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MARKETS IN MOTION
developments that matter in financial markets

Global Economic Recovery in 2011

"Current growth and inflation trends clearly warrant that we persist with the anti-inflationary monetary stance. Inflation is expected to moderate from the first quarter of 2011-12, but several upside risks are already visible. The monetary stance will be determined by how these factors impact the overall inflationary scenario."
Dr D Subbarao, Governor, RBI

Introduction

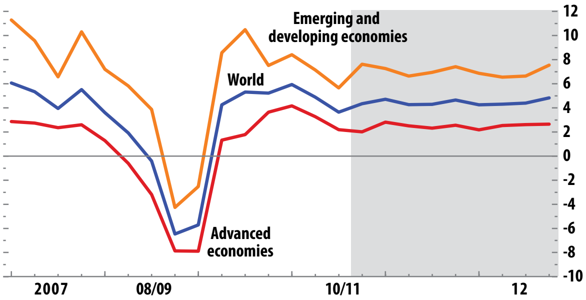
The global economy is set for a broad recovery in 2011, according to the International Monetary Fund's (IMF) world economic outlook update released on January 25, 2011. The global economy is expected to grow faster this year and the IMF has revised its growth forecast from 4.2 percent to 4.4 percent for 2010-11, but the Fund warned of a two-speed recovery as advanced economies grow slower than emerging ones.

Advanced Economies

Global economic activity in the second half of 2010 turned out to be stronger than earlier expectations. The US economic growth is projected to reach 3 percent, up from the previous estimate of 2.3 percent in October 2010, and the UK economy would grow by 2 percent. There was also no change in the 1.5 percent growth forecast for both the euro zone and Japan. However, the uneven pace of growth across regions and uncertainty about the durability of recovery in the advanced economies persist. While in the US the second dose of quantitative easing (QE2) was followed up with extension of fiscal stimulus, other advanced economies face a difficult choice of delayed fiscal exit to support growth and early exit to contain the sovereign debt concerns. The risk of sovereign debt crisis spreading from the euro zone periphery has resurfaced in recent months.

Global GDP Growth

(Percent; quarter over quarter, annualized)



Source: IMF staff estimates

Emerging Market Economies

Emerging market economies (EMEs), which had recovered ahead of the advanced economies, exhibited robust growth momentum, driven by domestic demand. However, inflation and overheating risks have prompted monetary tightening in many EMEs at varying degrees.

GDP Growth for Asia in 2010

Region	Growth in Percent
East Asia	9.2
South East Asia	7.5
South Asia	7.8
Central Asia	5.9

Source : Asian Development Bank

Growth projections for China and India are placed at 9.6 percent and 8.4 percent, respectively, and Sub-Saharan Africa is predicted to grow at 5.8 percent. But the rapid growth forecast for emerging economies has a downside risk as the flow of foreign capital into EMEs continues, fuelling inflation. Emerging economies account for almost 40 percent of global consumption and any slowdown in these economies could deal a serious blow to the global recovery. A number of EMEs resorted to soft capital controls and intervention in foreign exchange market to limit the adverse impact of excess capital inflows on their economies. Most EMEs face the risk of inflation from strong growth and hardening of commodity prices.

Indian Economy

The Indian economy has registered an 8.9 percent growth in the first half of 2010-11. Recent data on agricultural output and service sector indicators suggest that the growth momentum has continued in the third quarter as well as fourth quarter. However, inflation remains very high, led by spiralling food and fuel prices. It is against this background that the Reserve Bank of India announced an increase in the repo and reverse repo rates by 25 basis points (bps) each to 6.5 percent and 5.5 percent, respectively, on January25, 2011. The tightening of the monetary policy was prompted by elevated levels of food and non-food inflation in the recent weeks. There has been a sharp rise in global commodity prices, which has heightened upside risks to domestic inflation. Since mid-March 2010, the RBI has cumulatively increased the repo rate by 175 bps, the reverse repo rate by 225 bps, and CRR by 100 bps.

Contributed by M Ravindran

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FT Knowledge Management Company Limited
Exchange Square, 1st Floor, Suren Road,
Chakala, Andheri (East), Mumbai - 400093. India.
Tel: +91 22 6731 8888 • Fax: +91 22 6726 9541
Email: marketsinmotion@ftkmc.com • Website : www.ftkmc.com