How Slow Can We Grow? World Economy in 2013

*Session One was chaired by **Tan Sri Dr Sulaiman Mahbob,** Board Member, ISIS Malaysia. The speakers were **Mr Mangal Goswami**, Deputy Director, International Monetary Fund (IMF), Singapore Regional Training Institute, **Professor Dato' Dr Woo Wing Thye**, Executive Director, Penang Institute, and **Dr David Fernandez**, Managing Director, JP Morgan, Singapore. **Dr Jorah Ramlan,** Senior Analyst at ISIS Malaysia, reports.*

Dr Woo Wing Thye introduced three aspects for growth opportunities in the wake of the recent re-election of the President of the United States and the change of leadership in China. He coined the terms: economic hardware, institutional software, and power supply requirements for these growth aspects.

For the US, there is a need to restore social mobility, enhance social protection, regulate Wall Street from exerting undue influence on government, and fixing the crumbling infrastructure, in particular airports and railroads. The demands of the people were overshadowed; the focus was on overcoming high unemployment by resorting to a quantitative easing (QE) policy to bring the US back to full capacity.

To further explain the US government's failure to tackle the unemployment issue, Woo went on to discuss the distribution of the global labour force for the period 1990 to 2000, a period that saw an increase in the number of people who were engaged in the international division of labour from 1.08 billion to 2.67 billion, an increase of more than 100 per cent. This contributed to globalization, and China's adoption of the market system in 1992.

Theoretically, an increase in the labour force will result in a decrease in wage rates. This however, was not the case for the US. The migration of jobs from high wage nations to low wage nations due to unequal income levels and globalization did not have an adverse effect on employment in the US. Low-skilled workers moved from the manufacturing to the construction and service sectors. While the economy appeared to retain its positive momentum, the situation was not sustainable. The solution would be to invest in re-training, improve the educational level of the labour force, and to create new jobs through the macro stimulus approach.

Woo Wing Thye

The role of China in the global economy is more complex. It is argued that China is facing

Mangal Goswami

the middle income trap. China's 'hardware failure' relates to losing control of the fiscal policy created by the strain of the 2008 financial crisis, leading to the crowding out of the private sector. The 'software failure' is in social instability caused by government incompetence, and corruption in the civil sector. The 'power supply failure' relates to protectionism due to environmental collapses, in particular the problem with water supply in areas outside Beijing, which constitutes a hindrance to economic development. In addition, the leadership is caught up with issues involving employment surplus, socio-political governance, and state-sector inefficiency.

Mr Mangal Goswami highlighted the IMF's forecast for global growth which was marked down to 3.3 per cent this year and 3.6 per cent in 2013. The forecast rested on two crucial policy assumptions: (1) that European policymakers get the Euro area crisis under control and (2) that US policymakers take action to tackle the 'fiscal cliff' and raise the debt ceiling.

Advanced economies are projected to grow by 1.3 per cent this year, compared with 1.6 per cent last year and 3.0 per cent in 2010, with public spending cutbacks and the still-weak financial system weighing on prospects. Monetary policy in advanced economies is expected to remain supportive as major central banks have recently launched new programmes to buy bonds and keep interest rates low to mitigate market and liquidity risks. The economic strain in the Euro area is expected to increase as the IMF is of the opinion that it is not possible to have a common currency area without risk-sharing principles, in particular, fiscal and financial risk-sharing.

Several economies are expected to see low but positive growth throughout 2012-13 while most economies are likely to suffer a sharp contraction in 2012, constrained by tight fiscal policies and financial conditions. The problem faced with Greece needs to be isolated from other EU countries for markets to respond positively to financial lending conditions and fiscal consolidation.

Emerging markets, although resilient, are not immune to an economic downturn. Growth in emerging markets and developing economies was marked down to 5.3 per cent, against 6.2 per cent last year. Leading emerging markets such as China, India, Russia, and Brazil will see slower growth. In developing Asia, the main driver will be China, where activity is expected to receive a boost from accelerated approval of public infrastructure projects.

