

Outlook for Emerging Asia and India

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My presentation is to talk about the outlook for emerging Asia with a focus on India at the end. Ken Rogoff recently quoted the great Robert Frost lines, “Some say the world will end in fire, some in ice.” And he said this to highlight or contrast the differing approaches of the United States and the European Union to current problems. But if you look across Asia today and the choice of the two Armageddons offered by Frost, if you had to choose one of them, it seems to be the case that the Asian policymakers are very much concerned about the world ending in fire—the inflationary blazed Armageddon—because inflation has become not just a pressing problem but arguably even the dominant concern for policymakers across Asia. And indeed today’s and yesterday’s *Financial Times* reflect this concern. So, on the back of surging world prices of commodities, especially food, headline inflation has ticked up across the region. Just to give you a sense of what the recent numbers are: China’s inflation rate is 8.7 percent; India, close to 7 percent; Indonesia, 8 percent; and Singapore, 6.5 percent. These numbers may well be temporary. They’re certainly not core rates of inflation, but these are the attention-grabbing numbers, and in almost every case—indeed in every case—they exceed the targets that policymakers have implicitly or explicitly set for themselves. So this is a serious problem for policymakers, and in large part, this is a problem because it’s well above comfort levels, especially since food is involved and food still accounts for about 25 percent to 50 percent of the consumption basket all across Asia. So consistent with that, I think we can expect average annual inflation to be substantially higher than what it was last year.

Policymakers have responded in two ways: one very strong and one less strong. The strongest policy response has been what I call reverse mercantilism. If mercantilism is the view that exports are good and imports are bad, what we’re seeing is exactly the opposite: Exports of agricultural commodities are bad and imports are very good. What you see across the board is a spate of actions to restrict exports and liberalize imports. One could go on about what different countries are doing in this sector: India banned exports of rice and slashed its duties of agricultural commodities, and Indonesia and Korea have done the same. But I’d like to make two points about this response. First, this kind of response is not just confined to Asia, but is actually happening across the emerging world—Argentina, Russia, Kazakhstan, Egypt, Saudi Arabia are all doing something very similar. One can call this the revenge of the anti-mercantilist, at least as far as the food sector is concerned.

But there is a second comment I’d like to make on this, which is that it’s really ironic and somewhat surprising that whereas the Doha Round has been struggling with agricultural tariff cuts for and countless negotiating hours have been spent on this, in speed, scope, and size, the cuts that have been done in the last, say, two weeks, have vastly exceeded anything that Doha was even contemplating. Indeed I would say that these cuts would probably only have been accomplished in

some future round—maybe the Maltese Round of 2025 could have done something similar to what’s happened very recently in the emerging market world.

The second kind of policy response is macroeconomic, but it’s fair to say that there has been either modest or actually very little tightening of macroeconomic policies. Some of the policy response has taken more the form of inaction. For example, India and Indonesia didn’t cut interest rates in response to aggressive US monetary easing. China has increased its reserve requirements for the banking system, and it’s fair to say that one can see nascent signs of a greater willingness to appreciate the exchange rate in parts of the emerging world, although I’m told that in the case of China, one needs a kind of microscope to detect this greater willingness to allow the exchange rate to appreciate.

What does it all mean for growth? As Michael Mussa has projected, emerging Asia’s growth will slow from close to 9 percent in 2007 to 8 percent or slightly less in 2008. But my own view is that the risks are very much weighted on the downside because of three factors. One—Mike alluded to this in the case of the Caribbean countries—a number of emerging market countries in Asia—Korea, Malaysia, and especially Singapore and Hong Kong—are highly exposed to trade and even to the US market. The share of trade in goods and services or exports to GDP is pretty substantial across Asia, with India being a kind of exception to this rule.

Second, there are the financial linkages. Morris Goldstein was quite right when he said that emerging market spreads have not gone up very much. They’ve gone up a little bit, but what is true is that captive flows and cheap finance, which had been sustaining growth recently in emerging Asia, have declined. Debt issuance, IPOs, and even bond issuance have come down in large parts of emerging Asia. So on that score, too, one could expect some downside risk to growth as a result. But above all, it’s the uptake and inflation, which I spoke about earlier, that leaves much less room for maneuver in sustaining higher levels of domestic demand across Asia. So for all these reasons, my own view would be that the risks to Asian growth are very much on the downside, and that 8 percent, one might be underestimating the growth prospects for Asia.

A quick word about India before I close. India has had very rapid rates of growth for the last five years and well above 8 1/2 percent to 9 percent, and now that’s going to slow down to the kind of median forecast of about 8 percent or less. But of course there is absolute alarm in India about inflation as a result of the recent number of 7 percent, which is up from about 3 1/2 percent a few months ago. There was an emergency meeting of the Cabinet on Monday, which immediately announced a raft of measures. There is a kind of iron law of electoral politics in India, which goes something like this: For every one percentage point that inflation exceeds 5 percent, you lose about 5 percent of the voting constituency. And exactly ten years ago—and this is absolutely true—exactly ten years ago, a ruling government lost elections because the price of onions was too high, which tells you how important the electoral concern over inflation is. That is why one is beginning to see some tendency to allow the exchange rate to appreciate, some possible monetary tightening. In fact, the finance minister was very explicit when he said the government is considering sacrificing a bit of growth to contain inflation. So, again, my forecast for India would be that the 8 percent is very much a central forecast with all the risk on the downside, and one could see much less growth closer to 7 1/2 or 8 percent.

A final thought I want to leave you with is that I have said a great deal of liberalization in the food sector had been achieved as a result of what’s been going on. What I was going to say was that

there is no amount of protectionism that a strong dose of inflation or inflation scale cannot cure, and that's been happening around the world. But that's only half of the story, because we're seeing import liberalization on the one hand, and food stuffs accompanied by export protectionism on the other side. I call this reverse mercantilism, but then everyone is doing this, so there is a kind of competitive reverse mercantilism that's going on across the world in the food sector in regard to trade policy. Of course, each country's action to do this is individually understandable because of food security concerns, but if you put it all together and add it up, there is a sense in which these individually collective actions are collectively not so rational because everyone is restricting net supply. So there is going to be a tendency for world food prices to actually go up. It seems to me that this is a classic case where one needs a multilateral trade policy response to prevent policy-induced actions to put further pressures to counter the problem that's risen in the first place. So I would make a strong case for the Doha Round actually having done brilliantly well in bringing down import tariffs to actually take upon itself the task of actually regulating export restrictions. Then, the Doha Development Agenda could really be a development round rather than what...it is at the moment: a non-development, non-round.