

May 2014

## RECOVERY: NOT AS FAST AS EXPECTED

As compared to last year's grim prospects, the world is expected to recover only moderately in 2014-15. Despite having positive growth forecasts for the global economies, the Gross World Product is expected to grow at 2.8% in 2014 and 3.2% in 2015, according to a UN report.

It was earlier projected by the IMF that the world would recover at 3% in 2014 and 3.3% in 2015. However, a rising crisis in Ukraine, insecurity in Africa and harsh winters in the US has prompted revision this year.

## EMERGING ECONOMIES – NOT ALL BAD

Geopolitical risks originating from Ukraine and the indications of tapering from the US Federal Reserve were posing strong concerns to the emerging economies during the first quarter in 2014. However, these are not to be worried much about because of few reasons that are supportive of the overall global economy. They are:

- The recoveries of advanced economies has picked up.
- Concerns about China are going to be resolved by easing up the monetary policy, as indicated by the Chinese policymakers.
- Few political risks are gone. Stability in Turkey and Hungary has eased investor concerns. And the investors have cheered the result of elections due in India.

THE UKRAINE CRISIS HAS INFLUENCED INTERNATIONAL ECONOMICS AND TRADE TO A VERY SIGNIFICANT EXTENT ALREADY.



## ADVANCED ECONOMIES –THE PACE FACTOR

Advanced economies are expected to grow at 2.25% in 2014-15 with the US expected to be the top performer. Growth is expected to be positive across Europe, except for those with higher public debt, high financial fragmentation. Large output gaps have been contributing to low inflation in the EU; this has become a problem with all advanced economies today.

IMF suggests that advanced economies prevent premature withdrawal of monetary accommodations, as that may cause more harm than gain to the world.

## North America: Riding the recovery tide

*North America is on the recovery path with almost all analysts predicting positive growth. Except that the winters are again expected to slow the growth.*

- After slowing down in 2013, North America is expected to grow at 3.1% in 2014, according to D&B. The advanced economies are lingering under a significant stress and financial institutions are operating under tighter regulatory environment.
- The first quarter has shown stalled growth in the US, in May the economy's recession risk reduced significantly. Also, demand rise in China and recovery in Europe is expected to boost demand for US products and services and hence the US economy is further expected to revive better in 2014.
- The decision to withdraw quantitative easing by the fed is expected to affect the US economy negatively and could undermine the whole world's recovery. As even other countries are being proposed to reduce public debt and revive growth, the timing of such withdrawals has become key concern to the world.

The US has added over 288,000 jobs in April 2014, highest in 2 years - causing unemployment to fall to 6.3%.

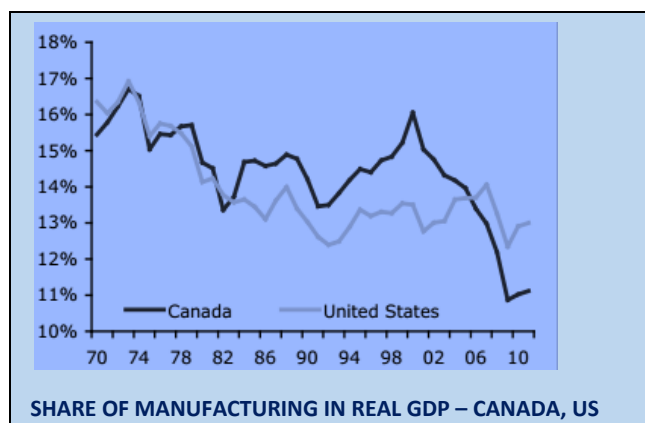
The US Fed has further reduced its bond purchasing by \$ 10 billion to keep interest rates low and stimulate economic activity.

Manufacturing recovery in Canada has been a concern - with manufacturing level still at 10% less than its pre-slump period.

Inflation has been falling and is currently lesser than 2% in the US. Deflation (negative inflation) can increase costs of debt and is a bigger concern today.

