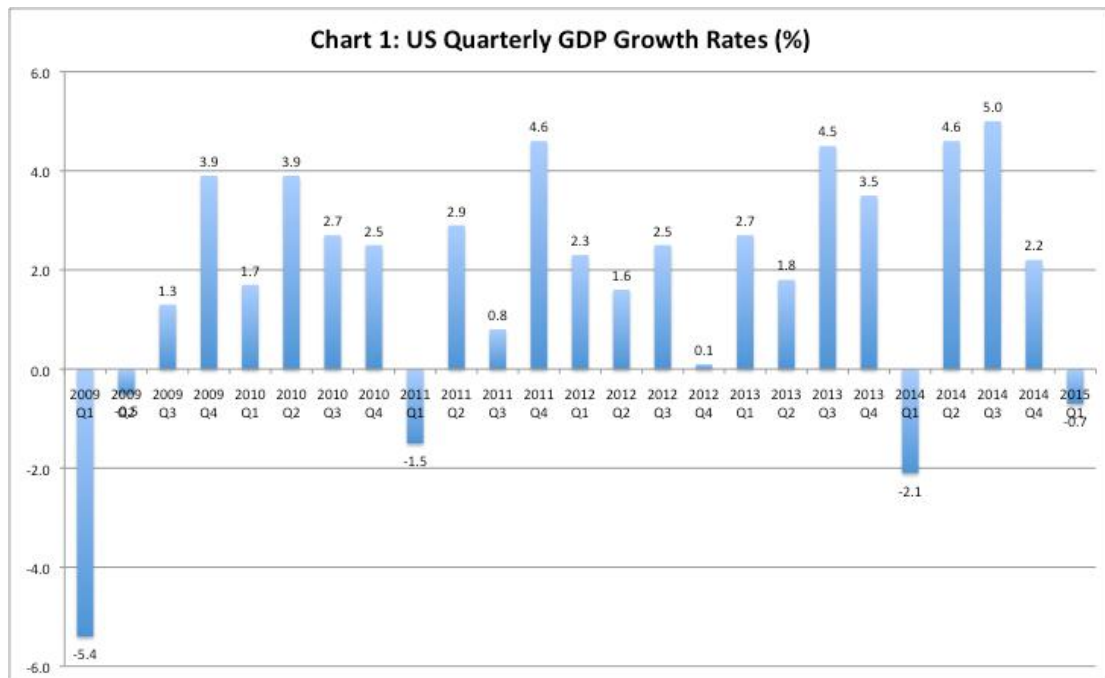


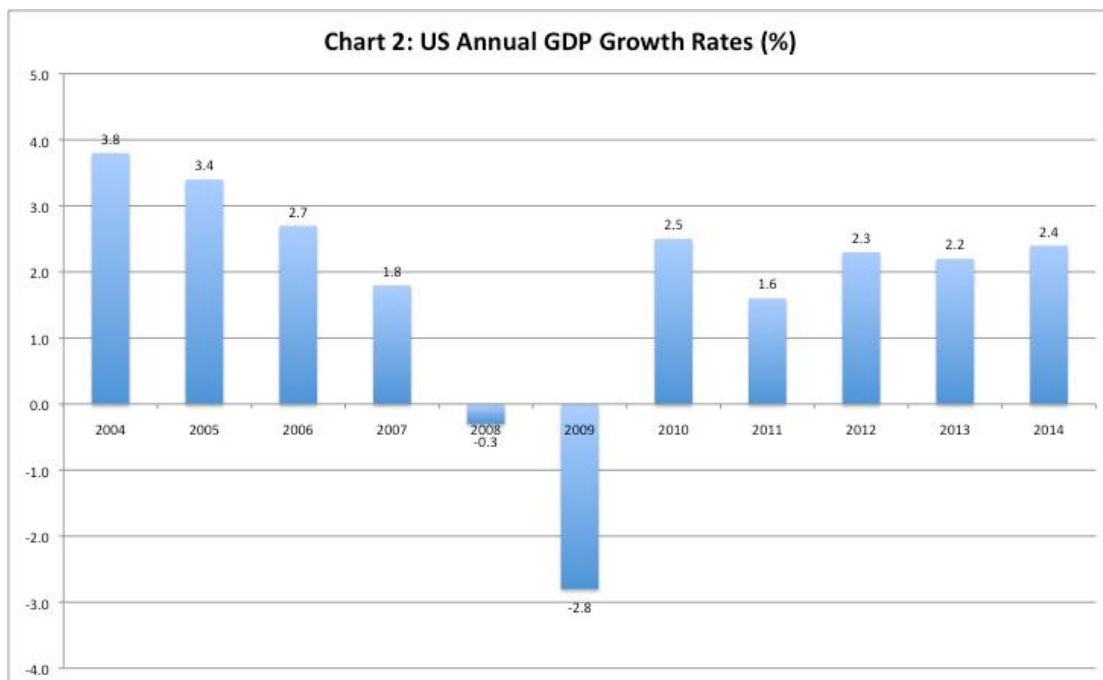
## Looking to the US\*

C.P. Chandrasekhar and Jayati Ghosh

All eyes are focused on the US economy and its performance. The explanations as to what motivates this are residual. With growth in China slowing, India's economic performance disappointing, Japan still in recession and the uncertainty in Europe resulting from EU brinkmanship with respect to Greece, growth in the US seems to be the only immediate hope for the long awaited recovery from the six years of sluggishness that have followed the 2009 crisis. So, only the US can help.



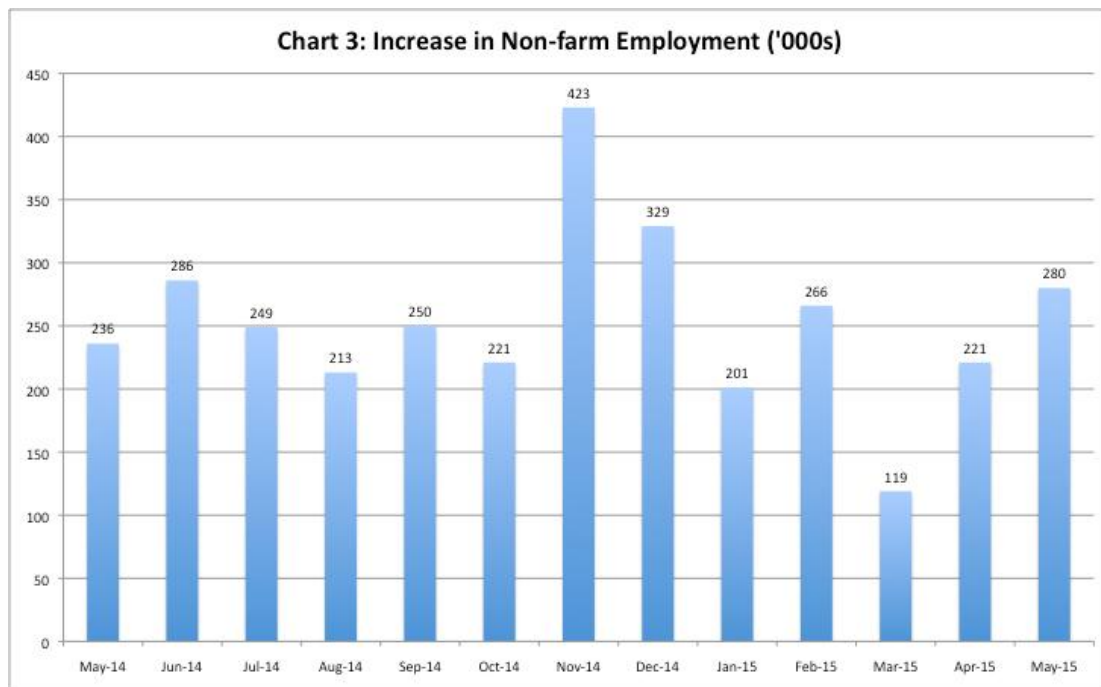
If that is true, May 2015 brought some disappointing news. US GDP figures for the first quarter of 2015 released that month pointed to a 0.7 per cent decline, as compared to positive growth rates of 2.2, 5.0 and 4.6 per cent in the three preceding quarters (Chart 1). That is, expectations till late last year that the US is on track to a robust recovery now seem overly optimistic. Remaining on its close to 2.5 per cent annual growth trajectory (Chart 2) (as opposed to 4 percent-plus in the second half of the 1990s) seems to be the immediate prospect. That is not merely inadequate in a context when the US is one of the few developed countries that are registering significantly positive growth, but also disappointing to those looking to the US to serve as the locomotive for global growth.



