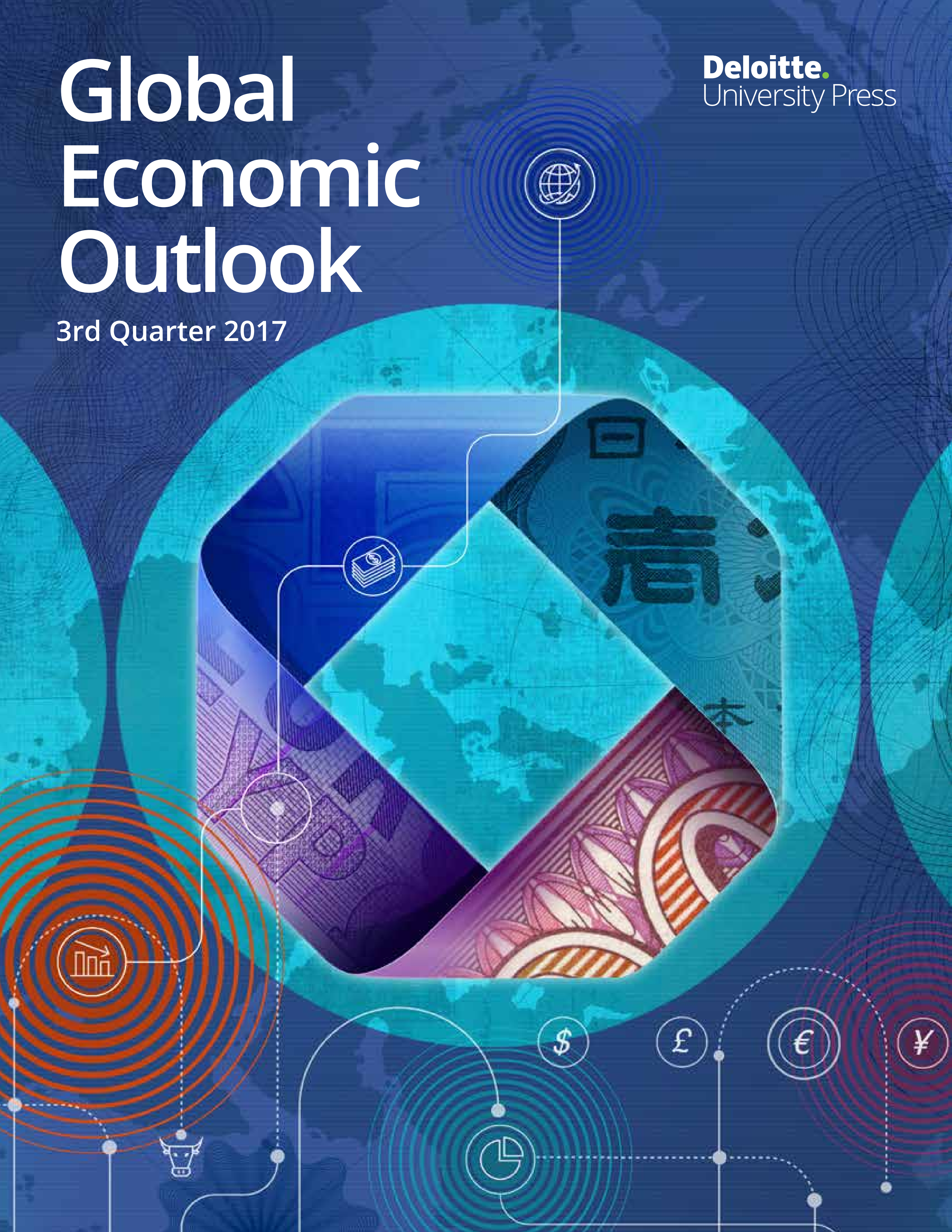
Global Economic Outlook
3rd Quarter 2017
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Introduction

By Ira Kalish

AT a time when the global economy appears to be accelerating, the two leading economies of the English-speaking world are not participating. The UK economy is evidently slowing, while the US economy simply continues to grow at a modest pace—albeit in the context of full employment. Likewise, the Chinese economy is also stabilizing at a moderate rate of growth. Meanwhile, the Eurozone and Japan show signs of acceleration, as do many of the major emerging economies such as Turkey and Russia, both of which are discussed in this report. One exception is India, which shows signs of slowing. Yet the overall trend is positive. Indeed, the central banks of most of the major developed economies are either starting to normalize monetary policy or are thinking about it. Perhaps the most significant threat to the health of the global economy is the specter of protectionism. In this edition of Deloitte's *Global Economic Outlook*, all of these countries and issues are examined.

We begin with Patricia Buckley's discussion of the US economy. She notes the demographic constraints on growth, not only influencing the supply side of the economy but also hurting the growth of domestic demand. Weakness in exports, emanating from a strong US dollar, has also suppressed growth. Patricia expects, however, that the dollar will not rise any further and may decline, possibly leading to an improvement in exports. Finally, she says that significant uncertainty about the future of policy means that it is fruitless to speculate on the potential impact of policy changes.

Next, I examine the economic situation in China. There economic growth has stabilized, while foreign currency reserves have started to rebound as capital controls have helped to stabilize the currency. However, the rising volume of debt has created a greater perception of risk, leading to the downgrading of the country's sovereign debt. Meanwhile, the possibility that China could obtain market-economy status threatens to boost trade tensions between China and the United States.

In his article on the Eurozone, Alexander Börsch notes that the region has hit a sweet spot, with accelerating economic growth, rising employment, and diminishing political risk following favorable election results in France and elsewhere. However, he also notes that other risks remain, including upcoming elections in Italy and Austria, as well as the potential fallout from the Brexit process. By country, Alexander says that Spain's situation is "dynamic," Germany's is "rosy," and the recoveries in France and Italy are "moderate, but gaining momentum."

India is the subject of our next article by Rumki Majumdar. She notes that there were signs of slowing economic activity even before the controversial demonetization. Although she says that there may be some short-term negative effects from the imple-

mentation of the goods and services tax (GST), over the long term, it could generate faster economic growth. She says that "the new tax regime is expected to improve the ease of doing business," thereby boosting growth.

In our next article, I look at the economic situation in Japan. The economy is accelerating, as evidenced by a variety of economic indicators. Moreover, the International Monetary Fund now says that the economic policy mix in recent years has been a success. Plus, despite the shelving of the Trans-Pacific Partnership, the government is actively seeking opportunities to expand trade, having just reached an agreement with the European Union to ease trade barriers. On the other hand, onerous demographics continue to suppress growth and create budgetary challenges.

Ian Stewart then offers his take on the British economy. He discusses how the sharp drop in the British pound following the Brexit referendum has boosted inflation and suppressed consumer spending growth. Moreover, uncertainty following the recent election means that the Brexit process will likely render a hard exit. On the other hand, Ian says that there are some mitigating factors that should help the British economy. A cheaper pound and an accelerating global economy are likely to boost exports, inflationary pressures could ultimately ease once

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the currency impact tapers off, and fiscal and monetary stimulus could helpfully increase.

Next, Lester Gunnion examines the Russian economy. He discusses the rebound in growth. In addition, he looks at the Russian government's policy of import substitution, meant to boost domestic production in the non-energy sector. While it might have short-term benefits, it is fraught with risk. Lester notes that "import substitution leads to the transfer of resources from efficient sectors of the economy that function competitively without protectionism to inefficient protected sectors of the economy." Lester also discusses Russia's difficulty in obtaining funding from the West given the sanctions regime, and its decision to pivot to China.

In our next article, Akrur Barua discusses the turnaround in Turkey's economy. He says that this is driven by more political certainty, fiscal stimulus, stronger demand for Turkish exports, a return of tourists, and strong household spending. On the other hand, he notes that investment remains weak, thereby boding poorly for future gains in productivity. He also discusses the risks Turkey faces due to inflation and a large current account deficit.

Finally, in our last article, Rumki Majumdar examines the slowdown in the growth of trade and the rising sentiment against trade liberalization. She reviews the recent evolution of trade policy in major economies and the behavior of trade between major countries. And, although she notes the costs of globalization, she says that a move away from globalization carries greater costs and few benefits. She discusses how policy ought to involve further trade liberalization along with a greater effort to address the concerns of those sidelined by globalization.

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Chief global economist of
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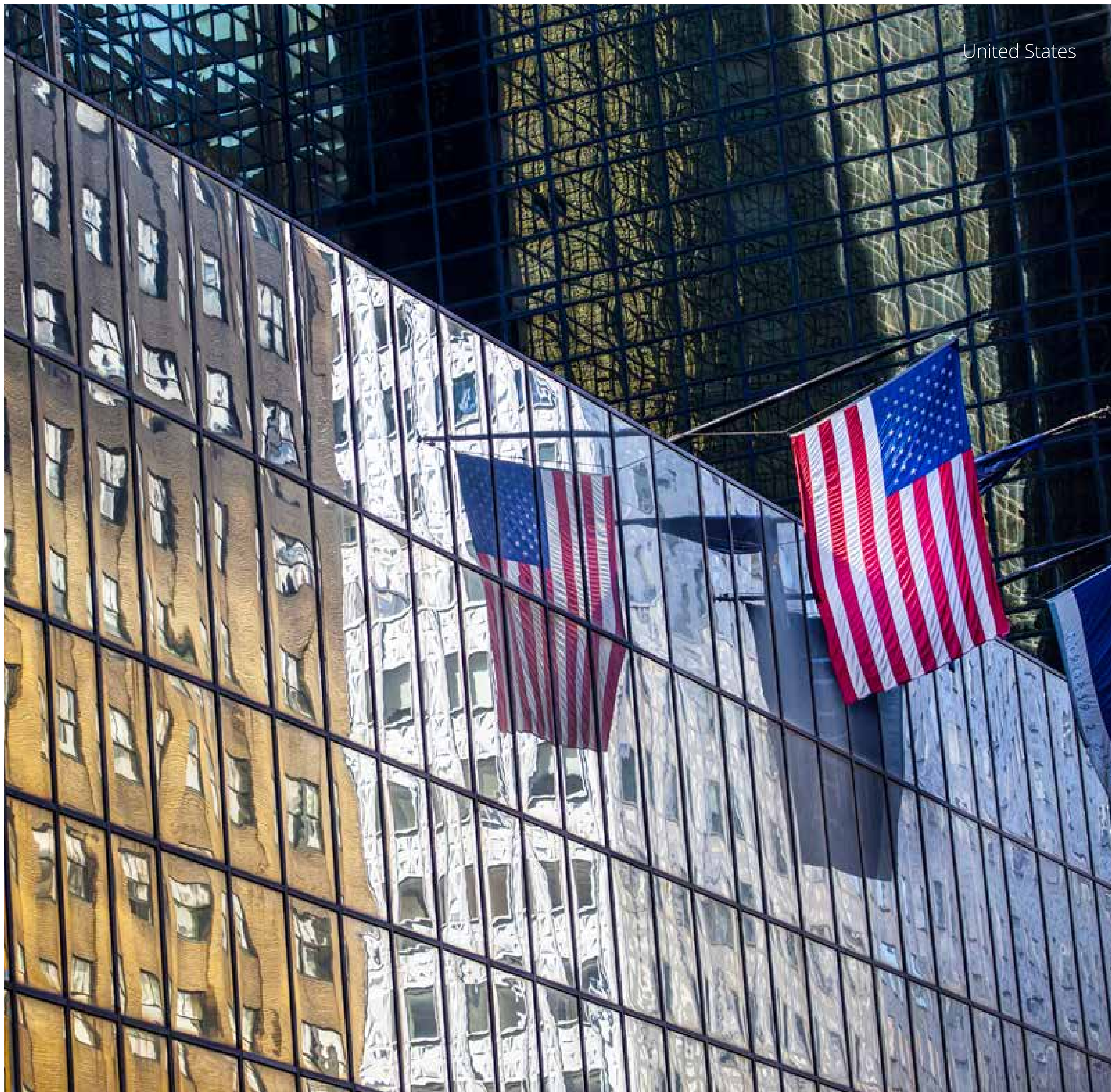
With the policy status quo, 2017 looks a lot like prior years

By Patricia Buckley

Introduction

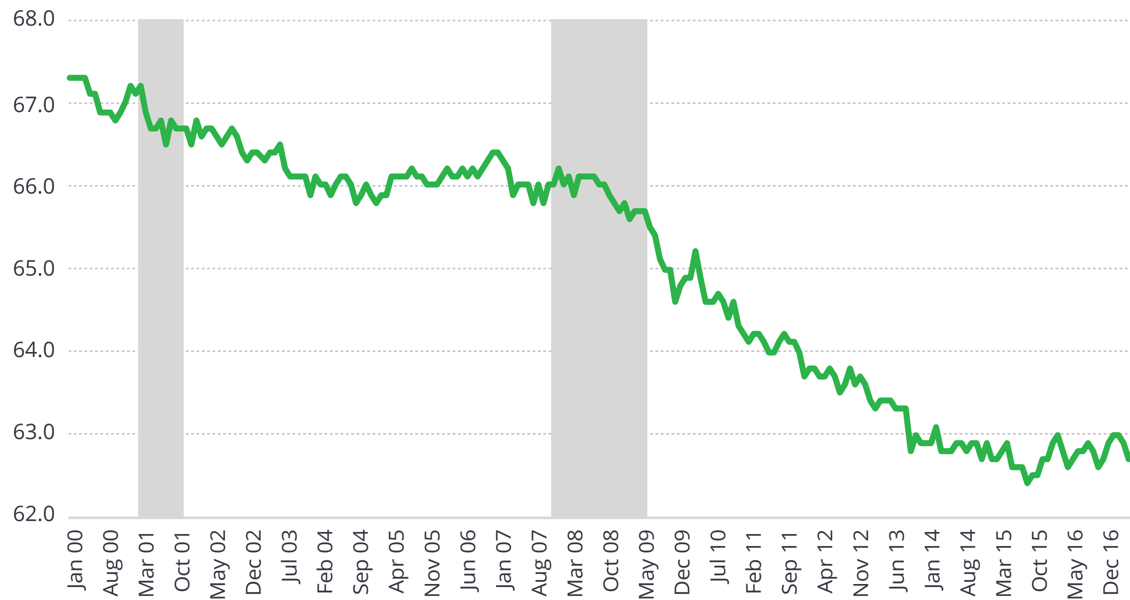
Growth in the first half of 2017 is currently estimated to be 1.0 percent, just below the average rate of growth seen over the last five years (2.2 percent).[1] Concurrently, the labor market continues to strengthen, with the average pace of job growth over the first six months of 2017 only slightly lower than last year's pace (on average 180,000 jobs per month in 2017 compared with 187,000 for all of 2016) and the unemployment rate hovering at very low levels (4.4 percent in June).[2] Even one of the areas of greatest concern, the labor force participation rate, has stabilized.

As the recession began in December 2007, the labor force participation rate began a decline that continued long after the official conclusion of the recession in June 2009 (figure 1). However, after reaching a low of 62.4 percent in September 2015—a rate not seen in almost 40 years—the labor force participation rate rose slightly and has averaged 62.7 percent over the last 24 months. While a decline from approximately 66 percent before the recession to just under 63 percent currently may not appear on the surface to be that large, each 0.1 percentage point change to the labor force participation rate represents around 250,000 potential workers, given the current size of the population.[3]



Even one of the areas of greatest concern, the labor force participation rate, has stabilized.

Figure 1. Labor force participation rate



Source: Bureau of Labor Statistics.

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Table 1. Labor force participation by age and sex, 2007 and 2017

	Both		Male		Female	
	2007	2017	2007	2017	2007	2017
Total	66.0%	62.8%	73.2%	69.0%	59.3%	57.0%
16–19	41.3%	35.9%	41.1%	35.5%	41.5%	36.4%
20–24	74.4%	70.6%	78.7%	74.0%	70.1%	68.5%
25–54	83.0%	81.6%	90.9%	88.6%	75.4%	74.8%
55–64	63.8%	64.4%	69.6%	70.4%	58.3%	58.9%
65 and over	16.0%	19.2%	20.5%	23.9%	12.6%	15.9%

Source: Bureau of Labor Statistics, current population survey.

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The decline in the participation rates of the younger groups is positive news because it has been coupled with increases in high school and college participation and completion.

A changed labor force

Part of the labor force decline is due to an aging of the workforce. When calculating the labor force rate, there is a lower age limit of 16 years for the denominator (civilian population), but there is no upper limit. However, as shown in table 1, the decline in overall labor force participation is not just a story of an aging population; labor force participation has declined among the lower-age cohorts and the largest group, the prime-age workforce (ages 25–54). The declines are evident for both males and females.

The decline in the participation rates of the younger groups is positive news because it has been coupled with increases in high school and college participation and completion. In the 2006–07 academic year, the average freshman high school graduation rate was 73.9 percent. By the 2013–14 academic year (the latest available data), that proportion had risen to 81.9 percent.[4] Further, the proportion of recent high school graduates, defined as individuals aged 16 to 24 who graduated from high school or received an equivalent certificate, currently enrolled in two- or four-year colleges increased from 67.2 percent in 2007 to 69.2 percent in 2015.[5] However, for some of those young people who have entered the labor force, the news is not good. The unemployment rate for 16- to 19-year-olds is currently 13.3 percent, and the unemployment rate for 20- to 24-year-olds is 7.3 percent.[6]

The decline in the participation among the 24- to 54-year-olds could be more problematic, because this is when people should be accumulating assets to fund their retirements. Estimates show that Americans, in general, are not saving enough for retirement. For example, the Federal Reserve Board's Survey of Consumer Finance found that in 2007, only 65.4 percent of households headed by someone in the 45 to 54 age range had at least one retirement account, and that the median value of the retirement accounts for those who did have accounts was only $63,000. By 2013 (the latest data available), the proportion of 45- to 54-year-olds with a retirement account had dropped to 56.5 percent, although the median value of these accounts for those who had one rose to $87,200.[7]

Employment trends for the two oldest cohorts shown in table 1 show a different trend: Participation in these two groups has been rising, with the increases being particularly pronounced in the 65 and older group. The reasons for this trend is likely a combination of a growing number of healthy individuals who want to keep working and a lack of retirement resources, which puts complete retirement out of the reach of many.

The net result of these shifts in participation and changes in the underlying age demographics of the US economy is a workforce that is older. Currently, 17.0 percent of those employed are between the ages of 55 and 64, up from 13.8 percent just 20 years ago;

Table 2. Labor force by age and sex, 2007 and 2017

	Both		Male		Female	
	2007	**2017**	**2007**	**2017**	**2007**	**2017**
16–19	4.0%	3.5%	3.7%	3.1%	4.4%	3.9%
20–24	9.6%	9.1%	9.4%	8.9%	9.7%	9.4%
25–54	68.8%	64.4%	69.4%	64.8%	68.0%	64.0%
55–64	13.8%	17.0%	13.5%	17.0%	14.1%	17.0%
65 and over	3.8%	6.0%	3.9%	6.2%	3.7%	5.7%
	100%	100%	100%	100%	100%	100%

Source: Bureau of Labor Statistics, current population survey.