**"Risk...comes crashing back to our shores from overseas when a run starts in any part of a modern, global financial institution."**

**Gary Gensler, Chairman, CFTC**



## North America: Riding the recovery tide

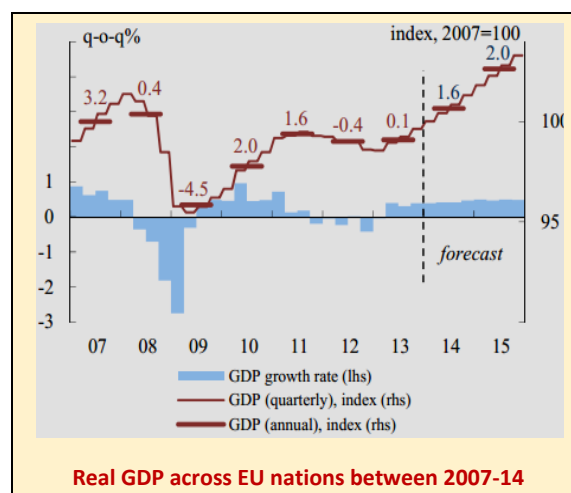
*With international demand picking up, growth engines across the globe have been kick started. The surge in demand which largely is a Keynesian thought has helped global economies and markets pick up.*

- The summer jobs program of Canada has helped create about 35,000 summer jobs for students and boost the economy. This is a part of the Youth Employment Strategy program and involved a spending of about \$ 330,000. The recently signed Canada – North Korea free trade agreement alone is expected to boost the economy by \$ 1.7 billion.
- The Economic Action Plan 14 (EAP 14) has been instrumental in easing the labor market by creating jobs and boosting the economy. The deficit has gone from over \$ 55 billion to about \$ 18 billion.
- However, the growth of Canada in the first quarter was predicted to grow at about 2% by Bank of America Merrill Lynch economists due to extreme weather predictions in the 2<sup>nd</sup> quarter onwards; stopping the consumer spending and infrastructure activities stalling economic growth until the harshness of the winters would be gone by.
- Expectations on inflation and thus economy have not been realized, which is not as low as expected by the Bank of Canada are proving to be positive factors.
- The labor force participation rate has dropped to 62.8% last month to a 36 year low and the reasons are two – retiring employees' withdrawal from labor force and the creation of new employment.
- The US economy is poised to grow strong this year; a few analysts predict that Canada grows at a higher growth rate than the US.
- However, the winter this year might be harsh to the economy even in the US and is expected to not allow the economy to grow faster.

## Europe – survival of the fittest

*Domestic as well as external demands are fuelling growth in Europe. However, the rise of euro-skepticism, the ideology that a political union will be harmful to the individual nation is gaining mass as the UK Independent Party has won the European Parliament elections in the end of May and is expected to affect the dynamics of Europe.*

- Domestic demand turnaround and a rising external demand are driving the European economy. However, low inflation, high unemployment, high debt, huge gaps in output, high financial fragmentation, low investments and rising geopolitical tensions are the down side aspects to the European economy.
- Although activity shrank by a half percentage point, growth has been positive since the second quarter of 2013, indicating that the economy is finally out of recession and has completely recovered.
- Growth optimism and reduced risk outlooks have reduced the sovereign bond spreads and have helped capital markets positively. However, policy has the same challenge remaining: low employment, low growth, high debt and low public & private balance sheets. This has raised concerns on the credibility of this recovery.
- The greatest challenge to the euro area still remains the same – the unevenness of the monetary union. Growth and positive economic outlook in countries like Germany and France has been affected by the low growth and economic outlooks of countries laden with low economic activity.
- Investments have grown asymmetrically across the EU despite improved CADs of member countries.



Pending bank reforms, financial fragmentation has been a hurdle for monetary transmission across Europe. While Germany continued to lead the EU with the highest growth forecast, Switzerland improved its outlook because of improved domestic demand and Sweden slowed due to a strong domestic currency, labor market weakness, although it is expected to recover well in 2014.

Growth in 2013 was driven by external demand across EU except in Turkey and Baltic countries, where growth was driven by private consumption.

Delayed recovery, rising geopolitical tensions, rising capital outflows and volatile capital markets continue to remain the downside risks to the European economy.

## Europe – survival of the fittest

*The United Kingdom Independent Party (UKIP) has won 43 out of UK's 73 seats in European Parliament to become the single largest party in contention. Believed to be anti-immigration and right wing of the parliament, this is expected to slow down the decision making in the European Union. French government has offered tax cuts to boost the economy after the ruling socialist party lost the election.*

- Primary concerns in the Euro area are with the current Ukraine crisis. The EU has been offered \$ 17.1 billion by the EU as a bailout package. The current Ukrainian crisis is far from over with Ukraine posing a threat of default and hence extensive bailout packages were imminent. In February alone, the hryvnia lost about a fifth of its value.
- With reforms already in place, the EU is ready to spend about EUR 350 billion between 2014-2020 in order to support SMEs fund research and development of various projects making it the biggest financing option for the region through the 6 year period.
- All the eyes are on the country specific recommendations that EU proposes to each member nation on June 2<sup>nd</sup>. The report is expected to make key policy prescriptions.
- With the UKIP and other right wing political parties winning the election to the European Parliament, which is seen as a wave against austerity measures imposed in the monetary union in Germany's interest.
- With the election of European Parliament and the ongoing Ukraine crisis, Europe is expected to slow down a little bit.