According to some, however, there are still grounds for optimism. One is the view that the factors responsible for driving down growth during the two quarters ending March 2015 were ‘temporary’ in nature. Prime among them are a fall in exports because of a strengthening of the US dollar vis-à-vis other currencies and worsened agricultural performance due to poor weather conditions. The first, of these can, of course be more permanent than expected. But, overall, argue the optimists, as happened in 2014, one or two quarters of poor growth could be followed by relatively high positive growth.

A more convincing reason for optimism is the evidence on employment gains. Figures for May 2015 show that non-farm jobs in the economy increased by 280,000, on top of an average growth of 250,000 a month in recent times (Chart 3). Moreover, the employment to population ratio in the economy touched 59.4 per cent, which is the highest it has reached after the crisis. But, this good news is not all too new. The US has been experiencing a prolonged phase of job growth, though this has been substantially in services and accompanied by low productivity gains. So there is no reason why one month’s employment numbers should be seen as more significant than another month’s GDP figure.

The principal problem in the United States, as elsewhere in the developed countries, is that even though household debt (relative to GDP) has come down from the peak levels it touched before the 2009 crisis, households are still highly leveraged and not willing to spend, and in many cases not able to access credit to spend. Moreover, the huge increase in public spending in the immediate aftermath of the crisis has substantially raised the public debt to GDP ratio. This is forcing the government to hold back on debt-financed spending, with the public-debt to GDP ratio tapering off in recent years. In the circumstances, with both household and government demand sluggish, there is little reason for the corporate sector to increase its investment and expenditure. Meanwhile, net exports, or the difference between exports and imports, is falling, because of a rise in imports prompted by a strong dollar and low productivity growth.



Thus, the optimism that growth would accelerate in the US and help pull the rest of the world economy out of a long period of sluggishness seems grounded on little more than an extrapolation that presumes that the hesitant recovery seen thus far would necessarily lead up to high growth rates. The reasons why that should occur are not all too clear.

The point is that even if such a transition does occur, this may not be all good for the so-called emerging market economies that have experienced a sharp increase in capital flows over the last few years. With signs that cheap money infused into the US economy in response to the crisis can prove damaging in the long run, the US Federal Reserve has announced that the policy of keeping interest rates low even after liquidity infusion has been tapered out has to change. The dominant view now is clear that the policy interest rate should be raised, ending a nine-year lull. The question is not whether it must be raised, but when.

If that occurs, capital flight from the emerging economies is more than likely, with adverse consequences for the financial sector and the currency. Moreover, emerging market corporates who borrowed heavily during the era of cheap and easy money are likely to be hit badly. Their balance sheets could be doubly damaged: first, by the higher interest burden they would have to bear; and, second, by the increase in their debt servicing burden in domestic currency terms, because of a depreciation of their local currencies vis-à-vis the dollar precipitated by capital exit.

The adverse impact that these developments can have on growth in the emerging markets, may neutralise the benefits for the world economy expected to come from whatever improvement in growth is seen in the US. Thus, even if all eyes are focused on the US in the six year-old search for the green shoots of recovery, the rationale for even that limited optimism is not so clear.

This scenario is of even greater relevance for India, where the government has placed all growth bets on the '[Make in India](#)' strategy, or the transformation of India into an export hub. Domestically, the concern seems to be the inadequacy of infrastructure

required to support that strategy, at a time when fiscal conservatism leaves the government with little money to spend on such projects. So the thrust is on finding measures of “reform” that would attract private investment into these sectors. Success here seems extremely improbable. But even if the improbable were to occur, the investments that would use that infrastructure to produce tradable commodities for export may not materialise. Why should they, when the markets to which those products can be exported are themselves stagnant?

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