ECONOMIC UPDATE

GLOBAL & INDIAN
June 2017

BIS warns rolling back globalisation would be 'detrimental'

The international body that represents the world's central banks has claimed that globalisation has been made a "scapegoat" for rising inequality, as it launched a defence of closer cross-border ties. Against the backdrop of protectionist rhetoric in many countries, including from US president Donald Trump, the Bank for International Settlements used its annual report to argue that globalisation has cut global poverty and will continue to lift living standards around the world.

The body – which is known as the central bank of central banks – warned that reversing globalisation would be "greatly detrimental to living standards". The BIS concedes gains from trade have not been evenly distributed at the national level but that other factors, most notably technology, have played a bigger role in widening the gap between rich and poor."There is ample evidence that globalisation has not been responsible for the majority of the concurrent increase in within-country income inequality," said the report.

"Attempts to roll back globalisation would be the wrong response to these challenges. Globalisation, like technological innovation, has been an integral part of economic development."The strong backing for globalisation echoes pleas from the International Monetary Fund and the Organisation for Economic Co-operation and Development not to move towards more inward-looking policies.

After Trump's presidential win following a campaign on an anti-globalisation platform, both bodies emphasised the apparent benefits from more global trade and placed the onus on national governments to ensure the gains are fairly shared. The BIS took a similar line in Sunday's report, urging governments to make their labour markets flexible enough to help people whose jobs are displaced to retrain and to benefit from regional employment drives. It also calls for international cooperation to shore up the stability of the global financial system.

"Instead of retreating from the ties of global trade and finance, we should reinforce them. Instead of loosening them, we should make them more resilient," BIS general manager Jaime Caruana wrote in a foreword to a chapter on globalisation.

"We must work together to create well designed policies, both domestically and internationally. Only then can we make sure that globalisation will continue to lift economic growth and living standards around the world for generations to come," Caruana continued.

The BIS noted that certain costs and financial risks had arisen from globalisation and that they needed to be carefully managed. "But they do not justify a backlash against globalisation," the report said. Instead there should be more acknowledgement of the gains from greater trade and cooperation, it said."The globalisation surge over the past half-century has brought many benefits to the world economy. Openness to trade has enhanced competition and spread technology, driving efficiency gains and aggregate productivity.

"The resulting stronger income growth has supported a remarkable decline in global poverty and cross-country income inequality. The ability to source cheaper, and better-quality, goods and services from all over the world has also directly increased households' living standards," the report said.

OECD: outlook for global economy is 'better, but not good enough'

Rising inflation and weak wage growth will leave Britain rooted to the bottom of the league table for living standards among the west's richest countries in 2018, the Organisation for Economic Co-operation and Development has warned. In the last piece of economic news before the general election, the Paris-based think-tank said the next government would spend the first 18 months of the next parliamentary term presiding over a severe squeeze on real incomes.

The OECD said inflation at 2.7% during 2018 would dwarf wage growth of 1.5% and result in the UK have the weakest real income performance, alongside Finland, of any of its 34 rich member states.The TUC general secretary, Frances O'Grady, said it was alarming that UK workers would face the biggest real wage fall of any advanced economy in 2018, while other OECD members, with the exception of Italy and Mexico, would experience real wage increases in 2018.In its latest health check on growth prospects, the Organisation for Economic Cooperation and Development described the outlook for the global economy almost a decade on from the financial crash as "better, but not good enough".

The Paris-based organisation nudged up its forecasts for global growth this year. But it trimmed its outlook for the US, to show growth accelerating a little more gently than in its previous assessment in March. The OECD made no changes to previous predictions that the UK will suffer a Brexit-related slowdown, with growth easing from 1.8% in 2016 to 1.6% this year and just 1% in 2018.But after being a strong supporter of austerity measures to curb Britain's budget deficit after the end of the 2008-09 recession, the think-tank said it was time for a different approach.

"The budget deficit is projected to remain broadly unchanged this year, but fiscal consolidation is planned for 2018 despite a weaker growth outlook. Instead, further fiscal initiatives to increase public investment should be considered to support demand in the near term and boost supply in the longer term," it said.

Referring to the UK's decline in GDP growth in the past six months, Catherine Mann, the OECD's chief economist, said recent data had been poor and the benefit of the lower pound for exporters was offset by inflationary pressures from higher import prices hitting disposable incomes."We are concerned about the purchasing power for consumers in an environment where the pass through [from higher import prices] seems pretty robust," she said.

