

# The Outlook for Emerging Markets and India's Troubles

Arvind Subramanian

*Dennis Weatherstone Senior Fellow*  
Peterson Institute for International Economics

*Senior Fellow*  
Center For Global Development

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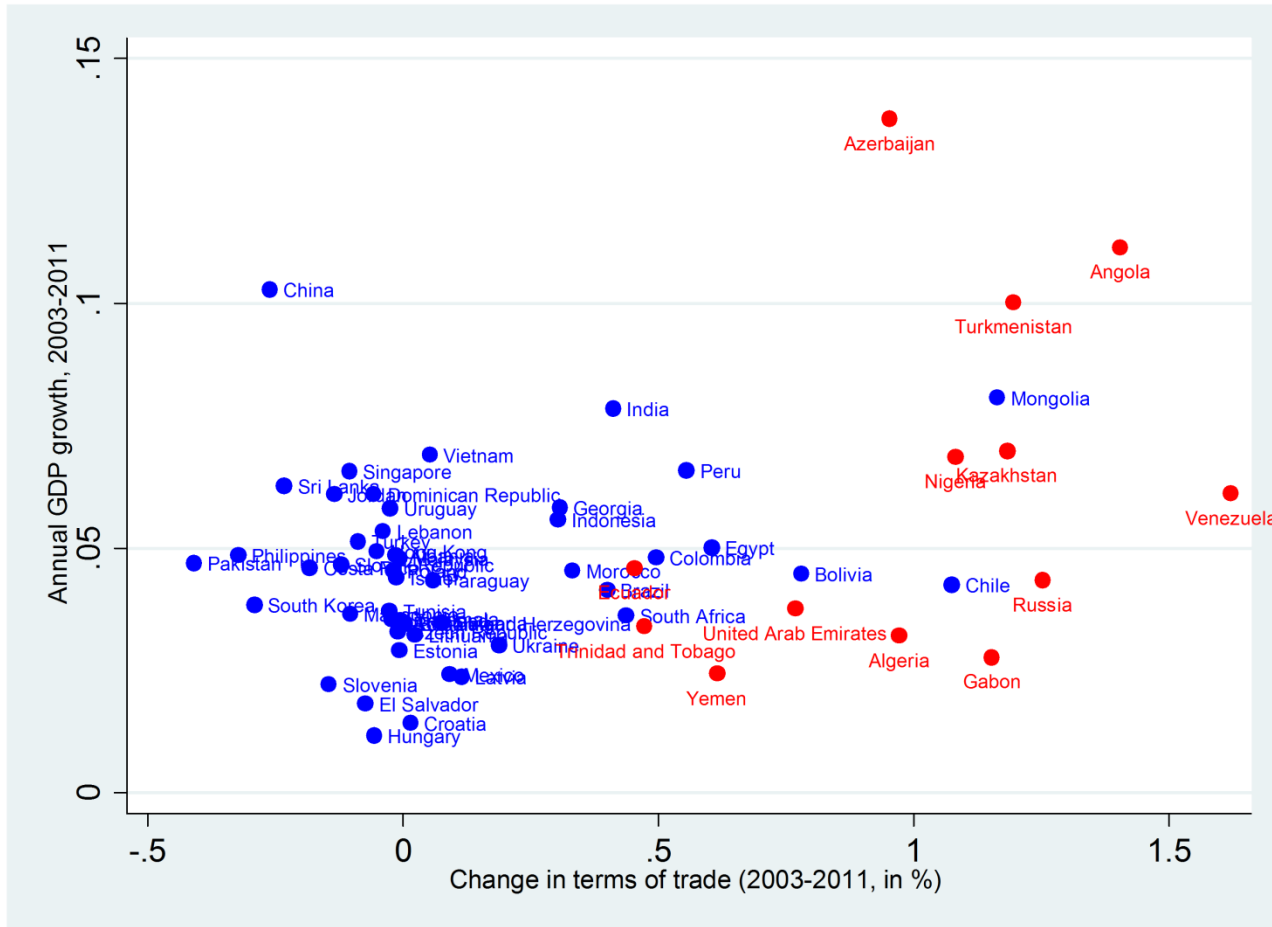
# Is the Rising Rest Story Over?

## Unprecedented rise of developing economies: *Convergence with a Vengeance*

	1870-1960	1960-2000	2000-2011	2008-2012
U.S. Growth Rate of GDP per capita	1.7%	2.47%	0.65%	0.02%
World Growth Rate of GDP per capita	1.3%	2.75%	2.28%	1.73%
Number of developing countries where growth exceeds US growth	2	21	80	78
<b>BROADENING</b> Percentage of developing countries where growth exceeds the US	<b>5.3%</b>	<b>29.2%</b>	<b>89.9%</b>	<b>83.9%</b>
<b>ACCELERATION</b> Excess over US growth (unweighted)	<b>0.02%</b>	<b>1.53%</b>	<b>2.94%</b>	<b>3.03%</b>

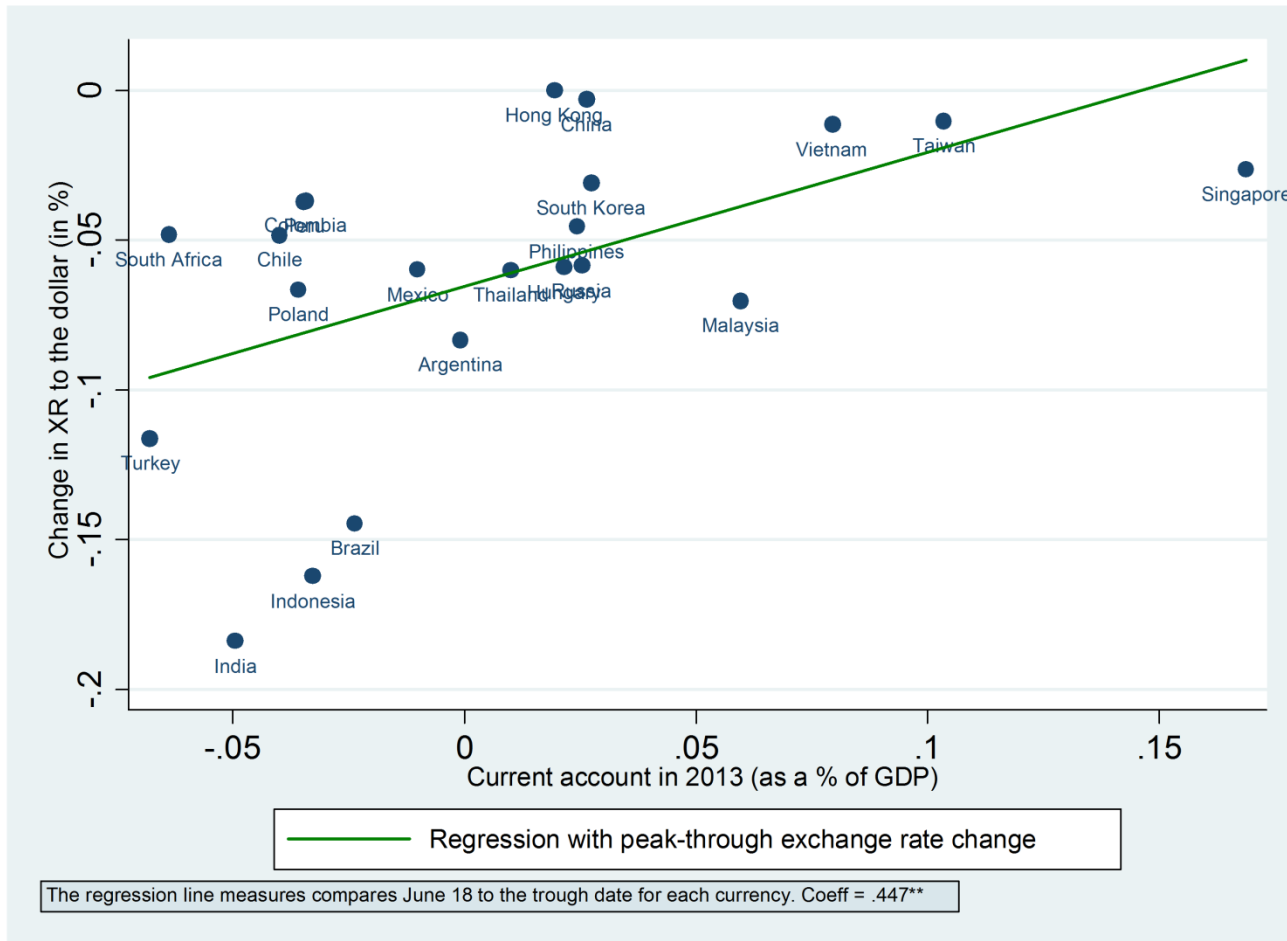
# Is the Rising Rest Story Over? Favorable Commodity Prices

