

CONNECTING THE DOTS

Global economy: Mid-year review



A. R. CHOWDHURY

THE global economy has clearly lost momentum in the first six months of this year. The US economy continues to expand at a sub-par annual rate of around 2%. Growth in the Chinese economy has dropped below 8% for the first time since 2009. Many European countries have slipped back into recession; while most of the emerging markets have seen minor downgrades in economic activity.

A side effect of the global slowdown is that many commodity prices have dropped recently. The lagged effects of past policy tightening and deterioration in global confidence have produced a moderate slowdown in emerging markets, denting commodity prices in the process. Inflation in most economies has also receded. In response, many major central banks have eased monetary policy. For example, the People's Bank in China has cut its benchmark lending rate twice in June, and has directed commercial banks to make more loans.

Due to space constraint, let us only consider the economic performance of a number of countries and regions that are of interest to the readers in Bangladesh. In Asia, Japan has been one of very few countries in which economic activity accelerated during the last few months. Real GDP

grew at an annual pace of slightly less than 3% in the first quarter, following four consecutive quarters of contraction. Household consumption was the leading driving force commanding this rebound, followed by fixed investments and public spending.

Going forward, Japan's economy should return to a moderate recovery path, as domestic demand remains firm and the economic performance improves among its Asian trading partners. In addition, reconstruction efforts will remain a key catalyst to growth, lifting both public and private housing investment, as well as propelling business fixed investment, as firms restore and rebuild disaster-stricken facilities. In line with these trends, the Japanese economy will expand by about 2% this year.

Contrary to Japan's recent performance, China's economy lost more steam during the first six months. Chinese GDP grew by less than 8% in the second quarter. In recent months, economic data has provided mixed signals regarding the strength of economic activity.

Industrial production, fixed asset investments, and retail sales remained weak, whereas both exports and imports expanded during May at a much stronger pace than expected. Credit data also came in significantly above market expectations, which suggests that the more lax monetary stance is already having an impact on the economy.

Against this backdrop, annual inflation has remained subdued, dropping to 3% in May. This, combined with the recent softening in commodity prices, suggests price pressures will remain on a declining path. This will provide Chinese authorities any needed room for additional policy accommodation, even after already cutting interest rates in early June.

In all, the Chinese economy should expand by anywhere between 7-8% in 2012. Although Chinese authorities have lowered their economic growth target to 7.5% in

to keep the repo rate at 8% in June. The Reserve Bank had front-loaded the policy rate reduction in April with a cut of 50 basis points, assuming that the process of fiscal consolidation critical for inflation management would get underway.

However, the sustained fiscal spending might be crowding out private investment. Consequently, the Reserve Bank further reduced policy interest rate. One problem is that, rather than supporting growth, it could exacerbate inflationary pressures.

Against this backdrop, the Indian economy should expand by at least 5% in 2012.

amounts of their respective government debts.

As the European financial system is interconnected, large losses in the banking system of one country could have a significantly negative effect on the banking system in other countries in the region.

What will it take to resolve the problem in the euro zone? As I had repeatedly argued in previous columns, the solution to the European sovereign debt crisis involves the creation of a fiscal and banking union in the euro area.

Until the European leaders show tangible progress in achieving fiscal integration, financial markets and the public at large will not regain confidence in the European common currency project, which is ultimately needed to contain the sovereign debt and banking crises.

A radical restructuring of the economic and political system is necessary in order to achieve this goal. In the absence of a major shock, however, such radical change is unlikely to happen within a short period of time.

Hence the mostly likely scenario is one of "muddle through." Each time the crisis rears its ugly head, European leaders would do just enough in terms of a policy response in order to make the crisis subside temporarily. I do not see the uncertainty arising out of the euro zone crisis going away anytime soon.

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The solution to the European sovereign debt crisis involves the creation of a fiscal and banking union in the euro area.

their recently published five-year plan, I believe they will be adamant about preventing too much of a deceleration in economic momentum in a year of transition of political leadership.

Other leading emerging economies mirrored China's moderate slowdown, as they assimilated the lagged effects of prior tighter monetary policies and the deterioration of global confidence. Take the case of India.

Indian GDP growth dropped to an annual pace of 5.3% during the first quarter, the weakest showing since late 2004. Despite this softer growth performance, inflation has accelerated above 10% which, among other factors, led the Reserve Bank of India

There are a number of risks that the global economy faces at present. But, in my view, the European sovereign debt crisis remains the predominant downside risk to the global outlook. European leaders are trying to contain several fires at the same time. Thus far, they have managed not to be engulfed by the flames, but the situation remains fluid and winds can change without warning.

