domestic growth drivers with appropriate policies will increase in this scenario. Soft commodity prices provide a significant cushion against external shocks for importers and also a window to implement structural reforms, whose payoffs will manifest only in the medium to long run. For commodity exporters, there is a compulsion to diversify growth drivers, but also a huge constraint on doing this because of weakening macroeconomic conditions.

Second, while the trade projections in the baseline scenario are quite optimistic, it is quite likely that protectionist pressures will emerge in, particularly, the slower-growing economies. Some arrangements may be robust enough to withstand these pressures despite divergences in economic performance, while others may be threatened. There is, clearly, a role for collective action to resist the intensification of such pressures, but the need for such action may not be matched by the willingness of the countries involved to cooperate in the face of such divergences.

Third, capital flows, particularly those driven by returns over relatively short horizons, will tend to cluster around the few bright spots. Going by these forecasts, India should clearly expect to see a persistence if not an increase in inflows over this year and the next. This will pose specific challenges to exchange rate management, particularly in an environment in which trade freedoms are under some pressure and to overall macroeconomic management, should inflationary pressures re-appear relatively soon. More generally, relative exchange rate movements across countries competing against each other in the world market will have an impact on trading patterns, with countries with appreciating currencies risking some loss of market shares.

Finally, with a number of "global public goods" requiring consensus-building and alignment across large numbers of countries, uneven economic prospects across major players may come in the way of this. All in all, while we can take some comfort from the global rising tide, its asymmetric benefits pose risks to sustainability.

The writer is director of research, Brookings India, and former deputy governor, RBI. These views are his own