**Italian Prime Minister Enrico Letta warned that the rise of UKIP and other right winged political parties as the 'most dangerous phenomenon' facing the EU.**



## Asia – the revival of the growth wave

*Asia has been steadily recovering. After brief fallout from high growth curve, Asia has begun to revive itself because of increased international and domestic demands. The historic verdict in India's general elections last month has favored the right winged political party, whose economic ideology is pro-growth and pro-business. This is expected to boost business in India and revive the economy quickly besides reducing unemployment.*

Economic activity in Asia picked up in the second half of 2013 with demand for exports getting better from advanced economies. Despite having Japanese economy slowing down due to high energy imports and a surge in domestic demand, Asia is projected to recover well at 5.5% in 2014 by the IMF.

Although having concerns of weakening due to the tapering by the US Fed, Asia is projected to grow steady due to strengths in fundamental policies and enhanced demand in advanced economies in 2011.

China is expected to grow at 7.5% due to increased external demand and accommodative policy. Also, the government's reform blueprint is also affecting the market sentiment positively.

With fiscal policy weighing heavy on overall economy, Japan is expected to grow at 1.4% in 2014, lower than the Asian average.

China is expected to surpass the United States to become the world's largest economy this year. Previously thought to be happening in 2019, the global analysts now predict that China, powered by its manufacturing prowess will become the world's largest economy.

The Chinese and Japanese manufacturing has improved but has been continuing to contract. Due to surge in external demand, Chinese purchasing manufacturers have reported increased orders. The Chinese premier in a statement said that "it was acceptable to have economic growth below 7.5% as long as the job market held up."



**Thailand bonds advanced and stocks fell after the coup was announced this week.**

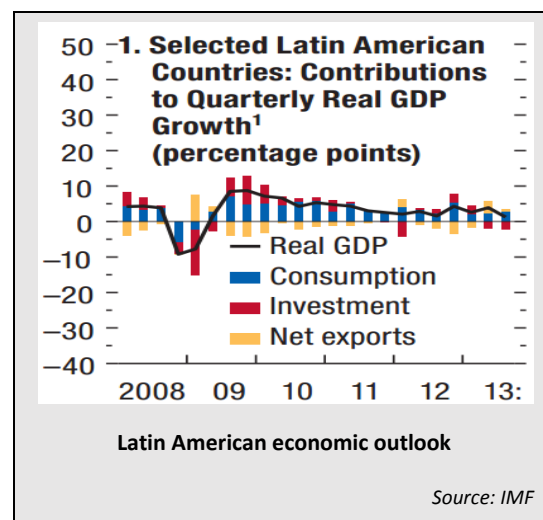


India has celebrated its historical verdict to induct the right wing political party into power after 10 years. Narendra Modi, the prime ministerial candidate of the party is a growth and business oriented administrator. The markets have been rallying ever since he was announced as the Prime ministerial candidate.

## Latin America – forlorn outlook

*Weak investments and low demand are expected to slow down the Latin American countries in 2014. Consumer spending is also expected to be weak and hence auto manufacturing, which has been a significant contributor to the economy, is expected to be low too.*

- The economic activity from Latin America is expected to be low for the year 2014. Spillover effects are expected on Latin America from a rather pacing global economy; however the problems of low prices, supply chain bottlenecks and tighter regulatory environments still remain.
- Latin America in 2013 grew at 2.75% growth rate. The growth has slowed down from the previous years. Weak investments and lower demand have caused the economy to slow down. For the year 2014 growth is expected to slow down to 2.50%.
- However, the bond and equity markets have been functioning with the same activity as they did a year ago, showing positive optimism for the economy.
- Growth in Mexico is expected to increase to 3% after it shocked the world with a growth rate of 1.1% in 2013. Headline inflation is expected to remain high but comfortable for monetary policy in 2014.
- Argentine industrial activity has contracted about 4.2% in May owing to high inflation and hence low consumer spending. This is because of a 20% fall in auto manufacturing. Argentina has successfully coped with its 2002-2003 crises and has grown diligently until the last year's 4<sup>th</sup> quarter. The economy grew at 3% last year and is looming with a risk for recession.





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