

Increasing uncertainty among countries, especially advanced economies, is prompting a rather bleak outlook on global economic growth. The developing countries, which have provided support to the global economy in the past to provoke much debate on the decoupling hypothesis, have its own set of problems centred on high inflation.

The IMF has presented its outlook on the world economy as well as regional outlooks, where it recognizes that “following a barrage of unfavourable shocks in the first half of 2011, global economic activity has weakened and become more uneven”. Against this backdrop, projections have been revised downwards.

Worldwide real GDP growth is now projected at 4.0% for 2011 and 2012 – about ½% lower than that presented in April 2011.

Global Economic Outlook

October 2011

Highlights

- **For Europe –**
 - Growth to slow down to 2.3% in 2011, from 2.4% in 2010. Projection for 2012 being 1.8%
 - Inflation to temper from 4.2% in 2011 to 3.1% in 2012, consequent on economic slack and retreating commodity prices
- **For US –**
 - Growth is projected to decelerate from 3.0% in 2010 to 1.5% in 2011, marginally picking up to 1.8% in 2012
 - Inflation pegged at 3.0% in 2011 and 1.2% in 2012 (lower than the 1.6% recorded in 2010)
- **For Asia –**
 - Growth is projected at 6.3% in 2011, substantially lower than 8.2% registered in 2010. The same is expected marginally increase to 6.5%
 - Inflation for China and India is set at 5.5% and 9.1% in 2011 and at 3.3% and 6.7% in 2012

Table 1: Growth and Inflation prospects

Year	2009	2010	2011(P)	2012(P)
Growth (%)				
World	-0.7	5.1	4.0	4.0
Advanced Economies	-3.7	3.1	1.6	1.9
EMEs/DEs	2.8	7.3	6.4	6.1
Inflation (%)				
World	2.5	3.7	5.0	3.7
Advanced Economies	0.1	1.6	2.6	1.4
EMEs/DEs	5.2	6.1	7.5	5.9

Source: IMF, World Economic outlook, October 2011

Contact:

Madan Sabnavis, Chief Economist
 madan.sabnavis@careratings.com
 91-022-67543489

Krithika Subramanian, Associate
 Economist
 krithika.subramanian@careratings.com
 91-022-675343521

Challenges for the Advanced Economies

- Lack of confidence amongst the countries' consumers, bankers, investors and entrepreneurs, resulting in negative demand shocks within each domestic economy
- A backdrop of tepid growth, hindered by private indebtedness, burst in asset prices, weak credit due to funding difficulties of banks
- Deeper fiscal austerity measures, private-sector balance sheet deleveraging and structural unemployment

Downside risks remain in the areas of

- Policy slippages in program countries
- Lack of commitment to pursue accepted programs
- Capital buffers for banks being inadequate
- Drying up of funds
- Slowing global growth impacting these economies.
- Withdrawal of monetary support if inflation increases

A major concern in terms of the policies being pursued by the nations under pressure is that demand compression will undermine adjustment efforts and that high debt countries hence face low long term prospects.

Core concern in Euro-zone

Recapitulating the developments in this region gives a fair idea of the intensity of the debt crisis amongst the 17 countries of this monetary union. Fears of a sovereign debt crisis in the Euro-zone emerged in late 2009, against a weakening of the banking system and insufficient bail-out by the concerned governments. Rising government deficits and debt levels intensified in May 2010, leading to the establishment of the European Financial Stability Facility (EFSF) with a rescue package of maximum of Euro 750 bn (Euro 60 bn from the European Financial Stabilisation Mechanism (EFSM) and up to Euro 250 bn from the IMF. Greece, Portugal and Ireland have been the three main countries to avail of this rescue package.

- The package for Greece consisted of Euro 110 bn (Euro 80 bn coming for Euro-zone countries) for three years, with Euro 30 bn coming in the first year in the form of bilateral loans

Table 2: Growth in Advanced Countries (%)

Country	2009	2010	2011(P)	2012(P)
US	-3.5	3.0	1.5	1.8
Japan	-6.3	4.0	-0.5	2.3
Germany	-5.1	3.6	2.7	1.3
UK	-4.9	1.4	1.1	1.6

Source: IMF, World Economic outlook, October 2011

Euro-zone debt crisis a major concern over the last one-and-half years

Major financial assistance from the Euro-zone countries through the ECB, EFSF and EFSM along with contribution of the IMF

Impending default averted but resolution of debt crisis far from encouraging

- The total assistance for Portugal and Ireland is placed at Euro 15.3 bn in 2011, the EFSF has placed two tranches of Euro 5 bn each for Portugal and Euro 5 bn for Ireland until now. The EFSF is further expected to raise Euro 13 bn in 2012.