Less than half of non-OECD countries are net exporters of primary commodities and correlation between medium-term growth and commodity prices not very strong



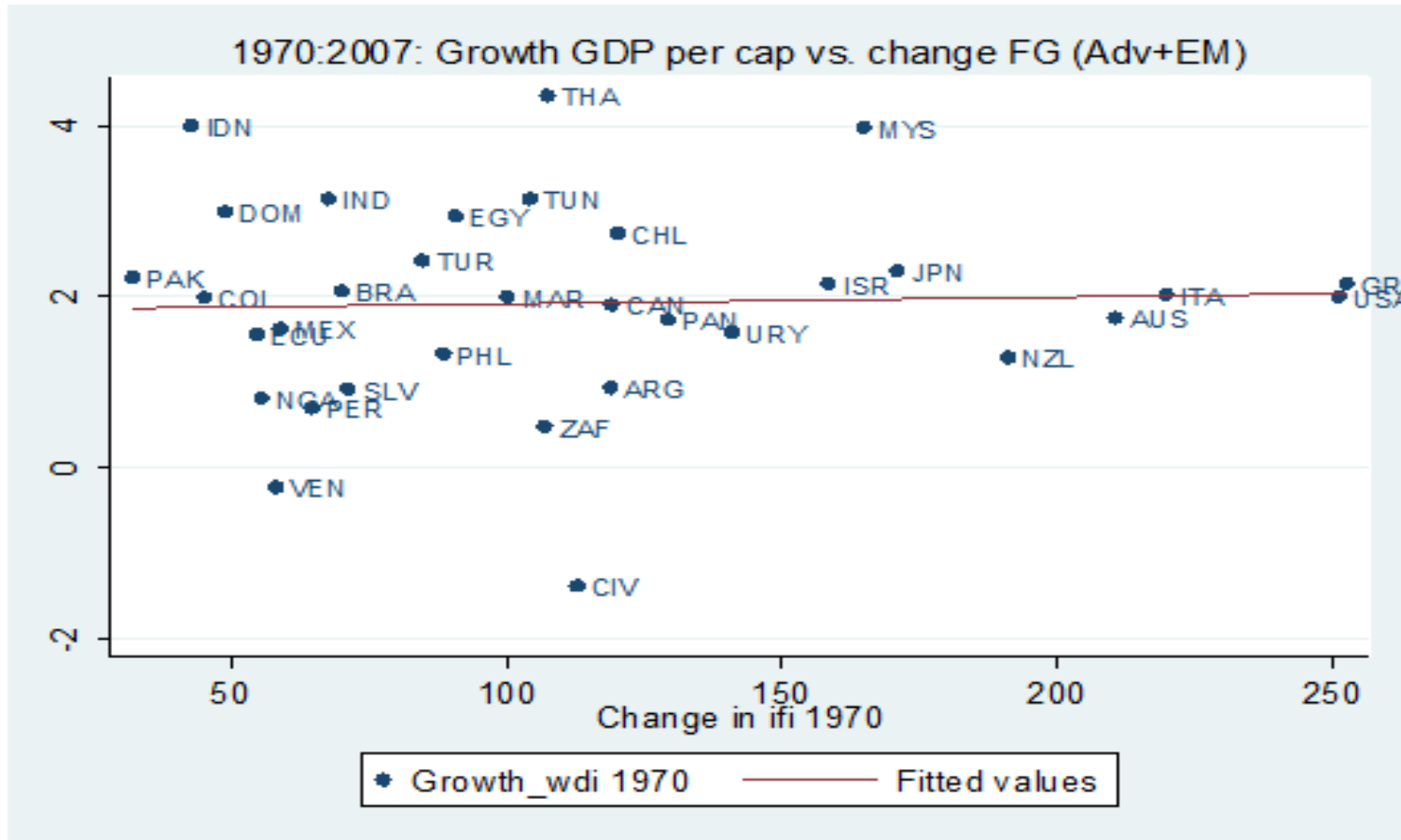
# Is the Rising Rest Story Over? Easy Liquidity

