Global Snapshots- June 2015

The impact of global developments on the domestic economy is important. Changes in the monetary policy stance of the Fed do have an indirect bearing on the policy stance of RBI as it affects the exchange rate. Similarly developments on the oil pricing front have a deep impact on domestic fiscal balances and inflation. There have been differing views on the progress being made in the USA which present perspectives on the possibilities in the next few months.

The OECD View

The OECD has projected a slowdown in growth in the world economy from 3.3% in 2014 to 3.1% in 2015, with the USA moving down from 2.4% to 2%. The Euro area is to improve from 0.9% to 1.4% with the OECD nations managing to stay afloat at 1.9% in 2015. The non-OECD nations would witness a significant slowdown from 4.7% to 4.2%, with China going down sharply from 7.4% to 6.8%. The OECD has further assumed that:

- In the United States, the target federal funds rate will increase gradually between September 2015 and December 2016 from the current level of 0.25% to 2%.
- ECB will keep refinancing rate at 0.05%.
- In Japan, the short-term policy interest rate will be unchanged at 0.1%.
- In UK, the Bank Rate is assumed to be increased gradually between February 2016 and December 2016 from the current level of 0.5% to 1.5%.

How about the emerging markets?

China growth is projected to edge down as the restructuring of the economy progresses, with services taking over from investment and real estate as the main driver of economic growth. In contrast, growth is set to pick up in the other main EMEs: the recessions in Russia and Brazil are projected to give way to low but positive growth in 2016; growth in India will remain broadly stable in 2015 and 2016; and Indonesia's growth is projected to rise over the remainder of 2015 and in 2016.

The India View

The view on India has been generally positive where it is assumed that economic growth will remain high supported by a revival in investment. The following considerations have been taken into account.

- The FY16 fiscal consolidation target has been relaxed to allow for increased infrastructure investment while structural reforms to improve the ease of doing business and the Make in India initiative should boost corporate investment.
- Export growth will be held back by the currency appreciation.
- The decline in oil prices will reduce pressures on the current account deficit, inflation and subsidies.
- Improved public spending efficiency to fund public investment in infrastructure.
- Fiscal consolidation will reduce SLR that would release funds for private credit.
- Subsidy to be better targeted, and GST and corporate tax reforms should be implemented swiftly.
- The reduction in inflation expectations provides room for monetary easing.
- Addressing non-performing loans would strengthen monetary policy transmission.

But, the IMF has a different view

The IMF view is quite different because while it also does not see a significant improvement in the state of the US economy, it has urged the Fed to wait until 2016 before it raises its interest rates. The view is that the US economy is not strong enough to warrant such an action. This is however, contrary to what Fed Chairperson Janet Yellen has stated earlier where she argued that the visible signs of a recovery could make the Fed raise rates sometime this year. Most experts believe the Fed will raise rates in September 2015 (like the OECD), but the IMF recommendation will likely re-open the debate.

The IMF report indicates that the U.S. economy is stalling. Although the IMF still expects America's economy to grow this year at a rate of 2.5% which is similar to that last year but lower than the April projection of 3.1%, it suggests that the Fed should wait until the economy shows higher wage growth and lower levels of part-time employment, among other improvements. The unemployment rate ticked up slightly in May 2015 to 5.5%, according to the Labor Department. Wages grew only 2.3% in May 2015, well below the 3.5% wage growth which is the ideal rate according to the Fed. Wages remain the last major economic measure to turn the corner and make significant progress. The Fed has not raised rates in almost a decade and any hike would show that the Fed is confident enough about the economy's health.

ECB status-quo

Across the Atlantic Ocean, the ECB left rates unchanged last week at a record low of 0.05%, its deposit facility at -0.20% and the marginal lending facility at 0.3%. President Draghi confirmed the continuation of asset purchases and the full implementation of the program. The ECB confirmed that it was not even discussing an "exit strategy" for its €60 bn ($67 bn)-a-month program, as there was still a "long way to go" before the Central Bank reached its inflation target of close to 2%. The ECB projected annual inflation at 0.3% in the euro area in 2015, 1.5% in 2016 and 1.8% in 2017. As of May 2015, Euro zone inflation edged upwards to 0.3% from nil in April 2015.

