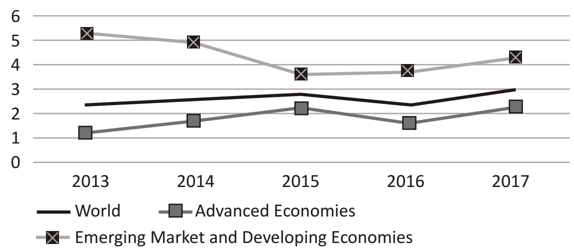
Global Economic Scenario*

Introduction

The pickup in the global activity that started in early 2016 continued at almost the same pace reflecting firmer growth in domestic demand in advanced economies and China and improved performance in other large emerging market economies. Global GDP growth has picked up from 2.4 per cent in 2016 to 3 per cent in 2017[1]. The global economic recovery is aided by marked recovery in investment and trade with favourable financing conditions and the dissipating impact of the earlier commodity price collapse. Despite risks of the possibility of financial stress, increased protectionism and rising geopolitical tensions, economists are hopeful that the recovery will be sustainable.

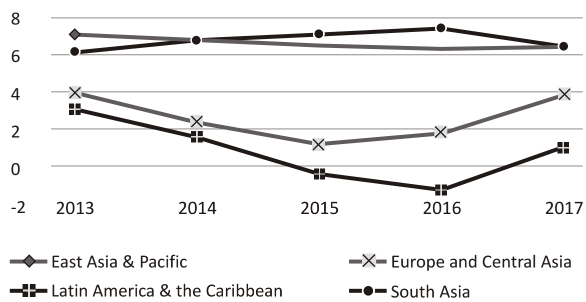
The growth of the economy in advanced economies recorded an increase from 1.6 percent in 2016 to 2.3 percent in 2017, while during the same period, the emerging market and developing economies experienced an increase in GDP growth from 3.7 to 4.3 per cent **[Chart 1.1]**.In United States growth was supported by private investment while private consumption also continued to grow at a robust pace. In Euro Area and Japan, stronger private consumption, investment and external demand boosted the overall growth momentum. Growth in most of the other advanced economies except United Kingdom is quite significant backed by both domestic and external demand. Among emerging markets and developing economies, Asian countries continue to account for over half of world growth. In India growth slowed due to uncertainty related to demonetisation followed by mid -year introduction of Goods and Services Tax (GST). But higher external demand boosted the growth of other emerging market economies in East Asia. While East Asia and the Pacific maintained economic growth rate of above 6 per cent, South Asian countries suffered a setback with growth falling from 7.5 to 6.5 per cent from 2016 to 2017 **[Chart 1.2]**. However, GDP in Latin America and the Caribbean reversed its downfall and recorded a positive growth rate of 0.9 per cent during 2017.

Chart 1.1: Real GDP Growth in Different Regions



Source: *Global Economic Prospects, World Bank, several issues*

Chart 1.2: Real GDP Growth in Emerging Market and Developing Economies



Source: *Global Economic Prospects, World Bank, several issues*

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We acknowledge the research assistance provided by Ms. Poulami Chakraborty

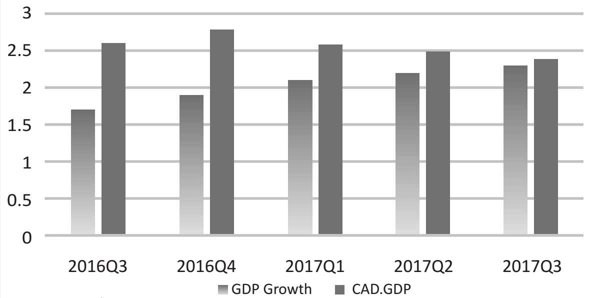
[1]World Bank Global Economic Prospects, January 2018

Advanced Economies

The US

The recent pickup in growth of the US economy is backed by private investment, robust consumption and increase in exports. Policies like lowering the statutory corporate tax rate and income tax cuts is likely to boost the economy in near future. GDP growth in US was at around 1.7 percent in the last quarter of 2016 a nd gradually improved to around 2.3 percent in the last quarter of 2017-18 (till January, 2018). The increase in Industrial production over the last four quarters is quite significant starting from -0.6 percent in last quarter of 2016 to 3.4 percent in the 4th quarter of 2017-18 (till Jan, 2018) **[Chart 2.1]**. Unemployment rate also