**Yes, capital flows (current account deficits) increase susceptibility to financial crises and turbulence BUT ...**



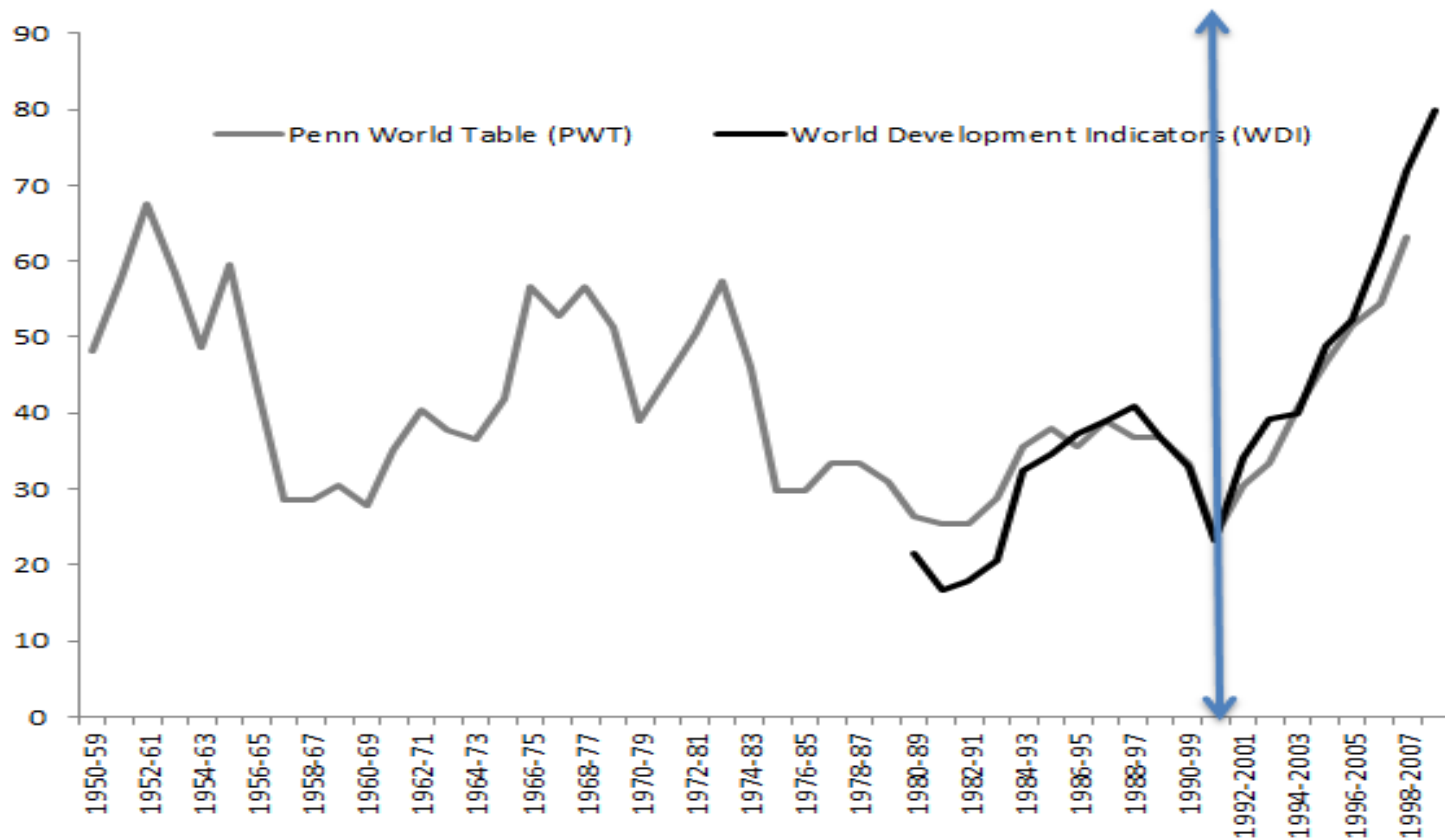
# Is the Rising Rest Story Over? Easy Liquidity

Medium term growth completely uncorrelated with capital flows



# Is the Rising Rest Story Over? Timing

- Improving economic performance pre-dates the commodity and liquidity cycles
- Percent of countries converging based on rolling 10-year average growth of per capita GDP



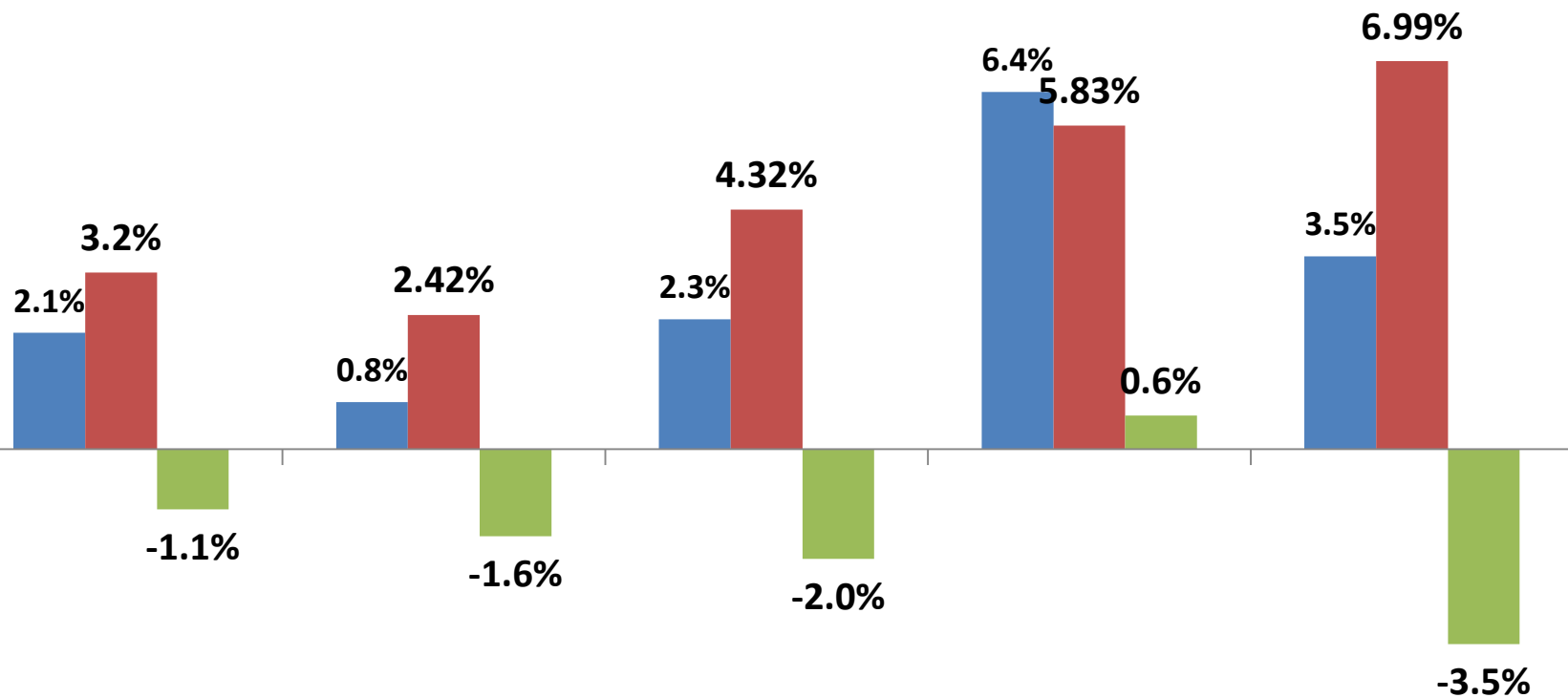
# The Rest Will Continue to Rise

- In the short run (12-18 months), there will be slower growth in many of the BRICs
- In the medium term, perhaps slower growth in some BRICs but not necessarily due to commodity and liquidity cycles: India
- And slower growth consistent with convergence: China
- And strong growth in many non-BRICs consistent with convergence

# World Growth: Still Below Convergence Potential

2000s (per capita growth)

