
Arvind Subramanian explains why India, Brazil, and other emerging market economies feel they are the victims of US monetary policy switches.


Steve Weisman: About one week ahead of the G20 Summit in St. Petersburg, the world economy is in another unstable phase marked by, among other things, continuing problems in southern Europe, continuing uncertainty about the US budget confrontation that looms this fall, but especially because of the turmoil in the markets for leading emerging market countries, including Brazil and India.

Arvind Subramanian of the Peterson Institute is here with me, Steve Weisman, to take a look at all of these factors, but particularly the emerging market factors.

Arvind, let me ask first how serious is this instability in India and Brazil and also other countries like Turkey?

Arvind Subramanian: I think it’s reasonably serious for these countries domestically, Steve, because remember some of them are facing some serious structural problems, lower end problems. Brazil’s growth has ground to a halt and there’s been a lot of social unrest. India’s growth has really decelerated and the rupee is basically in free-fall. There are fears of a full threaded financial crisis. Similarly in Indonesia, the same combination of slowing growth, very high external imbalances, relatively high inflation.

So in a sense there are serious macroeconomic problems in these countries. The question is that do they amount to a lot in relative to the world economy? And there I think that’s less clear.

Steve Weisman: In other words do these troubles in the countries you mentioned and in some others, endanger the rest of the world economy? You’re saying perhaps not as much as some fear. Why would that be?

Arvind Subramanian: Well for one thing these economies are relatively small compared to a large economy. China for example, on a purchasing parity basis is a huge country and arguably bigger than the United States. So the big countries like China, the US, are kind of either reasonably steady as in China, some deceleration in growth, but still at about 7.5%. The US is recovering. Today’s data shows that growth was higher in the second quarter than previously believed. Europe is making a kind of recovery, albeit anemic.

So in a sense that the big countries in the world are recovering and it’s these countries that don’t—I mean India for example accounts for about 8% of the world economy, and countries like the US don’t export a lot to countries that are now in serious crisis, so-

Steve Weisman: Eight percent is that...?

Arvind Subramanian: India accounts for about, I would say, about 6% of the world economy.

Steve Weisman: I see. Well let’s talk about India in a bit. But first I want to ask you, to what extent, you mentioned earlier that these countries are experiencing problems because of
their own policies and difficulties, but isn’t it also true and isn’t some of the blame for their problems being made against the United States because of US monetary policy, especially the market reactions to the announcement by the Fed that they may begin, as they say, tapering their monetary stimulus in the next six months or a year?

Arvind Subramanian: You know, in some ways the US is damned if it raises interest rates, it’s damned if it lowers interest rates. Right? Because when QE was in full force, the complaint from emerging market countries was there was a tidal inflow of dollars into their economies because investors were looking for higher returns in emerging market countries. Now-

Steve Weisman: And that in turn …?

Arvind Subramanian: And that in turn led to very over valued currencies, over hitting high inflation, widening external deficits, which created its own set of problems and that was a stage when these countries were saying, including Brazil, was imposing capital controls-

Steve Weisman: Right.

Arvind Subramanian: -to prevent the money from coming in. Now it’s the reverse problem. Money is fleeing because, for two reasons, it’s not just the taper which is raising the attractiveness of holding US bonds and US fixed income assets, it’s also the US is recovering, so even in terms of growth prospects and therefore returns, it’s higher than it used to be.

So for both these reasons now, money is going to now, it already has, a lot of it has fled these emerging market countries and so this sudden outflow creates its own disruption. Currencies start declining. All the problems in the financial system start reappearing, so you have those problems. So in that sense, I think what is fair to say is that the trigger for the current thing is related to US actions because let’s face it, I think what this shows is that the US is still the center of the world. If it changes its policies, it’s the financial center of the world, so if it changes its policies, capital is going to be influenced in terms of where it’s setting.

So the trigger perhaps is being caused by US actions, but fundamentals are brought upon by these countries themselves and in many of these emerging market countries, the fundamentals look very dicey and that’s what’s kind of really aggravated the problem.

Steve Weisman: Now the G20 of course are the 20 leading economies. Several of these countries that we’ve been discussing will be represented in St. Petersburg and obviously, the host, Russia, is considered in a way an emerging market country and it’s having its own problems. To what degree do we look to the G20 to hash these things through or is it just too unstable for them to reach a consensus?

Arvind Subramanian: Yes I think it’s still a very useful forum for all these problems of “cooperation and coordination” to get discussed and sorted out. But the problem is that countries primarily are looking after their own interests and are not willing to maybe take some actions which could in the short term hurt them for the sake of others or the for the sake of the global economy. So cooperation is kind of a much maligned word because it’s very difficult to achieve. But I think they have to try. We have no options as an interdependent world and the US has, I think, special responsibilities as the ‘Big Boy’ in this club, so they have to try. Whether they’ll succeed, your right, one can’t be too optimistic.

Steve Weisman: Arvind, let’s stop there and in part two of this conversation we’re going to focus in on Indiá’s, in particular, problems.