# The Illusion of an Economic Spring*

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While policy makers, analysts and observers paint a picture of an ongoing global economic recovery, the numbers seem to drag the optimists down. Barely days after IMF Managing Director, Christine Lagar de, declared at the spring meetings of the World Banka and the IMF that, “Spring is in the air and spring is in the economy as well,” came bad news from the US. The advanced economy that was being looked to as the one that would pull the world system out of a decade long period of sluggish growth performed poorly in the first quarter of 2017, growing at an annual rate of just 0.7 per cent. That compares with an annual rate of 2.1 per cent in the previous quarter, and rates of 0.8 per cent and 2.0 per cent in the corresponding quarters of 2016 and 2015.

That is disconcerting because the OECD’s seasonally adjusted annual growth rates elsewhere in the G7 are stagnant as well—at around 1.8 per cent quarter-on-quarter in Germany, 1.1 per cent in France, and 1 per cent in Japan, with some signs of a pick up in quarter 4 of 2016 in the last of these. Across the G7 as a whole, quarter–on-quarter growth has been at a below 1.5 per cent in four out of the five quarters ending the fourth quarter 2016.

The poor performance in the US is particularly distressing since it reflects the effect of a significant slowdown in household spending, growth of which was at its lowest since 2009. Personal consumption expenditure growth at an annual rate of 0.3 per cent in the first quarter of 2017 was well below the 3.5 per cent rate in the previous quarter and 1.6 and 2.4 per cent respectively in the corresponding quarters of 2016 and 2015.

In the years following the 2008 crisis, sluggishness in consumer spending was seen as inevitable. With household debt at extremely high levels and their inflated asset positions unwinding, borrowing to finance consumer spending was on the decline. Combined with slow growth, that was enough to dampen household spending on consumption, automobiles and much else. But more recently, as a result of the revival of at least the capital markets, the potential for a return of the “wealth effect”—in which persons feeling wealthier spend more—was a possibility. According to figures from the Federal Reserve of St. Louis, the ratio of net worth to household disposable income in the US which had fallen from a peak of 649 per cent at the end of 2006 to a low of 506 per cent at the end of the first quarter of 2009 had slowly, after much volatility, recovered to around 635 per cent in the first quarter of 2016. This restoration of relative wealth, largely influenced by financial asset price recovery has not obviously made much of a difference to consumer spending, because it has accrued largely to the rich and has not been accompanied by a similar recovery in household earning capacity.

The revival in markets despite sluggishness in income growth does influence however, what the Financial Times (April 21, 2017) terms “soft”, as opposed to hard, economic data. This consists of survey data on perceptions among executives and individuals, that point to considerable business and consumer confidence. That “confidence” has in recent times been buoyed by expectations that President Donald Trump would stick to his promise to not just cut taxes but boost spending on infrastructure. Such expectations seem to have influenced the Federal Reserve as well, which had decided to hand over the task of stimulating the economy and sustaining the recovery to the Treasury, and go back on its long standing policy of keeping interest rates near zero, in the hope that it would encourage consumption and investment spending.

The problem is that the evidence of persisting low growth in the US comes at a time when the expectations of a shift from a monetary to a fiscal stimulus generated by Trump's victory are fading. While he promises to go ahead with his tax cut stimulus, he does not have a concrete plan to ensure that this does not result in a substantial widening of the fiscal deficit. If that is unavoidable, then it is unlikely that Trump would win the support of the fiscal hawks in his own party. The result would be obstacles to implementation. Meanwhile, there is no evidence yet of a significant step up in infrastructure spending, which too is likely to run up against a fiscal constraint that Trump refuses to address with higher taxation on the top one or 5 per cent of the population.

These developments on one side of the Atlantic do not augur well for the world economy, since, on the other side, while much of Europe is still in the throes of a crisis or vulnerable, Germany, the leading economy in the region, is also slowing, as the figures quoted earlier suggest. Despite all this, policy makers meeting at Washington for the Spring meetings chose to be upbeat. The IMF has raised its forecast for global growth, placing it at a comfortable 3.5 per cent for this year. Former IMF Chief Economist Olivier Blanchard reportedly declared that "The strengthening of the recovery is for real." He was supported by Raghuram Rajan, also formerly IMF's Chief Economist, besides Governor of India's Reserve Bank, who said," what is different this time is that all the engines are firing for the first time." "They are not firing very strongly. But they are firing," he characteristically clarified.

The source of this optimism is a return to growth in China and India. China is reported to have grown at an annual rate of 6.9 per cent in the first quarter, and India is projected to record an even higher rate. Thus, these two economies are to serve as the drivers of global buoyancy. This is not new for the contemporary global economy. When the 2008 crisis engulfed the world economy, these were the countries that recorded recoveries within a short span of time triggered by stimuli provided by the state. But, later, as the rest of the world remained mired in recession, they too began to slow. The notion of a two speed global economy with these Asian giants on the fast lane, and the rest of the world spread across the slow lanes lost its validity. Yet, the argument now seems to be that the world system has returned to that scenario, with the average speed even on the slow lanes a bit faster than earlier.

There are two problems with this understanding. The first is that the view that there has been acceleration in the economies traversing the slow lanes has been questioned in the case of most developed economies, including the better performing US, possibly with the exception of Japan. Second, even in the case of China and India, there is much evidence to indicate that growth is dependent on an unsustainable credit boom that makes them vulnerable and renders their growth difficult to sustain.

The Indian banking sector, which since 2003 has expanded credit to the retail sector (involving personal loans of various kinds, especially those for housing investments and automobile purchases) and to the corporate sector(including for infrastructure projects), is now burdened with large volumes of stressed and non-performing assets that are in excess of 10 per cent of outstanding advances. Sustaining credit provision has become difficult with attendant implications for demand and growth.

According to calculations by the Financial Times (April 24, 2017), “China’s total debt rose to a record 237 per cent of gross domestic product in the first quarter, far above emerging-market counterparts, raising the risk of a financial crisis or a prolonged slowdown in growth.” Between 2007 and now, the debt to GDP ratio has risen from 148 per cent to 237 per cent, revealing how credit was crucial for China’s escape from the effects of the global crisis. According to comparable data from the BIS, China’s debt to GDP ratio stands at 249 per cent as compared with 248 per cent in the US and 279 per cent in the Eurozone. But that makes the boom difficult to sustain, even as the global economy remains weak. Despite this debt build up which calls for deleveraging, every time there are signs of a slowdown, the only instrument in the hands of the government seems to be expanding debt. The same FT article assets that fears of a hard landing had resulted in a Rmb6.2trillion increase in debt in the first three months of 2016, “the biggest three-month surge on record”.

This dependence on debt makes the boom in India and China difficult to sustain and raises the possibility that when the downturn occurs in these countries, deleveraging will accelerate the fall and make recovery difficult. So making these countries the growth poles on which the global economy can float is unwarranted, as is the optimism displayed in Washington this spring.

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