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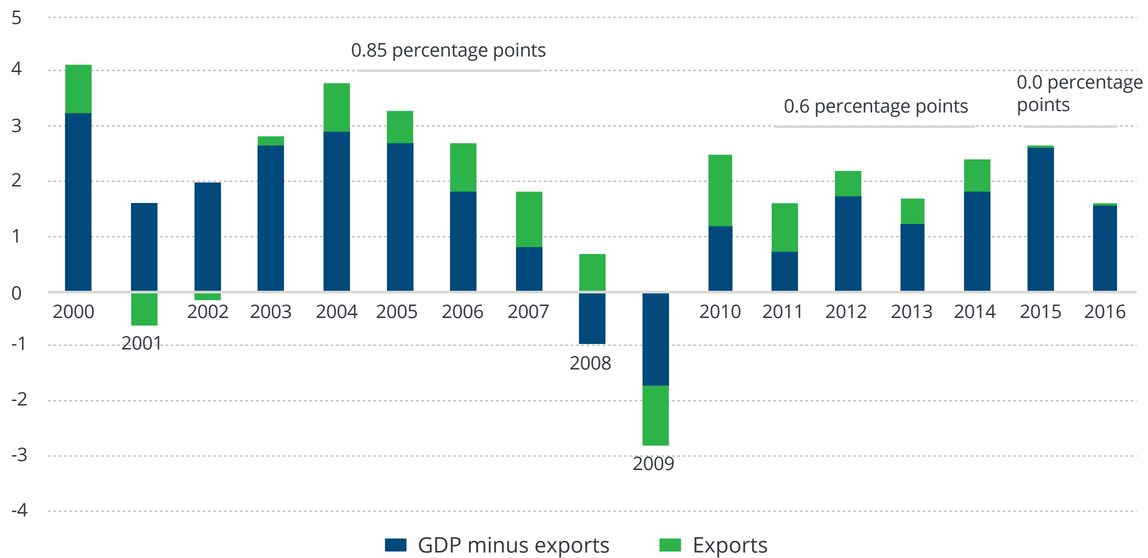
Figure 2. Exports contribution to GDP, 2000 to 2016



Source: Bureau of Economic Analysis.

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and 6.0 percent are age 65 and older, up from 3.8 percent over the same period (table 2). These differences are similar across the sexes and are projected to increase in the future.[8]

Missing growth factor: Exports

An outcome of the lower labor force participation of the 25- to 54-year-old cohort, in particular, is likely to be slower growth in personal consumption expenditure. The extra investment that the younger two groups are making in education will provide some offset, but an aging population with reduced retirement income expectations will definitely create a headwind going forward. So where might the United States look for growth? One possibility is exports.

During the latter part of the last recovery, exports provided a substantial boost to US GDP. Even after the current recovery finally took hold in a meaningful way, the contribution of exports was lower, before dropping away to almost nothing. As shown in figure 2, exports contributed 0.85 percentage points to GDP during the last years of the 2001 recession's recovery period. As the economy began to normalize post the Great Recession, the contribution from exports dropped to 0.6 percentage points (2011 to 2014). During the two most recent years, 2015 and 2016, exports contribution was near zero.

Suppressing growth in US exports have been slow world growth and the high value of the US dollar. Fortunately, we are seeing some improvement on both fronts. Figure 3 shows that world growth during the current recovery has been not only subdued but, in fact, deteriorating. However, according

Figure 3. World GDP growth

Source: International Monetary Fund, World Economic Outlook database, April 2017.

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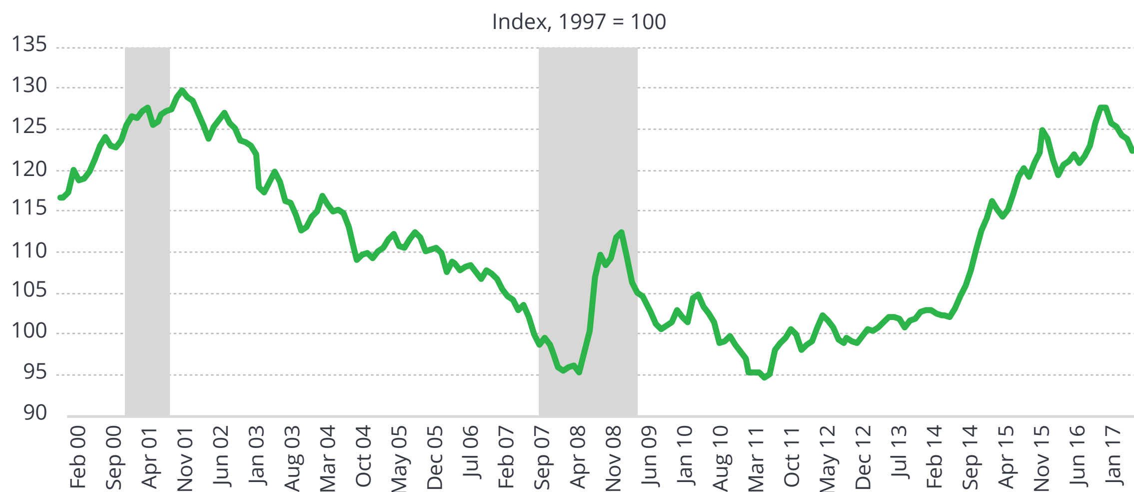
> Exporters will be at least somewhat cheered that their competitiveness on the world stage is not getting worse.

to the International Monetary Fund's most recent projections, "Global economic activity is picking up, with a long-awaited cyclical recovery in investment, manufacturing, and trade. World growth is expected to rise from 3.1 percent in 2016 to 3.5 percent in 2017 and 3.6 percent in 2018."[9]

The trade-weighted value of the US dollar has also backed away from its recent highs. While still at very high levels, it is trending down from its most recent peak in December 2016 (figure 4). Exporters will be at least somewhat cheered that their competitiveness on the world stage is not getting worse.

As we wait to see if stronger world growth materializes and what will happen to future demand for dollars, there are several policy discussions underway in Washington that could have a material effect on either or both of these situations. However, until details are developed and agreed upon around taxes, trade, and budget (to name just a few of the possible policy changes that could occur), we are not at a point where it would be useful even to speculate on how the US economy might be impacted.

Figure 4. Trade-weighted value of the US dollar



Source: Board of Governors of the Federal Reserve System via FRED.

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1. Bureau of Economic Analysis GDP estimate for Q1, bea.gov; Atlanta Federal Reserve Board, "GDPNow forecast for 2017: Q2," July 11, 2017, https://frbatlanta.org/-/media/documents/cqer/researchcq/gdpnow/realgdptrackingslides.pdf.

2. Bureau of Labor Statistics, *The employment situation—June 2017*, https://www.bls.gov/news.release/pdf/empsit.pdf.

3. More completely, the relevant population is the civilian noninstitutional population over the age of 16. For details see ibid.

4. Department of Education and National Center for Education Statistics, "Table 219.10. High school graduates, by sex and control of school," *Digest of Education Statistics 2015*, https://nces.ed.gov/programs/digest/d15/tables/dt15_219.10.asp?current=yes.

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Slowly stabilizing

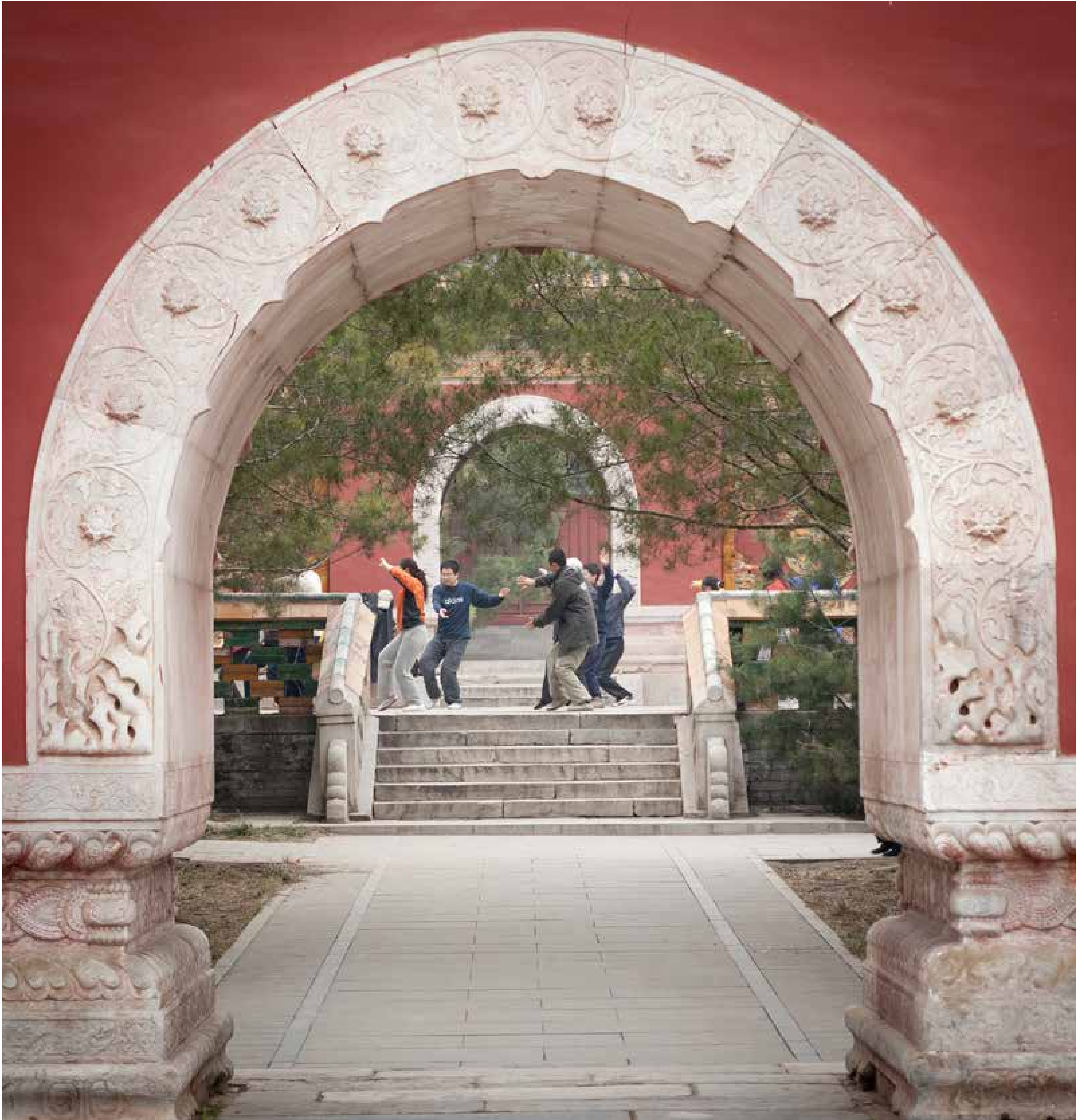
By Ira Kalish

Stable growth

The latest economic indicators from China reveal an economy that appears to be stabilizing at a moderate rate of economic growth.[1] Here are some details:

- Fixed asset investment in the first five months of 2017 was up 8.6 percent from a year earlier, roughly similar to the past year. Prior to 2016, fixed asset investment was growing at a much more rapid pace. In the most recent five months, foreign-funded investment declined 1.3 percent from a year earlier, while domestic-funded investment was up 9.4 percent. Government-funded investment fell 10.2 percent from a year earlier.
- Industrial production in China was up 6.5 percent in May versus a year earlier, the same rate of growth as in the previous month. Output by manufacturers was up 6.9 percent. This is a pretty strong rate of growth and is not consistent with the relatively weak purchasing managers' indices (PMIs) for the Chinese manufacturing sector, published recently. The PMI for May indicated declining activity, while the PMI for June indicated growth, but just barely.
- Chinese retail sales were up 10.7 percent in May versus a year earlier, roughly in line with that reported in the past year.
- The value of outstanding loans in China increased by 12.9 percent in May versus a year earlier. This was actually a relatively slow rate of growth compared with that of the past several years. The volume of new credit, both in and out of the banking system, grew more slowly in May than in recent months. Evidently, there is a deceleration in the growth of credit, reflecting the government's concern about a potentially excessive rate of credit expansion in recent years. This, in turn, is reflected in the slowdown in the growth of the broad money supply. In May, the broad money supply was up 9.6 percent from a year earlier. Moreover, in recent months there was barely any growth at all. Clearly, the central bank has tightened monetary policy in an effort

> The pattern in recent years has been alternate tightening and easing of monetary policy.



to stem the rise in credit. The pattern in recent years, however, has been alternate tightening and easing of monetary policy. The tightening took place when the central bank was concerned about debt, while the easing took place when the central bank was concerned about growth.

- Producer prices were up 5.5 percent in June versus a year earlier. Consumer prices were up only 1.5 percent. Thus consumer-facing businesses likely saw a decline in profit margins. More importantly, the low level of consumer price inflation suggests that the central bank has plenty of wiggle room should it need to stimulate the economy. The bigger risk for the central bank is that the easing of monetary policy is likely to stimulate more credit market activity, at a time when many analysts are concerned about the high level of debt in the Chinese economy.
- In the first five months of this year, foreign direct investment (FDI) into China fell 0.7 percent from the same period a year earlier. In May alone, FDI was down 3.7 percent from a year earlier. Outbound FDI, which had increased faster than inbound FDI in 2016, has fallen sharply in the first five months of 2017. This partly reflects government capital controls intended to stifle outflows of capital, which had been putting downward pressure on the currency. Indeed in April, nonfinancial outbound FDI from China was down 71.0 percent from a year earlier. In the long run, this will not be helpful for the globalization of Chinese companies.

Rising reserves

China's foreign currency reserves have increased for the fifth consecutive month. In June, reserves rose to their highest level since October, although the increases in the past several months have been very modest. Still, this is a big change from what transpired from early 2014 until early 2017. During that period, reserves declined by about $1 trillion, reflecting the fact that there was a sizable outflow of capital from China, which put downward pressure on the value of the currency. In order to prevent a sharp depreciation of the currency, the central bank massively sold reserves. However, in the past year, the government imposed new capital controls, meant to prevent outflows of capital. This has evidently worked: The currency stabilized, and the central bank was able to purchase new reserves without worrying about a declining currency. Yet imposing capital controls means postponing the time when China's capital markets become more fully integrated into the global economy. China's leadership had wanted to move the country's currency toward being convertible, for it to be seen as an important global currency for trade and wealth preservation. As long as capital controls remain in place, and as long as investors rightly fear the possibility of more controls, the currency will not become a major global player.

Is China's market status set to change?

The chief trade negotiator for the Donald Trump administration, Robert Lighthizer, has warned against a potential decision by the World Trade Organization (WTO) to label China a market economy.[2] Such a decision would make it more difficult for other countries to seek damages from China based on unfair trade practices. The decision would presumably be based on the determination that most product prices in China are based on market conditions and that government interference in markets is minimal. China has been lobbying for such a change, but the United States strongly disagrees. Lighthizer said, "I have made it very clear that a bad decision with respect to the non-market economy status of China would be cataclysmic for the WTO." This was interpreted as a suggestion that the United States might exit the WTO. Although Trump has eased public pressure on China with respect to trade following his meeting with China's President Xi Jinping, Lighthizer says that serious issues between the two countries remain. He noted that the US trade deficit with China "still hasn't come down." Of course it would be unrealistic to expect it to decline in just a few months. Moreover, a bilateral trade imbalance between two countries is not necessarily of economic significance. Nor does a trade deficit reflect trade rules. Rather, it is arithmetically due to a country investing more than it saves.

Moody's pointed to slower economic growth and rising debt as a potentially dangerous combination that could increase the probability of default.

Sovereign risk rating

Ratings agency Moody's has downgraded some of China's sovereign debt, the first such action in almost 30 years.[3] Moody's pointed to slower economic growth and rising debt as a potentially dangerous combination that could increase the probability of default. The agency said that "the downgrade reflects Moody's expectation that China's financial strength will erode somewhat over the coming years, with economy-wide debt continuing to rise as potential growth slows." However, the Chinese government took umbrage at this action, saying "Moody's views that China's nonfinancial debt will rise rapidly and the government would continue to maintain growth via stimulus measures are exaggerating difficulties facing the Chinese economy, and underestimating the Chinese government's ability to deepen supply-side structural reform and appropriately expand aggregate demand." Moody's, however, acknowledged that China is engaged in a reform process. Still, it said that "while ongoing progress on reforms is likely to transform the economy and financial system over time, it is not likely to prevent a further material rise in economy-wide debt, and the consequent increase in contingent liabilities for the government." Moody's also said that, because of continued outflows of capital and the resulting depreciation in the currency, the Chinese central bank will be constrained in its ability to provide easier monetary policy. Indeed if, to stem outflows, the central bank were to tighten monetary policy, it could exacerbate difficulties in servicing debts.

Following the announcement of the downgrade, the Chinese currency briefly fell in value before rebounding. Likewise, yields on Chinese government bonds initially rose before falling back. The muted reaction to the ratings change reflects the fact that domestic investors in China rarely pay much attention to foreign ratings, as most sovereign debt in China is sold to domestic investors. In addition, Moody's conclusions about the risk from rising debt hardly represents new information for investors. The problem of debt has been well publicized. Notably, the problem is not central government debt, which remains at a modest level of less than 40 percent of GDP. Rather, Moody's is concerned about the off-budget special purpose vehicles established by local governments to provide funding for infrastructure investment. Moody's is also concerned about the rising debt of state-owned enterprises, which are seen as quasi-sovereign and potentially creating a liability for the government. Nevertheless, many observers have expressed concern about China's debts, which could remain a key issue for China in the coming years.

Endnotes

1. Unless specified otherwise, all data have been taken from National Bureau of Statistics of China, "Consumer prices for May 2017," http://www.stats.gov.cn/english/.
2. Shawn Donnan, "Trump trade tsar warns against China 'market economy' status," *Financial Times*, June 22, 2017, https://www.ft.com/content/4d6ba03e-56b0-11e7-9fed-c19e2700005f?mhq5j=e1.
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Summer-blue skies for the economy

By Alexander Börsch

Introduction

Spring and summer 2017 brought good news for the Eurozone. Tensions in the political risk landscape have decreased, and populist parties underperformed in relation to expectations in the key Eurozone countries of the Netherlands and France. In particular, the election of a decidedly pro-EU president in France has eased fears about a fragmentation of the Eurozone.

At the same time and partly as a consequence, the recovery is developing stronger than many analysts believed only a few months ago. Growth forecasts were revised upward, and employment increased by 1.2 million in the last two quarters. Nevertheless, political risks are here to stay. Forthcoming elections in Austria and potentially in Italy will be a new test of Europe's political stability. Meanwhile, the Brexit negotiations that started on June 19 will be a source of uncertainty as long as a clear direction is not discernable.

Characteristics of the recovery

The recovery in the Eurozone has been ongoing since 2013 but has remained feeble until 2016. Since then, the pace has picked up, especially since last winter. GDP growth in the first quarter increased to 0.6 percent, more than double the US growth in the same period.

From a country perspective, **Spain** is experiencing the most dynamic recovery among the major Euro-

> Spain is experiencing the most dynamic recovery among the major Eurozone countries.

