The Other Side April 21, 2016

The Global Political Economy

Just before the last week's Group of Twenty (G-20) finance ministers' and other meetings in Washington, the International Monetary Fund (IMF) revised downwards its forecast for global growth in the current year. (It reaffirmed its expectation that India would be the fastest growing large economy in the world.) In a press conference, the IMF Managing Director also urged member states to consider growth-friendly fiscal policies. Have the virtues of fiscal austerity been exaggerated?

Turning first to the global political economy, in the European Union, the European Central Bank's monetary stimulants under various technical names, and zero/negative interest rates in the euro-zone and several non–euro countries, have so far failed to bring inflation up to its target of 2%. The UK is also slowing. The referendum in June over "Brexit" from the European Union, and if the vote is "yes", its impact on the European economy in general, and the British economy in particular, add to the uncertainties. Europe is also distracted by the problem of the refugees from the middle east – with most countries reluctant to admit them. Extremist parties seem to be gaining political ground.

Across the Atlantic, the US economy is doing a little better, but there is talk of the Federal Reserve having to defer the second rise – and even being forced to reverse the December increase in the Federal Funds rate. The fact that 2016 is an election year adds to the uncertainties. (Is Donald Trump's possible election as President of the US, the biggest risk to the global political economy?) With unemployment refusing to fall much, the US Treasury Secretary urged the IMF to monitor exchange rate fluctuations closely and punish currency "manipulators", whoever they are. Trade protectionist agenda seems to be once again back on the agenda – partly also because wages are stagnant.

Turning to Japan, years (indeed a couple of decades) of ultra low interest rates and fiscal deficits have helped spur neither inflation nor growth – and the recent rise of the yen is another negative factor for the economy. Clearly, even for the US and Japan, exporting so-called "differentiated" goods, the exchange rate is an important macroeconomic variable. We are of course braver – the Finance Minister reiterated in Washington that we do not follow an exchange rate policy to gain competitive advantage: this despite our imports of goods being almost 50% higher than exports, helping create jobs in other countries! How altruistic!

Coming to China and India, the former recorded a growth rate of 6.7% in Q1 of 2016 thanks partly to higher exports, and we are expected to grow at 7.5% or so in fiscal 2016-17 if official forecasts, also confirmed by the IMF, are to be taken at face value. Both have major problems of bad debts in the banking system: China because of overinvestment and excess capacity; India at least partly because of double digit real interest rates for much of business, and an overvalued exchange rate. The other BRICS are having even bigger problems: Brazil because of low commodity prices – and a corruption scandal that has led to impeachment proceedings against the President and her predecessor. The country's largest company, Petrobras, is suffering from both low oil prices and another corruption scandal in which a billionaire banker is also caught up. The situation is South Africa is not very different: low commodity prices, three finance ministers in less than a week, and question marks over President Zuma's relationship with an Indian–origin business family. He seems to be losing confidence of his own party. Russia has been hit by low energy prices but seems to be weathering the problem better than other commodity producers, despite western sanctions arising from its supposed role in Ukraine. Some of the large non-BRICS emerging economies are also in trouble: Indonesia, a commodity producer; Malaysia (a corruption scandal involving the Prime Minister, who of course denies the allegations); Nigeria; Venezuela, a major oil exporter with a leftist government. The list is long – and growing.

Overall, global economic recovery has clearly slowed and the slowdown may well continue for the rest of the decade. Growth in global trade has also stalled, partly because of lower oil and other commodity prices – and also because of volatile exchange rates in real terms? Will globalisation, the process of integrating the global economy, go into reverse? If this is limited to volatile, speculative finance capital flows and their impact on exchange rates, I, for one, would be happy.

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