

Slowing Down of the World Economy and Rising Challenges for India

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As we are at the start of yet another year, which happens to be the third year of the Covid-19 pandemic, the loss of lives stands at 5.5 million and the economic loss is estimated at around \$13.8 trillion.

The International Monetary Fund (IMF) in its updated World Economic Outlook (WEO) which was released on January 26, has a grim message: the global economy is entering 2022 in a weaker position than previously predicted. The earlier projections of growth rates for 2022 in the October 2021 WEO have now been revised downwards - except for India and Japan.

India's economy is projected to grow by 9% in fiscal year 2021, an upward revision from the previous 8.5%. For the coming fiscal year 2022-23, the same growth rate of 9% for India has been projected. The IMF's projections are based on expectations of higher investments and consumption due to credit growth and better financial sector performance. According to the latest WEO update, the upward revision is unrelated to the Covid-19 developments. On the other hand, there will be rising challenges for policy makers.

The world economy

The revised global economic growth rate in calendar year 2022 is going to be half a percentage point lower than predicted by the IMF in its WEO of October 2021. It would now be 4.4% - not 4.9%. The emergence of the new Omicron Covid-19 variant in December has done the damage. The slowing down of the economic growth is due to reimposed restrictions including lock-downs. Aside from the unabated virus spreading on one hand, though the new Omicron variant is now reported to be causing less severe illness than the previous Delta variant, we have new problems on the production front. They include rising energy prices, notably petroleum crude and supply disruptions. These new issues have resulted in higher and more broad-based inflation than anticipated in the advanced countries and in a large number of emerging economies of the world.

India is no exception. Consumer price index (CPI) and wholesale prices index (WPI) released in mid-January this year showed inflation in December, owing to steep rises in food and manufactured items, rose to a five-month high of 5.6% (on a year-to-year basis) and compared with 4.9% in the previous month. Price rise in December moved

closer to the upper limit of Reserve Bank of India's (RBI) 2% - 6% target. The obvious reason is the spread of the new Covid-19 variant. But there are other lurking challenges. The unwinding of cheap money policy liquidity in the United States and the risk of higher global crude oil prices could raise India's inflation. The January CPI and WPI data will be available in mid-February.

Worldwide growth decline

Downward revision in world output growth is because of downgrades for the United States (US) and China. The US, with no prospects of pushing the Senate stalled \$ 1.75- trillion, 'Build back better fiscal' package is now confronted with inflation, due to supply disruptions. China, the other growth engine of the world economy, is afflicted with continued retrenchment of the real estate sector and falling private consumption.

The US's growth forecast of October 2021 has been cut by 1.2 points to 4% and China's growth forecast has been reduced by 0.8 points to 4.8%. There are also cuts of 0.8 points for Germany and Canada, and 0.4 points for France and Italy. The 19 European countries in the Eurozone would grow only to 3.9% this year - down from 5.2% in 2021.

IMF updated Output Growth Rate: Estimate for 2021 and Projection for 2022

Year	2021 (Estimated %)	2022 (Projected %)
World Output	5.9	4.4
Advanced Economies	5	3.9
USA	5.6	4
Euro zone	5.2	3.9
Germany	2.7	3.8
France	6.7	3.5
Japan	1.6	3.3
UK	7.2	4.7
Emerging and Developing Economies in Asia	7.2	5.9
China	8.1	4.8
India	9	9
ASEAN	3.1	5.6



The new pandemic: inflation

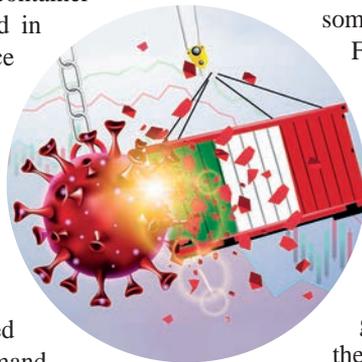
The IMF WEO update of January 2022 has raised forecasts for retail inflation. It would touch 3.9% in advanced economies, the highest since 1991 as against the 2.3% IMF forecast in October. For the developing and emerging economies, the forecast is 5.9% inflation in 2022 as against the October 2021 forecast of 4.9%. That will be the highest since 2011.

Aside from the usual petroleum crude prices going up in the midst of rising demand for energy as recovery is underway, there have been certain other unusual problems. These include shipping snarls dominated by shipping container shortage and a steep post-pandemic rebound in demand have left producers struggling to source components and raw materials. Shipping costs have soared; export prices and import prices went up. There were other supply-chain bottlenecks too: shortages of electronic chips and semi-conductors for industries created problems for the automobile sector.

Though there is optimism that supply/demand imbalances would decrease over this year based on expectations of improved supply as demand would gradually re-balance from goods to services and when the extraordinary cheap money policy support is withdrawn. Also, there is optimism that energy and food prices are expected to grow at more moderate rates in 2022 and inflation is expected to be anchored.

All forecasts are bristled with a good mixture of optimism when facts are to the contrary. Certainly, the US Federal Reserve, which in November last year dismissed the fear of inflation as transient, would no longer do so.

The US Fed is now fully aware that the US economy grew in 2021 at 5.7%, fastest since 1984, although it contracted by 3.4% in 2020, the biggest drop in 2020. The fourth quarter of 2021 growth was at a stunning annualised growth rate of 6.9%. Aware of the dangers of inflation, the Fed Chairman at the end of a recent policy meeting said, "The economy no longer needs sustained high levels of monetary policy. It will soon be appropriate to raise the policy rate."



The dictum Inflation is, always and everywhere, a monetary phenomenon put forward by Milton Friedman holds good for all seasons and for all, the low and the mighty!

Choices before India

India is now more globalised than it was in 2013. The taper tantrum of discontinuing quantitative easing by the US Fed in 2013 did not affect the Indian economy then. So, there is some brave talk. Since the foreign reserves are much higher today than ever before, India can withstand the outflow of the capital flows, especially the hot money variety; and the fear of depreciating rupee can be met with by downloading of country's dollars; and India can arrest the decline in the rupee. India's march towards recovery cannot be stopped; and India should not have to give up the easy money policy.

The brave talk can continue for a while. In fact, in the last few weeks, outflows of capital from India have caused concerns. Foreign portfolio investors (FPIs) have turned net sellers this fiscal year. They have been active to reduce their Indian equity and debt holdings over the last two months. After recording net inflows in August and September, foreign investors turned to be net sellers in October and November. Foreign fund outflows have intensified following the indications of discontinuance of cheap money policy in the US, as

some central banks raised their interest rates. The FPIs did more selling in December, as it already exceeded that of October and November. Till 22 December, foreign investors have pulled out more than \$3 billion dollars, bulk of which was in equities.

Experiences would indicate a symbolic rise (such as 0.25%) would be enough to convince FPIs that RBI is aware of the gravity of the situation and would monitor the developments. This would avoid any panic reactions at a late stage such as capital controls which

only dent the central bank's credibility, as history has taught knee-jerk reach actions would eventually scare away FPIs for a long time. In the meanwhile, we will have the budget for FY 2022-23, which has to ensure that macroeconomic fundamentals are kept intact and stability remains safe and secure. ■



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