BANCO DE ESPAÑA

zone countries. After growing at slightly more than 3 percent in 2015 and 2016, growth accelerated slightly in the first quarter of 2017. Currently, the main drivers of growth are private demand and corporate investments; exports were the main driver in the early phases of the recovery. Unemployment has fallen from 25.0 percent to a still-high 18.0 percent. The booming tourism industry, which has recorded more than 20 million tourists over the last six years, has played a substantial role in the improved labor market outlook, as has the export industry.[1]

The economic situation in **Germany** continues to be rosy. The Ifo economic climate index reached its highest value in 26 years in June, while the unemployment rate was the lowest during the same period. The economy grew 0.6 percent in the first quarter of 2017, and analysts expect a similar growth rate for the second quarter. The recovery in Germany has been driven especially by private consumption in the wake of low energy prices, a tight labor market, a booming real estate sector, and increasing disposable income. Growth contributions from exports have been modest due to rising imports, and corporate investments have developed very weakly. Supported by an improvement in industrial sentiment since the beginning of the year, capacity utilization in the German industry has now markedly moved past its long-term average and is currently at a nine-year high, suggesting a need for new investment.[2]

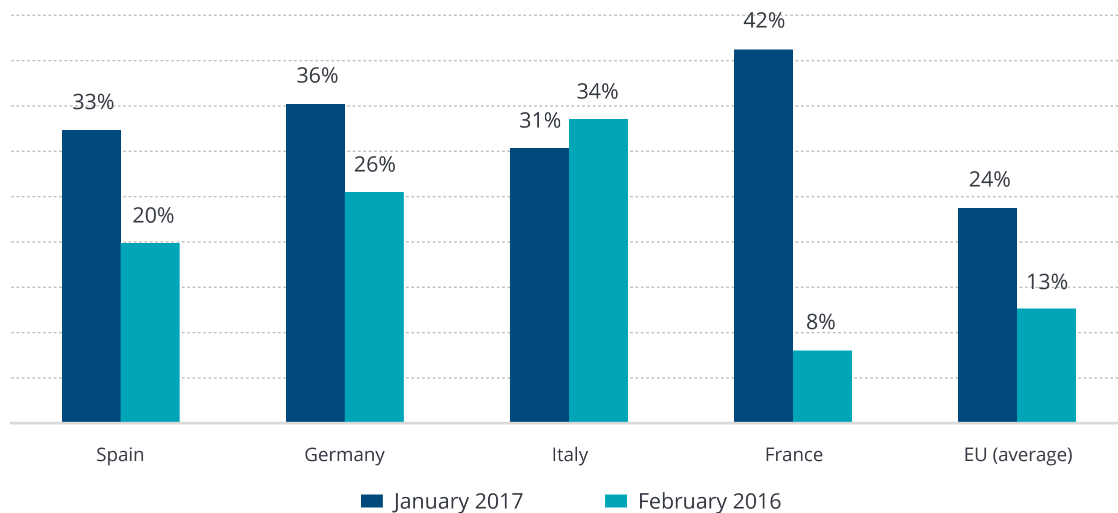
The pace of economic recovery in **Italy** and **France** has been moderate so far, but it is gaining momentum. While both countries grew at around 0.2 percent quarterly between 2014 and 2016, the growth rate in the first three months of 2017 amounted to 0.4 percent. Unemployment in France fell from 10.5 to 9.5 percent in the last two years, and in Italy from 13.0 percent to 11.1 percent. The Italian economy is held back by problems in the banking sector, which are curbing credit growth.[3]

Further acceleration?

There are some indications that the biggest bottleneck in the further acceleration of the recovery in Europe—corporate investments—is easing. They have lagged far behind expectations and patterns from previous recoveries. However, according to the latest Deloitte European CFO survey of 1,500 European CFOs, the investment propensity of European corporates is on the rise (figure 1).

Figure 1. Investment propensity of European corporates

In your view, how are capital expenditures for your company likely to change over the next 12 months?



Deloitte, *European CFO Survey Q1 2017.*

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> The next test of the Eurozone's stability and the reach of populist parties will be in autumn.

Overall investment propensity in Europe has almost doubled since last autumn, with a notable jump among French corporates and significant increases in Germany and Spain. Italy recorded a slight decline, but investment intentions remained at a comparatively high level.

This suggests that the recovery stands increasingly on solid ground, becoming broader-based and opening up the possibility that the Eurozone could turn into a pretty robust growth environment.

Political risks: Next round

The next test of the Eurozone's stability and the reach of populist parties will be in autumn. Snap elections will take place in Austria in mid-October after the governing coalition of Social Democrats and the conservative People's Party collapsed. Snap elections in Italy are a possibility but not certain. The next regular voting is set to take place in spring 2018. Earlier, elections in autumn seemed almost certain but hinge on a new electoral law that was not passed at the very last minute in June.

In both countries, populist parties have a fair chance of becoming part of the new government. The Austrian right-wing Freedom Party was narrowly defeated in the presidential elections last autumn and is, according to current polls, the second-strongest party. While polls in Italy are in flux and the populist Five Star Movement suffered defeat in recent municipal elections, it is neck and neck with the governing Democratic Party.

Meanwhile, the Brexit negotiations have finally started, while the official two-year negotiation period had already begun in late March when the United Kingdom submitted its letter of intent to leave the European Union. Until the end of the year, the focus will be on the divorce modalities.

Three topics need to be resolved in the first negotiation phase from the perspective of the European Union, before future relationship modalities can be dealt with: the rights of EU citizens residing in the United Kingdom and vice versa, the border between the Republic of Ireland and Northern Ireland, and the financial obligations of the United Kingdom. The last point, especially, provides ample room for conflict and disagreement, and holds the biggest risk that no consensus can be reached.

The political uncertainties surrounding Brexit and the rise of populist parties will undoubtedly shape economic growth prospects in the medium term. In the short run, the recovery in the Eurozone is very likely to continue, given that it stands on a more solid footing.

Endnotes

1. CESifo Group Munich, "Ifo economic forecast for 2017/2018: Germany's economy is strong and stable," June 20, 2017, http://www.cesifo-group.de/ifoHome/facts/Forecasts/Ifo-Economic-Forecast/Archiv/ifo-Prognose-20-06-2017.html.

2. KfW Research, "Germany's economy in 2017/2018: Like a long-distance runner," May 23, 2017, https://www.kfw.de/KfW-Group/Service/Download-Center/Research-(EN)/KfW-business-cycle-compass/.

3. CESifo Group Munich, "Ifo economic forecast for 2017/2018."

Wiggling through demonetization and GST

By Rumki Majumdar

Introduction

India's economic growth seems to be losing steam, as the economy posted weaker-than-expected growth in the fourth quarter of FY 2016–17. According to the latest data on economic activity, GDP grew at an annual rate of 7.1 percent, almost 1.0 percent lower than the previous fiscal year.[1] While one might assume that there is nothing surprising about the slowdown and that demonetization is to be blamed for the economy's poor performance, a deeper dive shows that the economy had started slowing even before demonetization was announced. Post demonetization, the slowdown further intensified, specifically in the fourth quarter of FY 2016–17 as the economy struggled to cope with the cash crunch.

Even as the impact of demonetization gradually phases out, the outlook remains mired in uncertainty for the next few quarters because of the fiscal tightening at the center, the base effect of agricultural growth, stressed assets in the banking sector, and global risks emanating from rising protectionism. In addition, there are concerns that growth and inflation might be impacted in the coming quarters as the economy transitions to a new national sales tax regime—the goods and sales tax (GST) that went live on July 1, 2017.

That raises questions about the sustainability of the strong economic performance India has been boasting about. Will these impact the long-term growth outlook and optimism about India?

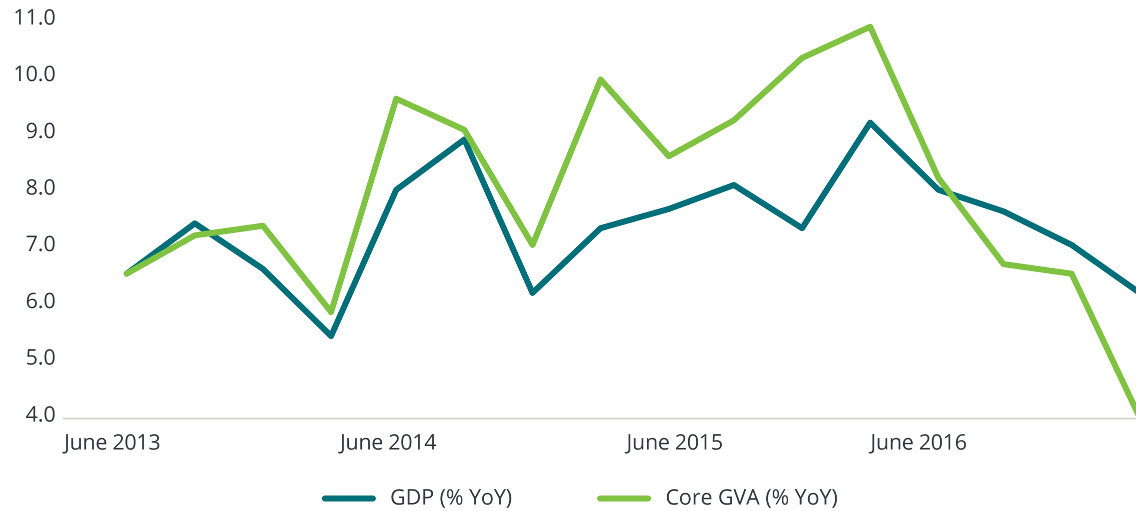
Growth slowly lost steam through FY 2016

GDP growth fell from an annual rate of 8.0 percent in FY 2015–16 to 7.6 percent in the first half of FY 2016–17. It might seem a marginal decline, but much of this growth was masked by very strong agriculture and government spending in the period prior to demonetization. Growth net of these two sectors depicts a very different picture.

Gross value added (GVA) growth on the supply side net of contributions from the agriculture and public sectors (referred to as core GVA) fell from 9.8 percent in FY 2015–16 to 8.1 percent and 6.6 percent in the first two quarters of FY 2016–17, respectively. In other words, growth was evidently slowing even before demonetization. The slowdown further intensified in the second half of FY 2016–17, and core GVA grew 3.9 percent in Q4 FY 2016–17—the lowest growth rate recorded since 2009 (figure 1). While one may attribute the poor economic performance in the second half of the year to demonetization, it is

While one might assume that demonetization is to be blamed for the economy's poor performance, a deeper dive shows that the economy had started slowing even before demonetization was announced.

Figure 1. Growth net of contributions from the agriculture and public sectors fell substantially



Source: Central Statistical Office, May 2017; Haver Analytics.

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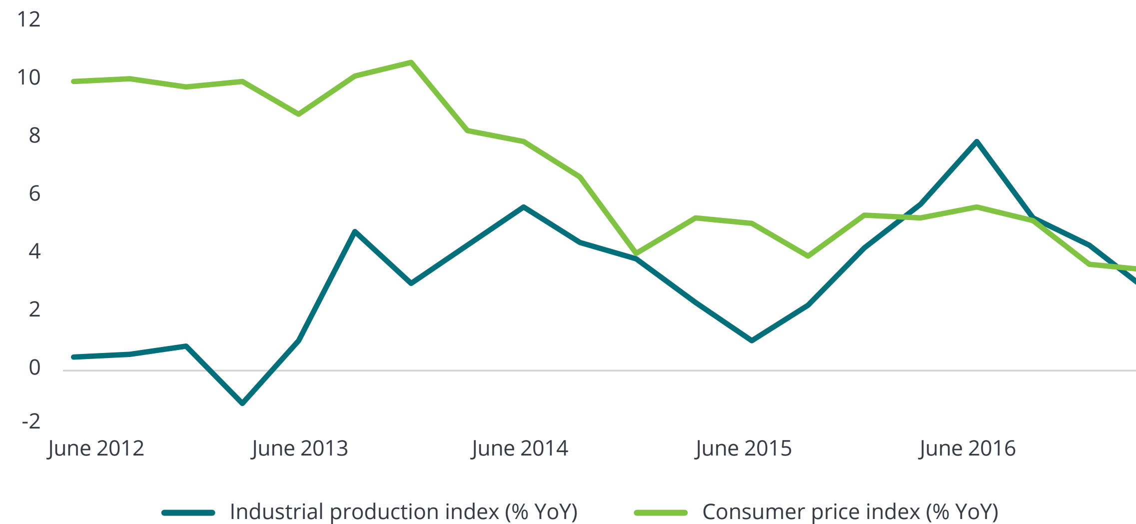
Figure 2. High-frequency data have been indicating a slowdown since early 2016



Source: Ministry of Statistical Programme and Implementation, June 2017; Haver Analytics.

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As India finally gets rid of segmented markets with different effective tax rates and becomes a common market for all goods and services, it will likely ease the movement of goods and services across the country, reduce transaction costs, and boost allocative efficiency.

difficult to discern how much of the slowdown was exclusively because of it.

What is noticeable from the latest data release is that finally there is some parallel between the GDP growth story and the narrative from the past year's high-frequency economic activity. The new industrial production series had been signaling a slowdown in economic activity since early 2016. On the other hand, low inflation suggested that weaker (rural) demand and a negative output gap (the actual output being lower than the potential output), among other factors, were likely resulting in a poor pricing power in the economy (figure 2). However, this slowdown was not apparent from the GDP data until the latest numbers were released in May.

Looking forward, a pickup in demand will likely depend on the impact of fiscal consolidation, removal of infrastructure bottlenecks, and the pace of revival of private investment and the banking sector. It might take some time for demand to improve as the impact of demonetization on consumer spending and investment wears off completely. The implementation of the GST might impact activity as businesses cope with the new tax structure. There are upside risks to inflation as food and commodity prices are expected to remain low. However, only the inflation data in the coming quarters can reveal a clearer picture.

The landmark tax reform

The GST—India's biggest landmark tax reform since independence—went live on July 1 after 17 years of debate, replacing a myriad of central, state, interstate, and local taxes, and uniting the nation with a single tax rate for any good or service across the country. Calling the levy "good and simple tax," the prime minister expressed his hope that the reform will likely herald the economic integration of India, streamline businesses, and boost the economy by tearing down barriers between 31 states and union territories.

As India finally gets rid of segmented markets with different effective tax rates and becomes a common market for all goods and services, it will likely ease the movement of goods and services across the country, reduce transaction costs, and boost allocative efficiency. There are expectations of higher compliance because of the structure it follows, which will likely broaden the tax base and boost tax revenues.

Since all taxes will be collected at the point of consumption, it will include both central and state governments' taxes. Transparency in taxation will likely deter the government from indiscriminately increasing taxes. In addition, tax revenues are likely to get redistributed from the large producing states to the states with higher consumption, which are

also the states with higher population and low per capita income, and which therefore are expected to benefit from such a redistribution of taxes.

That said, when a change of this magnitude is undertaken, there are bound to be some teething troubles and difficulties in the initial stages. Although large-scale businesses are ready for the new tax regime, medium- to small-scale industries are likely to take time to adjust to the new structure. The transition to the GST system may disrupt some businesses' production plans, and require them to reduce existing inventory and modify their supply chain based on the assessment of tax savings and inventory management costs. This could impact economic activity temporarily as the economy adjusts to a new normal.

The impact of this transition to a national sales tax on inflation and growth remains uncertain. First, it was hoped that the new tax structure would be simple, with a maximum of three tax rates as had been recommended by the Arvind Subramanian committee. However, the current GST has a five-rate structure, plus a potential tax on luxury and "sin" goods.[2] This might result in potential disputes over the classification of goods and lead to corruption, thereby reducing ease of monitoring, increasing tax authorities' discretion, and partially offsetting the compliance and efficiency gains of a simpler structure.

Products of mass consumption have been exempted, while those consumed by the rich are charged at a higher percentage, which might not impact inflation significantly. However, the average burden of tax on

services, which accounts for a significant share in consumption, has risen to 18.0 percent from the current 15.0 percent level, which may fuel inflation. However, it is expected that better flow of input credit and improved competitiveness will likely negate the impact of higher rates on services.

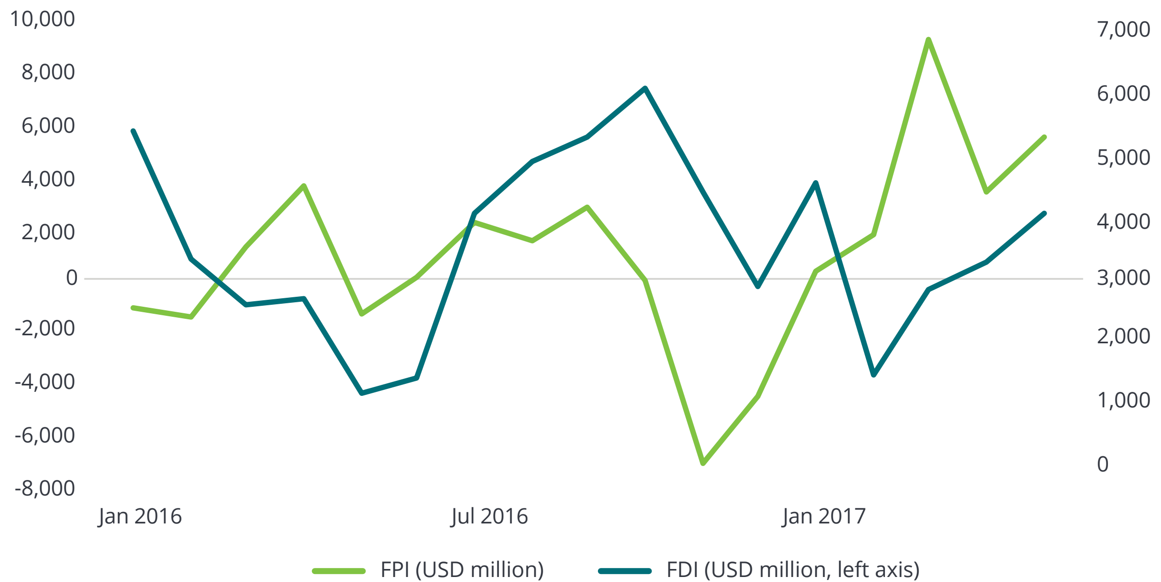
In the long run, the new tax regime, in addition to the permanent account number regulations and cash restrictions in business transactions, is expected to impact all businesses and encourage a shift from the unorganized to organized sectors. A simplified tax structure will likely improve the ease of doing business in the country, increase productivity and efficiency in operations, and incentivize foreign investors to invest more. The government is confident that more streamlined businesses due to the GST might boost GDP growth by 0.4 percent to 2.0 percent.[3]

The long-term outlook is optimistic

Investors are optimistic about the medium to long-term economic outlook. An expectation of a modest but synchronized global economic recovery, strong economic fundamentals, the government's continued efforts to increase foreign investment inflows, and economic resilience amid global uncertainty have improved business perceptions about risk taking. In addition, with the implementation of the GST, there is growing confidence in the government's ability to take on difficult reforms in India.