Actual      Convergence      Difference



World

High income

Upper middle  
income

Lower middle  
income

Low income





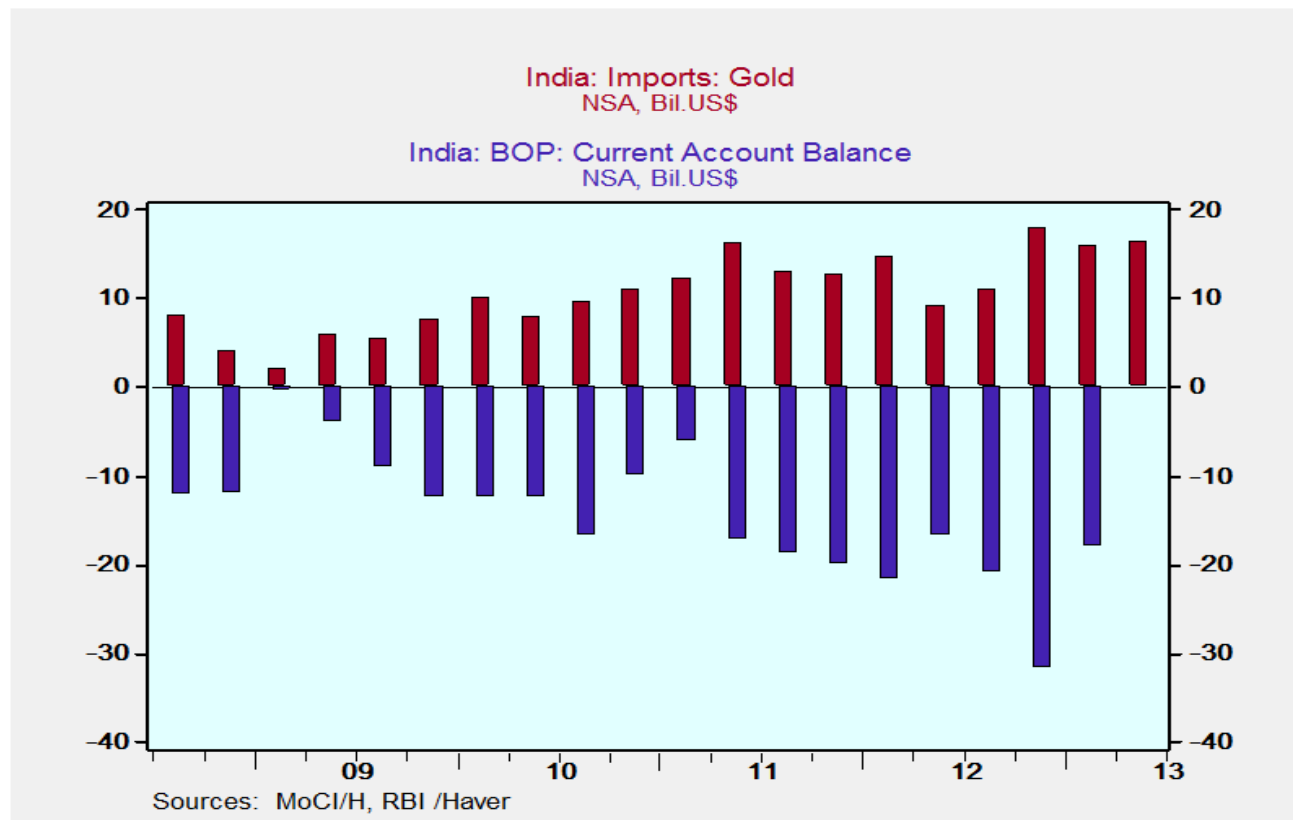
# India: The Chronicle of a Thirst For Gold

# India's Troubles

- External factors but they were proximate not deep causes
- Macro-economic vulnerability stemming from the fiscal excesses of the boom years
- Decelerating growth: The Indian development model running out of steam

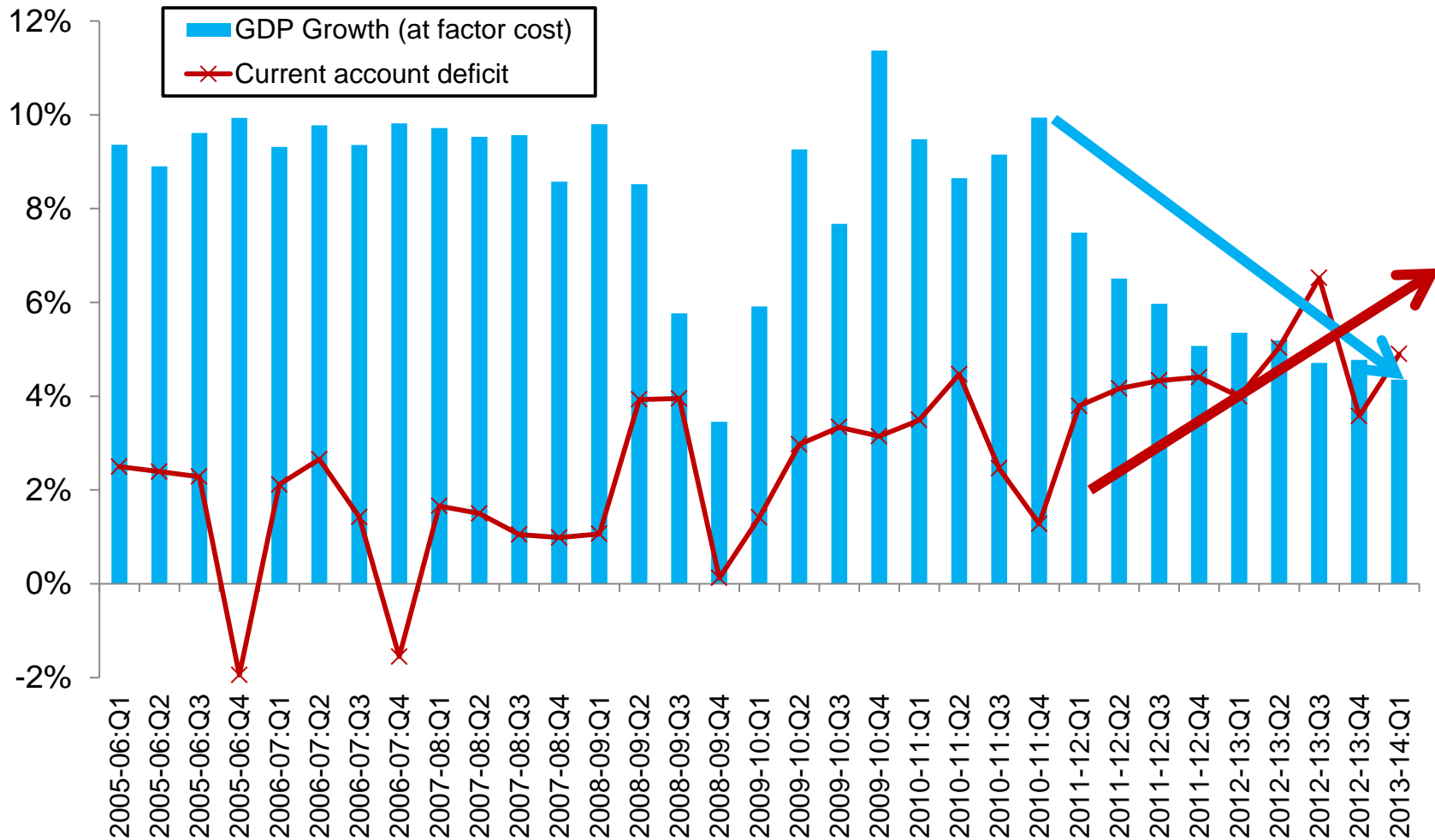
# In a Crisis, Follow the Locals Not the Foreigners

