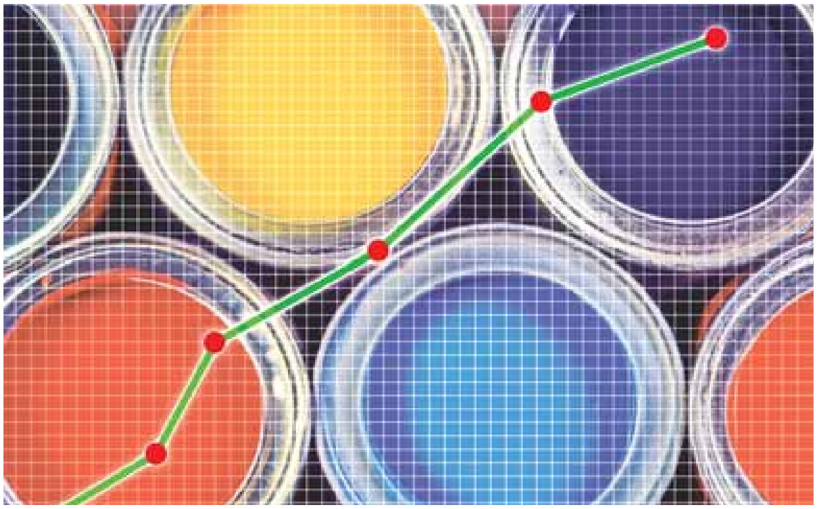
Global economic recovery

On the right track?



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Every nation is anxiously keeping a tab on the happenings in the global economy, especially giving due cognisance to the current growth phase being witnessed, following the aftermath of economic recession. Yet, there are some global issues such as the US fiscal deficit, Chinese monetary policy, food and energy scenario worldwide, to name a few, that will determine whether the fate of the economic recovery would continue on a positive note or take an undesirable turn.

■ Dr Mosongo Moukwa

Last February, the finance ministers and central banks of the G-20 countries held a meeting in Paris to ponder about the direction the economic recovery is moving. There were several briefings and talks about some major issues likely to impact the world economy. In this context, there are some pointers on things to watch, which might happen in the coming months. At the heart of the matter is whether the present growth phase of the economy will encounter some sort of early pause, and if so, how serious that might be. Experts believe that there are a number of unresolved issues that will determine whether the present recovery will take a pause, depending on how they are handled. Those unresolved issues include: The US fiscal deficit; the Chinese monetary & currency policy; European sovereign solvency; global energy and food production; and the fate of the dollar. Therefore, what one should be looking for are hints about future policies on those issues.

The growth phase

It is not easy to predict the future. No one knows how long the present expansion will last, but it is reasonable to expect several years of solid growth. In the past, growth phases have lasted seven to nine years. The present phase would be different from the previous ones in the sense that most of the growth is expected to come from the fastest growing and largest emerging economies. At the moment, the developed world still accounts for 65 per cent of the global GDP. Of the rest, a new paper by Goldman Sachs identifies a number of large emerging economies, which it describes as the 'growth markets'. Going forward to 2020, these markets will deliver most of the growth that is bound to happen.

As per the study, among the developed countries, only the US will deliver a significant portion of global growth. Japan and Korea get onto the chart, but no European country seems to be able to make it. It is a somewhat sobering thought for some that Turkey and Indonesia will add more to global wealth over the next decade than Germany, France or the UK. However, these countries will only be able to deliver that growth within a freely trading world economy, and this is the crucial point. So, what the G-20 has to confront are the threats that can be summed up under the global imbalances. The issues to be considered are as follows:

The US fiscal deficit: The first and foremost critical issue is the US fiscal deficit. In the US Budget for the coming fiscal year, President Obama has projected that the deficit will come down from 12 per cent of GDP to 7 per cent. That would actually be a faster decline than, for example, that predicted in the UK. If the US were to achieve this goal, it would be a huge step forward. Unfortunately, in subsequent years, the pace for correcting the deficit eases back and the US is still likely to run a deficit of 3 per cent of GDP in 2017. This is only the US President's plan and it can be changed by the US Congress. Which way this will go is anyone's guess.

There are few months to determine how serious the US is in cutting its fiscal deficit and that will have significant impact on elements of global imbalances. The savings imbalance, whereby Chinese savings finance the US deficit, is one destabilising element in the world economy. Though the link between the fiscal deficit and the current account deficit is a loose one, a narrowing of the former is an essential pre-condition for the narrowing of the latter. If debtors must take responsibilities for their debts, creditors must also take responsibility for their lending.

Chinese monetary and currency policy: The second issue is the Chinese monetary and currency policy. Here three things are happening that needs to be looked at. One is that the trade surplus is declining fast; it has halved in the past few months. The second is that inflation has become a serious problem in China and export prices are rising fast. Finally, the third one is that monetary policy is being tightened at last, and it would be consistent were China also to permit some further upward creep of the Yuan/Dollar exchange rate. As a result of all these, it is at least plausible that the trade imbalance between China and the rest of the world will decline in the coming months. In short, China's contribution to global imbalances will decline.