After 3% growth in 2016, the global economy is expected to expand by 3.5% this year and 3.6% in 2018. That compares with previous forecasts of 3.3% and 3.6% respectively."After many years of weak recovery, with global growth in 2016 at the lowest rate since 2009, some signs of improvement have begun to appear," Mann wrote in the OECD's latest outlook report.

China manufacturing activity accelerates in June, with official PMI at 51.7, beating expectations

China's manufacturing activity accelerated more than expected in June, suggesting the world's second-largest economy continues to confound expectations for a slowdown. The official manufacturing Purchasing Managers' Index rose to 51.7 in June, accelerating from May's 51.2 and beating a Reuters poll forecast for 51.0.Levels above 50 indicate expansion, while levels below signal contraction.

In the services sector, the official services PMI for June rose to 54.9 from May's 54.5.While the manufacturing PMI data tends to be more closely watched, China's pivot toward domestic consumption and away from investment-led growth means the services sector accounts for a bigger slice of the mainland economy. The services sector includes consumer industries such as real estate, retail and leisure.It is also a key barometer of consumption, accounting for more than 50 percent of gross domestic product (GDP).

"Today's official PMI readings suggest that growth may have held up reasonably well this month," Julian Evans-Pritchard, a China economist at Capital Economics, said in a note on Friday, adding that the reading was consistent with other data he tracked.

"The breakdown suggests that stronger foreign demand is helping to support manufacturing activity – the new export orders increased by a larger margin than overall new orders," he said.

In the first quarter, China's GDP grew 6.9 percent on-year, slightly faster than the 6.8 percent forecast in a Reuters poll and the fastest pace since the third quarter of 2015.The government is targeting growth of around 6.5 percent for this year, compared with last year's target of 6.5-7 percent, Reuters reported, noting that 2016's growth was at 6.7 percent, the weakest for 26 years. Concerns over China's economy have grown as policy makers' stimulus efforts have also spurred a leverage buildup. In a note on Monday, Nomura estimated that China's outstanding non-financial sector debt hit 191.3 trillion yuan ($27.96 trillion), or 251 percent of gross domestic product (GDP) in the first quarter, up from 158.3 trillion yuan, or 231 percent of GDP, at the end of 2015.Last month, Moody's Investors Service expressed concern that China's effort to support economic growth would spur higher debt levels, and the ratings service downgraded the mainland's sovereign credit rating to A1 from Aa3, changing its outlook to stable from negative

China's debt surpasses 300 percent of GDP, IIF says, raising doubts over Yellen's crisis remarks

Global debt has hit a record level in the first quarter of this year, mainly driven by emerging markets, raising questions of whether there will be another financial crisis in the near future. Data from the Institute of International Finance showed that global debt reached $217 trillion in the first quarter of this year, or 327 percent of gross domestic product."The debt burden is not distributed evenly. Some countries/sectors have seen deleveraging while others have built up very high debt levels. For the latter, rising debt may create headwinds for long-term growth and eventually pose risks for financial stability," the IIF said in its Global Debt Monitor report on Tuesday.

Casrten Brzeski, senior economist at ING said that "high debt levels mean that the debt crisis has not been solved, yet. Neither in the US, nor in the Eurozone. Increasing debt levels in Asia and other emerging market economies also show that a structural change has not yet taken place."

In the U.K., however, the Bank of England seems more cautious about the future. It instructed U.K. banks to raise their capital ratios as a precautionary step in the event of an economic slowdown. In its Financial Stability Report released Tuesday, the central bank noted that Brexit, high

levels of indebtedness in China and an increase in consumer credit in the U.K. as potential risks.

According to the IIF, despite the fact that debt levels have slowed down in mature economies, emerging market debt rose 5 percentage points from a year ago."Total debt in emerging markets (excluding China) has increased by some $0.9 trillion to over $23.6 trillion in the first quarter of 2017—mainly driven by Brazil (up $0.6 trillion to $3.6 trillion) and India (up $0.2 trillion to 2.9 trillion)," the IFF said in its report.

China poses a great risk in itself with households accelerating their borrowing."The household debt-to-GDP ratio hit an all-time high of over 45 percent in the first quarter of 2017 —well above the Emerging Market average of around 35 percent. In addition, our estimates based on monthly data on total social financing suggest that China's total debt surpassed 304 percent of GDP as of May 2017," the IIF noted.