- Near-perfect correlation between gold imports and current account deficits



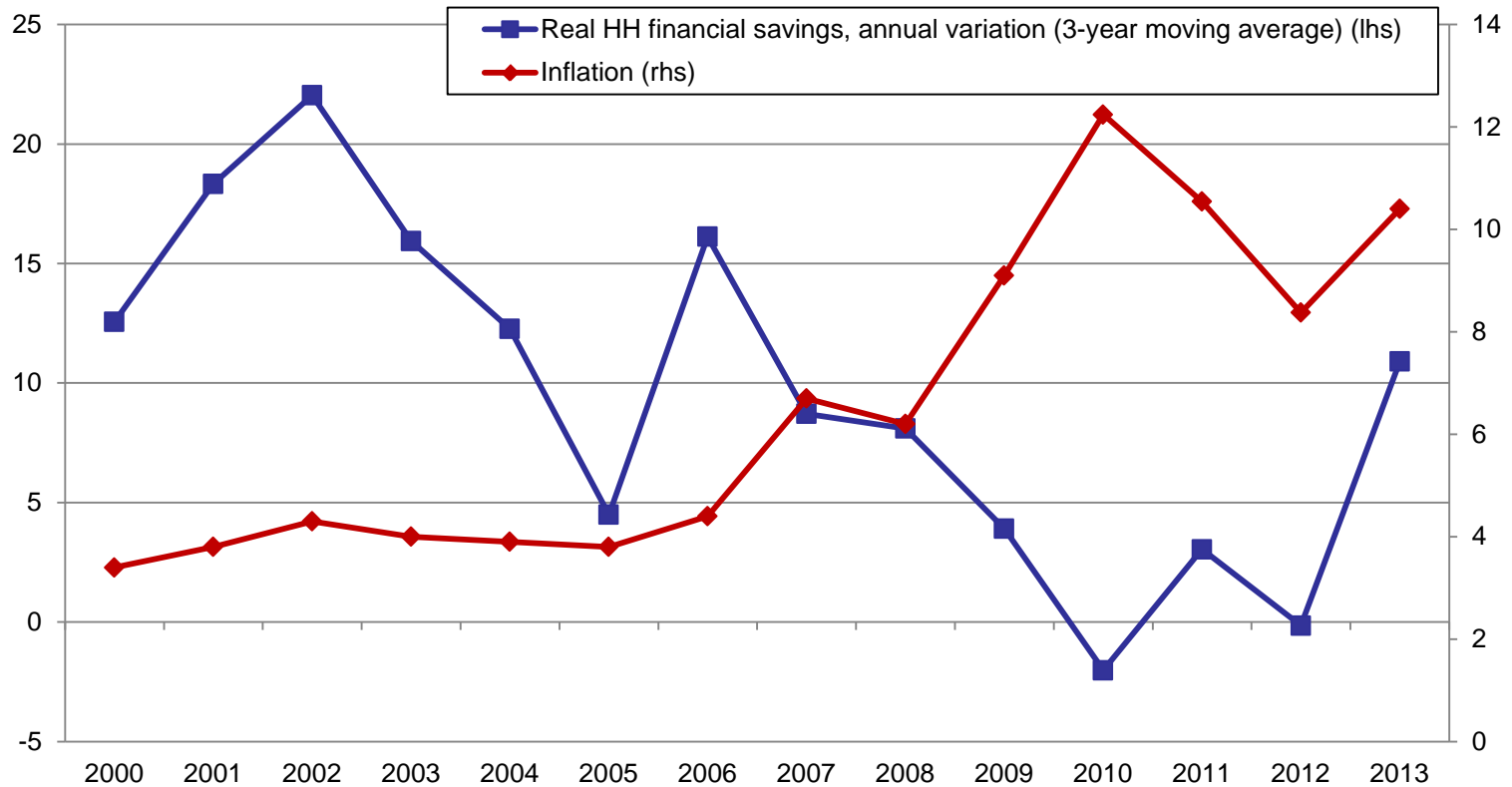
# The Indian Macro-Deviancy/Puzzle

## Slowing Growth Associated with Rising Current Account Deficits



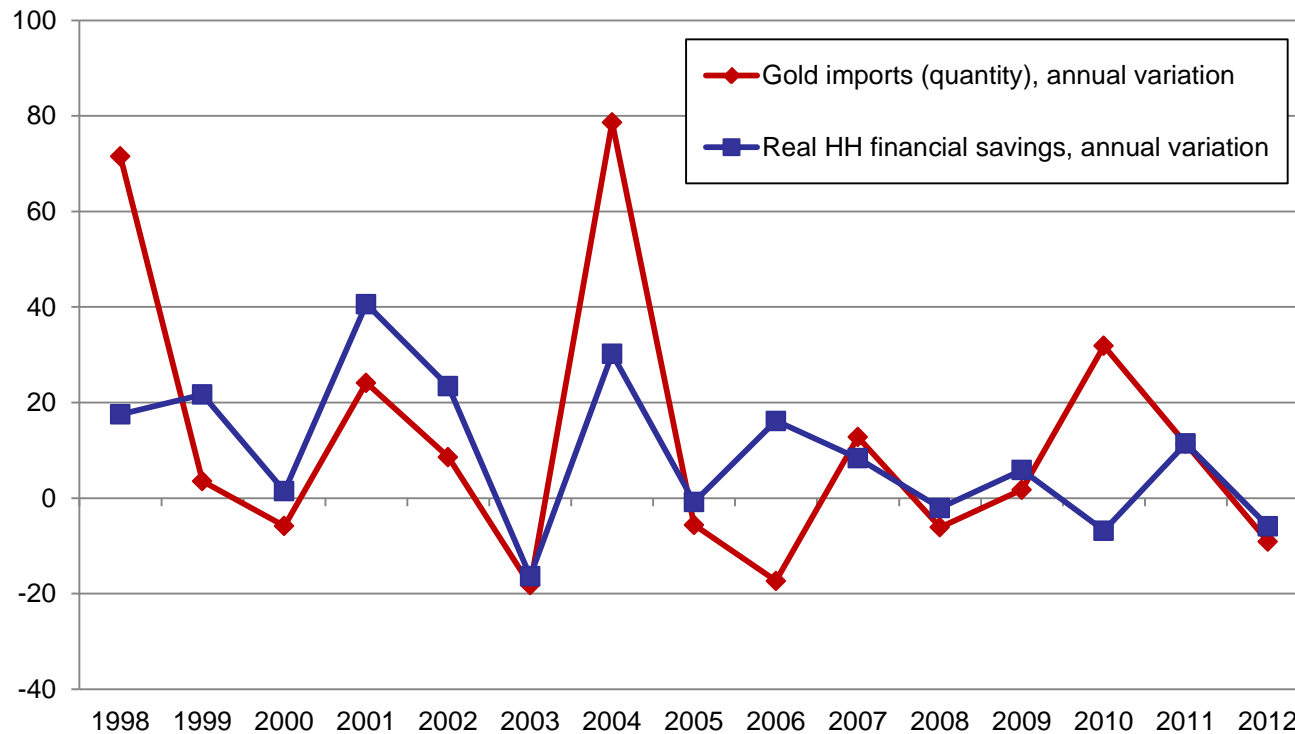
# The Possible Explanation

High Inflation led to decline in household financial  
(mainly bank) savings...



