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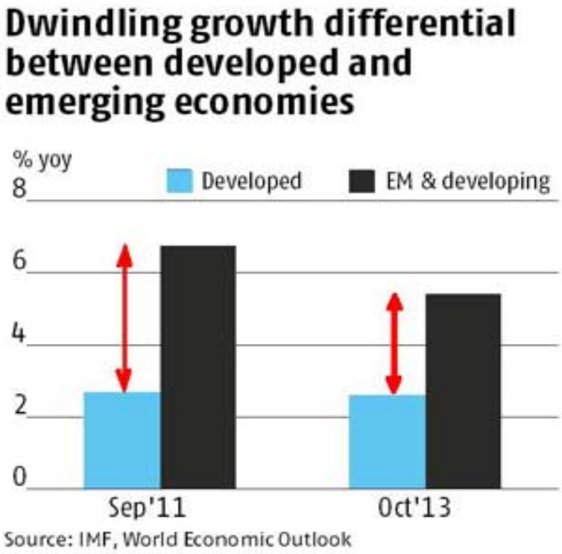
Kunal Kumar Kundu: A tough challenge

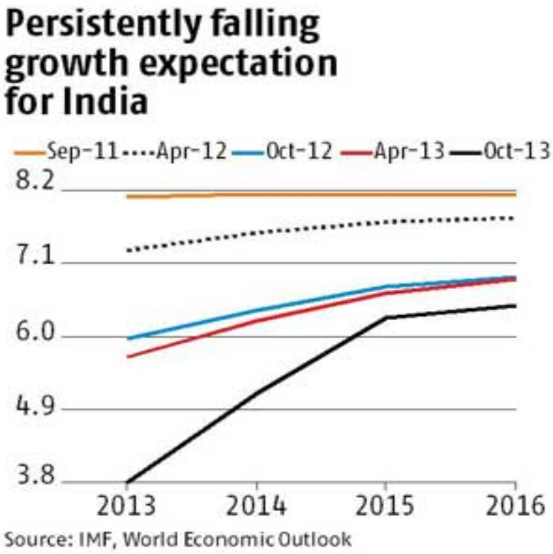
Emerging markets (EMs), which have for long been shouldering the burden of global economic growth, have seemingly hit a rough patch now and that's not good news since they matter more now to the global economythan before. The fact is, in 1994, emerging and developing economies made up 18 per cent of the nominal world gross domestic product (GDP). Today, that number is just short of 40 per cent. China's increase is the most notable, soaring from four per cent to 14 per cent. As a result, a broader EM crisis today would come with much greater ramifications for the global economy. Some of the main drivers of EM growth of the past decade (rising commodity prices, cheap labour, global growth and so on) are gone. Growth is structurally slowing down in many EMs since 2013. The gap between GDP growth in developed countries and emerging economies has been falling steadily. In fact, if one compares the International Monetary Fund (IMF)'s 2016 GDP growth estimate of developed economies and emerging market & developing economies made during September 2011 and October 2013, the expected growth differential between these two regions has come down significantly.

This is not a surprise since the emerging economies today show that several countries still suffer from the type of large imbalances and poor policy choices that drove past crises. Argentina, Venezuela, Chile, Peru, South Africa, Ukraine, Turkey and Thailand (with a combined share of four per cent of global GDP) are among the weakest links. Brazil, Indonesia and India also suffer external imbalances and are in need of significant structural reforms. These three economies alone account for six per cent of the world GDP.

EM growth will not benefit from the same drivers as in the past decade, and many EM economies are facing increasing structural challenges in their attempts to rebalance their economy at a time of tightening global financial conditions.

Within the EM world, India's challenge persists. Not surprisingly, IMF has been consistently revising downwards India's growth expectation with every subsequent release of its World Economic Outlook.





In fact, India's GDP growth during the current financial year will be lower than what was originally expected. The first advance estimate of India's FY14 GDP indicates a 4.9 per cent annualised growth rate, higher than the 4.5 per cent growth recorded a year earlier. The fact, however, remains that potentially higher growth for the current year can be attributed to the fairly sharp downward revision of the previous year's data.

As India's FY13 GDP growth rate was revised down from five per cent to 4.5 per cent, the base effect expectedly came into play when the first estimate of FY14 data was released. Hence, a 4.9 per cent growth rate. Although this is higher than the FY12 growth rate of 4.5 per cent, it is still lower than the government's expectation of five per cent. What is important to note here, however, is that the estimated growth rate for the current year would actually have been 4.4 per cent had the previous year's data not been revised downwards.

According to the advance estimate, India's nominal GDP (at market price) for FY14 would be 0.5 per cent lower than what was expected according to the Union Budget presented during February 2013. The shortfall would have been even higher had inflation not remained persistently elevated during the year.

During the first nine months of this year, central government's tax revenue was a mere 58.55 per cent of what has budgeted for the full year. With actual GDP for the year likely to be lower, lower revenue would mean higher fiscal deficit.

We believe that, within the EM basket, India continues to be among the most vulnerable countries when one takes into account indicators such as growth, inflation external vulnerability, forex vulnerability and fiscal condition. In an environment where tapering is a reality, India will need to compete with better positioned EM economies with regard to its ability to attract forex flows. Not surprisingly, Raghuram Rajan has been castigating the US for its decision to stick to tapering, unconcerned about the impact on the EM economies.

The author is vice-president and India economist, Societe Generale.
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