Borrowing costs in Spain, which has more than 700 billion euros worth of outstanding government debt, and Italy (€1.6 trillion) remain between 6 and 7%. If borrowing costs stay at these levels, the debt dynamics of these two governments could become unsustainable. In that case, Spain and Italy would need to restructure their debt. The resulting losses would fall largely on the domestic financial systems that hold large

BITTER TRUTH

Containing price hike: A challenge



MD. ASADULLAH KHAN

WITH prices rising almost every day and incomes remaining the same, all classes of people excepting the affluent section are in dire straits. The rise in the price of petroleum products for the fourth time has pushed them to the brink. The government handout explaining the rationale behind the hike, in a bid to save the exchequer of the subsidy burden and transfer the burden on the people already living on the margin, seems to be very unkind.

According to one government handout, 3.8 million metric tons of petroleum products were imported in the last fiscal year, which has gone up to 7 million tons this fiscal because fuel oil was supplied to rental power plants. Fiscal analysts opined that the price hike of fuel oils caused by the depreciation of Bangladeshi taka against US dollar would contribute further to the already soaring inflation and price escalation. Sectors and services relating to energy consumption, like transport and agriculture, will be costlier.

The government must understand that if there is anything that sends shock waves and unnerves people as much as politics, it is unbridled price hike of essentials, especially food items. And if there is anything challenging in running the government, it is controlling the business world.

Notwithstanding all unpredictable and capricious market forces, there is certainly a large amount of analysis and statistical information available on many intricate issues. To ignore such information or to remain oblivious of production mechanism, supply situation, connectivity issues, population growth, and last of all people's sufferings and resentment, and to live by slogans and rhetoric, is to court disaster

The problem is that in spite of the fact that agriculture is the mainstay of our economy, it has remained neglected for the last three decades. With meat, chicken, fish and vegetable prices touching the roof, the poor and middle income groups do not look for anything beyond *dal bhat* for their survival. But commodity production has fallen drastically in absence of logistic support and shrinking arable land. Even when the population has crossed 150 million from 130 million in just about five years, the administration remains with the statistics of demand and supply it had decades ago.

Prices of some commodities most needed during Ramadan went up suddenly without any discernible reason. For instance, do we have to accept that the price of masur dal registered a sharp rise of Tk.20 per kg because the demand has surged up suddenly? Moreover, why should the price of sugar sold by TCB be Tk.60 per kg when it is available at Tk.53 -55 in the open market? How can the government restore stability in the market

when its own actions are at variance with what it preaches?

With the introduction of e-governance in the country, data and statistics related to production, stock situation, and consumption vis-à-vis population growth data need to be put in the government website on day to day basis like "e-choupal" in India. The government could have reformed the public distribution system by better supply chain management at the retail level.

The fixed income group, retired persons, employees of private firms and daily wage earners find themselves in a bind. Abdul Karim, a retired government employee now living in a rented house, with four members dependent on him, faces a grueling battle

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with his savings, a small monthly pension and the pension benefit he has put in the post office through purchase of *Sanchaypatra* (savings certificate). The returns from these instruments have not increased but his family expenditure continues to shoot up every day. These days he does not include pulses and milk in his monthly grocery purchase list. For the last six months he could not buy even a kilo of meat or chicken.

Amirul, a 30 year old car driver with two children, wife and old mother finds it almost impossible to make both ends meet with a monthly salary of Tk.8,000. After paying the house rent he is left with Tk.6,000. He says: "I have withdrawn my daughter now studying in class seven as there was no way I could afford the cost of her schooling, especially the conveyance to and from school."

Ironically, during the last decade, wages or incomes rose less than the prices of essentials, putting the taxpayers in higher brackets and forcing them to pay higher bills on gas, electricity, water and municipal taxes. Business groups and transport owners continue to hike the prices of goods and transport fares citing increased expenses in goods production and transportation due to oil price hike.

How much can people cut down on consumption of onion, gram and edible oil during Ramadan? Milk has now become a luxury not only for lower income groups but for all classes of people.

There has been spectacular rise in rice production in the past year but the cost of production has increased manifold because of the increase in the price of irrigation water, fertilizer, pesticide and seed. Even though the

Tariff Commission or other monitoring agencies rule out the possibility of any shortfall in supply of the commodities people need most during Ramadan, there is no scope to be complacent.

It must be taken into consideration that population is growing by two million every year, and arable land is shrinking further. With fall in production due to drought and inadequate monsoon rain, speculation drives up the price through all the hands the produce passes.

As for containing price spiral, two policy measures or suggestions seem pertinent: containing inflation and improving the supply situation. Inflation is defined as too much money chasing too few goods. With remittance flow and export earning increasing, raising forex reserve to about \$11 billion during the last fiscal year, the economic future of the country still looks very bleak.