# The Possible Explanation

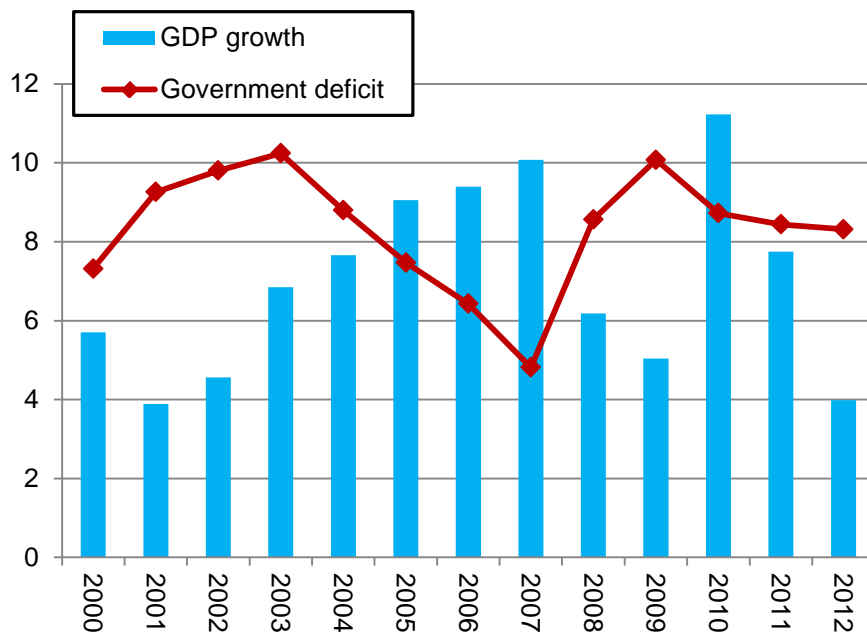
..and to increase in gold accumulation, causing current account deterioration



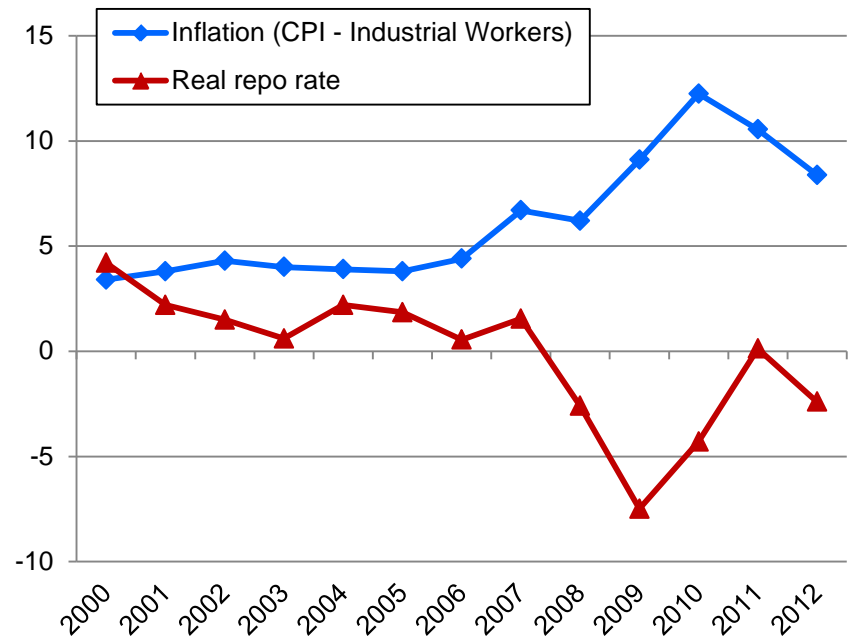
# The Underlying Causes of Inflation

High fiscal deficits combined with easy monetary accommodation

General government net borrowing  
(% of GDP)



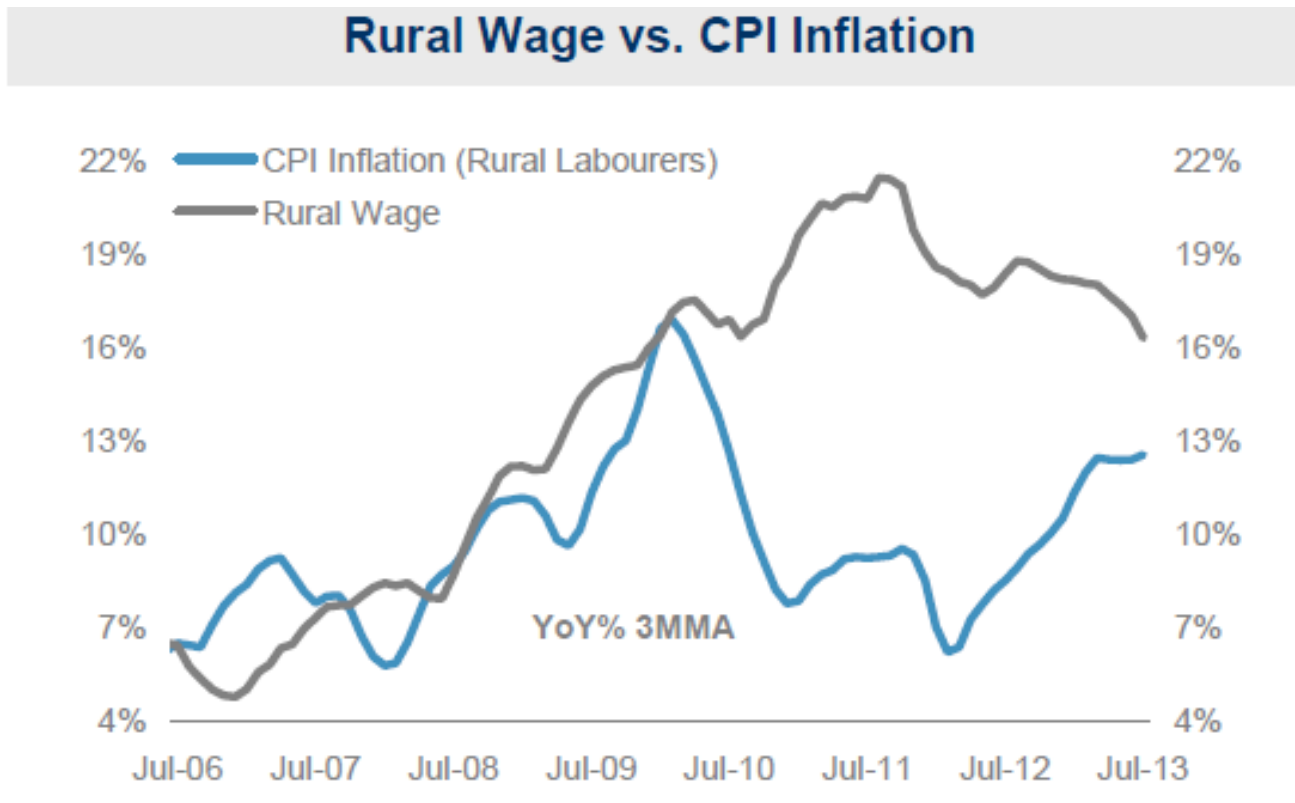
Real policy rate and inflation



Note: Real policy rate is the repo rate minus CPI inflation of the following year