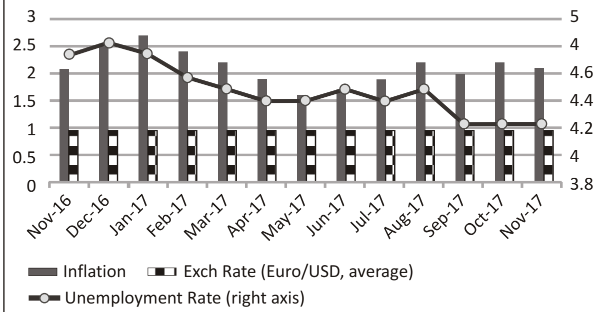
Chart 2.1: US GDP Growth and Current Account Balance



Source: The Economist

decreased slightly from 4.6 percent to 4.1 percent over the last four quarters **[Chart 2.2]**. Current account deficit as percentage of GDP did not change much, revolving around 2.5 to 2.6 percent. The depreciation of the US dollar so far in 2017, if not reversed, would similarly contribute to reducing the United States' net external liability position. United States being net creditors in foreign currency and net borrowers in domestic currency, an exchange rate depreciation implies improvement in the net external position through an increase in the domestic-currency value of net foreign-currency

Chart 2.2: Trends in Key Macroeconomic Variables in US



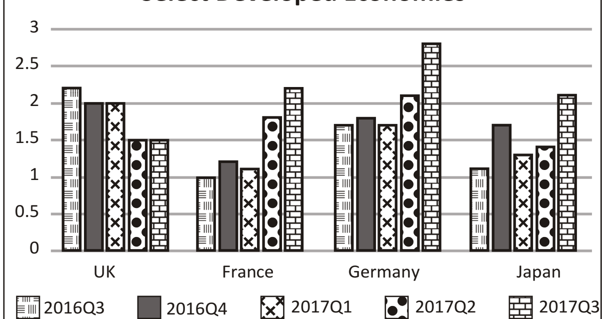
Source: The Economist and www.x-rates.com

assets. Owing to weaker fuel prices and negative shocks linked to cell phone prices and prescription drugs, consumer price inflation has been increasing from 1.7 percent in Q4 of 2016-17 to 2.2 percent in Q4 of 2017-18 (till January, 2018).

Euro Area

The euro area experienced almost similar kind of growth trends like the US over the last 4 quarters with real GDP growth rising from 1.7 percent to 2.6 percent buoyed by surprisingly rising labour force participation rate in many European countries including Germany, Italy and United Kingdom. The Euro Zone industrial production recorded significant increase during the last financial year **[Chart 3.1]**. The unemployment rate reached its

Chart 3.1: Trend in GDP Growth in Select Developed Economies



Source: The Economist

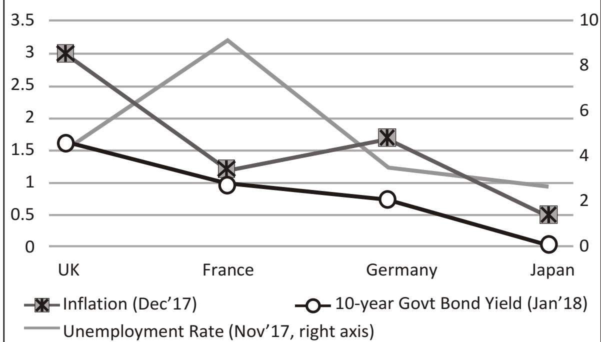
lowest level since 2009 and inflation remained low and range bound. The increase in growth in 2017 mostly reflects a quick growth in exports in the context of the broader pickup in global trade and continued strength in domestic demand growth supported by accommodative financial conditions amid diminished political risk and policy uncertainty.

There has been a significant increase in the growth of GDP during last quarter of 2016-17 and that of 2017-18 in France (from 1 percent to 2.3 percent) and Germany (1.7 percent to 2.8 percent). Inflation has picked up in Euro area from 0.2 percent to 1.5 percent during the same period, mostly reflecting higher energy prices and the ongoing cyclical recovery in demand. In UK too, inflation picked up from 1.2 percent to 3.1 percent during the last year **[Chart 3.2]**. On the positive side, unemployment rate had decreased from 9.8 percent to 8.8 percent over the year; similar declining trend is observed in France and Germany also during the same period (9.7 percent to 9.4 percent and 6 percent to 3.6 percent respectively). Also, in the region, bank credit growth to non-financial private sector has been positive since mid-2015, though Non-performing Loan (NPL) ratios are still high. Long-term sovereign bond yields have remained broadly stable in UK at around 1.25 percent, France at about 0.78 percent and marginally increased in Germany (0.27 percent to 0.45 percent) over the last four quarters (till January, 2018).