The outlook for India is unusually uncertain for 2012 and real GDP growth is projected to be close to five per cent. However, improvements in external conditions, and confidence, helped by a variety of reforms announced very recently, are projected to raise real GDP growth to about six per cent in 2013.

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Fiscal adjustment due to rising public debt results in negative growth impact. It is argued that the 'impact,' which refers to the fiscal multiplier, is underestimated. Debt levels in advanced economies are higher compared to those in emerging markets. Lending consolidation is tight in advanced economies while fiscal consolidation has had a negative impact on growth as fiscal expansion turned to fiscal contraction. Real credit growth in emerging markets including Turkey, Brazil, India, and China, has slowed down. Downside risks are elevated due to the possibility of higher oil prices, a persistent housing problem in the US, and increasing economic stress in the EU zone.

The remedy suggested by the IMF is to remove immediate risks. For advanced economies, this refers to managing fiscal consolidation. In the US and in Japan, gradual and sustained fiscal consolidation needs to be anchored by a detailed medium-term plan. For growth contingency, there is a need for cyclically-adjusted targets, to let automatic stabilizers operate and, where there is room, to allow for a smooth medium-term adjustment. Advanced economies need to maintain an accommodative stance where monetary policy is concerned. For emerging markets, there is a need to rebuild fiscal consolidation and to provide room for monetary policy to manoeuvre over the medium term.

David Fernandez

While the IMF growth outlook focused on the medium-term and long-term issues, **Dr David Fernandez** spoke about near-term issues of the global economy, of emerging markets in Asia, and Malaysia. Businesses and investors are concerned with near-term (three months) stimulus activities. In this respect, global growth is expected to improve from mid-2012 onwards. Despite the optimism, there is caution in the wind for the business sector, policy makers, and investors who are heavily dependent on near-term actions and results.

Advanced economies need to maintain an accommodative stance where monetary policy is concerned

The manufacturing sector is said to bear the brunt of global weakness. There is a downward trend in global manufacturing and while finished goods inventories are high, output is low. This is crucial to many economies, in particular emerging markets in Asia that rely heavily on the manufacturing sector.

Real gross domestic product has declined since 2010 and is expected to flat-line throughout 2012. Growth in emerging markets in 2012 has been very disappointing. While GDP growth in China and India tends to be less volatile, the rest of the emerging markets in Asia are expected to be highly cyclical and sensitive to domestic demand. Despite fundamental economic factors, the real driver for growth in emerging markets is political influence, particularly the change in leadership in China, the Presidential election in Korea, and the general elections in Malaysia.

On the growth outlook for Malaysia, Woo is of the opinion that one of the challenges facing Malaysia is that of the rising expectations of the people. While Government policies are not improving, neither are they getting worse. It is the economic expectations of the people that have changed. According to Fernandez, the growth numbers for Malaysia in 2012 are not disappointing due to a favourable fiscal policy.

However, market expectation for the rate in 2013 is disappointing, at less than four per cent. This is due to the subdued global outlook and the drag in external issues. As opposed to Woo's opinion on the role of QE policy, Fernandez is supportive of QE and is of the opinion that it has contributed positively to the US and other economies, including Malaysia.

In conclusion, it appears that the outlook for the global economy in 2013 is quite gloomy but it is expected to improve later in the year. However, it is not the speed of growth that is important; it is sustaining the momentum of growth that should be of concern to most policy makers.

Despite fundamental economic factors, the real driver for growth in emerging markets is political influence

The growth rate is subjective and is based on the level of development of an economy. Under-developed and developing economies may experience a high and sustainable growth rate for a considerable period with appropriate policy tools, but they are highly susceptible to external events. Developed economies on the other hand commonly experience low growth rates and are less affected by external influence. Regardless of the development status of economies, it is important to achieve a sustainable growth rate to secure economic stability.

From left: Woo Wing Thye, Sulaiman Mahbob, Mangal Goswami and David Fernandez