# The Underlying Causes of Inflation

**High Fiscal Deficits: Populism in Rural India plus  
breakdown of social consensus in favor of low inflation**

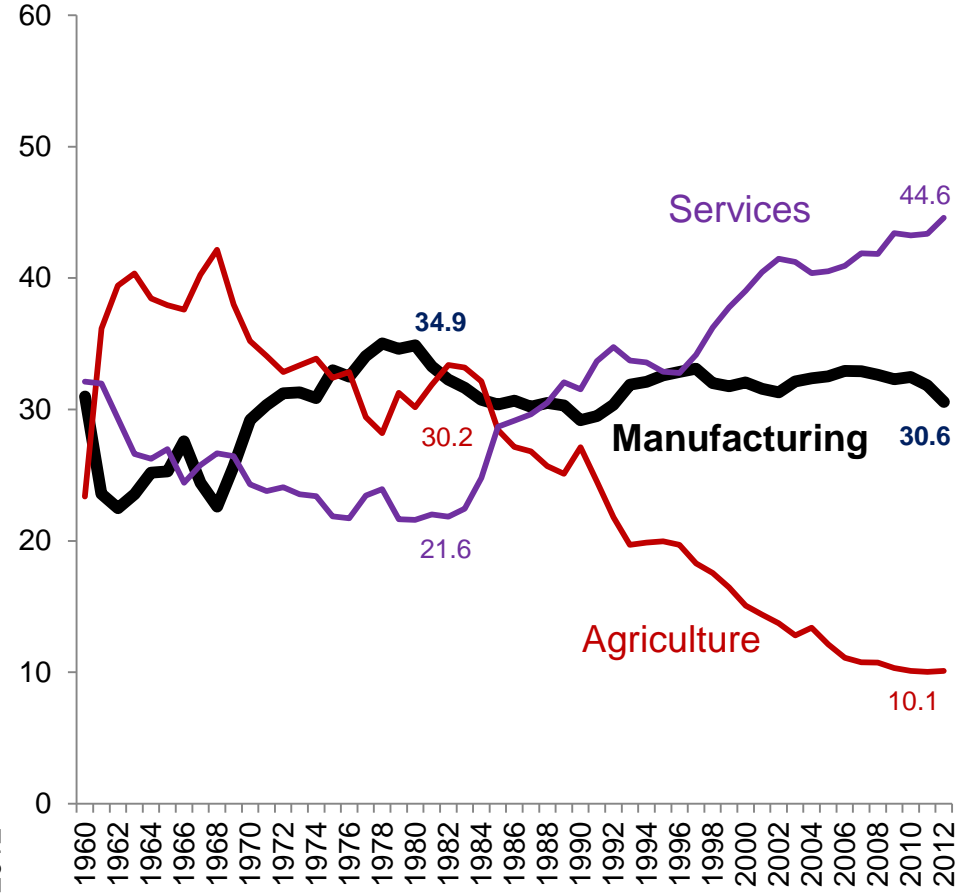
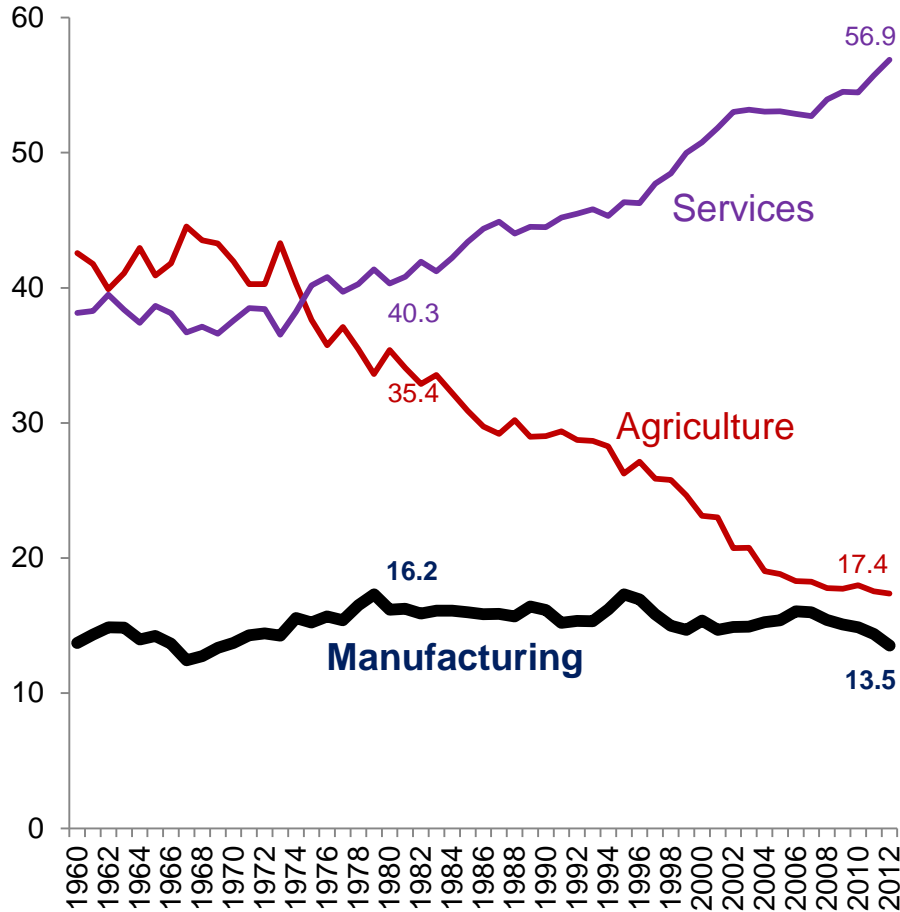