The improvement in investor confidence is evident from capital flows as foreign investors continue to bet on India as one of the promising destinations for investment. Since the beginning of 2017, India has witnessed robust growth in foreign investment (figure 3). Indian businesses, too, have expressed

Figure 3. Foreign investment has been picking up since the beginning of 2017



Source: The Reserve Bank of India.

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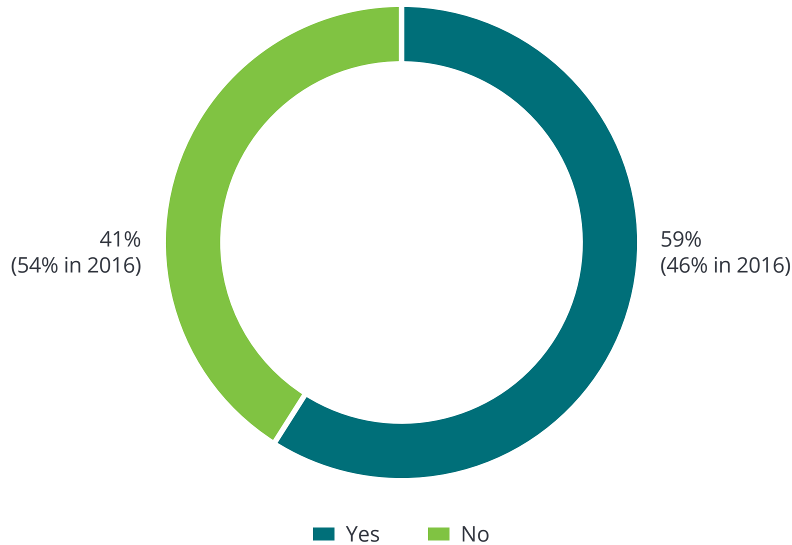
Figure 4. Willingness to take business risks among CFOs



Source: Deloitte India CFO survey, 2017.

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their "heightened optimism" and willingness to take business risks over the medium to long term.[4] This bodes well for capital investment growth, which has been trailing for a while.

A prudent monetary policy is likely helpful in the current scenario

The Reserve Bank of India (RBI) kept policy rates on hold, though it hinted at future easing, contingent on the inflation outturn. It revised down its inflation forecasts—the new consumer price inflation rate is expected to remain within the range of 2.0–3.5 percent in the first half of FY 2017–18, and 3.5–4.5 percent in the second half. But, at the same time, the RBI also marked down its GVA growth forecast from 7.4 percent to 7.3 percent.

While it may appear that a rate cut might be prudent to boost the economy and revive investment, which has failed to pick up, the RBI is probably erring on the side of caution. The current health of the banking sector and risks to inflation (although low) are preventing the RBI from taking any premature action at this stage. This is because if a situation warrants a hawkish policy stance in the future, policy reversals later could be disruptive and may result in a loss of the bank's credibility. Most likely, the RBI will likely keep the policy rate unchanged with a neutral stance for some more time as it keeps an eye on the monsoon and its impact on inflation.

Endnotes

1. Growth rates are measured in year-over-year terms throughout this document, unless otherwise specified.
2. Sin goods include tobacco, *paan masala*, and aerated drinks, as well as luxury vehicles.
3. "GST comes into force after 17 years of debate," *Economic Times*, July 1, 2017, http://economictimes.indiatimes.com/articleshow/59394169.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.
4. Deloitte's CFO survey for India was conducted earlier this year.

An accelerating economy, though not quite at breakneck speed

By Ira Kalish

Rebound

While it would be an exaggeration to say that Japan's economy is on fire, it is safe to say that it is doing unusually well. The Japanese economy appears to be turning a corner, accelerating to a more robust rate of expansion. Of course, given its declining population, it cannot be expected that Japan will ever again return to breakneck growth. Still, on a per capita basis, it is doing well. There are a number of indicators that point to progress:

- Industrial production was up 6.8 percent in May versus a year earlier, the fastest rate of growth since 2014. Moreover, the overall level of output is now the highest since 2008. The strength of industrial output has been driven by strong demand for Japanese exports. This is one of the several indicators that the economy is finally stabilizing at a decent rate of growth. Still, headwinds remain, including poor demographics, inadequate Japanese fiscal and regulatory policies, and potential US protectionist policies.[1]
- Japanese exports grew strongly in May, although more slowly than some analysts had expected. Exports were up 14.9 percent versus a year earlier. In particular, exports were up 23.9 percent to China, 22.9 percent to South Korea, and 12.7 percent to North America. The strength of exports reflects the impact of a weak Japanese yen as well as accelerating global demand. Meanwhile, imports grew faster at 17.8 percent, reflecting an improvement in domestic demand as well as strong growth by manufacturers that needed components for their exportable products.
- Retail sales in Japan grew 2.0 percent in May from a year earlier. This follows exceptionally strong growth in April, the fastest rate of growth in two years. Moreover, strong growth two years ago was artificially inflated by the rise in the national sales tax. Excluding that episode, retail sales are now rising at the fastest pace since 2012. The strength of retail sales is due to strong growth of spending at department stores and supermarkets. On the other hand, overall household spending grew modestly in May, up 0.7 percent from a year earlier. This was likely due to weakness in the growth of household income. In real (inflation-adjusted) terms, household

The Japanese economy appears to be turning a corner, accelerating to a more robust rate of expansion.

spending was actually down from a year earlier. Thus the consumer sector of the Japanese economy remains uncertain.

- Japan's labor market appears to be strong. The unemployment rate rose to 3.1 percent in May after hovering around 2.8 percent in the previous two months. Still, this is a relatively low rate. Unemployment has been falling rapidly and steadily since it peaked at 5.5 percent during the global recession of 2009. Moreover, the tightness of the market is indicated by the fact that the ratio of job openings to job applicants is now 1.49, almost the highest level since 1974. This suggests a significant shortage of labor.

The tightness in the labor market is not only due to strong demand for workers, but also reflects a declining supply of workers. The working-age population is declining by about 700,000 people each year. Normally, one would expect that such a situation would generate considerable wage pressure, thereby boosting inflation. This is not happening, and it is not entirely clear why not.

Several explanations have been offered. First, an extended period of low inflation has trained businesses to offer modest pay increases. Old habits die hard. Second, many workers prefer to stay with one employer for a lifetime. As such, they are relatively immune to offers of higher pay from other employers. Third, some employers may prefer to invest in labor-saving technology rather than boost wages, especially if the available pool of labor lacks the skills needed. Fourth, there is an increasing number of women entering the workforce, thus removing some of the pressure on wages. Finally, the job market appears to be tightest in Tokyo, where the ratio of jobs to applicants for full-time work is now especially high. It is rather low in other parts of the country. This suggests a bifurcated job market in Japan.

> Japan's government is eager to be involved in trade liberalization, partly to gain more favorable access to foreign markets.

Monetary policy

Japan's central bank has lately left monetary policy unchanged, reflecting its confidence that the economy is on a favorable path of faster growth and higher inflation—even though core inflation remains at zero. The policy remains highly accommodative. Meanwhile, the International Monetary Fund (IMF) feels that the policy has been a success. It says that Japan has done enough to boost growth and inflation, and that the current policy of "Abenomics" is a "success" and should be continued.[2]

Recall that Abenomics refers to the policies undertaken by Prime Minister Shinzo Abe since he came to power. These include aggressive monetary policy, fiscal stimulus, and deregulatory reform. Only the monetary policy part of Abenomics has been implemented in a significant way. However, the government is likely to engage in more fiscal stimulus in the coming year. As for deregulation, the government hoped to use the Trans-Pacific Partnership (TPP), a free-trade agreement between Japan, the United States, and 10 other Pacific Rim nations, as a political cover for engaging in politically difficult reforms. Unfortunately for Abe, US President Donald Trump cancelled the TPP on his first day in office, despite Abe's efforts to convince Trump otherwise.

Although the IMF expressed confidence in the current policy mix, it warned that the government ought not to allow a 2.0-percentage-point increase in the national sales tax, now scheduled to take place in 2019. The last time there was such an increase, it caused a temporary setback to economic activity. The IMF suggested that future increases take place more gradually.[3] The government is keen to enact a tax increase in order to offset the rising cost of pensions associated with an aging population.

Demographics

Japan's population is declining. In 2016, the indigenous population fell by 308,000, a record drop. This was partly offset by a 149,000 increase in the foreign resident population—an increase of 7.0 percent. The native-born population is falling because of a very low birth rate, which is not sufficient to offset the death rate. Meanwhile, the population continues to age, with a sharp decline in the working-age population partly offset by a rise in the elderly population.

This situation is creating a number of challenges for Japan. A declining working-age population means slower economic growth, which reduces Japan's footprint in the global economy. It also means persistent excess capacity, which contributes to very low inflation. A combination of low growth and zero inflation has contributed to a very high debt/GDP ratio for the government. The decline in the ratio of workers to retirees means a higher cost of caring for the elderly. This is why the government is keen to ultimately boost the national sales tax, in order to fund pensions and health care for the elderly. Finally, the population continues to shift toward big cities. Tokyo's population is rising, while that of many small towns is being quickly depleted.

What is the solution? First, more immigration would help—this is evidently taking place, but far more slowly than in most other developed economies. This is a difficult political issue in Japan, one about which politicians barely speak. Second, an increase in the rate of female labor force participation would help, and indeed the government has taken actions to encourage more women to work. Japan's female participation rate is similar to that of the United States but far lower than that in Western Europe. Finally, faster productivity growth would help. However, this will require more business investment in new technologies, which might be encouraged if the government relaxes anti-competitive regulations in various industries. Freer trade would help as well.

Trade

Japan's government is eager to be involved in trade liberalization, partly to gain more favorable access to foreign markets. Japan and the European Union have just reached an agreement on a free-trade deal, which was announced at the G20 Summit held in July. The deal will eliminate tariffs on 99.0 percent of goods traded between the two economic giants. Companies in each region will have access to public sector procurement in the other region. The deal will mean that European farmers gain access to the Japanese market, while Japanese automakers gain greater access to the EU market. This is hugely significant because the European Union and Japan are two of the four biggest economic players in the world—the others being the United States and China. This comes only months after the United States withdrew from the TPP.

Such agreements will require the dismantling of non-tariff barriers such as onerous regulations. Abe hopes that the requirement to end such barriers will provide his government the political cover needed to implement difficult reforms, including liberalization of domestic markets. He had hoped that the TPP might provide such an opportunity. The new deal between the European Union and Japan is a way for both sides to sidestep the United States, which increasingly is turning inward in terms of economic relations with the rest of the world.

Endnotes

1. All statistics in this article are sourced from Statistics Japan, http://www.stat.go.jp/english/, unless otherwise stated.
2. IMF, "Japan: Staff concluding statement of the 2017 Article IV Mission," June 19, 2017, https://www.imf.org/en/News/Articles/2017/06/19/MS061917-Japan-Staff-Concluding-Statement-of-2017-Article-IV-Mission.
3. Ibid.

Growth cools amid growing political uncertainty

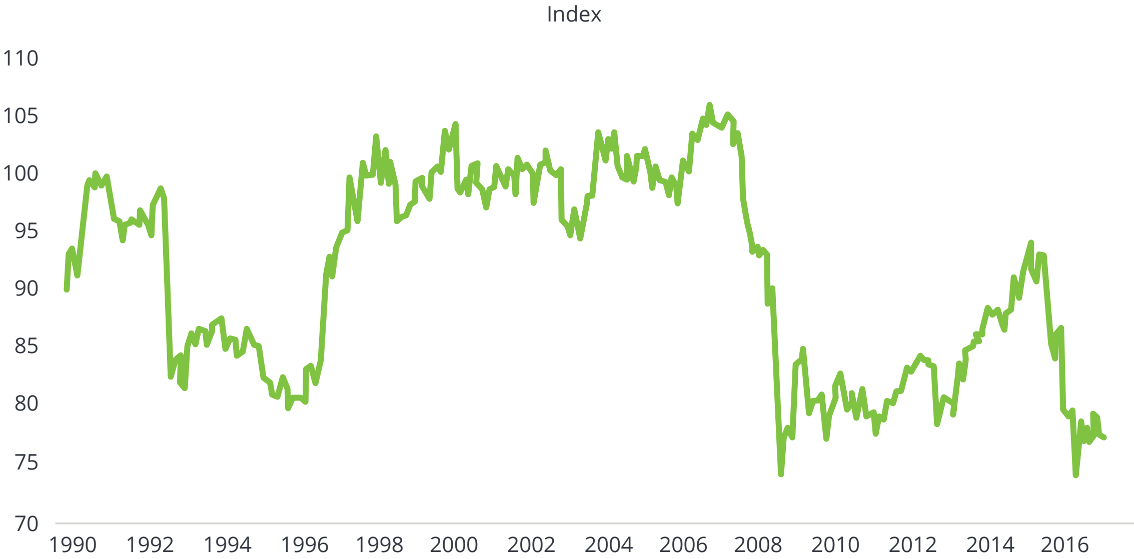
By Ian Stewart

In a world where growth is generally accelerating, and at a marginally faster-than-expected rate, activity in the United Kingdom is softening. The sharp devaluation of the sterling that occurred after the EU referendum in June 2016 has fed through to inflation and is now squeezing spending power (figure 1). In the first quarter of 2017, the economy grew by just 0.2 percent over the previous quarter, down from 0.7 percent in the final quarter of 2016.[1] Having outperformed activity in the euro area in 2016, the United Kingdom is likely to be overtaken by it in 2017 as the euro area recovery strengthens.

The consumer is, as in most rich economies, the engine of growth, and, in the United Kingdom's case, accounts for about two-thirds of GDP. Consumer activity, which remained resilient in the face of the Brexit vote last year, has softened in recent months as rising inflation, which reached a four-year high of 2.9 percent in June, has eaten into spending power. With average earnings growing at around 2.0 percent, consumers are facing a decline in their spending power (figure 2). The ability of consumers to either borrow or save less to help bolster spending is constrained. After a period of rapid growth in consumer credit, driven particularly by car finance, banks are cutting back on credit lending. Meanwhile the savings ratio—the proportion of disposable income that is saved—has dropped to 1.7 percent, the lowest level in 55 years. While the inflation shock shows few signs of becoming embedded, and nominal wage growth remains weak, the prognosis is for inflation pressures to ease through next year. But the big picture is of a period of subdued, below-trend growth in consumer spending in 2017 and 2018.

Having outperformed activity in the euro area in 2016, the United Kingdom is likely to be overtaken by it in 2017 as the euro area recovery strengthens.

Figure 1. Trade-weighted sterling



Source: Thomson Reuters Datastream.

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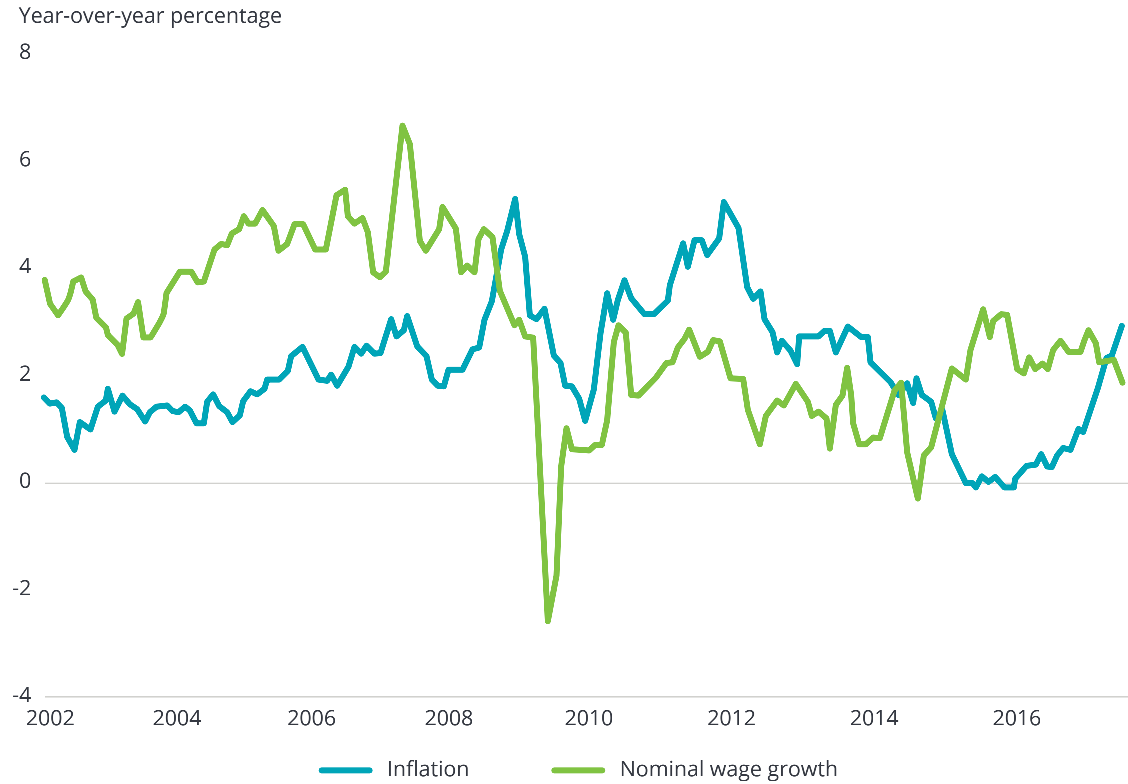
Figure 2. UK nominal wage growth and inflation



Source: Thomson Reuters Datastream.

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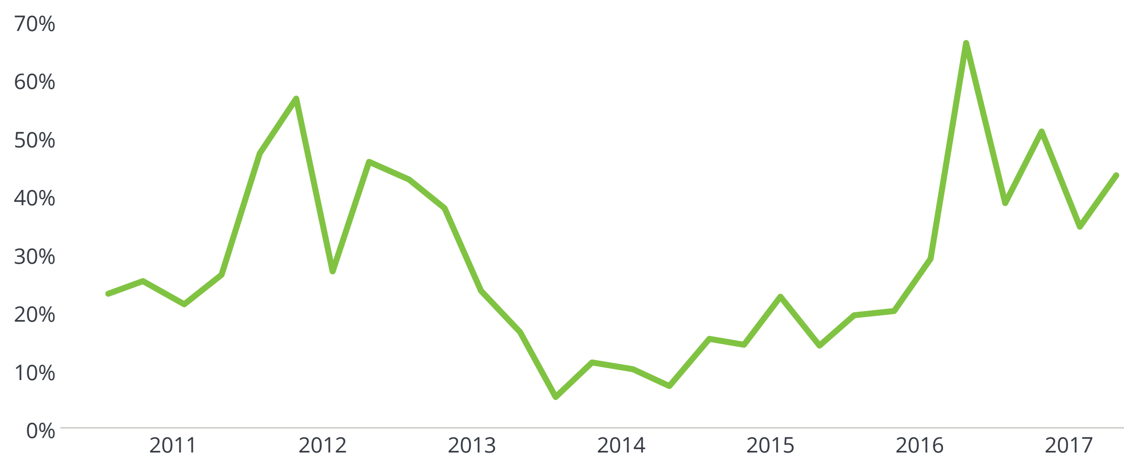
Brexit has dominated UK politics since last June's referendum. The result of the general election, which took place on June 8, has compounded Brexit-related uncertainties (figure 3). Rather than delivering a strong Conservative majority, as the government and most commentators had initially expected, the result was a hung parliament. To govern, the Conservative Party now relies on the votes of Northern Ireland's 10 Democratic Unionist Party (DUP) MPs. The Conservative Party's precarious situation, and the strong showing by the Labour Party under Jeremy Corbyn, has weakened the authority of the Prime Minister Theresa May. This, in turn, has fueled speculation about the possibility of either an early general election or a change in the leadership of the Conservative Party and the prime minister. And so, an election that was called by PM May to help strengthen her hand at home and in Brexit negotiations has ended up having the opposite effect.

