

Timing of Fiscal Measures also Crucial for Medium-Term Growth

Dr. Chaipat Poonpatpibul

Team Executive

International Economics Department

Bank of Thailand

The world economy has demonstrated encouraging signs of an initial recovery as gross-domestic-product numbers in advanced and emerging economies in the second quarter were significantly better than expected.

Confidence and production indicators have also improved continuously for the past few months.

While declining uncertainties and improving financial market conditions have been helped by central banks' conventional and unconventional measures, fiscal measures have undeniably been the main propelling factor of the recent recovery.

In the US, Japan, Germany and the UK, the fiscal stimulus packages in forms of payments to social-security beneficiaries, cash exchange for old cars, food stamps and tax cuts have eventually triggered a significant improvement in private consumption. Correspondingly, industrial production has edged up and employment has begun to show smaller contractions.

However, private investment, which is an important key of any sustained recovery, still declined, as industrial capacity utilisation has remained at a very low level.

It will likely take quite some time before the G-3 (the US, Japan and the European Union) recovery will be on a solid footing.

As for Asia, the fiscal measures in China and a number of Asian economies have led to both private consumption and investment improvement since the second quarter.

The stimulus packages in advanced economies China have also helped improve the performance of Asian exports for the past few months, especially exports to China. Therefore, it is becoming more apparent that Asian emerging economies will push further ahead on its path of recovery.

In the second half of 2009 and in 2010 the important factor determining the pace of economic recovery in advanced economies will continue to be the fiscal stimulus measures.

With less than a quarter of the US package and roughly half of the major European packages having been disbursed, there remains ample room for stimulation domestic demand through the fiscal channel. Indeed, timely and appropriate deployment of additional fiscal assistance along the pipeline will be very crucial for the continued recovery prospects.

That said, most economists believe that the recovery will be very gradual. Even though the overall financial markets have rebounded, the global financial system is still fragile, with elevated credit risks.

The US housing sector will likely recover at a slow pace, as the mortgage securitisation market has barely restarted.

Meanwhile, unemployment rates in advanced economies are still at very high levels and will likely climb further in 2010.

Going forward, fiscal developments will constitute a major determinant of a post-crisis global economic and financial landscape.

While an untimely phasing out of the fiscal measures could endanger real-sector recovery and the health of the financial sector, we have to monitor whether the considerable amounts of fiscal spending across countries puts upward pressure on global interest-rate trends - as well as raising concerns about public-debt sustainability.

Hence, decision about the appropriate timing of further deployments and future cutbacks of the fiscal measures will be essential not only for effectively pulling the global economy out of this recession, but also for ensuring an environment conducive to medium-term growth.

(The views expressed are the author's own.)

Published in The Nation on Monday, October 26, 2009