

GLOBAL ECONOMY: PROSPECTS: 2012 AND 2013

Global economic prospects for 2012 and 2013 continue to remain downbeat as uncertainty and vulnerabilities of economies towards financial stress and real economy constraints continue to persist.

The World Bank and the UN both have presented rather congruent outlooks for 2012 and 2013, highlights of which are presented in this report.

Prime Concern

Though region-centric to begin with, the financial turmoil in Europe has now spread to developing and other high-income countries and this contagion has

- increased borrowing costs in many parts of the world
- pushed down stock markets, and
- lowered capital flows to developing countries

Europe has entered a recessionary phase and growth in several major developing countries (Brazil, India and, to a lesser extent, Russia, South Africa and Turkey) is significantly slower than it was earlier in the recovery, mainly reflecting policy tightening initiated in late 2010 and early 2011 in order to combat rising inflationary pressures. Hence, despite a strengthening of activity in the United States and Japan, global growth and world trade have slowed down sharply.

What may be expected?

- The global economy is expected to expand 2.5 and 3.1% in 2012 and 2013 using purchasing power parity weights
- High-income country growth is to be 1.4% in 2012 and 2.0% in 2013,
- Developing country growth has been revised down to 5.4 and 6%
- World trade, which expanded by an estimated 6.6% in 2011, will grow only 4.7% in 2012, before strengthening to 6.8% in 2013.

Expectations on GDP growth as estimated by the UN are placed close at heels of forecasts by the World Bank as illustrated in table 1 below. A noteworthy difference in the two estimates pertains to the outlook towards the Euro area. While the World Bank presents a rather bleak outlook with negative growth of 0.3%, the UN maintains a near zero but positive growth rate for region in 2012.

Table 1: Global GDP growth (%)

	2011(e)	2012(f)	2013(f)
World	2.8	2.6	3.2
High Income	1.6	1.4	2.0
<i>Euro Area</i>	<i>1.5</i>	<i>0.4</i>	<i>1.3</i>
<i>US</i>	<i>1.7</i>	<i>1.5</i>	<i>2.0</i>
<i>Japan</i>	<i>-0.5</i>	<i>2.0</i>	<i>2.0</i>
Developing	6.0	5.6	5.9
<i>Brazil</i>	<i>3.7</i>	<i>2.7</i>	<i>3.8</i>
<i>Russia</i>	<i>4.0</i>	<i>3.9</i>	<i>4.0</i>
<i>India</i>	<i>7.6</i>	<i>7.7</i>	<i>7.9</i>
<i>China</i>	<i>9.3</i>	<i>8.7</i>	<i>8.5</i>

Source: UN, *World Economic Situation and Prospects, 2012*
(e-estimate, f-forecast)

Main challenges

- The medium-term challenge represented by high debts and slow trend growth in other high-income countries has not been resolved and additional risks to the outlook include the possibility that political tensions in the Middle East and North Africa disrupt oil supply, and the possibility of a hard landing in one or more important middle-income countries
- Developing countries simultaneously, have successively been subject to global financial and economic shocks that have resulted in banks deleveraging, thereby interrupting credit supplies (high borrowing costs have also impacted the demand-side for credit)
 - o Mounting debt and widening budget deficits remain a challenge for fiscal austerity. Bulk effects of the European crisis, high commodity prices (especially oil) and slow down in manufacturing output weigh on the growth prospects of developing countries. Low investor and consumer confidence is depressing already subdued aggregate demand
- Capital flows would be governed by global financing conditions. Economies have been subject to worsening external financing conditions that could make short-term debt and bond financing unfeasible. Countries would then be forced into cutting reserves or reducing imports to maintain budget balances
- With economic activity projected to remain rather benign, a job shortage of 71 million is estimated, nearly 24% of which must be created in developed countries. The UN warns of that it might be difficult to return to pre-crisis levels far beyond 2015, in the event of slippages in improvement in economic activity in developed countries

Worst case scenario: How about the euro region?