Concerning the recent increased market volatility, ECB has maintained that that this was to be expected in an environment of extremely low interest rates and that one should get used to periods of high volatility in financial markets. At the same time, monetary policy must look through these developments. Mr Draghi made it clear that it was not the task of monetary policy to react to higher volatility.

So is it with Bank of England

The Bank of England has also left rates unchanged at 0.5% and kept the size of its bond-buying stimulus programme unchanged at £375 bn. The decision by the Bank's Monetary Policy Committee (MPC) comes more than six years after the record low was introduced. The half-dozen years of ultra-low interest rates have cut savings' returns, while mortgage borrowers have benefited from lower repayments. Ultra-low inflation, which turned negative in April 2015 at -0.1%, has put on hold expectations about the Bank raising rates in 2015. There are expectations now of the Bank of England increasing interest rates up in the first half of 2016 as there are signs of robust consumer activity and housing market picking up. However, inflation will remain below 2% for the next 12-18 months.

Greece hangs on

In a major development last week which has temporarily deferred the shadow on the future of the euro union, Greece has asked IMF to be allowed to pay back its debt maturing in June 2015 in a single payment to be made on 30th June 2015. The Greek authorities plan to bundle the country's four June payments into one which is now due on 30th June. Under the IMF rules that were formed in the late-1970s, its member nations could ask to bundle multiple principal payments into one to address the administrative difficulty of making several payments in a short period.

Greece faced € 300 mn ($338 mn) debt repayment to the IMF on June 5th and further repayments later in the month adding up to €1.3 bn. The postponement will buy more time for Athens after inconclusive talks between Greek PM and European Commission. Negotiating for Greece's bailout lenders - the EU Commission, the European Central Bank (ECB) and the IMF offered some concessions on fiscal targets to help enhance growth. In return, Greece was asked to commit to selling off state assets and maintaining unpopular labor reforms. However, the demands are seen crossing the ruling Syriza party's declared red lines and have already invited a backlash from senior party members, who described them as unacceptable.

The oil struggle continues

An important call taken by the OPEC was to maintain its official output target at 30 million barrels per day as its ceiling. OPEC consists of 12-nations and their output is around one third of the world's oil supply.

The decision comes despite growing warnings of a second slump in prices as some members such as Iran look to ramp up exports. OPEC has hinted that they would rather continue their policy to preserve market share and pressure high-cost US shale producers, knowing that shale and deep-water oil producers needed much higher crude prices to make their operations profitable again.

The global oil market fell by around 60% between 2014 and late January 2015 but has recovered somewhat, lifted by a brighter outlook for the global economy and rising energy demand. The challenge really is how to cope with some member nations' desire to increase their own output. The market could be further saturated with oil from Iran and Libya should conditions become normal.

There was quite interestingly no effort to push for output constraints from countries like Venezuela which has fiscal pressures at prices below $100 per barrel. At the same time, the US tight oil industry has proven to be more resilient than many had expected, with falling costs helping sustain the revolution and possibly setting up another downward spiral.

Due to oversupply and the resilience of shale oil prices are likely to fluctuate between $60 and $70 a barrel the rest of the year.

The IMF estimates that the influential Gulf nations of Saudi Arabia, Kuwait, Qatar and the United Arab Emirates are losing out on $287 billion in oil revenue this year. However, they have withstood pressure to boost prices by cutting output. They have the luxury of having the lowest production costs in the world, estimated at between $2 and $10 a barrel. Their reserves stand at $2.4 trillion, according to the Sovereign Wealth Fund Institute.

The China syndrome

China's exports fell for a third month in May 2015, while imports slumped the most in three months, underscoring a sluggish domestic environment in need of more monetary policy support. The trade slowdown coincides with a slump in investment growth that is putting the 2015 growth target of about 7% at risk. In response, officials have eased monetary policy and engineered a debt swap for local governments so they can keep funding infrastructure projects. China's central bank had cut its benchmark lending rate by 25 basis points to 5.1% earlier last month, its third reduction since November, as economic growth cools to levels not seen since the global financial crisis.

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