European sovereign solvency: The third issue is European sovereign solvency. When will the first EU state default? Could it be Greece? These are the questions one is afraid to ask, and many observers predict that default may happen within three years. The new Irish Government's efforts, post the forthcoming elections, to renegotiate its loan package will probably trigger a reassessment of the dangers of the sovereign default, and the need for a sovereign default. In the meantime, the financing needs of other much larger EU nations in the coming months are huge and it needs to be accepted that there will be further bail-outs. Things could become difficult indeed.

Global energy and food production: The fourth issue is global energy and food production capacity. There is great pressure on the oil and food prices very early in the growth phase of the cycle. If growth happens on the scale envisaged by Goldman Sachs, the pressure will remain and indeed grow in the years to come. One of the things being talked about is the role of speculation in raising food and raw material prices. Whatever the impact in the short term, in the long run it will all even out.

Today, it is pretty clear that the last spike in oil prices was indeed driven by speculation. The question therefore remains, what will hold down the prices? Will it be the ability to increase capacity? This is difficult in the case of oil. Will it be possible to hold down the demand? This is difficult in the face of rapid growth.

The fate of the dollar: Fifth comes the issue related to the fate of the dollar. The basic question here is how long the dollar retains its role as the global currency as there is lot of talk about its replacement by some other currency. At the head of the queue is the International Monetary Fund's (IMF) Special Drawing Rights. But there is no point talking about this, if central banks, particularly the Chinese, go on buying dollars and keeping them in their reserves. In any case, it is expected that within the foreseeable future, the dollar's role will decline. What will happen in the coming months may give a clue to the speed of that decline.

Now let us take a look at the paints and coatings industry and how it is faring in these times.

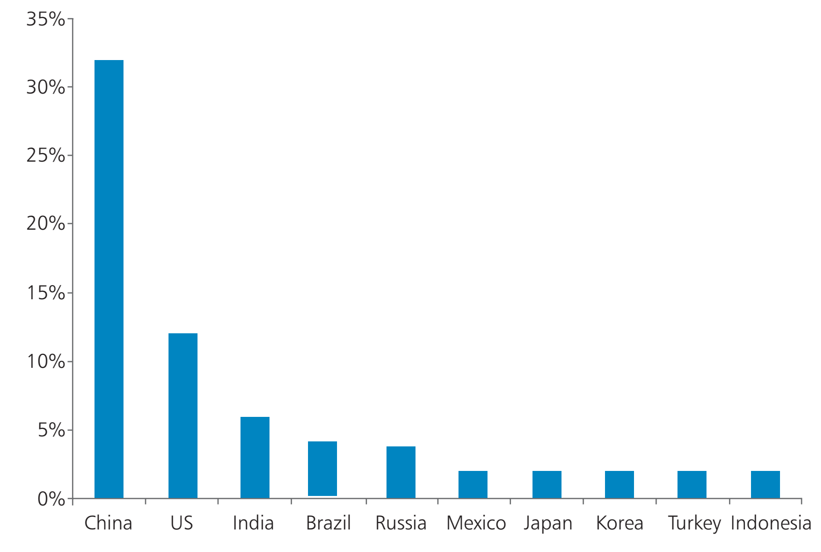

Figure 2: Share of total GDP increase (%) 2010-2020

Paints and coatings industry

The recession in the recent past two years has affected the paints and coatings industry as never before. Today, there is a shortage of key raw materials; main among them is TiO_2 representing 60 per cent of raw materials for the industry. The growing markets are China, Mexico, Korea, Turkey, Indonesia, Brazil, Russia and India. Several suppliers are flocking to those countries, and some are moving away from the paints and coatings industry towards more lucrative market segments. At the same time, new suppliers from these growing markets are also emerging.

What this will mean for the industry is anyone's guess. What needs to be kept in mind is from where the growth is coming, and as a result, how the balance of power is changing or bound to change. ■

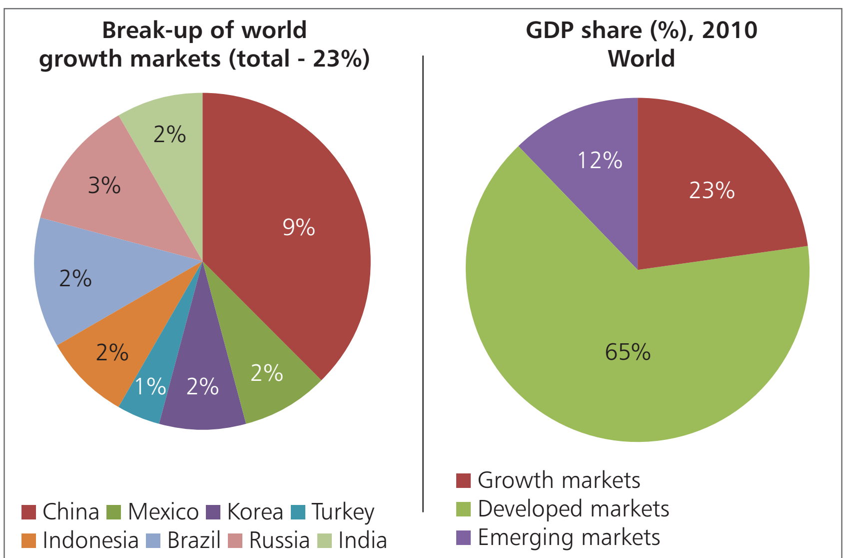

Figure 1: Fast growing emerging markets

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