# Development Model Running Out of Steam: Manufacturing (never significant)

- India

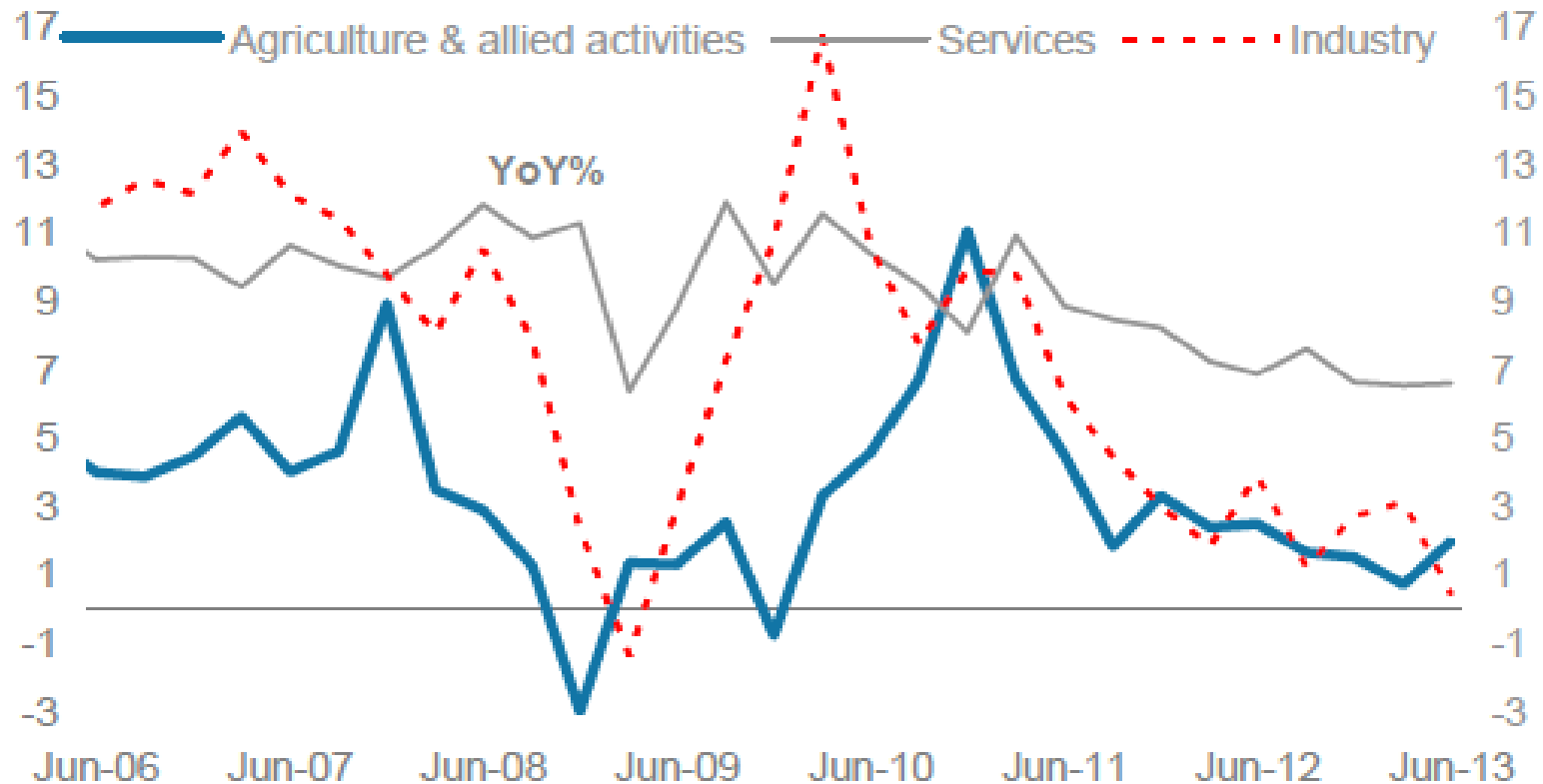
- China



Sources: Chinese National Bureau of Statistics and WDI, PIIE calculations.

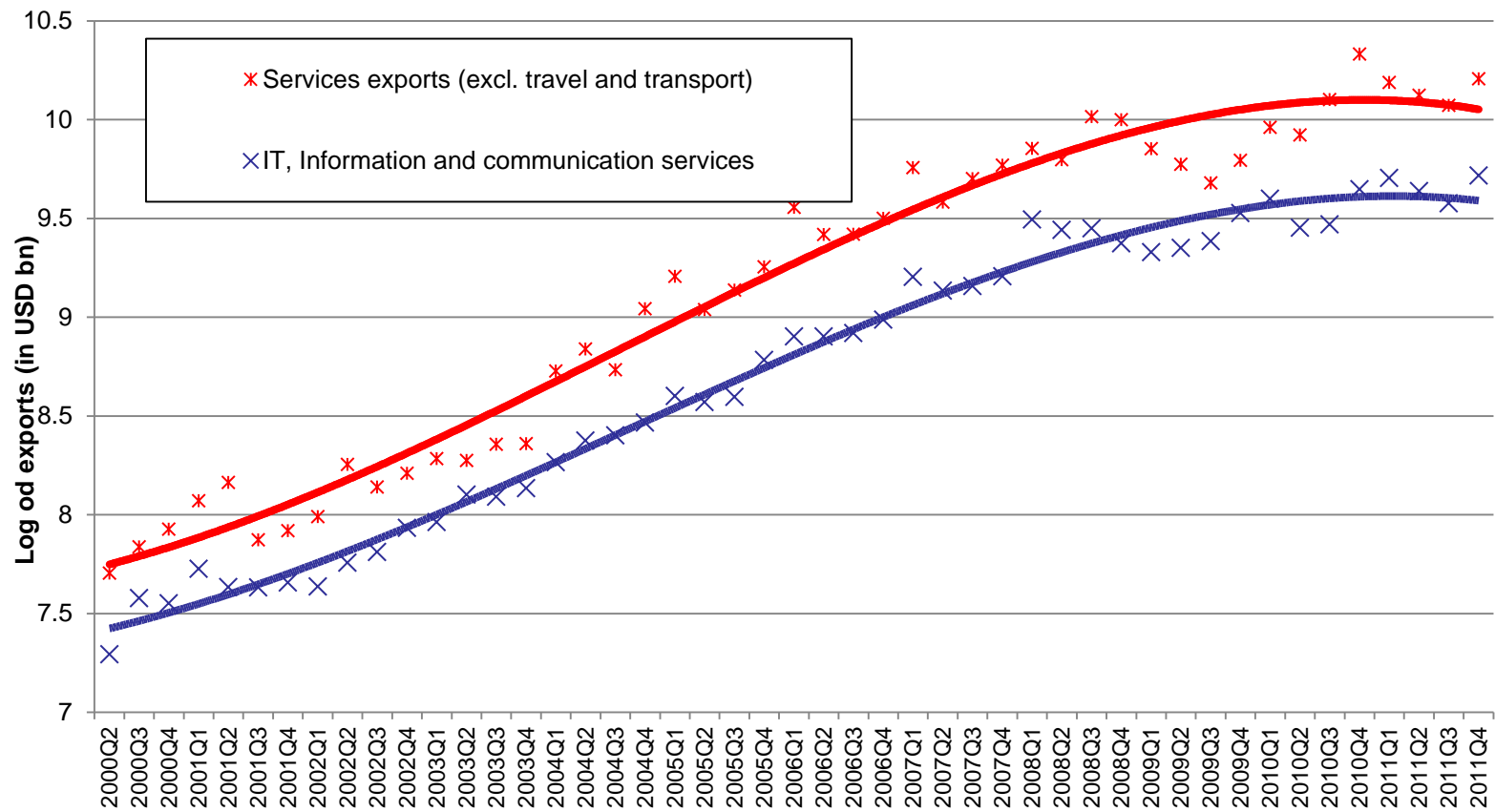
# Development Model Running Out of Steam: Manufacturing (never significant) in further decline

## Growth by Segment



# Development Model Running Out of Steam: Services

- Deceleration in exports of IT-based and other services



# Conclusions

- Fiscal adjustment: Reducing subsidies and implementing new goods and services tax
- Governance and regulatory reform
- How will these happen???