

IMF's World Economic Outlook: October 2013

The IMF released its latest economic outlook for the global economy and the main takeaways are:

- Global growth to be 2.9% in 2013 which will increase to 3.6% in 2014
- Growth to be driven more by advanced economies and the emerging markets are expected to be weaker than expected
- Risks to forecast remain on the downside.

Overview

The IMF forecasts global growth to average 2.9% in 2013 below the 3.2% recorded in 2012 and to rise to 3.6% in 2014. Much of the pickup in growth is expected to be driven by advanced economies. Growth in major emerging markets, although still strong, is expected to be weaker than the earlier IMF forecast.

This is partly due to:

- Cooling in growth following the stimulus-driven surge in activity after the Great Recession.
- Structural bottlenecks in infrastructure, labour markets, and investment have contributed to slowdown in many emerging markets.

Quite significantly long-term interest rates in the United States and many other economies have increased more than expected. Although the U.S. Federal Reserve recently decided to not slow the pace of its asset purchases yet and capital outflows from emerging markets have subsided somewhat, bond yields remain well above levels of early May. Also there is a distinct risk that financial conditions will tighten from their current, still supportive levels.

Some observations

- The impulse to global growth is expected to come mainly from the USA where activity will move into higher gear as fiscal consolidation eases and monetary conditions stay supportive. In the USA, the projections are based on the key assumption that the ongoing shutdown in the federal government will be short-lived and the debt ceiling will be raised on time. Growth is expected to rise from 1.5% this year to 2.5% in 2014 driven by continued strength in private demand, which is supported by a recovering housing market and rising household wealth. Following sharp fiscal tightening earlier this year, activity in the USA is already regaining speed, helped by a recovering real estate sector higher household wealth, easier bank lending conditions and more borrowing.
- In the euro area, policy actions have reduced major risks and stabilized financial conditions, although growth in the periphery is still constrained by credit bottlenecks. The region is expected to gradually pull out of recession, with growth reaching 1% in 2014. In the euro area, business confidence indicators suggest that activity is close to stabilizing in the periphery and already recovering in the core economies. In 2014, a major reduction in the pace of fiscal tightening, to less than 0.5% of GDP

from about 1% of GDP in 2013, is in the offering. However, the support for activity from the reduction in the pace of fiscal tightening is dampened by tight credit conditions in the periphery. Thus, growth is expected to reach only 1%, after contracting by about ½% in 2013.

- In Japan, fiscal stimulus and monetary easing under the authorities' new policy package—the so-called Abenomics—has enabled an impressive rebound in activity. But the expected unwinding of fiscal stimulus and reconstruction spending together with consumption tax hikes will lower growth from 2% this year to 1¼% in 2014.
- China's growth is projected to decelerate slightly from 7½% this year to 7¼% in 2014. Policymakers have refrained from stimulating activity amid concerns for financial stability and the need to support a more balanced and sustainable growth path. The forecasts assume that Chinese authorities do not enact major stimulus and accept somewhat lower growth, consistent with the transition to a more balanced and sustainable growth path. This slowdown will reverberate across developing Asia, where growth is expected to remain between 6.25 and 6.5% in 2013–14.
- The projections for real GDP growth in India have also been marked down significantly, with growth foreseen at 3.8% in 2013 and about 5% in 2014. However, this number is reckoned at market prices and at factor cost will be 4.25% and 5% in 2014.
- Overall, growth in emerging market and developing economies is expected to remain strong at 4.5–5% in 2013–14, supported by solid domestic demand, recovering exports, and supportive fiscal, monetary and financial conditions. Commodity prices will continue to boost growth in many low-income countries, including those in sub-Saharan Africa. But economies in the Middle East and North Africa, Afghanistan, and Pakistan region will continue to struggle with difficult economic and political transitions.

Table 1: GDP projections for 2013 and 2014 (%)

	2011	2012	2013	2014
World	3.9	3.2	2.9	3.6
Advanced	1.7	1.5	1.2	2.0
USA	1.8	2.8	1.6	2.6
Euro	1.5	-0.6	-0.4	1.0
Germany	3.4	0.9	0.5	1.4
France	2.0	0.0	0.2	1.0
Japan	-0.6	2.0	2.0	1.2
UK	1.1	0.2	1.4	1.9
Emerging/developing	6.2	4.9	4.5	5.1
China	9.3	7.7	7.6	7.3
India	6.3	3.2	3.8	5.1
Russia	4.3	3.4	1.5	3.0
Brazil	2.7	0.9	2.5	2.5
Asean-5	4.5	6.2	5.0	5.4

Source: IMF

What are the downside risks?

1. The changing global growth constellations have exacerbated risks in emerging market economies. Less U.S. monetary policy accommodation combined with domestic vulnerabilities in emerging market economies may lead to further market adjustment globally, with risks of asset price overshooting or even balance of payments disruptions.
2. Unfinished financial sector reforms in the euro area, impaired monetary policy transmission and corporate debt overhang in some euro area economies, and high government debt and related fiscal and financial risks in many other advanced economies, including Japan and the United States are also to be monitored.
3. Geopolitical risks have also resurfaced in recent months which can upset calculations.

What needs to be done?

1. The euro area needs to repair its financial systems and adopt a credible banking union supported by a common backstop.
2. The USA should resolve its political standoff relating to fiscal policy, and promptly raise the debt ceiling. In addition, the Federal Reserve should carefully manage the process of monetary policy normalization, taking into consideration prospects for growth, inflation, and financial conditions.
3. Both Japan and the United States need to accomplish medium-term fiscal adjustment and reform of their social safety net programs. Japan and the euro area should adopt structural reforms to boost potential output.
4. Policymakers should allow their exchange rates to respond to changes in the environment and act as shock absorbers, while avoiding disorderly market conditions.
5. In economies where monetary policy frameworks are less credible, efforts may need to focus more on providing a strong nominal anchor. Financial regulation and prudential actions should be taken to guard against financial instability.
6. Fiscal adjustment should continue to rebuild buffers, unless downside risks materialize and funding conditions allow fiscal easing.
7. A new round of structural reforms is a must for many emerging market economies, including investment in infrastructure, to reignite potential growth.
8. China needs to rebalance growth away from investment toward consumption to make way for more balanced and sustainable domestic and global growth.

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