Nonetheless, the most likely outcome for the United Kingdom is still that it will leave the European Union and that it will seek a relationship outside the single market and the European Union's customs union. This is partly because the Conservatives, supported by the Eurosceptic DUP, hold a parliamentary majority. The government, if it can carry its own backbenchers, has the power to prevail. In addition, the formal position of the Labour Party, like the Conservatives, is that the United Kingdom should leave the European Union and its single market and end freedom of movement for EU citizens. The government will face stiff opposition and criticism in parliament and outside as it negotiates the United Kingdom's exit from the European Union. Those opposed to Brexit seem to be coalescing around the idea of the United Kingdom staying in the European Union's single market. However, this would mean accepted free movement of people, something which both Conservatives and Labour say they wish to end.

Brexit is a process, not an event, and a process that has got more complex as a result of the general election. As the outcomes of the United Kingdom's EU referendum last year and its general election this year demonstrate, making political predictions is a risky game. But my hunch remains that, despite the twists and turns, the United Kingdom is heading out of the European Union and its single market.

In the meantime, the question is what will happen to UK growth. The consumer is on a slowing path and, as a result, some slowdown in GDP growth is unavoidable. The extent of that slowdown should be mitigated by four factors. First, a 20.0 percent devaluation in sterling should boost Britain's export and trade performance. Second, the global economy is recovering and this will help to boost UK activity. Third, the negative shock from higher inflation is likely to be transient, and inflation seems likely to ease next year, taking some of the pressure off the consumer. Fourth, Brexit-related uncertainties point to fiscal and monetary policy being more stimulative than would otherwise be the case. Thus despite the uncertainties, we would expected manufacturing, exports, and investment to pick up this year and look for below-trend growth of around 1.5 percent in 2017 and 2018.[2]

Figure 3. External factors driving uncertainty for businesses



Source: Deloitte CFO Survey.

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Endnotes

1. Unless stated otherwise, all data have been taken from the Office for National Statistics, https://www.ons.gov.uk/.
2. Consensus forecasts from economists.

Back to growth, but economic diversification remains a challenge

By Lester Gunnion

Introduction

The Russian economy continues to recover. Indicators point to a third straight quarter of growth in real GDP in Q2 2017. Industrial production, after dipping in February relative to a year ago, has grown each month through May; real retail sales, after having declined every month relative to a year ago for more than two years, edged up in April and accelerated in May; and real disposable income growth has gathered pace (figure 1).[1] A third quarter of year-over-year growth is likely to put Russia firmly in the black and set the stage for quicker annual growth in 2017.

During the last couple of years, one of the policy strategies that Russia accelerated through a combination of a weak Russian ruble, Western sanctions, and a self-imposed embargo on food imports was import substitution. The strategy aims to build self-sufficiency and diversify the domestic economy by providing purchase and subsidy assistance to certain sectors in order to boost nonhydrocarbon exports. While import substitution appears to have shown short-term benefits in the agriculture sector, its benefits in the manufacturing sector and on the economy as a whole are yet to be proven. The major determinants of the long-term success of this strategy, apart from the calculated selection of which sectors to target, are the level of investment in those sectors and Russia's ability to access and compete in new markets. A pivot toward the east is evident as Russia receives increased funding from China. However, Chinese investment in Russia remains closely tied to energy requirements, and Russia's access to new export markets has not yet materialized. Furthermore, with policy loosening likely to slow, oil prices likely to remain weak, and Western sanctions likely to remain in place through the medium term, growth in 2017 is unlikely to be robust.

While the economic incentive behind import substitution is self-sufficiency and diversification of the economy away from a dependence on hydrocarbons, the political incentive is greater sovereignty.

Figure 1. Indicators point to a third straight quarter of growth in real GDP in Q2 2017

Source: Federal State Statistics Service via Haver Analytics.

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Russia's import substitution strategy remains a risky bet

Russia's increased emphasis on import substitution in agriculture and certain manufacturing sectors (metal production; machinery and equipment; cars, sea craft, airplanes, and spaceships) was under pressure from two factors. The primary factor was the precipitous weakening of the ruble between mid-2014 and the end of 2015 in response to a collapse in global oil prices. The significantly weaker ruble translated into higher import prices for Russian businesses and consumers. The other factor contributing to the acceleration of import substitution was the sanctions imposed by the United States and the European Union, as well as Russia's counterembargo on the import of food from certain countries in the European Union and elsewhere. While the sanctions imposed by the West meant that Russian manufacturers can no longer import machinery, equipment, and other intermediates from these destinations, the Russian embargo on the import of food meant higher domestic prices or, in some cases, the unavailability of food products for Russian consumers. While the economic incentive behind import substitution is self-sufficiency and diversification of the economy away from a dependence on hydrocarbons, the political incentive is greater sovereignty.

On the surface, the strategy of import substitution appears to have benefitted Russia's agriculture sector in the short term. Domestic production of pork, for instance, has increased to a level of self-sufficiency.[2] More significantly, a surge in the production of grains, particularly wheat, resulted in output reaching a record high in 2016.[3] In fact, Russia was the world's largest exporter of grains in 2016.[4] Agriculture surpassed arms as the country's second-largest export after oil and gas during the year.[5] However, recent growth in the sector can be partially attributed to improved land management and favorable weather. Nevertheless, Russian authorities claim import substitution in agriculture will help the country move closer to self-sufficiency in certain products while boosting exports in others.[6] But this comes at a cost to consumers. In the first half of 2016, expenditure on food was more than a third of total household expenditure.[7] Even though inflation has slowed and real disposable income is growing, households are likely to continue paying

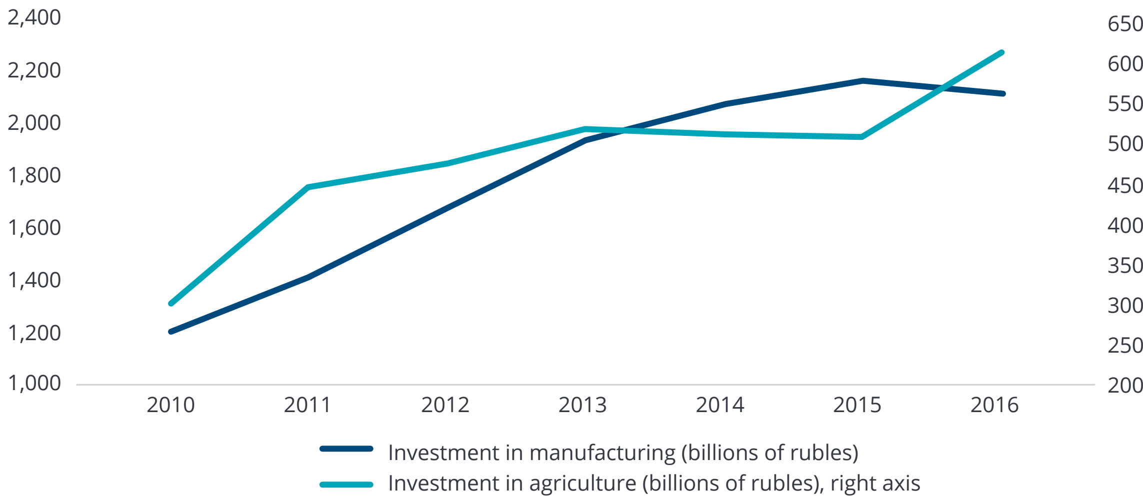
comparatively more for domestically produced food products that were earlier imported. Furthermore, quality is unlikely to remain at par.

While investment in agriculture grew strongly in 2016, investment in manufacturing declined during the year (figure 2).[8] However, the import substitution of capital goods is likely to require large investment in the development of skills, technical know-how, and manufacturing capability. Furthermore, only 10.0 percent of Russia's manufacturing workforce is not directly linked to the hydrocarbon sector.[9] In fact, most of Russia's manufacturing output is consumed domestically and is not globally competitive.[10] This is likely to make diversification away from hydrocarbons in the manufacturing sector a challenging task.

If import substitution is successfully applied to sectors that fuel higher output across the entire economy, then the overall loss to welfare might be overshadowed by the gains.

More than half (60.0 percent) of Russia's manufacturing imports are intermediate capital goods used for further production.[11] Studies across countries reveal that industries that have a higher share of imported intermediate goods tend to be more productive than industries that have a lower share of imported intermediate goods.[12] The same logic has been found to apply to companies.[13] In Russia, firms that import manufacturing intermediates enjoy 20.0 percent higher labor productivity compared with firms that do not import intermediates.[14] In short, access to imports of high-quality, cheap, intermediate capital goods is a key determinant of competitiveness in manufacturing. Import substitution in the manufacturing sector could lead to an overall erosion in the competitiveness of the sector due to the production of lower-quality manufacturing intermediates that

Figure 2. Investment in agriculture grew strongly while investment in manufacturing declined in 2016



Source: Federal State Statistics Service via Haver Analytics.

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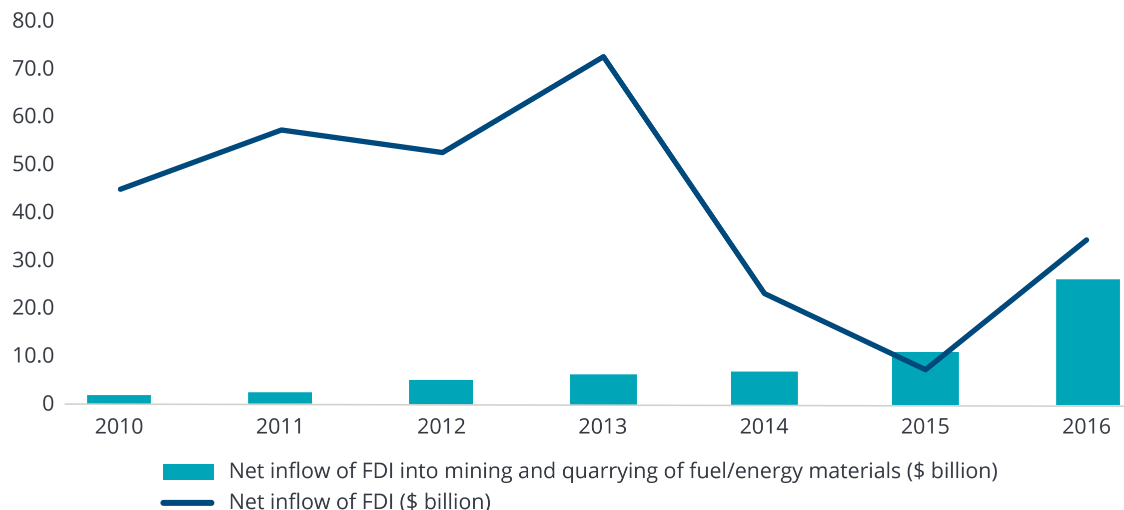
Figure 3. Investment in mining and quarrying of fuel and energy materials dominated net FDI inflows in 2015 and 2016



Source: The Central Bank of the Russian Federation, "External sector statistics, direct investment."

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are expensive to produce domestically. This would be counterproductive to the administration's goal.

Overall, import substitution has potentially negative effects. In theory, especially when an economy is at full employment, import substitution leads to the transfer of resources from efficient sectors of the economy that function competitively without protectionism to inefficient, protected sectors of the economy, leading to an overall reduction in efficiency, competitiveness, and welfare in the long term. In Russia, rather than firing workers, the widespread practice is to build up wage arrears. Furthermore, labor mobility is usually unresponsive to systematic late payment. In such a situation, import substitution, while resulting in short-term improvements in certain sectors, could also result in the transfer of labor and other resources from productive to unproductive parts of the economy, leading to an overall loss. On the contrary, if import substitution is successfully applied to sectors that fuel higher output across the entire economy, then the overall loss to welfare might be overshadowed by the gains. This would require a carefully calibrated investment plan as well as access to and the ability to compete in new markets.

Russia's pivot to China continues to be driven by the energy sector

One of the most important obstacles facing Russia's economic diversification efforts is the inability to access Western financial markets. As a result, Russia has adopted a policy that pivots to the east, particularly to China. However, it appears that China's credit line to Russia in recent years has been closely linked to the energy sector and China's future energy requirements. In 2014, China signed a $400 billion, 30-year gas supply deal with Russia.[15] In March 2016, the Bank of China extended a $2.2 billion, five-year loan to Russia's largest state-owned gas producer.[16] In April 2016, two Chinese state-owned banks agreed to extend $12 billion in funding for a Russian liquefied natural gas project in the Arctic.[17] Additionally, it was announced in July 2017 that China will extend renminbi-denominated funding worth $11 billion to two Russian state entities.[18] Part of this funding will go toward joint cross-border investment in China's One Belt One Road initiative, which requires sizable investment in infrastructure and a steady supply of cheap en-

ergy. A significantly smaller part of the funding will go toward supporting innovation in Russia.[19] In fact, China's direct investment in Russia fell from $1.3 billion in 2014 to $645 million in 2015 and $350 million in 2016.[20] Overall, net foreign direct investment inflow increased in 2016 after declining for two years, but the increase was driven by investments in mining and quarrying of fuel and energy materials (figure 3).[21] The inability of other sectors to attract sufficient funding is likely to remain a challenge. As a result, Russia's forward linkages into global value chains are likely to continue being dominated by the hydrocarbon sector.

Policy and growth outlook

Russian sovereign debt continues to remain attractive to international investors in search of higher yield, as its two-tranche, dollar-denominated eurobond placement of $3 billion attracted demand of over $6 billion in June.[22] This is in continuation of a successful return to the international debt market in 2016. Russian companies have also been raising funds in the international debt market, with the level of eurobonds issued in the first five months of the year almost equal to the total debt issued in 2016.[23]

International interest in high-yielding Russian debt is likely to lend support to the ruble, which, in turn, is likely to lower inflation. However, global crude oil prices, which have been trending down in 2017, are likely to have the opposite effect—weakening the ruble and fueling inflation. In fact, inflation accelerated to 4.4 percent in June from 4.1 percent in May.[24] Though the increase was primarily due to a temporary rise in fruit and vegetable prices, a continuation in the downward trend in oil prices could feed into higher inflation in the months to come. This risk is likely to have an effect on monetary policy easing. The Bank of Russia cut the policy interest rate by 25 basis points in June, slowing down from a 50-basis-point cut in April.[25] If oil prices drop further, interest rates might have to be put on hold or raised.

In terms of fiscal policy, the Russian administration is likely to stay the course of fiscal consolidation. The budget for the current fiscal year was planned assuming a crude oil price of $40 dollars a barrel. Since oil has remained above this mark for most of the fiscal year, it is likely to contribute to higher government revenues and a lower fiscal deficit in 2017. Moreover, the Russian administration has assumed an oil price of $40 a barrel for the next three fiscal years.[26] However, failure of the existing production reduction agreement, increased shale oil production in the United States, or higher oil production in Iraq, Libya, and Nigeria could result in lower global oil prices, which, in turn, would delay budget balance in Russia.

Given the existing risks, the short-term outlook is that Russia's return to growth in 2017 is unlikely to be robust. The World Bank projects a growth rate of 1.4 percent.[27] Long-term growth is likely to be determined by the impact of Russia's import substitution policy, which, in turn, will be influenced by the trajectory of oil prices and the likely continuation of economic sanctions.

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Uncertainty giving way to growth

By Akrur Barua

Introduction

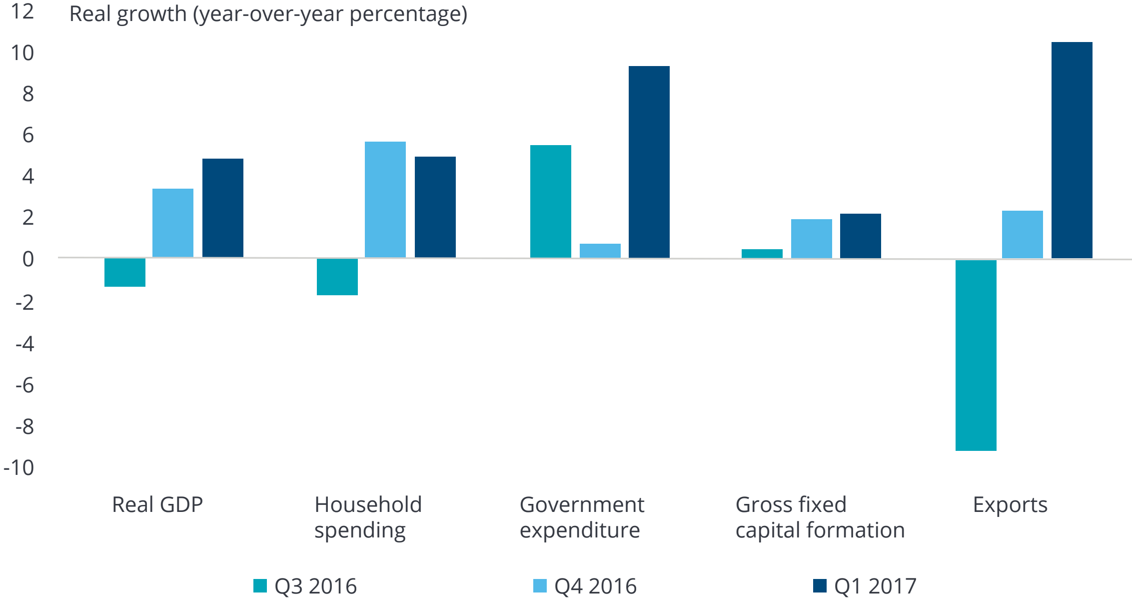
In Turkey, the momentum of economic activity appears to be blowing away the clouds of uncertainty. After a shaky Q2 and Q3 2016, the past two quarters have reinforced confidence in the economy. Growth has picked up with households ramping up spending. Given a referendum in its favor and fiscal stimulus bearing fruit, the wind appears to be in favor of the government. Tourism appears to have bottomed out, with the number of foreign visitors going up year over year in April and May, breaking a trend of more than a year of decline.[1] And exports have revived due to rising growth in key markets. There are concerns, however, about weak investment and its impact on long-term growth and productivity. Also, while reviving growth and central bank action have boosted the Turkish lira in recent months, much will depend on how the current account pans out and how much impact the present monetary stance has on denting inflation.

The economy gained momentum in Q1

Real GDP grew by 5.0 percent year over year in Q1 2017, gaining momentum after a 3.5 percent rise in Q4 2016. Households continue to show resilience, with spending increasing by 5.1 percent in Q1, although the fact that the figure is lower than the previous quarter's rise (5.7 percent) shows that price pressures and high unemployment are weighing on consumer purchases—household spending remained flat on a quarter-over-quarter basis. Within household consumption, it was nondurable goods and services that mostly pushed up growth in Q1.[2] Apart from household spending, there are two other expenditure categories that stand out for strong growth in Q1: government consumption and exports (figure 1).

