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Significant volatility in cross border flows can impact global growth

By Dr R Seetharaman

The US Fed last week was dovish and committed to be patient on the timing of increase in rates. It gave policymakers new flexibility as they evaluate the economy to see if it has enough internal momentum to start to bring interest rates back towards levels that would historically be more normal during a recovery.

The Fed was also hesitant to move too soon on account of core CPI, which was at 1.7% in 12 months through November, and has remained below the Committee's longer-run objective" of about 2% a year. Fed chair Janet Yellen indicated that the committee didn't anticipate raising rates "for at least the next couple of meeting", which has given expectations of first rate hike by April or later.

The Fed is upbeat on US economy and expect it grow between 2.6% and 3.0% next year. The global markets which had witnessed volatility on account of fall in oil prices in recent times recovered after Fed's statement.

Last week Russia's central bank made a drastic interest rate move overnight, raising its key rate from 10.5% to 17% on

account of economy's concern from falling oil prices and Western sanctions.

Despite this, the Russian rouble touched an all time low of 80 against the US dollar. However, it recovered after Russia's finance ministry considered the rouble extremely undervalued, and is starting to sell its leftover currency on the market. It ended last week at 59.61 against the US dollar. It has fallen by more than 81% YTD.

Russia stock market had fallen by more than 46% YTD. Russia had bond issues worth $16bn this year as against $31bn in 2013. Russia economy had already slowed to 0.7% in the third quarter, year-on-year, down from a growth rate of 0.8% in the preceding quarter. It had weakened by several rounds of Western sanctions over the Ukraine crisis which have spurred capital flight and deterred foreign investment.

The recent steep fall in oil prices and weakening of rouble will result in Russia falling into recession. Russian banking sector will also be significantly affected. In terms of contribution to World trade and Global GDP Russia may not be very significant. However, the fears of South Asian crisis 1997 revived as Thailand was insignificant when compared to World trade and Global trade but the crisis got transmitted across the world.

China's economy expanded by 7.3% in 3rd quarter of 2014, down from 7.5% in the previous quarter. There are concerns that growth can fall below 7%. China's industrial production in November grew 7.2%, compared with the 7.7% rise in October 2014. China's inflation fell to 1.4% in November from 1.6% in October, which is the

lowest since November 2009. In Nov 2014 China Central Bank cut 40 basis points to the one-year lending rate to 5.6% and 25 basis points to the one-year saving rate to 2.75%, and an increased ceiling for deposit rates, mainly to protect households and consumers.

China's central bank said its surprise move to cut interest rates for the first time since 2012 is designed to help small firms and protect depositors instead of all-out monetary easing. The Chinese yuan is down by close to 3% YTD against the dollar and closed at 6.22 against the US dollar by end of last week. The Shanghai index was up by more than 47% YTD and had surged significantly in last one month after China's Central Bank cut rates. China had bond issues more than $690bn in 2014 as against $606bn in 2013.

Brazil's economy shrank 0.2% from a year earlier in the third quarter of 2014. Brazil's annual inflation accelerated to 6.46% in mid-December from 6.42% the month before. The Brazil Central bank has a mandate to keep inflation at 4.5% with a two percentage-point tolerance range on either side of that, but inflation has stayed close to 6.5% ceiling.

Brazil real closed by end of last week to 2.65 against the US dollar and has weakened by more than 12% YTD. Brazil stock market was down by more than 3% YTD. Brazil had bond issues more than $17bn in 2014 as against $25bn in 2013.

India's GDP grew at 5.3% in the third quarter of 2014. India's consumer price inflation (CPI) rate was at 4.38% in November 2014. India's trade deficit widened to highest in 18months to $16.86bn in November as strengthening demand for gold pushed up imports.

The rise in gold imports could revive some worries about India's current-account deficit. The Indian rupee had closed last week at 63.3 against the US dollar and had fallen by more than 2% YTD. Indian capital market was up by more than 30% YTD and arose after dovish comments from Fed. India had bond issues more than $43bn in 2014 as against $41bn in 2013.

Today cross border flows between economies are significant and find it's way in capital, commodity, bond or currency markets. Moreover Central Banks of Advanced economies had pursued easing measures and low interest rates after the Global financial crisis.

This has resulted in huge inflows into emerging economies. Such inflows were to a great extent justified as they were the new drivers of growth to global economy.

However, with domestic challenges appearing in emerging economies, this could not only create significant outflows from them but can also impact their growth and thereby global economic recovery. Significant volatility in cross border flows creates shocks to financial system and can affect global growth.

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