

External Sector

After a subdued performance for nearly three years, global economic activity is finally showing distinct signs of revival. The optimism about a buoyant global economy emanates largely from a turnaround in the US and the robust growth outlook for emerging Asia. The latest World Economic Outlook (WEO; April 2004) of the International Monetary Fund (IMF) projects world trade growth to rebound sharply in 2004 and maintain its upbeat trend in 2005 (Table 6.1). Despite high global energy prices, the WEO expects global output to grow by

almost one additional percentage point in 2004 and sustain the momentum in 2005.

6.2 A much improved performance in 2003 suggests that the US economy is poised to bounce back on a high growth path in 2004. While the policy stimulus provided through fiscal and monetary measures appears to have paid dividend, concerns remain over the low employment growth despite strong productivity gains. As far as the rest of the G-3 (US, Euro area and Japan) are concerned, economic activity continues to remain

Table 6.1 : External environment
(Annual per cent change unless otherwise noted)

	2002	2003	Projections	
			2004	2005
A. World output	3.0	3.9	4.6	4.4
Advanced economies	1.7	2.1	3.5	3.1
United States	2.2	3.1	4.6	3.9
European Union	0.9	0.4	1.7	2.3
Japan	-0.3	2.7	3.4	1.9
Other advanced economies	2.8	1.9	3.2	3.5
Newly industrialized Asian economies	5.1	3.0	5.3	5.0
Other emerging market and developing economies	4.6	6.1	6.0	5.9
Developing Asia	6.4	7.8	7.4	7.0
China	8.0	9.1	8.5	8.0
India	4.7	7.4	6.8	6.0
ASEAN-4*	4.3	5.0	5.4	5.4
Commonwealth of Independent States (CIS)	5.1	7.6	6.0	5.2
Russia	4.7	7.3	6.0	5.3
B. World trade volume (goods & services)	3.1	4.5	6.8	6.6
C. World trade prices (in US\$ terms)				
Manufactures	2.4	14.5	7.7	1.4
Oil	2.5	15.8	3.8	-10.0
Non-fuel primary commodities	0.5	7.1	7.6	-0.8
D. Emerging market and developing countries; Private capital flows (net) (in US \$ billion)	47.0	131.3	162.9	100.9

* Includes Indonesia, Malaysia, Philippines and Thailand.

Source: World Economic Outlook; April 2004; The International Monetary Fund.

sluggish in the Euro area. The output gap, reflecting the difference between potential and actual output, is projected to widen from -2.1 per cent in 2003 (as a proportion of potential GDP) to -2.4 per cent in 2004 in the Euro area, underscoring the lack of adequate policy stimulus in the pipeline. Japan, however, appears to be out of the prolonged deflationary pressures. Buoyed by recoveries in both external and domestic demand, the Japanese economy is projected to achieve its highest growth since 1996 in the year 2004.

6.3 Growth prospects for emerging market economies are dominated by bright projections for developing Asia. The region is expected to post an overall growth of 7 per cent plus in 2004, the highest since the East Asian crisis in 1997. Like in the other years, China would continue to be the main driver of economic momentum in developing Asia, strongly supported by rising exports and domestic investment. India is also expected to contribute substantially to the robust outlook for developing Asia. The upbeat expectations about global trade growth are expected to positively impact the growth performances of most developing Asian economies in the current year.

6.4 Though the nascent recovery of the previous year appears to be gaining momentum, global economic activity continues to remain vulnerable to several downside risks. Structural imbalances in the US economy, notably in the form of large current account and fiscal deficits, remain serious concerns, in view of their impact on global financial and currency markets in the event of their disorderly resolution. The likelihood of an increase in the global interest rates, particularly in the US, may induce some reallocation of portfolio funds among regions, affecting particularly the emerging markets. Despite moderation of hostilities in Iraq, global crude prices continue to remain high, creating balance of payments pressures for many oil-importing developing economies. The timing and sequencing of the policy-induced slowdown of the 'over heated' Chinese economy is another short term downward risk faced in the present phase of global recovery. Finally, the optimism about global trade growth can translate into reality only if the roadblocks encountered at the failed talks in Cancun are negotiated successfully through meaningful efforts by the international community.