High growth in government consumption in Q1 (9.4 percent) is not surprising given the fiscal stimulus

Figure 1. Exports and government expenditure were the stand-outs in Q1 2017



Source: Haver Analytics; Deloitte Services LP economic analysis.

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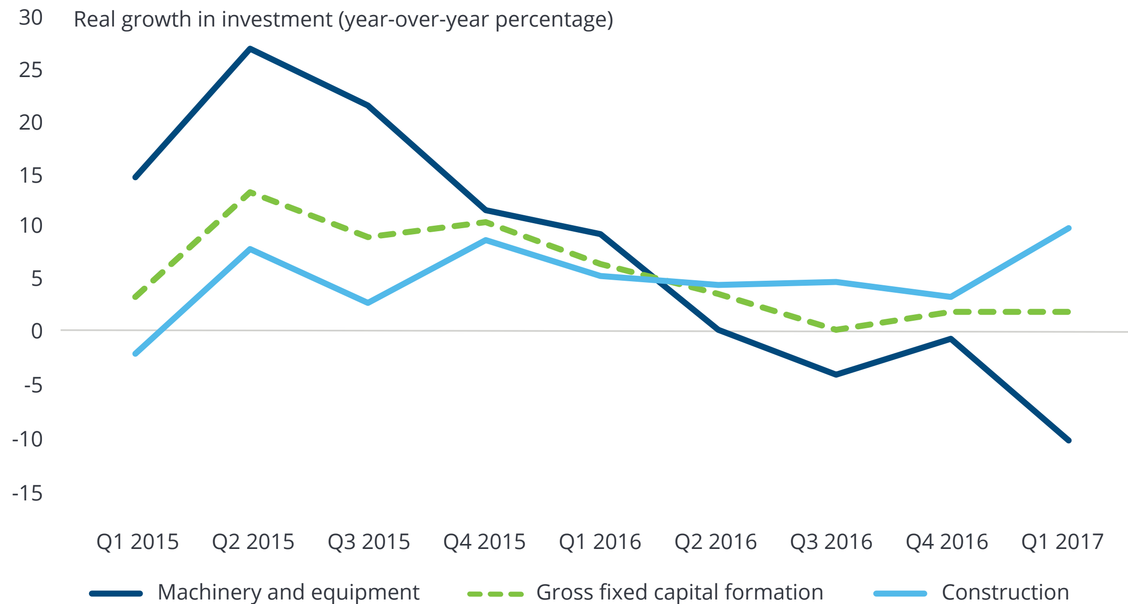
Figure 2. Investment in machinery and equipment contracted in Q1 2017



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte University Press | dupress.deloitte.com

to shore up the economy. Part of the stimulus in the form of tax discounts, and cheaper credit will continue to benefit households in the near term. Exports, benefitting from reviving demand in key markets such as the European Union, grew 10.6 percent in Q1, up from a 2.4 percent rise in the previous quarter. Investment, however, continues to remain subdued, with gross fixed capital formation growing just 2.2 percent in Q1. And within that, much of the growth came from construction, with investment in machinery and equipment declining for a third straight quarter (-10.1 percent).

Amid weakness, some green shoots for investment

Weak investment, especially in machinery and equipment (figure 2), is a worry for long-term productivity gains and, hence, potential GDP growth. According to Oxford Economics, total factor productivity growth is likely to fall to 0.6 percent per year during 2016–2025 from a 2.1 percent rise over 2006–2015.[3] Nevertheless, there appears to be some green shoots for investment in the near term. Household demand is recovering, and growth in the European Union has been improving, albeit slowly. Arguably, the biggest relief for investment is an end to the political uncertainty that started with a failed coup in 2016 until a referendum this year. Business confidence is up as a result, with the real sector confidence index in June rising to its highest level since October 2014.[4]

In manufacturing, rising output and capacity utilization are good news for investment. Manufacturing output grew 7.1 percent year over year (seasonally and working-day adjusted) in April, the fastest pace of growth since August 2015. Capacity utilization (seasonally adjusted) is up slightly, from 77.7 percent in Q4 2016 to 78.8 percent in Q2 2017; capacity utilization growth was even better in investment goods over the above period.[5] Interestingly, fiscal stimulus measures are more likely to aid residential investment than those in machinery and equipment. Building permits have been reviving since the latter part of 2016, and the pace of house price growth has edged down toward more sustainable levels.[6]

Households have something to look forward to

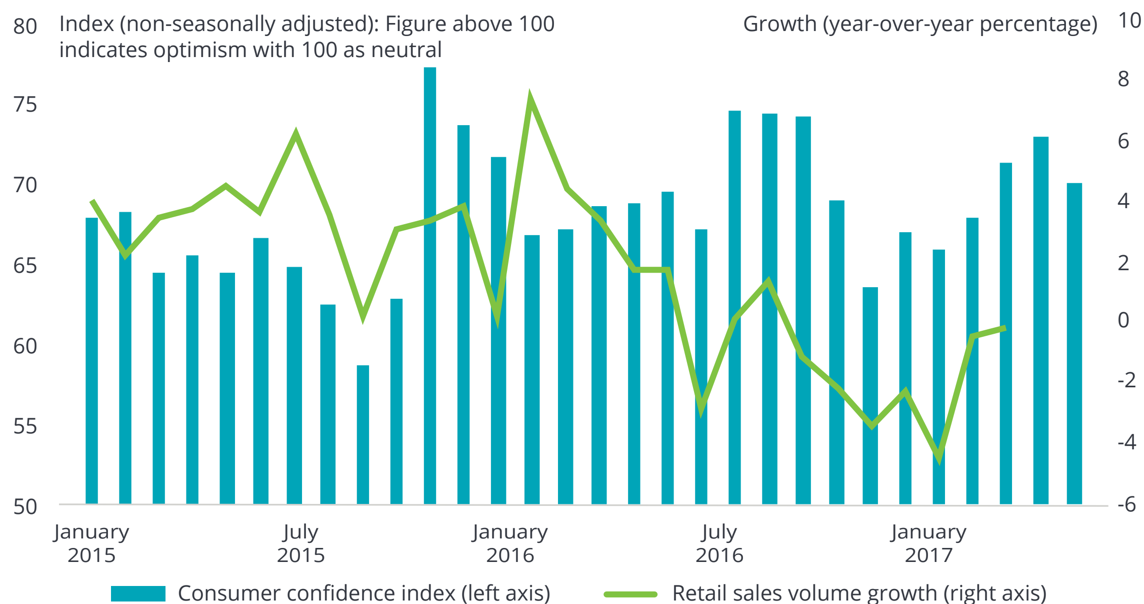
A key worry for households has been the weak labor market and high inflation. It's no wonder, then, that consumers appear nervous: Consumer confidence fell in June after a slight increase in April and May.[7] This is also evident in retail sales, with growth slowing to 0.1 percent month over month in April from healthy growth in the previous two months; year-over-year growth continues to be negative (figure 3). While a weak labor market has dented nominal wages, high inflation has pushed down real wages. Real earnings, for example, fell in Q1 relative to a year ago, according to the index of gross wages and salaries.[8]

The good news, however, is that the labor market is reviving, and inflation is likely to have bottomed out as the lira starts strengthening. The unemployment rate, after peaking at 11.9 percent in December 2016, has dipped slightly this year (11.4 percent in March). Employment has also increased this year after a shaky 2016, with the participation rate edging up once again.[9] Price pressures are also easing, with the growth in both energy and food prices—key drivers of inflation in recent times—slowing down in June, thereby bringing down headline inflation to 10.9 percent from a nearly nine-year peak of 11.9 percent in March.

CBT remains focused on the lira and inflation

The lira has been a key concern for the Central Bank of Turkey (CBT), with the currency losing about 23.7 percent of its value against the US dollar and 21.1 percent against the euro between the end of June 2016 and end of January 2017. A weaker lira, in turn, has contributed to higher inflation.[10] The CBT's response to the weakening lira as well as high prices has been to hike interest rates. While it raised the one-week repo rate in November 2016 by 50 basis points, its focus has been primarily on the late liquidity rate, a window by which it has channeled as

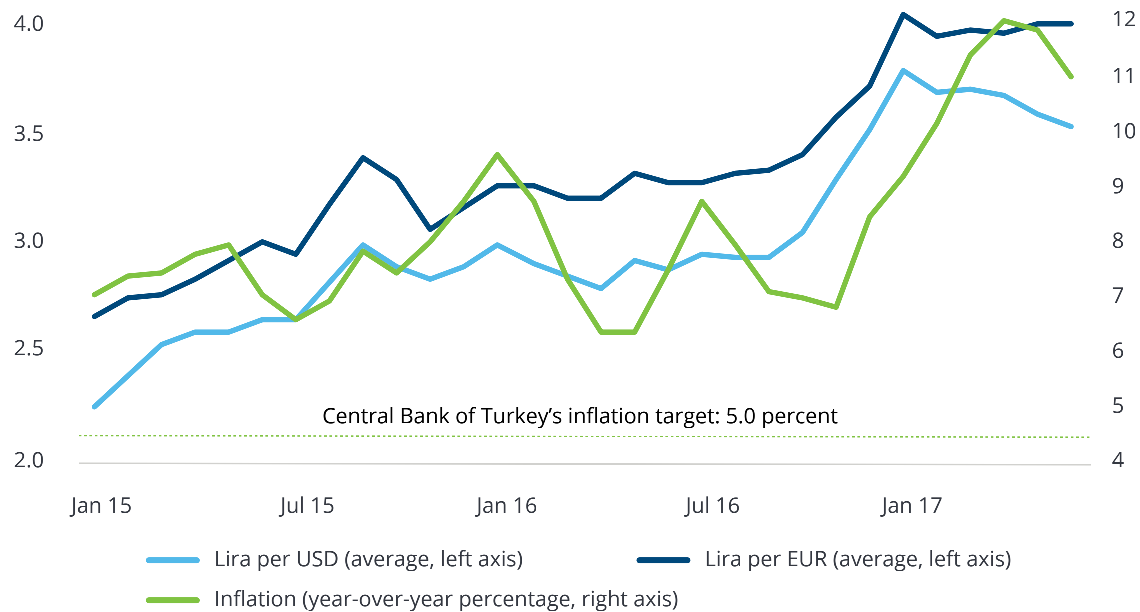
Figure 3. Consumer confidence remains shaky, while retail sales are subdued



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte University Press | dupress.deloitte.com

While a return of assets back into Turkey will likely shore up the lira, the current account deficit will act in the opposite direction.

Figure 4. With the lira strengthening, it is likely that inflationary pressures will ease



Source: Haver Analytics; Deloitte Services LP economic analysis. Deloitte University Press | dupress.deloitte.com

much as 90 percent of credit to commercial lenders in recent times.[11] Since October 2016, it has raised the rate by 300 basis points, with the latest rate hike coming in April.[12]

The strategy seems to be working, with the lira up against the US dollar this year, although part of this could also be due to dollar weakening (figure 4). The tighter monetary stance has, however, not been able to stem credit growth much, although the month-over-month growth of domestic loans in lira fell to 2.1 percent in May from 4.1 percent in March. It is still too early to predict the outcome of the current monetary stance. While a return of assets back into Turkey will likely shore up the lira, the current account deficit will act in the opposite direction.[13] For the CBT, its fight against inflation and the currency appreciation helps in getting back some credibility. Its use of the late liquidity rate for monetary tightening helps thwart political pressure to keep the policy rate low. Also, with the government focusing on getting growth back on track through stimulus in the near term, it helps that the CBT is not losing its focus on medium-term economic stability.

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Why reversing globalization may not be a good idea

By Rumki Majumdar

Introduction

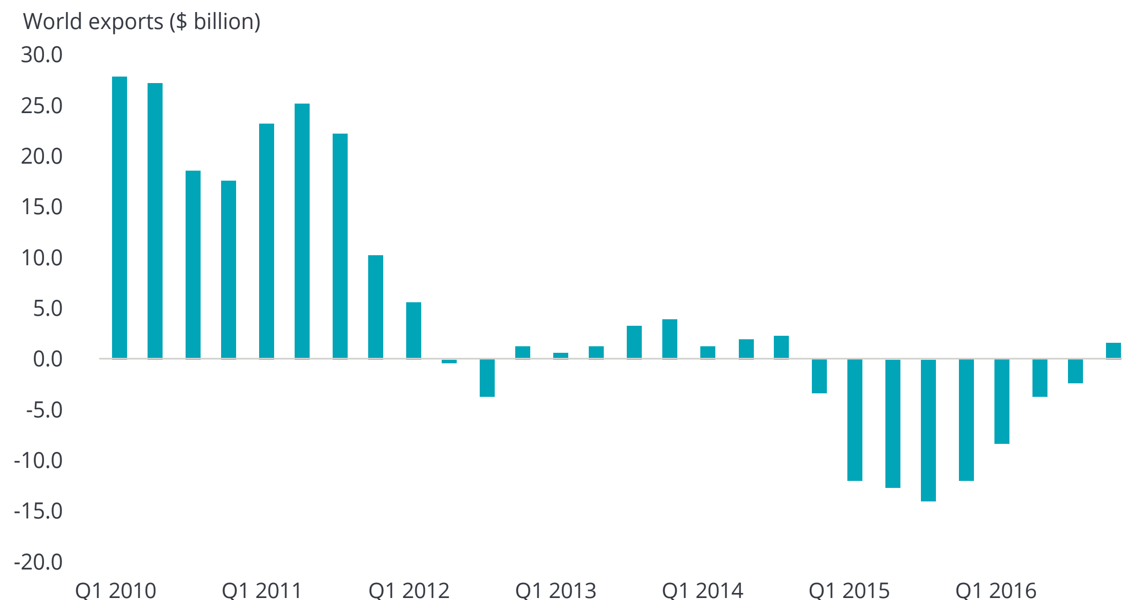
Throughout history, countries have used a range of protectionist measures to limit imports or promote exports. While many economic arguments favor free trade and trade liberalization, protectionism is still widely practiced by almost all countries for any or all of the following reasons: to protect their strategic and infant industries, deter competition that is perceived as unfair, safeguard jobs in certain industries or for specific workers, protect the environment, and political reasons. What has changed over the years is that industrialized nations have gradually moved toward using different deterrents to trade, such as non-tariff barriers, instead of resorting to more direct protectionist methods, such as imposing tariffs.

After the 2008 global financial crisis, G20[1] leaders signed a pledge in November 2008 to avoid protectionist measures in order to speed up economic recovery and boost growth through increased trade. Ironically, protectionism has witnessed a worrisome rise since then. Several countries, including the G20 countries, were reported as increasing trade-restrictive measures.[2] Slow global growth post the 2008 financial crisis, together with this rising protectionism, has impacted global trade volume, which has been declining since 2011 and was in negative territory for two years up to Q4 2016.[3] In addition, there are rising anti-globalization sentiment and support for populist parties in some Western industrial nations, even as mainstream policy makers of Western industrial nations are co-opting policies to restrict free movements in goods, services, and resources—factors that have been held responsible for rising income inequality and marginalization of labor. The year 2016 witnessed the traditional champions of open government and free trade—the United States and United Kingdom—appeasing populists, while China staunchly defended globalization.[4]

The unpredictable direction of the global economy and the lack of clarity around governments' (especially the US and UK governments') actions on monetary, fiscal, and trade policies have increased downside risks to trade growth. In addition, there are fears that the vulnerability of emerging nations to volatile capital flows, which are a result of policy uncertainties in the West, may impact the former's domestic currency, inflation, and dollar-denomi-

The year 2016 witnessed the traditional champions of open government and free trade—the United States and the United Kingdom—appeasing populists, while China staunchly defended globalization.

Figure 1. World trade has slowed since 2011



Source: International Monetary Fund, 2016.

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nated debt—leading to higher interest rates, tighter fiscal policies, and stronger barriers to trade.

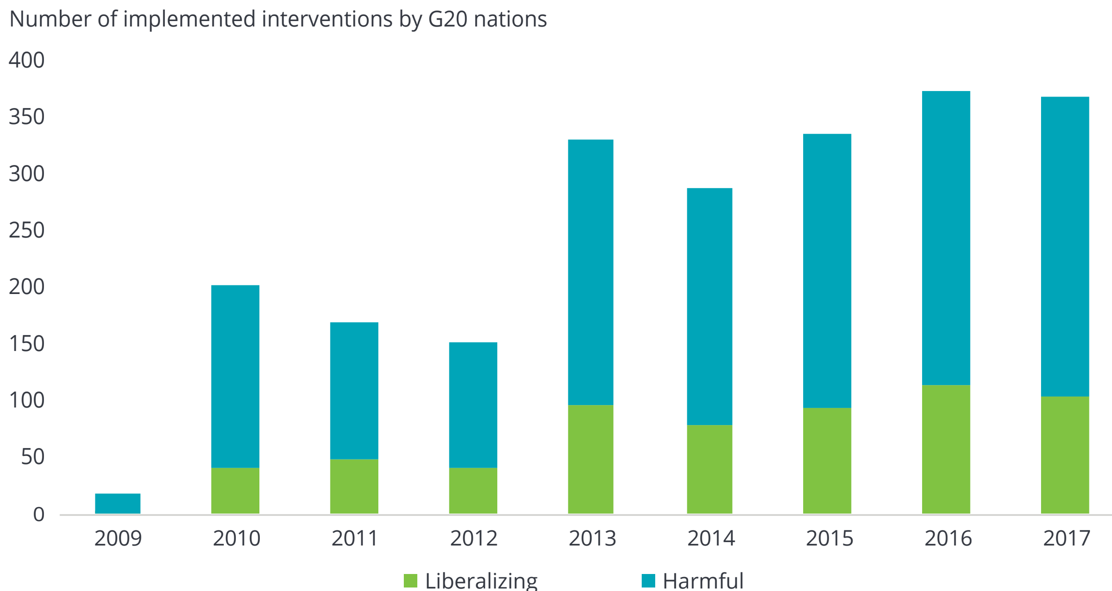
Slowing trade and increasing protectionism: Just a coincidence?

With world trade growing at 1.3 percent in 2016—the slowest trade growth since the global financial crisis—the slowdown in global trade is now in its sixth year.[5] Weak international trade growth in the last few years largely reflects continuing weakness in the global economy. Trade in emerging economies began to decline from 2011 due to slowing economic growth in China and a fall in commodity prices. During this time, trade in developed economies stalled as economic activity slowed in North America and Europe. The global trade volume turned positive for the first time in Q4 2016, after contracting for eight consecutive quarters (figure 1).