Japan

In Japan growth recorded considerable upsurge, from 0.9 per cent in 2016 to 1.7 per cent in 2017 so far, supported by increased demand and investment fuelled by the implementation of the fiscal stimulus package. Inflation remained below 1 per cent and the Central Bank continued to calibrate its bond purchases to stabilise long-term bond yields around zero. The 10 year government bond yield remained at around 0.04 percent over the last four quarters **[Chart 3.2]**. The growth forecast for Japan has been

Chart 3.2: Macroeconomic Variables in Select Advanced Economies



Source: The Economist

revised upwards for next two years, reflecting upward revisions to external demand, and carry over from stronger-than-expected recent activity.

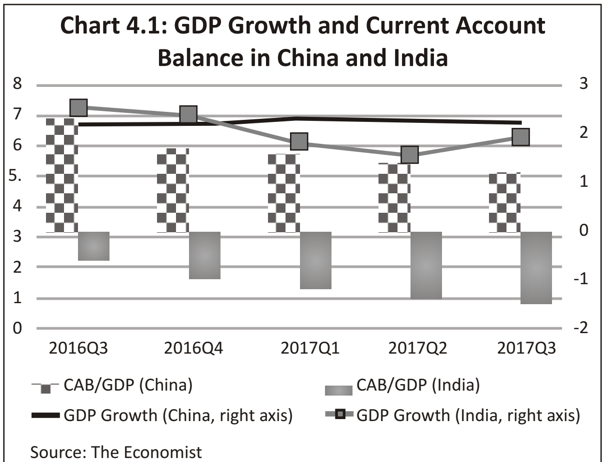
Emerging Market and Developing Economies

Among the emerging economies, while most of the countries recorded increase in GDP growth, it is the Asian countries which continued its fast pace of growth. During the last year, domestic demand continued to benefit from improved confidence and greater price stability and investment also recovered in many economies. Trade in commodity exporter countries recovered markedly, while a significant rebound in import growth also took place.

Asian Emerging Economies

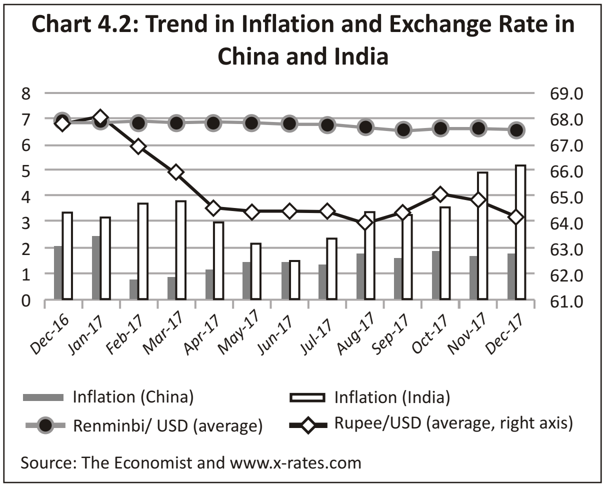
The projected aggregate growth rate over 2017–22 is sustained by fast growth in the two largest economies in Asia, viz. China and India, which account for more than 40 percent of GDP (measured at purchasing power parity) and more than 40 percent of the population of emerging market and developing economies. In emerging market economies, financial conditions since March 2017 generally have been supportive of a pickup in economic activity. Equity markets have shown improved performance; long-term interest rates on local-currency bonds have generally declined, China being the exception (10 year government bond interest rate hovered around 2.93 percent to 3.88 percent over the last four quarters) and spreads on the Global Emerging Markets Bond Index have fallen slightly. Emerging market currencies have generally strengthened relative to the US dollar.

Backed by continued fiscal support and reforms and better than expected recovery of exports, real GDP growth in China sustained at around 7 per cent in 2017 **[Chart 4.1]**. China's trade flows recovered



remarkably in 2017, partly reflecting rising commodity imports amid tightly enforced production cuts as well as strengthening foreign demand. Inflation surged, but remained within target during the last one year. However, key downside risks relate to financial sector vulnerabilities, the possibility of increased protectionist policies in advanced economies as well as rising geopolitical tensions.

India's economic expansion has been bouncing back from a temporary liquidity squeeze. The decision to demonetize high-denomination banknotes in November 2016 quelled cash-intensive economic activity, but the impact is expected to be short lived. Government deregulation and reform of taxes on goods and services, among other areas, is likely to boost up confidence and thereby business investment and growth prospects. Growth is expected to edge up to 7.4 percent in 2017 and 7.6 percent in 2018 **[Chart 4.2]**. Inflation has been



range bound and the fiscal deficit to GDP ratio also remained low, though could not meet the target. In the recent budget the policy makers are increasing focus on rural development and boosting the economic activity by reducing tax rates for small corporates.

