# Economic Review October 2013

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## 1. Recent Global Economic Developments: Implications for Lesotho Economy

*"Global growth is still weak, its underlying dynamics are changing and the risks to the forecast remain to the downside ……………"*

### Introduction

The IMF October 2013 World Economic Outlook (WEO) indicates that the global economic growth remains sluggish with changing underlying growth dynamics and persistent downside risks. Notwithstanding, the growth rates for emerging markets are expected to be much higher than those of developed economies. There has been some improvement in private demand in the United States although it was moderated by a slower than normal public sector demand. Japan continues to show good signs of growth that is expected to dampen in 2014 following fiscal policy tightening while the Euro area steadily moves out of recession in spite of reduced economic activity forecasts.

In spite of the sluggish growth, the downside risks such as high unemployment in developed economies, lack of fiscal consolidation in Japan and weak recovery in E.U. periphery[1] remain persistent. As a result of these downside risks, the world economy is expected to experience a 3 per cent growth rate

[1] E.U. periphery countries are those that are less developed compared to the rest of E.U. countries. Examples include Greece, Spain and Portugal

instead of 4 per cent growth initially forecasted.

This article attempts to provide an overview of the recent global economic developments and prospects. It further shows the implications of World Economic Outlook on Lesotho economy.

## Recent Global Economic Developments and Outlook

The October 2013 WEO shows that the global economic growth rate was weak at an average growth rate of 2.5 per cent during the first half of 2013 which is nearly the same rate as that of second half of 2012. The slowdown in growth of emerging markets (which account for the bulk of global growth) caused this sluggish growth rate despite some recovery in some advanced economies. The changing underlying growth dynamics warrant policy formulation aimed at mitigating negative spill overs effects and improving robust growth prospects. For instance, emerging economies that experienced increased capital inflows as a result of quantitative easing should formulate policies aimed at mitigating the effect of capital inflows reversal when The Fed starts winding down on asset purchases. This will help minimize the impact of erratic foreign exchange movements as a result of capital flight. This is particularly critical as emerging markets already face weakening economic activity.

The advanced economies should also adopt policies that will enhance their growth prospects; otherwise the rest of the world will remain in a subdued medium term trajectory. Moreover, export led emerging markets should put in place policies that will boost domestic consumption in order to lessen reliance on exports.

Table 1: SELECTED ECONOMIC INDICATORS (Percentage Changes)

| Indicators | 2011 | 2012 | 2013[2] | 2014[3] |
|---|---|---|---|---|
| **World Output** | 3.9 | 3.2 | 2.9 | 3.6 |
| **Advanced Economies** | 1.7 | 1.5 | 1.2 | 2.0 |
| United States | 1.8 | 2.8 | 1.6 | 2.6 |
| Euro Area | 1.5 | -0.6 | -0.4 | 1.0 |
| Germany | 3.4 | 0.9 | 0.5 | 1.4 |
| France | 2.0 | 0.0 | 0.2 | 1.0 |
| **Emerging and Developing Economies** | 6.2 | 4.9 | 4.5 | 5.1 |
| Sub Saharan Africa | 5.5 | 4.9 | 5.0 | 6.0 |
| South Africa | 3.5 | 2.5 | 2.0 | 2.9 |
| Developing Asia | 7.8 | 6.4 | 6.3 | 6.5 |
| **Commodity Prices (U.S. Dollars)** | | | | |
| Oil[4] | 31.6 | 1.0 | -0.5 | -0.3 |
| Non Fuel[5] | 17.9 | -9.9 | -1.5 | -4.2 |

**SOURCE**: IMF World Economic Outlook, October 2013

[2] Indicates Projections
[3] Indicates Projections
[4] Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate Crude oil
[5] Average based on World commodity export weights

## The United States

In the first half of 2013 the United States experienced a moderate growth of about 1.25 per cent mainly as a result of the fiscal consolidation. Compared with second half of the previous year growth of 1.5 per cent, this was a moderate fall. The rebound in the housing market and improved households net worth continue to support growth. Between 2009 and August 2013 there was a fall in unemployment from 10.0 per cent to 7.3 per cent although much of this reduction was on account of reduced active participation in the labor force.

The outlook is that recovery is projected to pick speed towards the end of 2013 and is expected to go into 2014 as fiscal consolidation starts to slow down. This projected growth will be supported by low cost of borrowing, increased household net wealth and housing market recovery. It is estimated that economic growth will average 1.5 per cent in 2013 and increase to 2.5 per cent in 2014. It is further assumed that policy rates will remain near zero until early 2016 and that the Fed will only gradually scale back on asset purchases towards end of 2013.

However, there remain downside risks on the outlook. There is a possibility of larger than expected hike in interest rate if unforeseen increase in inflation expectations occurs. The possibility of U.S. tightening its monetary policy too soon could dampen growth by about 50 basis points over the next year and by 100 basis points in the medium term.

Clearly, these downside risks call for decisive policy action to mitigate any potential negative effect of growth prospects. First public debt has to be at sustainable levels and this warrants a fiscal consolidation plan. Furthermore, an accommodative monetary policy remains appropriate and any tightening should be accompanied by recovery.

## Europe

Following six consecutive quarters of recession, the Euro zone registered a very mild growth during the second quarter of 2013. This growth was a result of weak demand (especially in periphery economies), high unemployment and financial markets fragmentation.

The Euro zone growth prospects remain bleak with economic activity forecasted to fall by 0.5 per cent in 2013 following a similar contraction in the previous year. Persistent output gaps are expected to cause the inflation to remain at 1.5 per cent in 2013 and will increase by a few basis points to 2 per cent in 2014. Growth will remain subdued over the medium term with inflation substantially below the European Central Bank medium term objective.