Weak trade growth also reflects a change in the structural relationships between economic activity and trade. This period of slow growth coincided with an increase in protectionist trade measures around the world. The total number of discriminatory (protectionist) measures implemented by the G20 increased over the past five years (when reporting lags are taken into account), indicating that overall the G20 nations are resorting to more protectionism over time (figure 2).[6] The BRICS countries recorded the maximum number of protectionist measures, accounting for around 30 percent of the total measures implemented since 2009. However, the share of the G7 nations and Australia together also has grown markedly (figure 3). Between 2008 and October 2016, a total of 1,671 trade-restrictive measures were recorded for G20 economies (figure 4). Since October, only 408 (about 24 percent of the total) have been discontinued, leaving a new total of 1,263 (figure 4). The World Trade Organization (WTO) has recorded a moderate rise in G20 trade restrictions since October 2016.[7]

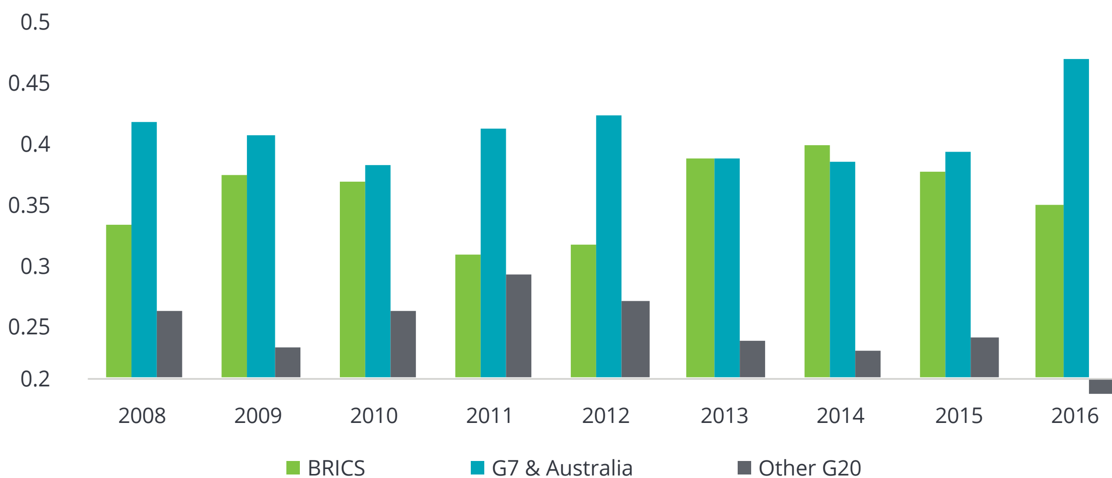
Over 50 percent of the trade-restrictive measures by G20 economies were in the form of initiation of trade remedy investigations, the majority of which were anti-dumping investigations. Several other

Figure 2. G20 trade-restrictive measures have gone up steadily since 2012



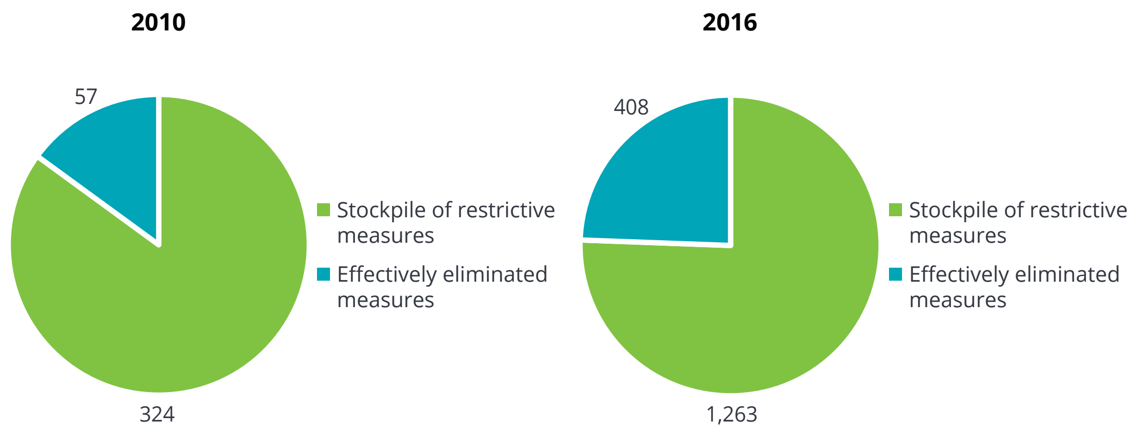
Note: "Liberalizing" and "harmful" are categories used by the source.
Source: Centre for Economic Policy Research, April 2017. **Deloitte University Press | dupress.deloitte.com**

Figure 3. Percentage of all G20 discriminatory measures implemented by year



Source: Centre for Economic Policy Research, April 2017. **Deloitte University Press | dupress.deloitte.com**

Figure 4. The number of restrictive policies has gone up since 2010



Source: World Trade Organization, October 2016.

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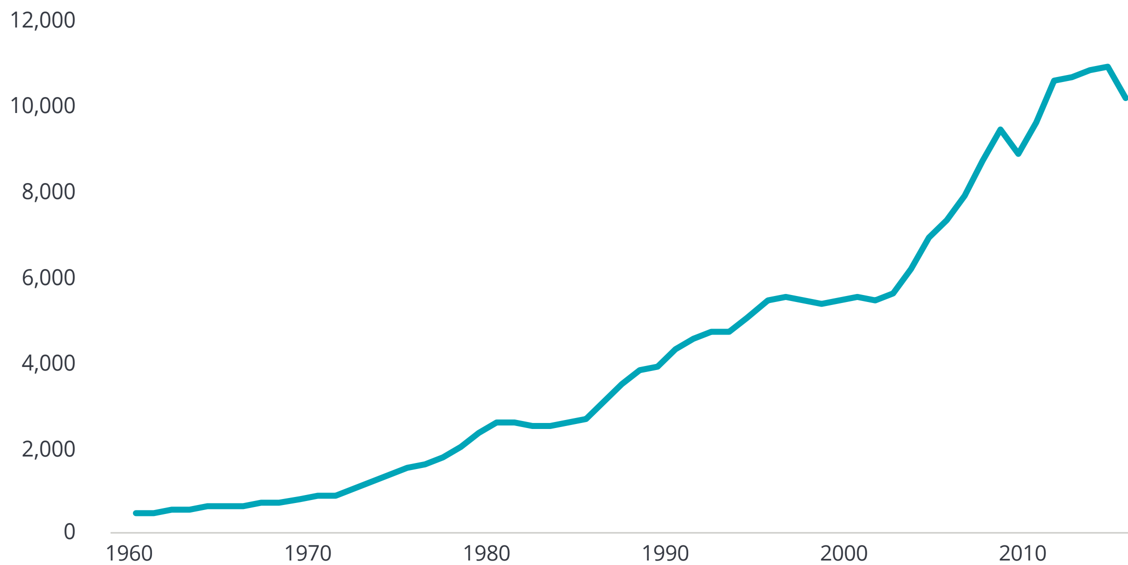
Figure 5. GDP per capita grew five times since 1980 due to globalization



Source: World Development Index, International Monetary Fund, 2016.

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distortive measures were also imposed, such as government support for sectors such as infrastructure, agriculture, and export-specific activities.

A halt in the globalization trajectory

Globalization has a long history, dating back to the trade routes developed in Asia and Egypt, which gradually integrated economies spread across continents. As the global marketplace expanded, the process evolved, resulting in rapid trade expansion, technology growth, and financial liberalization.

However, it was not until the second half of the 20th century that globalization picked up pace; outward-oriented policies made economic performance more dynamic and brought greater prosperity, improving living standards for countries that were able to integrate with the global marketplace. The global per capita GDP increased almost fivefold over the past three-and-a-half decades (figure 5).[8] Along with nations becoming more prosperous, businesses and employment also became more global and integrated, facilitated by modern electronic communication and technology.

THE NEGATIVES OF GLOBALIZATION

However, a lit candle also casts a shadow. Amid prosperity and opportunities, globalization has also created a widening gap between the world's haves and have-nots. Rising income inequality has created profound changes in the workforce and society, leading to asymmetric access to knowledge and skills, and shrinking welfare safety nets have resulted in economic insecurity and social deprivation among those left behind in this whole globalization gala. In addition, globalization has interconnected global risks arising from volatile capital movements and social, economic, and environmental degradation created by poverty and inequality, leaving low-income nations vulnerable to shocks.

Consequently, people belonging to the less secure strata of society—those who feel they are losing their jobs to immigrants or foreign competitors, have been unemployed for a long time, are at the low end of the wage spectrum or are witnessing income stagnation, and are living on shrinking social benefits—are now raising their voice against the changes brought about by globalization. The anxiety about immigration and trade is now translating into rising support for populism in several nations, including in the West, leading to policy uncertainty. Even mainstream politicians are directing their policies toward more restrictive immigration and imports. The rising clamor for protectionism around the world, together with slowing growth in trade, is impacting global business sentiment, investments, and, thereby, growth.

The questions that everyone is asking are, how big a threat are these sentiments to globalization and its impact on growth, and are we already seeing a reversal of the globalization process?

Rising income inequality has created profound changes in the workforce and society, leading to asymmetric access to knowledge and skills, and shrinking welfare safety nets have resulted in economic insecurity and social deprivation among those left behind in this whole globalization gala.

Figure 6. Depth of global connectedness, relative to 2005

Source: Pankaj Ghemawat and Steven A. Altman, DHL Global Connectedness Index 2016, DHL, http://www.dhl.com/content/dam/downloads/g0/about_us/logistics_insights/gci_2016/DHL_GCI_2016_full_study.pdf.

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To answer the first question, we go back in time to when a major trade war broke out in the early 1930s, often argued to be the period when the world witnessed the largest reversal of globalization.[9] Although global trade dropped by two-thirds between 1929 and 1933 (primarily because of a fall in prices), it didn't dry up completely. In addition, established trading partners increased trading with each other after the crash to compensate for the lack of trade with those with whom they had no prior trade relationship. While the past is not prologue, today the trade volume is too large and interconnectedness too complex, which means protectionism by any measure may not result in a substantial fall in global trade, or the fall might have no sustainable impact.

To answer the second question, we assess the impact of recent events on globalization by looking at the DHL Global Connectedness Index, which tracks international flows of trade, capital, information, and people. Undoubtedly, merchandise trade and investment were hit hard during the 2008 global financial crisis (figure 6). They quickly recovered, but remained stagnant in the following years. Trade fell in 2015, but it reflects the price effect, driven by plunging commodity prices and the rising value of the US dollar. The latest data are not available at the time of writing this article, but rising asset prices and economic performances across the globe in 2016 indicate that globalization might have stayed flat.

Reversing globalization isn't the solution . . .

Advancements in transport, technology, and communications and an increasing pool of talent and skills post 1980 led to rapid economic integration through trade and financial flows. Greater integration, increased competition, efficient use of resources, and improved productivity benefited all economic entities: Nations benefited as economic growth accelerated; businesses profited from the access to cheap raw material, increased labor supply, and markets to sell finished products; consumers gained because of the availability of the wide variety and lower price of goods; and many workers got exposure to new jobs and skills. While it is true that

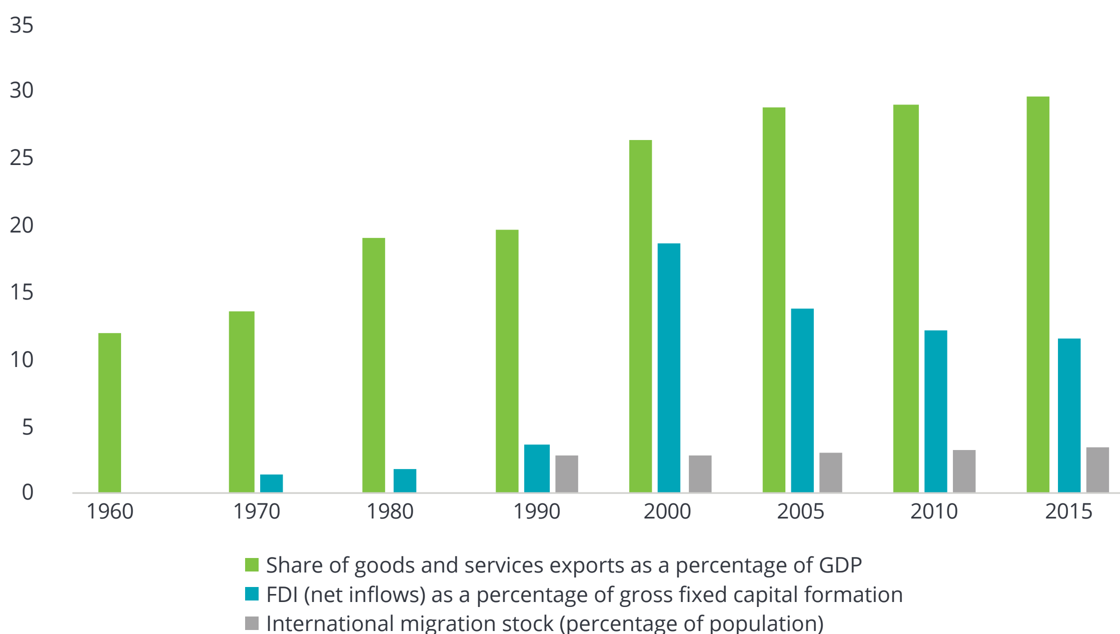
globalization opportunities have not come without costs, that doesn't seem to be a sufficient reason to erect trade barriers and reverse the entire process.

. . . BECAUSE THE WORLD ISN'T AS FLAT AS IT IS PERCEIVED TO BE

While the world is believed to have become "flat" post 1980 due to rapid globalization, the truth is that globalization is far less prevalent than is commonly perceived:

- Global foreign direct investment (FDI) inflows account for just about 10 percent of the world's gross fixed capital formation, and total international migration stock accounts for less than 3.5 percent of the world's population (figure 7).
- The share of global exports is less than a third of the world GDP (figure 7).
- Only 0.1 percent of the world's firms are multinationals, collectively generating 10.0 percent of the world GDP and more than 50 percent of the world's trade.[10]
- While the United States is perceived to be highly globalized, its share of trade relative to other nations is among the lowest, indicating that its international business contribution is small relative to domestic activity (figures 8a and 8b).
- While it is true that emerging nations have widely practiced protectionist policies to safeguard local industries and jobs, and deter competition, several advanced nations too have pursued restrictive policies for years. For instance, among the top 10 G20 countries that implemented the highest number of discriminatory measures between November 2008 and the end of June 2017, five were advanced nations: the United States (top rank), Germany (5th), the United Kingdom (7th), Italy (8th), and France (9th) (figure 9).[11] It is worth noting, though, that these statistics refer to the counts of protectionist policy inter-

Figure 7. Export intensity, FDI, and immigration since the 1960s



Source: World Development Index, 2016.

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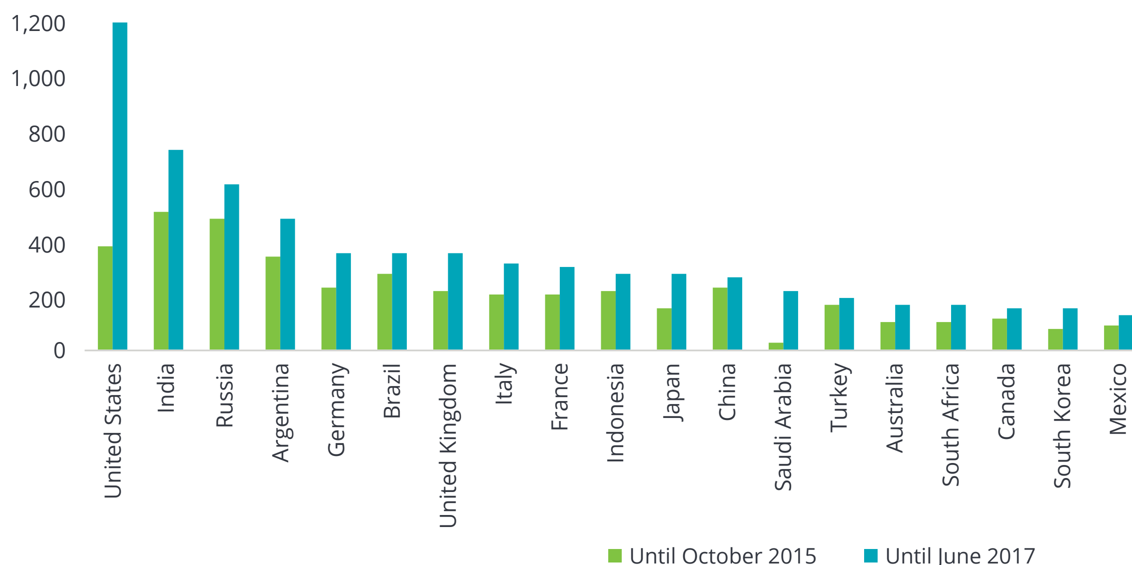
Figure 8a. Exports as a percentage of GDP

Source: International Monetary Fund, 2016; Haver Analytics. **Deloitte University Press | dupress.deloitte.com**

Figure 8b. Imports as a percentage of GDP

Source: International Monetary Fund, 2016; Haver Analytics. **Deloitte University Press | dupress.deloitte.com**

Figure 9. Number of protectionist measures implemented since November 2008



Source: Centre for Economic Policy Research, April 2015 and April 2017.

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ventions and do not reflect the impact on their trade or welfare.

. . . BECAUSE IT MIGHT HURT ECONOMIC ENTITIES MORE THAN BENEFITTING THEM

An exaggerated perception of how much globalization impacts an economy often results in an overstatement of the adverse effects of globalization. Biased views based on such perceptions lead to increased support for public policies that restrict movement of goods and services, capital, and labor. However, a shift toward protectionism, which is lately being promoted by various policymakers across the globe, may not bode well for all nations, businesses, and consumers.

There are instances in the past when a few nations pursuing protectionism suffered an economic slowdown and inefficiencies. In the 1970s and 1980s, when globalization was gradually picking up in the rest of the world, several countries in Latin America and Africa pursued inward-oriented policies to protect strategic industries and jobs from competition. Subsequently, their economies stagnated or declined, poverty increased, and high inflation became the norm. As these regions changed their policies and liberalized their economy post 1990, their incomes gradually rose.[12]

Policy changes favoring localization are likely to impact several multinational corporates that have prioritized shifting their operations beyond their own countries to seek new growth opportunities and benefit from the advantages of scale, access to resources, proximity to the market, and arbitrage opportunities. For instance, several US technology, manufacturing, and life science and medical technology companies that have expanded in regions such as BRICS over the past several decades are likely to face operational and supply chain disruptions. It is estimated that if a quarter of US multinationals shift jobs home at American wages and pay higher taxes on the revenue earned beyond US borders, their profits will likely drop 12.0 percent. This excludes the impact of rising costs due to shifting operations to the United States.[13]

That said, the impact of protectionism may not be uniform across sectors. For example, since the crisis, the metals, machinery, and chemical sectors

An exaggerated perception of how much globalization impacts an economy often results in an overstatement of the adverse effects of globalization.

have been affected the most (7 out of the top 10 most affected sectors), with their commercial interests hit more than 750 times. The other sectors that were affected the most by G20 protectionism were the transport equipment and agricultural product sectors. Together, these sectors account for more than a quarter of global trade.[14] These are also sectors that employ low-skilled labor and have strong external linkages. Often, disruptions result in cost cutting via layoffs or rising product prices for which consumers have to bear the costs.