On the other hand, there's been a steady decline in euro area private sector debt, from $103.4 trillion in the first quarter of 2016 to $97.7 trillion in the first quarter of this year.The IIF warned that there's over $1.9 trillion of emerging market bonds and syndicated loans maturing through to the end of 2017, with redemptions in USD making for about 15 percent of the total.

US Fed rate hike: How it will impact India

The US is returning to normalcy with short-term rates moving up from the near-zero level in the post-2008 period to 1-1.25 per cent. The rate hikes started late last year, and there are expectations of another 25 basis points hike in 2017. The interest rate hike in the world's largest economy has implications for emerging economies like India. Here are five possible ways it can impact the country going forward.

The dollar inflows from foreign institutional investors (FIIs) have been robust in the past due to troubles and uncertainties in the US. The focus on a normal monetary policy is now playing out well for the financial markets. There are expectations that a part of the money will flow back to the US as there will be investment safety and also good returns.

There has been a spurt in Indian stocks over the past 12 months. The rally is purely liquidity-driven, especially when it comes to funding flows from global funds, and there is not much support from earnings growth. The over-leveraged corporate houses of India are already facing the wrath of the government and the Reserve Bank of India (RBI) as these are keen to push the stressed companies to bankruptcy proceedings that will see a resolution or liquidation within 180 days.

The rupee value against the US dollar can also come under pressure if dollar funds' outflow from the Indian markets take place. The rupee, which has strengthened a bit lately, came under pressure post the US Fed rate hike. The rupee is currently hovering around 64.50 levels against the US dollar. The weakness, as reflected in the fourth quarter (January-March 2017) GDP number of 2016/17, could be a trigger for many foreign funds to make an exit now and return later when things stabilise in India. The farm loan waiver cry across the states has the potential to create further trouble with fiscal management.

For quite some time, the interest rate differential between the US rates and the Indian interest rates was quite high, which created a space for the funds to make money. But as India started easing interest rates and the US started hiking its rates, the differential is now narrowing fast. This narrowing of differential impacts the speculative or short-term money that comes to the domestic financial markets.The gradual hike in Fed rates will also make the international debt more expensive. In the past, many companies have raised US-denominated debts at cheap rates. But things are now changing due to volatility in the currency. The US and Europe are slowly returning to normalcy, and that will affect the domestic currency as well as international debts.

Azevêdo: Helping MSMEs to trade is vital for sustainable development

Speaking at an Informal Dialogue on Micro, Small and Medium Enterprises (MSMEs) held at the WTO on 29 June, Director-General Roberto Azevêdo highlighted that MSMEs face greater barriers than larger players when dealing with the challenges posed by trading across borders. He outlined some of the ideas members have put forward to tackle these obstacles and stressed that helping MSMEs to join trade flows in greater numbers would be a focus of discussions during the forthcoming Global Review of Aid for Trade in July. This is what he said:

Azevêdo: Helping MSMEs to trade is vital for sustainable development

More MSMEs doing business across borders would mean more women benefitting from trade, more people in LDCs, more people in rural areas, more agricultural firms, and more young people benefitting as well. They often don't have the resources, or the ability to absorb risk, or the necessary expertise. Similarly, they don't always have access to the necessary infrastructure. For example, MSMEs struggle to access trade finance. Globally, 58% of trade finance requests by MSMEs are rejected, against just 10% for multinational companies.

WTO research shows that the fixed costs involved with trade can be particularly difficult for MSMEs. This includes dealing with standards, costly border procedures, or other

non-tariff barriers. The ITC has found that increases in regulatory burdens hit the revenues of MSMEs twice as hard as larger firms.

But as well as fixed costs, variable costs are also an issue. Last year's World Trade Report found that tariffs are considered a major obstacle by MSMEs. This has been an ongoing focus of your discussions in recent months. I have been hearing a lot of interesting and very practical ideas. And I would like to highlight just a few today.

First, between all of our organizations we have a lot of information and expertise on regulations and standards in markets around the world. We already work hard to make that information available in an open and transparent way. But perhaps there is more that we can do.

Last year the WTO, UNCTAD and ITC launched the ePing notification alert system. The idea is to alert members about new TBT and SPS measures and to facilitate dialogue amongst the public and private sector in addressing potential trade problems at an early stage. It is a fairly simple innovation, and it has been a huge success. In the digital age, we might want to look at new ways to make the data we already have even more readily available. This is an area where we are already working together with our institutional partners – and I think there is more that we can do.