With increased borrowing from banks to meet the budget deficit, and absence of facilities to absorb this money flow in industrial sector expansion, it is not surprising that inflation crossed the double digit figure during most of last year. Fiscal managers in the government might say that the economy is growing because of the increasing remittance flow from Bangladeshis working abroad and increased earnings from garments. But our inability to put this money in sound investment project and accelerate industrial growth has put the nation in a quandary. That means our economy has swelled incomes and put money in people's hands to pay for goods and services that are in short supply.

A combination of supply side bottleneck and arbitrary increase in transport fare due to oil and power price hike has fuelled a sustained rise in prices of primary goods -- food grain, vegetables, and pulses. Unhappily, this rise has never been consistent and proportionate with the fuel price hike. Compounding the crisis is the extortion on the roads by political party activists, union leaders, and some unscrupulous police personnel.

In such a context, as capacities are created and supply situation improves, competition will drive inflationary pressure down and prices will even out. One might accept inflationary trend in a growing industrial economy but this is not so with Bangladesh economy. The most important factor causing a 40 to 45% increase in the prices of primary goods may be attributed to market manipulation by interested groups and coteries

The government, despite achieving spectacular success on the food front, especially rice production, failed to initiate steps to crack down on hoarders and market manipulators, and ban forward trading in primary goods. There has been poor perception management, ranging from indiscreet statements about imports, stock situation and price stabilisation. All these have left consumers confused and profiteers delighted.

Asean, undermined

EDITORIAL DESK: Philippine Daily Inquirer.

THE failure of the Association of Southeast Asian Nations (Asean) to issue a joint communiqué after a regular meeting of foreign ministers concluded in the Cambodian capital of Phnom Penh last Friday was truly unprecedented.

It was the first time in the 45-year history of the Asean, a virtual paper factory with dozens of regularly scheduled, amply documented conferences every year, that a post-event statement could not be released. The failure bodes ill for the usefulness of the Asean as a regional association.

We should be clear: Nobody expected the Asean to issue a statement proposing a solution to the current controversy between the Philippines and China over claims to Scarborough Shoal.

To be sure, the Philippines approached the foreign ministers' conference hoping to convince the nine other member-countries of the Asean to advance the discussion regarding China's recent expansive claims over the South China Sea. But it was always a long shot -- China, a long-time regular dialogue partner of the Association -- dominant economic power in the region; it is with at least three countries.

The genius of an alliance, however, lies in its members' ability to balance power and finesse. That Southeast Asian nations could not reach a fateful passage or would have members without against China is of diplomacy.

scholar Carl

is not only the economic power in the region but also closely allied Asean member-countries.

Asia's chief diplomat agreed on an inoffensive paragraph that assured all Asean members a position of equality, therefore a failure (Southeast Asia scholar Thayer defined the problem simply: "I find it difficult to believe that Asean foreign ministers cannot come up with some formulation that satisfies all parties.")

That the extraordinary inability to issue a statement was in likelihood a concession to China means it was also a failure of the Asean as Asean -- that is, as a regional bloc.

The Association's Secretary General, Surin Pitsuwan of Thailand, told reporters the crux of the matter was the insistence by Vietnam and the Philippines that the joint communiqué reflect the current impasse at Scarborough Shoal.

Foreign Secretary Albert del Rosario said the actual demand was even narrower. "We simply wanted the fact that we discussed the issue reflected in the joint communiqué, no more, no less. It would have just been a simple sentence or paragraph in the communiqué. We just want recognition that the Scarborough Shoal was in fact discussed." (The Asean Secretariat, incidentally, supported the position that some mention of the discussion must be included in the statement.)

But Cambodian Foreign Minister Hor Namhong blamed both the Philippines and Vietnam for "taking the communiqué as a hostage and insisting on turning the 10-nation group to a tribunal." As best as we can tell, this is a dishonest account. While the week-long discussions may have included attempts to find a resolution to the controversies -- isn't that, after all, the point of a regular meeting of equal members? -- the discussion over the communiqué must have been a different matter altogether.

Any communiqué is a distillation of the conference it seeks to document; the assertion that the communiqué was held hostage makes sense only if the Philippines and Vietnam had insisted on including in the final statement some sort of consensus that was not in fact reached during the conference, or strong language that was not in keeping with Asean's tradition of regional harmony.

But as we have learned from various news reports, Cambodia from the start wanted to discourage discussion of any issue with bilateral import -- code, in this context, for the territorial disputes which China wants to be resolved bilaterally. This was a precondition which undermined the very nature of the Asean; surely, the role of a regional conference is to promote a regional, i.e. a multilateral, approach to common issues.

The unfortunate result of host Cambodia's renewed emphasis on the virtues of neutrality was that the somewhat acrimonious end of the latest conference favoured a non-member, rather than Asean's own. Cambodia, in other words, was "neutral" for China.

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