While the situation in Europe is contained presently, if the crisis expands and markets deny financing to these European economies, global GDP can be 4% lower than in the baseline. Developing countries would feel its effects deeply, with their GDP declining by 4.2% by 2013. The downturn may well be longer than in 2008-09 because high-income countries do not have the fiscal or monetary resources to bail out the banking system or stimulate demand to the same extent as in 2008-09. A more 'pronounced and synchronized' downturn is a major impending threat. Although developing countries have some maneuverability on the monetary side, they could be forced to pro-cyclically cut spending – especially if financing for fiscal deficits dries up.

Market signals: Post August 2011

- The heightened market volatility has differed qualitatively from earlier ones because this time the credit default swaps (CDS) spreads have increased by an average of 117 basis points (bps) between the end of July 2011 and early January 2012, as did those of almost all Euro Area countries, including France and Germany, and those of non-Euro Area countries, such as the United Kingdom
- Repeated sovereign credit rating downgrades of major advanced economies is acting as an impressionistic signal as well reinforcing the negative outlook on economic and financial stability
- For developing countries, the contagion has been broadly based
 - o In addition to higher bond spreads and CDS rates, developing-country stock markets have lost 8.5% of their value since July-end
 - o This, combined with the 4.2% drop in high-income stock-market valuations, has translated into \$6.5 trillion, or 9.5% of global GDP, in wealth losses
- Capital flows to developing countries have weakened sharply as investors withdrew substantial sums from developing-country markets in the second half of the year. Overall, gross capital flows to developing countries plunged to \$170 billion in the second half of 2011, only 55% of the \$309 billion received during the like period of 2010
- Equity issuance plummeted 80% to \$25 billion with exceptionally weak flows to China and Brazil accounting for much of the decline. Bond issuance almost halved to \$55 billion, due to a large fall-off in East Asia and emerging Europe. The decline in syndicated bank loans was much less marked, largely because such activity remained very depressed following the 2008-09 crisis
- Activity in Europe and Central Asia, the United States and Japan has accelerated since August
- Trade data suggests a clearer impact from the post-August turmoil and weakness in Europe

Source of Relief

Global commodity prices are expected to moderate through 2012, on the back of improved supply prospects, monetary intervention and weak aggregate demand that prevails currently. A softening trend in inflation could help release pent up consumer and investor demand, thereby pushing forth economic activity. This would be a positive development for developing and lesser developed countries that are easily vulnerable to commodity price shocks. Commodity exporting economies could witness buoyancy in export volumes, against lower prices. Greater export earnings could change a government deficit of 2.3% of GDP in 2010 for resource-rich countries to a marginal surplus of 1.2% by 2013.

A pertinent risk in this context is the integration of commodity markets with financial markets. This could cause a spillover of volatility from financial markets onto the commodity space, especially as currency (exchange rate) uncertainty and volatility is expected to prevail through 2012-13.

What is clear now?

- Growth in high-income countries is going to be weak as they struggle to repair damaged financial sectors and badly stretched fiscal balance sheets
- Developing countries will have to search increasingly for growth within the developing world, a transition that has already begun but is likely to bring with it challenges of its own. Developing countries look to be

more vulnerable if there is a sharp deterioration in global conditions. Post 2009 crisis, by 2010, 53% of developing countries had regained levels of activity close to, or even above, estimates of their potential output. Further, government balances have deteriorated in almost 44% of developing countries and some 27 developing countries have government deficits of 5 or more% of GDP

Both global financial stress and domestic economic conditions would have important implications for advanced and developing economies alike. Better monetary policies and deeper financial reforms are needed to curtail capital flow, exchange rate and commodity price volatility.

Impact on India

The Indian economy is largely a domestic oriented economy. However, as was seen in FY12, the global crisis has impacted us quite significantly through:

- Flow of capital through both FII and commercial borrowings
- Forex inflows through remittances and software receipts
- Volatility in the exchange rate
- Growth in exports as well as projects undertaken overseas
- Price inflation (in particular oil)
- Sentiment in stock market which in turn has a bearing on corporate earnings

Based on the projections made by the World Bank and UN, conditions may be expected on the whole to be better than that in 2011, with the caveat being that conditions do not deteriorate further in the euro region.

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