Although risks are much lower, there are still downside risks. The Euro area remains vulnerable to domestic an external shocks given a fragile growth and limited policy space.

## Asia

During the first half of 2013 growth across Asia was moderate and lower than it was anticipated during the April 2013 WEO. This was on account of a much slower economic growth in China which reduced industrial activity in most of emerging Asia. Most Asian countries experienced capital outflows as markets anticipate QE tapering.

The regional growth is expected to remain solid in 2014 supported by the projected global recovery. The overall growth is estimated to average 5.25 per cent in 2013 to 2014 while inflation is projected to remain subdued due to stable outlook for global commodity prices.

Export led Asian economies, such as China; stand to suffer from a relative global economic activity slowdown. Deterioration in domestic fundamentals and unwinding of QE will cause further capital outflows. Because of these downside risks, growth in Japan is projected to be 0.75 per cent lower while in the rest of the region it will be 1.0 per cent lower.

Against the backdrop of these downside risks, the accommodative monetary policy is advised and other structural reforms that will improve medium term growth prospects.

## Sub- Saharan Africa (SSA)

Improved domestic demand underpinned increased economic activity in Sub- Saharan Africa (SSA) in 2013. Growth was particularly strong in low income countries mainly due to increased commodity prices. However, the global financial markets volatility impacted negatively on some SSA economies albeit with different degree.

It is projected that SSA economic growth will improve from 5 per cent in 2013 to about 6 per cent in 2014. This is largely attributed to robust investment in infrastructure, energy and natural resources projects. In the medium term, resource exporting SSA countries will be negatively affected by sluggish growth in China. Subdued global food prices and prudent monetary policies will continue to cause a decline in inflation. On the other hand, current account balances are expected to weaken further owing to further deceleration in growth in China and other emerging markets.

Therefore, SSA economies should adopt policies aimed at increasing the revenue base for social and investment need while at the same time deepening structural reforms.

### Implications for Lesotho Economy

The generally sluggish economic growth, particularly in advanced economies, does not bode well for Lesotho. However, the moderate growth of 1.25 per cent in the U.S. is good news to Lesotho textile exports as about 80 per cent of Lesotho's textile exports are destined to the U.S. market.

Weak growth in the E.U. and bleak growth prospects in the E.U. periphery economies and high unemployment will have a negative impact on diamonds mining exports.

This might be worsened by the generally subdued commodity prices due to low demand in emerging markets such as China. However, the weakening Rand/Loti is likely to improve Lesotho's competitiveness in diamonds sales. Relatively stable world crude oil prices and a food price index that is projected to fall by about 6 per cent in 2014 will continue to help subdue the domestic inflation.

## 2. Featured Definition

*Liquidity Trap*

A condition that arises when short term interest rates are so low that expansionary monetary policy cannot reduce them further and thus rendering the monetary policy ineffective. Hence, most Central Banks resort to Unconventional Monetary Policy (UMP) during liquidity trap. For instance the Fed injected extra liquidity by purchasing long term government securities thereby lowering long term interest rates which will in in turn stimulate aggregate demand.

This featured definition benefited from:
The Economist (2013), Economics Terms Beginning with L. 18th November 2013. Available at: http://www.economist.com/economics-a-to-z/l#top [Accessed: 18th November]

## 3. Featured Economic Event

*U.S. Government Shutdown*

The U.S. congress failed to enact either appropriation legislation[6] or continuing resolution[7] for the 2014 fiscal year that started on the 1st October and as a result the U.S. federal government was shut down on October 1. Consequently, about 800 000 federal government employees were furloughed[8] due to lack of funding for government daily operations. The bone of contention in this funding gap was the affordable care act popularly known as “Obama care” that the Republicans led House of Representatives attempted to defund by not enacting the appropriation bill.

It is generally believed that the more than two weeks shut down caused between 0.2 and 0.6 percentage points slowdown in the U.S. fourth quarter growth. According to Standard’s and Poor Financial Services company, in monetary terms, the shutdown cost the U.S. economy about U.S. $ 24 billion while the Council of Economic Advisers estimate that 120 000 fewer private sector jobs were created during the first two weeks of October 2013. During the 16 days of the shutdown, the stocks fell steadily with the foreign holders of American Treasury bonds deeply concerned about the prospects of the U.S. government defaulting. This was particularly because by mid-October, the President and Congress were supposed to agree on raising the debt ceiling that would help U.S. avoid defaulting on public debt.

On the 16th October, the U.S. Congress passed a bill that raised a debt ceiling and therefore avoid the U.S. government defaulting. However, this was only a temporary fix as it funds the government until January 15th and raises debt ceiling until February 7th 2014.

[6] A bill that authorizes the government to spend money for a particular fiscal year
[7] An interim authorization to the government to spend money when the appropriation bill has not been enacted by parliament.
[8] A temporary involuntary leave of workers due to unfavorable financial position of the employer

## 4. Featured Descriptor

*Weighted Index*

In general, weighted index refers to a statistical measure of a change in economic activity whereby some more important items are given more value than other less important ones. For instance, in finances, weighted index occurs when certain stocks are assigned more weight than others usually based on their market value or their prices. For example, Dow Jones Industrial Average is a price weighted average that compares each security based on its price relative to the sum of other stock prices. On the contrary, Nasdaq is a market capitalization index where each company is measured relative to its market value.

This Featured Descriptor benefited from:
Reuters (2013), Financial Glosary. 14th November 2013. Available at: http://glossary.reuters.com/index.php?title=Unweighted/Weighted_Indices.