

Suman Bery: Are happy days here again?

The global financial crisis seems almost over

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Yesterday's editorial in this newspaper ("The IMF gets more upbeat", July 12, 2010) noted that the IMF has had a patchy record in charting the evolution of the present crisis, following developments more than anticipating them. Despite this performance, and its poor performance in predicting the crisis, each update of its forecast for the global economy (the "World Economic Outlook", or WEO) receives considerable international press attention and commentary.

While the Fund's full analysis of the global economy is undertaken twice a year — in April and September at the time of the meetings of the governors (i.e. finance ministers) of the IMF and the World Bank — the organisation also undertakes summary intermediate revisions. One such forecast was unveiled last week (World Economic Outlook Update, July 8, 2010; www.imf.org). Before examining the implications of this forecast for Indian policy, particularly the quarterly monetary policy update due at the end of July, it is worth reflecting briefly on the context in which this latest forecast has been prepared.

Unusually, the release occurred in Hong Kong, China. It was timed for the eve of a major gathering of Asian policy-makers to take place in Seoul, Korea, this week, on the joint invitation of the Korean government and the IMF. Both events signal the increased importance of Asia in the global economy. They also indicate the desire of the IMF to reconnect with a group of countries which it alienated through its response to the Asian crisis of 1997.

With the notable exception of Pakistan, these Asian countries (Asean, China, India, and the "old" newly industrialised economies of Singapore, Taiwan and South Korea) are unlikely to return to the Fund for resources any time soon. Instead they have spent the past decade "self-insuring" against an unpredictable global financial system through a large build-up of foreign exchange reserves. Under Chinese and Japanese leadership, within the framework of a mechanism of swap arrangements referred to as the Chiang Mai Initiative (CMI), the underlying agenda has, in fact, been to develop alternatives to an IMF seen as subservient to American and European interests.

The alacrity with which the Fund has rushed to support countries and banks in Europe in the present crisis, even as the reform of voting power and board representation in the Fund proceeded at a glacial pace, would perhaps have done little to assuage these concerns. Yet the Fund wishes to remain at the heart of the reform of the international monetary order (exchange rate regimes, capital movements, liquidity provision, safety nets) and the rebalancing of the global economy. For this, it badly needs Asian engagement, particularly from the Asian emerging market members of the G20 (South Korea, Indonesia, China and India).

As widely reported in the Indian press, global growth in 2010, weighted by purchasing power parity, is now forecast at 4.6 per cent as against 4.2 per cent as recently as late April. Despite the turmoil in European sovereign debt markets, almost all parts of the globe have been upgraded. In addition, the charts supplied in the document clearly indicate that the world is experiencing a classic "V"-shaped rebound in output, of the kind associated with an extreme inventory cycle.

Within this generally positive global picture, as might be expected, both the absolute levels and the upgrade are strongest for Developing Asia: China, India and the "Asean-5" (Indonesia, Malaysia, the Philippines, Thailand and Vietnam). The April projection of 8.8 per cent for calendar 2010 has been further boosted to 9.4 per cent. Several people have asked me how it relates to the more usual forecast of 8-8.5 per cent for fiscal 2010-11 that is circulating in official Indian circles. I would surmise that the main difference is the very strong

growth performance of the first quarter of this calendar year. Given the very weak performance in early 2009, this can have a big effect on the calculation of the change in average level of GDP for 2010 over 2009.

What does this comparatively buoyant picture imply for Indian policy? While the usual caveats about forecasts are in order, and for many parts of the world, notably the US, the jobs picture remains dismal, it now seems safe to say that the global recovery is well established. This was not my view at the time of the April monetary policy. My earlier concern was that simultaneous tightening of both fiscal and monetary policy was risky at a time when the global prospect was uncertain and domestic private investment was still shaky; but now, equity market developments, the continuing good news on the manufacturing front (the index of industrial production) and indirect tax receipts are reassuring.

This then leaves the external sector: trade, capital movements and the external price of the rupee. There have been a number of developments in this space in recent days. These include the release of the preliminary balance of payments data by RBI for the full fiscal year 2009-10; the simultaneous release, also by RBI, of data on external debt of India; recent numbers on merchandise exports; the announced return to a gradual crawl of the Chinese yuan (RMB) against the US dollar; and the general recovery in world trade.

As I noted in April, eminent columnists of this paper have expressed concern on the real effective appreciation of the Indian rupee. In speeches delivered in Washington and Zurich, RBI Governor D Subbarao has also expressed concern on volatile capital flows and their impact both on asset markets and on managing the nominal exchange rate. The balance of payments data for the last quarter of FY10, and for the full fiscal year, would seem to give some credence to these concerns, with the current account deficit estimated at 2.9 per cent of GDP by RBI. This is certainly a level that deserves watching, but given the big difference between the trade data reported by the Directorate General of Commercial Intelligence and Statistics and that reported by RBI, as well as the healthy growth of overall exports, it may make more sense to adjust the current account through fiscal consolidation, rather than through aggressive intervention in the exchange market.

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