Has the assistance helped?

The rescue package for the Euro zone countries has provided some relief by avoiding immediate default on sovereign debt. The five PIIGS countries (Portugal, Ireland, Italy, Greece and Spain) have aggregate outstanding debt of about Euro 3 tr (with Greece alone having an outstanding of more than Euro 300 bn). Spreads on sovereign credit default swaps (CDS), that are indicative of the cost of borrowing and the associated probabilities of default for the PIIGS countries are presented in table 3. Though an impending default has been averted, credit rating downgrades for these Euro-zone countries has been unavoidable. With rating agencies downgrading these countries, outstanding ratings today look gloomy when compared with sovereign ratings of these countries a year ago.

Going forward, the major challenges for the Euro-zone countries include higher interest costs on sovereign debt which would constrain current and future capacities of the governments to raise and service debt. Front-loaded fiscal adjustment is a need of the hour, but the big question would be – can it be achieved? Increased weakness of the banking system and possible contagion effects are further threats. The IMF expects continued balance-sheet headwinds for the region, thereby making downside risks to the baseline severe.

The American story...

The US economy continues to display some persistent macro-economic drags as suggested by leading indicators including low growth in industrial output, structural unemployment and poor housing starts. Reduction of public debt to pre-crisis levels would be a major challenge for the US. Latin American countries with strong real linkages with the US, are additionally

Table 3: A glimpse at credit-worthiness of PIIGS

Country	CDS Mid-spread	CPD* (%)	Credit Rating**
Greece	7318.25	97.64	CC
Portugal	1308.51	63.75	BBB-
Ireland	977.55	53.3	BBB+
Italy	503.2	35.01	A
Spain	428.81	30.66	AA-

Source: Credit Market Analysis, Datavision

*CPD stands for Cumulative Probability of Default

**Sovereign ratings by S&P reported here

Table 4: Major Macro-Economic Indicators for North America

Year	2009	2010	2011(P)	2012(P)
GDP growth (%)				
Canada	-2.8	3.2	2.1	1.9
Mexico	-6.2	5.4	3.8	3.6
US	-3.5	3.0	1.5	1.8
Inflation (%)				
Canada	0.8	2.2	2.6	2.0
Mexico	3.6	4.4	3.3	3.0
US	1.9	1.7	2.5	0.9
Current Account Balance/GDP (%)				
Canada	-3.0	-3.1	-3.3	-3.8
Mexico	-0.7	-0.5	-1.0	-0.9
US	-2.7	-3.2	-3.1	-2.1

Source: IMF, World Economic outlook, October 2011

expected to face some tailwind pressure in external financing.

Outlook for Developing and Emerging Market Economies

Developing and EMEs are projected to grow at 6.5% in 2011, faced by two kinds of pressures, namely, domestic structural concerns and macro-economic and financial spill-overs from advanced countries. While the former is expected to impact the aggregate demand-side, the latter would impact the aggregate supply-side. A softening of exports may be inevitable.

While domestic demand is set to cushion these economies against external shocks, the extent of economic inclusion would be pertinent.

Developing and EMEs to support global growth at 6.5%

The Domestic Scenario

The IMF notes that while domestic demand has been resilient in these economies, overheating pressures would be pertinent. In particular, China is expected to remain in the overheating zone in 2011, while India has registered some minor easing. Real credit growth in the Asia-Pacific region is projected to be around 9.6-9.7% until end-2012, lower than the credit growth of 16% that is historically seen to be consistent with a boom period. Inflation, that has been persistently high for most EMEs, is pegged at 6.7% in 2012 (against 9.1% in 2011 and 9.8% in 2010) for India and at 3.3% in 2012 (as against 5.5% in 2011 and 6.2% in 2010) for China.

On the external front

Import of inflation, especially on the back of elevated global commodity prices, lower production and investment activity, drawdown of inventories internationally and lower exports would undoubtedly have implications on the economy. Estimates of impact of a severe global slowdown on real GDP growth suggest a 2% reduction in the first year and a 1.4% reduction in the second year for EMEs.

Import of inflation a concern to begin with which can however be reversed with the global slowdown

While China is expected to continue to face its 'twin surplus' problem, an encouraging sign is the estimate of a lower current account deficit for India (projected at 2.18% in both 2011 and 2012).

Going forward...

The IMF identifies some policy actions as critical for developing and EMEs –

Generally, challenging time ahead

- Reprioritizing fiscal spending, for the creation of crucial infrastructure investment and social sector expenditure
- Phasing of subsidies roll-out
- Taming inflation and anchoring inflationary expectations

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