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Outlook for economy still hazy

A key takeaway after half a decade since the Lehman crisis is that unconventional monetary policies have seemingly saved the global economy from the far worse outcomes of economic depression and a potential euro break-up. The central banks have been able to keep bond yields and volatility well under control.

However, the key challenge now is to find the right policy gear as one sees multi-speed recoveries across the globe. While the US is now on the path to sustainable recovery, the outlook for the euro area continues to remain gloomy. The road to euro area repair remains a long one and continues to be strewn with downside risks. On the other hand, Asia is experiencing greater divergence in growth drivers, with a clear shift away from China being the sole growth driver.

Balance sheet repair is progressing at very different speeds across the advanced economies. In the US, the bulk of the repair has been completed, with the only missing link now the public sector. This is likely to pave the way for sustainable recovery. On the other hand, the euro area continues to suffer deleveraging headwinds and only a very gradual recovery is in the pipeline.

While Japan will enjoy a boost from policy stimulus, large public sector debt would continue to pose a big challenge. As for China, their excess debt is in the corporate sector and local government funding vehicles which will act as a headwind to growth and all the more so as the US Fed starts to taper the QE.

While tapering is a certainty, timing and the extent continues to be in the realm of conjecture. Tapering will most likely start this month, though the quantum, to begin with, would be at the margin. However, what is important to note here is that ever since talk of tapering began, the soft under-belly of several emerging market economies stand exposed. The assumption that the EM economies will be able to shoulder the burden of global growth have taken some beating as growth slowed down, inflation rose, currencies plummeted and deficits increased.

The ensuing crisis period has also seen a surge in youth unemployment, especially in Europe. As per the ILO, The world is facing a worsening youth employment crisis. Seemingly, young people are now three times more likely to be unemployed than adults and almost 73 million youth worldwide are looking for work. To address this, countries need to undertake critical structural reforms, not only in labour markets but also product markets and education system.

As for the Indian economy, as it hurtles from one crisis to another, things are looking ominous. The 4.35 per cent GDP growth recorded during 1st quarter of the current financial year may yet turn out to be better than what has to come during the next quarter. When during 2004, the global growth was strong and the Indian economy was growing at a fast clip, we were all reminded that it was strong fundamentals of the Indian economy that was responsible for the enviable performance.

But now that the economy is floundering, the blame is sought to be deflected to external factors. Surely there's some grain of truth in this assertion. But that explains the problem only partially. Essentially, however, it is the evils of the past (read unrestrained spending on populist polices) that are coming back to haunt India.

What started off with partial implementation of the 6th pay commission recommendation, continued with farmer's debt waiver scheme, unprecedented hikes in MSP, MGNREGA and now the Food Security Bill. What to talk of the fetish for subsidies. Clearly India's fiscal position has been pummelled out of shape. The debilitating impact of such policies would have remained hidden had the economy continued to grow at a fast pace. But with the global economy struggling, the much-touted fundamental strength of the Indian economy stands exposed.

While India may not be in a crisis that was faced in 1991, things are not much better either. What is important is for India to be able to take hard policy decisions (which may not be politically palatable) to address the structural barriers to self-sustained economic growth. The problem is, unlike in 1991 when a brand new government came to power, 2013 sees India facing political instability with the government and the opposition parties not seeing eye to eye with regard to the policy imperatives that can help navigate the economy out of the crisis. What is more worrying is that even some of constituents of the ruling coalition parties seem to have differences in opinion on this issue.

Clearly for the world and for India, crucial structural reforms need to take place. If we continue to muddle through with the soft options, we will be confronted with a larger set of crises in the future.

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Views are those of the author