GDP growth showed considerable increase in South East Asian economies. Economies in emerging Asia are already experiencing net capital outflows. In spite of the negative trend in net flows all over the world, India, Indonesia, and Vietnam received net inflows of foreign direct investment.[2]

[2]Asian Development Outlook 2017, Asian Development Bank

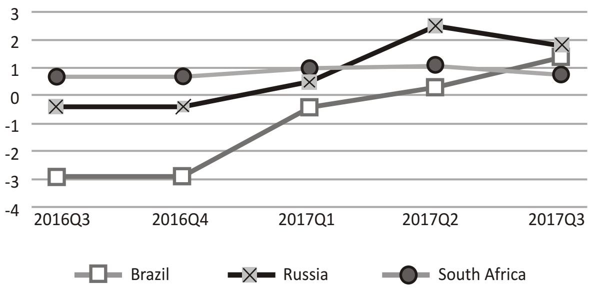
One risk is mounting household debt in some Asian economies. The ratio of debt to GDP has increased in several economies, rising significantly in the Republic of Korea from 74 percent in late 2008 to nearly 91 percent in the third quarter of 2016, and to about 71 percent in Malaysia and Thailand. However, there is scope to strengthen macro prudential policy, such as tightening ratios of debt to income and of loans to asset values. Policy makers may also have to scrutinize their banking sectors regularly to track bank exposure and identify needs for special reserves. They may have to intervene more decisively in housing markets as well to cool speculative demand and head off asset bubbles.

Latin America and the Caribbean

In Latin America and the Caribbean, real GDP in most of the emerging economies increased. Although growth is holding up well in Central America and strengthening in the Caribbean and domestic demand continues to underperform in much of the rest of the region, some factors are playing a key role in shaping substantially different outlooks across countries.

Due to strong export performance and huge diminishing rate of contraction in domestic demand, Brazil started seeing positive growth phase since the last quarter of 2017. GDP growth in Brazil reached nearly 1 percent for the year 2017-18 **[Chart 5.1]**, backed by a plentiful crop, a boost to consumption and the policy of allowing workers to draw on savings accumulated in their severance accounts. As key reforms to ensure fiscal sustainability are implemented over time, confidence improved. Mexican GDP growth showed a decline in 2017 compared to that of 2016, due to uncertainty related to renegotiation of the North American Free Trade Agreement and significant tightening of monetary policy. In

Chart 5.1: GDP Growth in Select Emerging Economies



Source: The Economist

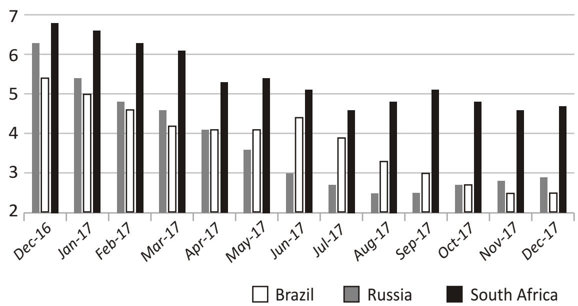
Mexico, consumer price inflation has been rising to 6.6 percent in last quarter of 2017-18, (till January, 2018), 2018) from 3.3 percent in early 2017 because of the liberalization of domestic fuel prices and pass-through from the peso's depreciation through January 2017.

European Emerging Economies

In developing Europe and Central Asia, GDP growth recorded notable increase, from 1.7 per cent in 2016 to 3.8 per cent in 2017 till January, 2018. The rise in growth in Turkey has been driven in part by a recovery in exports after several quarters of contraction and a more expansionary fiscal stance. The outlook was also revised up for Poland, reflecting better-than-expected growth in the first half of 2017 and the expected pickup in EU-funded projects. The consumer price inflation rate in Turkey has spiked to 11.9 percent (by end of January, 2018) from 8.5 percent in early 2017 following the depreciation of lira.

Growth in Russia, which came out of recession during 2017, was also well supported by domestic and external demand, banking sector support, targeted fiscal stimulus, and reduced external imbalances amid exchange rate flexibility. Lower inflation and greater monetary policy accommodation supported private consumption growth in large economies like Russia and South Africa. After rising to 6.6 percent in January 2017, consumer price inflation in South Africa has declined to 5.4 percent in June 2017 and further to 4.6 per cent in January 2018 **[Chart 5.2]**. However, in South Africa, growth prospects remain to be subdued at the backdrop of increased political uncertainty that weighs on confidence and investment.

Chart 5.2: Trend in Inflation in Select Emerging Economies



Source: The Economist

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[2]Asian Development Outlook 2017, Asian Development Bank