Turning the tide toward awareness and targeted policies will be the key

The US presidential election, the 2016 UK referendum on the membership of the European Union, and Italy's referendum for structural and constitutional reforms signal rising economic and cultural anxiety among those with stagnant incomes, less education, and low job opportunities. A part of the problem is that the benefits of globalization go largely unrecognized, primarily because policymakers have failed to highlight them, while adverse effects have been overstated. For example, globalization has been blamed for trends that are largely due to technological innovation and automation. Roughly 80 percent of manufacturing jobs have been lost due to innovation, automation, and new technologies.[15]

Instead of appeasing populism, policymakers have to address the real cost of globalization and promote inclusion. Targeted domestic policies, such as improving education, funding more job training and social programs, and providing better social safety nets may help in addressing the anxiety of displaced workers and dislocated communities, and enable them to get back on their feet.

Better coordination between international and domestic policies is essential, and will likely warrant a uniform assistance program for labor upskilling, adjustments in capacity building in terms of capital investment and labor reforms, and the reduction of red tape. The B20 Germany task force has several recommendations for the G20 countries to ensure that the benefits of globalization are more inclusive:

1. "**Strengthen an open and inclusive trading system . . .** underpinned by transparency and robust adjustment assistance programs, resistance to protectionism in all forms, and a strong, nondiscriminatory rules-based global trading system."

2. "**Make use of digital trade potential . . .** by accelerating capacity building, encouraging implementation of interoperable and nondiscriminatory e-commerce-related policies, and calling for a WTO negotiation mandate on digital trade."

3. "**Foster investment facilitation . . .** [by establishing] a reliable legal environment, [enhancing] sustainable investment facilitation, and [identifying] the benefits and drawbacks of a multilateral investment framework."[16]

Today, no person, business, or nation is an island, but all are part of a massive, complicated interconnected system, thanks to globalization. The phenomenon that started several hundreds of years ago has resulted in greater interdependence and integration among nations. With freer movement of resources, increased trade and technology transfer, spread of knowledge, and cultural exchange, nations have seen unparalleled economic growth. Going backward and undoing globalization may impose more costs than reap benefits and thus may not be a prudent way forward.

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Endnotes

1. The G20 countries comprise Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and European Union.
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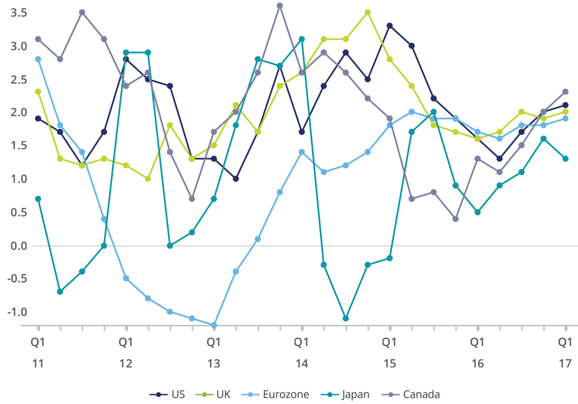
Economic indices

Figure 1. GDP growth rates (percentage, year over year)



Source: Bloomberg, Haver Analytics.

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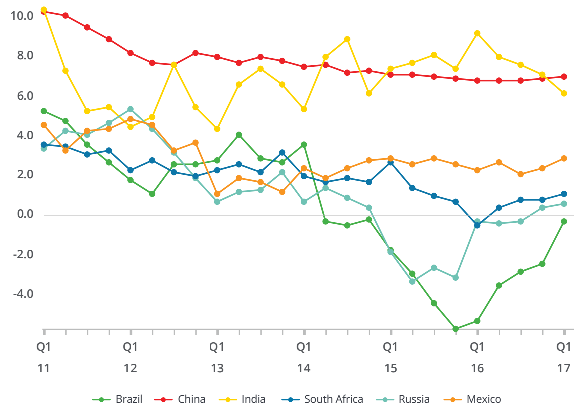
Figure 2. GDP growth rates (percentage, year over year)



Source: Bloomberg, Haver Analytics.

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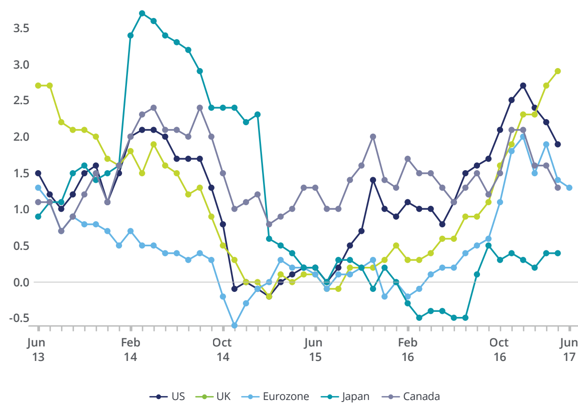
Figure 3. Inflation rates (percentage, year over year)



Source: Bloomberg, Haver Analytics.

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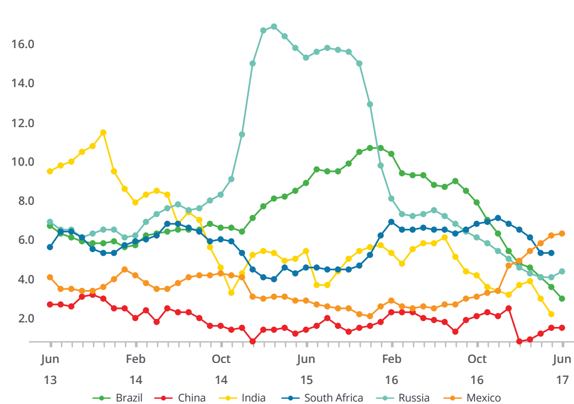
Figure 4. Inflation rates (percentage, year over year)



Source: Bloomberg, Haver Analytics.

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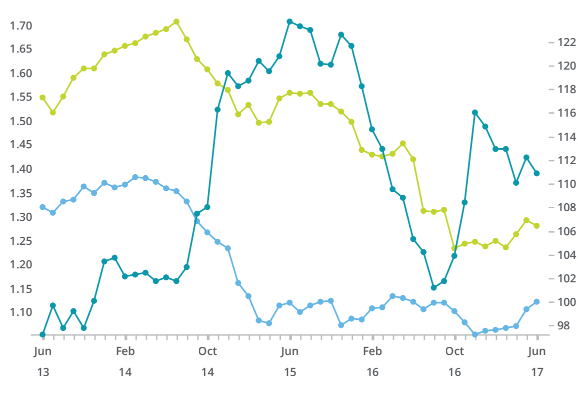
Figure 5. Major currencies vs. the US dollar (percentage, year over year)



Source: Bloomberg, Haver Analytics.

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Yield curves (as of July 11, 2017)*

	US Treasury Bonds & Notes	UK Gilts	Eurozone Govt. Benchmark	Japan Sovereign	Canada Sovereign	Brazil Govt. Benchmark
3 Months	1.03	0.32	-0.58	-0.09	0.76	9.27
1 Year	1.21	0.30	-0.54	-0.11	1.04	8.55
5 Years	1.93	0.66	-0.11	-0.03	1.48	10.26
10 Years	2.37	1.27	0.54	0.09	1.89	10.51

	China Sovereign	India Govt. Bonds	South Africa Sovereign	Russia‡	Mexico
3 Months	-	6.27	6.55	8.11	7.06
1 Year	3.47	6.39	-	7.97	7.07
5 Years	3.52	6.57	7.86	7.98	6.65
10 Years	3.60	6.47	8.87	7.94	6.83

Composite median GDP forecasts (as of July 11, 2017)*

	US	UK	Eurozone	Japan	Canada	Brazil	China	India	South Africa	Russia	Mexico
2017	2.2	1.6	1.9	1..3	2.5	0.5	6.6	-	0.7	1.3	1.9
2018	2.3	1.3	1.6	1	2	2	6.3	7.3	1.4	1.5	2.2
2019	2.2	1.6	1.4	0.8	1.9	2.5	6.1	7.6	1.6	1.6	2.3

Composite median currency forecasts (as of July 11, 2017)*

	Q3 17	Q4 17	Q1 18	Q2 18	2017	2018	2019
GBP-USD	1.26	1.27	1.26	1.27	1.27	1.31	1.3
Euro-USD	1.12	1.13	1.13	1.14	1.13	1.15	1.2
USD-Yen	112	114	115	114	114	113	113
USD-Canadian Dollar	1.33	1.33	1.32	1.32	1.33	1.3	1.31
USD-Brazilian Real	3.3	3.35	3.4	3.45	3.35	3.42	3.57
USD-Chinese Yuan	6.85	6.95	6.98	6.99	6.95	7	6.92
USD-Indian Rupee	65	65.67	66	66	65.67	66	67.5
USD-SA Rand	13.28	13.55	13.55	13.8	13.55	14.1	14.43
USD-Russian Ruble	59	59.7	59.25	59.85	59.7	60	61.92
USD-Mexican Peso	18.45	18.5	18.5	18.71	18.5	18.9	19.26

*Source: Bloomberg ‡MICEX rates

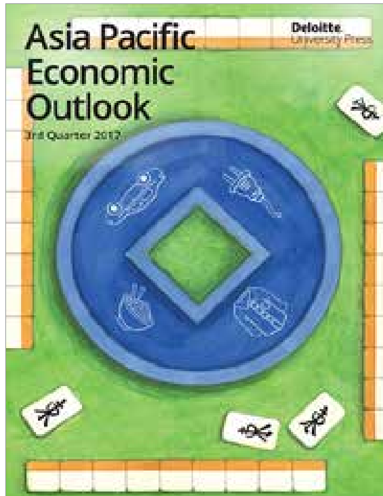
OECD composite leading indicators (Amplitude adjusted)†

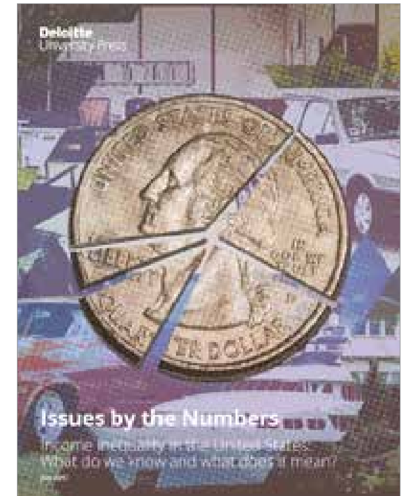
	United States	United Kingdom	Euro area	Japan	Canada	Brazil	China	India	South Africa	Russian Federation	Mexico
May 14	100.9	102.0	100.3	100.6	100.3	98.4	100.7	98.6	100.2	101.2	98.8
Jun 14	100.9	102.0	100.2	100.4	100.3	98.5	100.7	98.7	100.2	101.3	98.9
Jul 14	101.0	101.9	100.1	100.3	100.3	98.5	100.6	98.8	100.4	101.3	99.2
Aug 14	101.0	101.7	100.1	100.2	100.3	98.5	100.5	98.9	100.5	101.2	99.4
Sep 14	101.0	101.6	100.0	100.1	100.3	98.4	100.4	99.0	100.6	100.9	99.8
Oct 14	100.9	101.4	100.0	100.1	100.2	98.3	100.3	99.1	100.7	100.6	100.1
Nov 14	100.9	101.3	100.1	100.1	100.1	98.1	100.2	99.1	100.7	100.2	100.4
Dec 14	100.8	101.2	100.1	100.1	100.0	97.9	100.1	99.2	100.6	99.8	100.6
Jan 15	100.7	101.1	100.2	100.2	99.9	97.7	100.0	99.3	100.6	99.5	100.9
Feb 15	100.6	101.0	100.3	100.2	99.8	97.5	99.9	99.4	100.6	99.3	101.1
Mar 15	100.5	100.9	100.3	100.3	99.7	97.4	99.9	99.5	100.6	99.3	101.1
Apr 15	100.4	100.8	100.4	100.3	99.6	97.2	99.9	99.5	100.6	99.3	100.9
May 15	100.3	100.8	100.4	100.4	99.6	97.1	99.9	99.6	100.6	99.3	100.6
Jun 15	100.2	100.7	100.4	100.4	99.5	97.1	99.8	99.7	100.6	99.2	100.3
Jul 15	100.1	100.6	100.3	100.3	99.4	97.0	99.7	99.8	100.5	99.0	99.9
Aug 15	99.9	100.5	100.3	100.2	99.3	97.0	99.6	99.9	100.4	98.8	99.7
Sep 15	99.7	100.3	100.3	100.1	99.2	97.0	99.5	99.9	100.3	98.5	99.6
Oct 15	99.5	100.2	100.3	100.0	99.1	97.1	99.4	100.0	100.2	98.3	99.7
Nov 15	99.4	100.1	100.3	99.9	99.0	97.1	99.3	100.0	100.2	98.0	99.8
Dec 15	99.3	99.9	100.3	99.8	98.9	97.2	99.2	100.0	100.1	97.8	100.0
Jan 16	99.2	99.8	100.2	99.7	98.9	97.3	99.1	100.1	100.0	97.8	100.3
Feb 16	99.1	99.6	100.2	99.7	98.9	97.5	99.1	100.1	100.0	97.9	100.5
Mar 16	99.1	99.4	100.1	99.7	99.0	97.8	99.1	100.1	99.9	98.2	100.7
Apr 16	99.1	99.3	100.0	99.6	99.1	98.2	99.1	100.1	99.8	98.5	100.9
May 16	99.1	99.1	100.0	99.6	99.2	98.7	99.1	100.1	99.7	98.9	101.0
Jun 16	99.1	99.0	99.9	99.6	99.4	99.1	99.1	100.0	99.6	99.2	101.1
Jul 16	99.1	99.0	99.9	99.6	99.5	99.6	99.1	100.0	99.6	99.5	101.0
Aug 16	99.1	99.1	100.0	99.6	99.6	100.0	99.1	99.9	99.6	99.8	100.9
Sep 16	99.2	99.3	100.0	99.7	99.8	100.3	99.0	99.9	99.6	100.1	100.7
Oct 16	99.3	99.4	100.1	99.8	99.9	100.7	99.0	99.8	99.7	100.3	100.4
Nov 16	99.5	99.6	100.1	99.9	100.1	100.9	99.0	99.7	99.7	100.6	100.1
Dec 16	99.6	99.7	100.2	100.0	100.2	101.2	99.0	99.6	99.7	100.8	99.7
Jan 17	99.7	99.7	100.3	100.0	100.3	101.5	99.0	99.6	99.7	101.0	99.2
Feb 17	99.7	99.8	100.3	100.0	100.4	101.7	99.0	99.5	99.5	101.1	98.8
Mar 17	99.7	99.7	100.4	100.1	100.5	102.0	99.1	99.5	99.4	101.1	98.5
Apr 17	99.7	99.7	100.4	100.1	100.5	102.1	99.2	99.5	99.2	101.0	98.3
May 17	99.6	99.6	100.4	100.1	100.5	102.3	99.4	99.6	99.0	100.9	98.2

Note: A rising composite leading indicator (CLI) reading points to an economic expansion if the index is above 100 and a recovery if it is below 100.
A CLI that is declining points to an economic downturn if it is above 100 and a slowdown if it is below 100.

Source: OECD.

Additional resources





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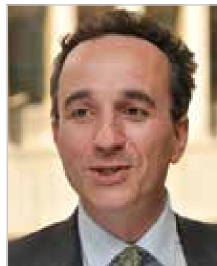

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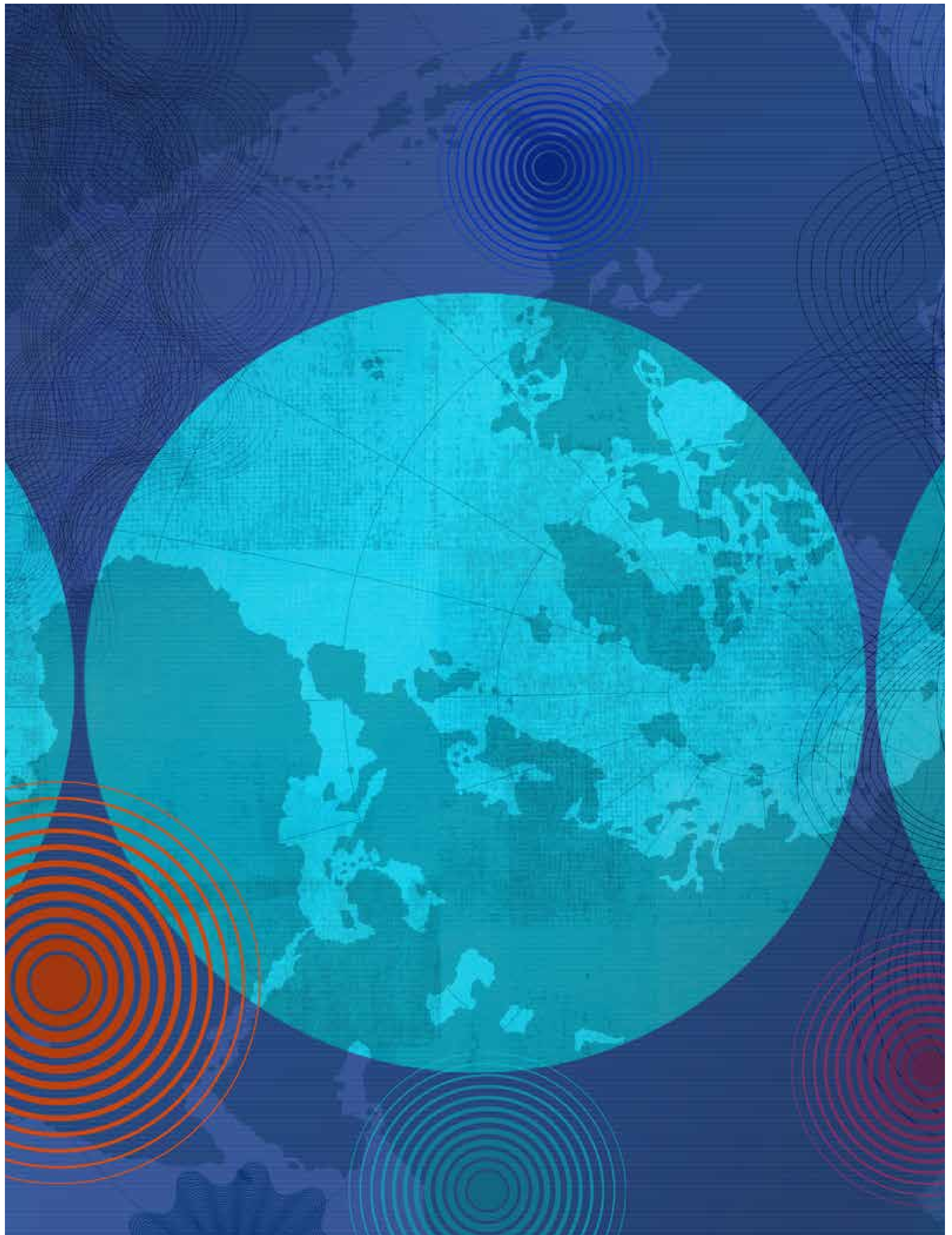

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