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## Economic Slowdown in the United States: Importance of Domestic Market Leverage in South Asia

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Is the United States economy on the verge or already in a recession? How much of this United States economic troubles will spill over and impact the global economy? These are still much debated questions among economists and key policy makers. A recession, let us recall, is typically defined as a sustained period (two or more quarters) of negative growth in real gross domestic product (GDP). In the last quarter of 2007, the United States' real GDP grew by only 0.6 percent. Therefore the jury is still out as far as the realisation of actual recession. The central bank chiefs and finance ministers of the group of seven (G-7) industrialised countries in their recent meeting at Tokyo, Japan, have reportedly warned that the global economy could continue to slow down. They, however, seem to have endorsed the view of Mr Henry M. Paulson, the United States Treasury Secretary, by suggesting that the United States was likely to avoid recession. Closer home, the survey of American economists by the Wall Street Journal has raised their odds of the United States falling into recession to 49 percent in February 2008 as against 40 percent in the January 2008 survey. The suggested bottom line is an emerging scenario of growth slowdown in the United States and that will in turn pull down the global growth prospects.

This is reflected in the revised projection of the global growth by the International Monetary Fund (Update on Global Economic Outlook, January 29, 2008).According to the revised estimates, global growth is projected at 4.1 percent in 2008, down from 4.9 percent in 2007. The projected growth in the United States in 2008 has been lowered to 1.5 percent on a year-on-year basis, down from 2.2 percent in 2007. For the Euro area, growth has been lowered to 1.6 percent in 2008 down from an estimate of 2.6 percent during 2007. Will this slowdown have an impact on South Asia? If so, how intensive will it be?

Vulnerability of poor developing economies to external shocks can spring from many sources. The most common are terms of trade shocks due to volatility in primary commodity prices, commodity booms resulting in the Dutch disease, external aid reduction and natural disasters (floods, droughts and tsunami). Recession in rich countries that translates into fluctuation in GDP of high income countries (irrespective of the causes of the recession) that are the main markets for their manufactured products is certainly a key source. The intensity of the impact depends on the extent of external/export dependence of South Asian countries.

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The United States and the Euro area constitute the major markets for countries of South Asia and the predicted slowdown is bound to have some impact. The expected belt tightening by consumers in the United States in the face of higher food and energy cost (average United States inflation 4.1 percent) is likely to put severe pressure on retail sales of manufactures. This, in turn, can be expected to lower imports into the United States of labour intensive manufactured goods of the South Asian countries. What is the extent of export dependence of South Asia?

A good measure of export dependence is the share of exports of goods and services in GDP. At present, the average export to GDP ratio for the five South Asian countries is 21 percent (World Bank 2007). It ranges from a minimum of 15.5 percent (Pakistan) to a maximum of 32 percent (Sri Lanka). Nepal and Bangladesh have similar export to GDP ratios (18 percent). India is closer to the average (20 percent). On average, South Asia (except Sri Lanka perhaps) does not seem to suffer from a serious problem of export dependence.

The average conceals the underlying structural problem. This problem is with the structure of exports of South Asia which are heavily dependent on ready-made garments and regional concentration of export markets. For instance, the share of garments, including textiles, is nearly 80 percent in Bangladesh, with more than 70 percent going to the United States and the European Union. Any slowdown in the United States (and global) economic activity will result in a decline in imports which, in turn, will have a negative impact on South Asian manufactured exports. This is likely to lead to reduction in South Asian growth rates to but it will not necessarily derail the growth prospects.

According to the growth projections of The Economist, London, GDP growth rates in Pakistan in 2008 will be 5.4 percent (against seven percent in 2007), 5.5 percent in Bangladesh (6.5 percent in 2007) and close to eight percent in India (9.4 percent in 2007). Sri Lanka is estimated to have grown by seven percent in 2007 and one could expect a decline in growth rate in 2008. Sri Lanka may suffer more if tourism income also falls due to the global economic slowdown. It is important to note that these reductions in projected growth rates are due to a combination of domestic and external factors.

India, in particular, enjoys the advantage of an economy with a large domestic market (GDP of US$2.3 billion) and, therefore, insulted from trade shocks to a greater extent. In other words, India can leverage its domestic market size and growth to stave-off any adverse impact of global slowdown. The importance of a having healthy and growing domestic consumption based economy is perhaps never driven home more than in these turbulent times. Recent reports indicate that India’s information technology exports have also not been affected by recent United States slowdown.

However, the other key countries of South Asia do not seem to be that blessed. These economies have the misfortune at present of suffering from serious domestic political and institutional problems. A combination of domestic conflict and the United States (global) growth slowdown is not a happy set of events for these South Asian economies. The slowdown will inevitably create greater economic uncertainty in South Asia.

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