

# Monthly Briefing

## World Economic Situation and Prospects and Monitoring of Global Vulnerability\*

No. 12

UN/DESA

11 September 2009

### Summary

- The global economy shows tentative signs of a recovery, but substantial risks and uncertainties remain. If employment growth and private investment demand do not pick up strongly before the effects of fiscal stimuli fade out, the world economy may face a double-dip recession.
- Global trade activity could recede again as final consumer demand remains sluggish.
- Fiscal stimulus measures have been a major factor for the stabilization or expansion of aggregate demand across the globe, especially in a number of large developing countries.
- A major food crisis is imminent in East Africa.

## Part 1: World Economic Situation and Prospects

### Global issues

#### *Growth trends across the globe are diverging strongly*

The world economy continues to show signs of an incipient recovery. However, significant ambiguity remains about the factors that may trigger either a sustained rebound or a relapse. The most notable growth performer is China. On the back of fiscal and monetary stimuli the Chinese Government's target of 8 per cent growth in 2009 could well be within reach. Also other East Asian economies, including those of Hong Kong Special Administrative Region of China, Malaysia, the Republic of Korea, Singapore, and Taiwan Province of China, have rebounded strongly in the second quarter of 2009. South Asian countries (India in particular) have so far weathered the global economic storm reasonably well. Among the developed countries, GDP growth in some of the largest economies including France, Germany, and Japan inched towards positive territory in the second quarter, while GDP figures for the United States and the United Kingdom showed that the pace of the contraction has slowed.

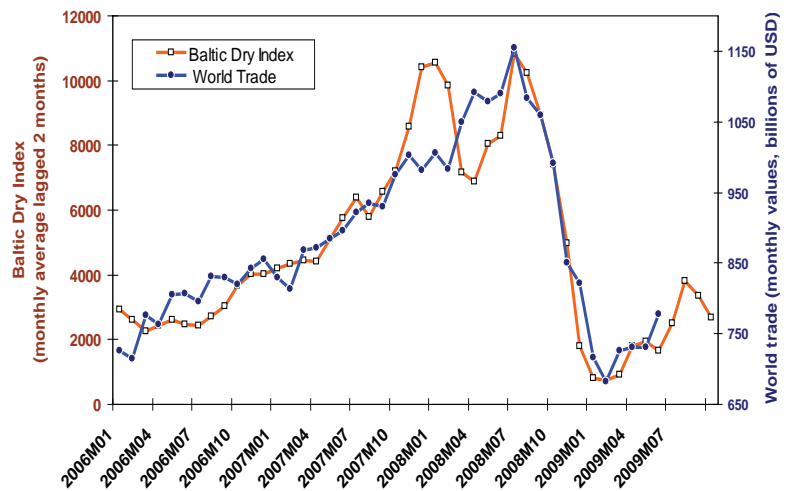
At the other side of the spectrum, the developed economies which have seen their housing bubbles burst, such as Iceland, Ireland, and Spain, remain mired in deep recessions. Also countries of the CIS, in South-Eastern Europe as well as some of the New EU member States continue to face sharp contractions of GDP following significant capital reversals and stock market or real estate crashes. Those developing and emerging economies that suffered significant trade shocks (see Monthly Briefing No. 11, August) and for whom neither the size nor the momentum of fiscal stimuli triggered sufficient counterbalancing effects - including Mexico, the Russian Federation, South Africa and Ukraine - continue to remain in negative growth territory.

\* This issue of the Monthly Briefing includes a new feature to assess the impact of the global financial crisis on the vulnerability of countries based on the "Integrated Monitoring and Analytical System for Crisis Response by UN-DESA", work on which is still in progress.

## Trade activity has picked up in recent months, but may falter again

Over the past few months, trade activity has picked up, but leading indicators like the Baltic Dry Index suggest that there is a risk that demand may soon be faltering. Figure 1 shows monthly values of global trade together with the Baltic Dry Index lagged by two-months. A fall in this index reflects a decline in contracts for future shipments of industrial inputs (“dry commodities”). The 30 per cent decline of the index over the past two months may therefore signal that the recent surge of international trade was only a temporary phenomenon; possibly the result of restocking inventories by warehouses and a related increase in manufacturing supply, rather than a result of more robust recovery of consumer and investment demand. In this case sluggish trade activity is to be expected in the months ahead.

Figure 1: Baltic Dry Index (lagged) and World Trade Value



Sources: Monthly averages of the Baltic Dry Index are computed by UN-DESA/DPAD based on daily data provided by the Baltic Exchange Information Services Ltd. <http://www.balticexchange.com/> Values of world trade are computed by UN-DESA/DPAD

## Fiscal stimulus measures have emerged as a main contributor to growth

Fiscal stimuli in some economies have started to emerge as a main contributor to the growth of aggregate demand, for example in Brazil, China, and Egypt. In some cases, however, fiscal injections have been large (see Table 1 of Monthly Briefing No. 7, April), but the effect on growth has been negligible. In Singapore, in contrast, the direct contribution of increased government spending on growth has been very small, but subsidies to sustain employment, direct credit creation and tax rebates have helped turn around private sector spending. In other cases, like in the United States, tax rebates seem to have been mostly saved by households. In some countries, like in Mexico, the policy packages implemented have been ambivalent, with increases of investment on the one hand and expenditure cuts on the other hand. Elsewhere, like in South Africa, the stimuli put so far in place have turned out to be clearly insufficient.

## Unemployment continues to rise, constraining private consumption

The continued rise in unemployment rates worldwide is an important sign that the current crisis remains severe and has not bottomed out yet. The speed at which unemployment rates have been rising until recently in developed countries seemed unthinkable a year ago, not only because the extent of the contraction was underestimated but also because labour adjustments were severe. As noted in the Global Data Watch (JP Morgan, 28 August 2009), it seems that labour supply has augmented despite the downturn as households had to absorb the fall in net wealth, while demand adjusted abruptly as corporations were laying off workers in order to protect profit rates. In several European countries, for example Germany, government-subsidized part-time employment and training programs have prevented a more pronounced rise in unemployment rates. However, this buffer may be limited and unemployment rates may further increase as long as there is no real recovery. Meanwhile, contractions of employment in many developing countries may not have been as severe as in other recessions although official statistics may not adequately reflect the full increase in unemployment and underemployment. In some countries, for example Brazil, the Republic of Korea and Singapore, government programmes to support employment have helped. Indeed, according to the ILO ([http://www.ilo.org/public/libdoc/jobcrisis/download/statistics/2009-08/Bulletin\\_CompletAug09.pdf](http://www.ilo.org/public/libdoc/jobcrisis/download/statistics/2009-08/Bulletin_CompletAug09.pdf)), the unemployment rate has slightly decreased in recent months in Brazil, Peru, the Republic of Korea, Turkey, and Uruguay. Despite these few “green shoots”, the growing number of unemployed people worldwide works as a drag on household consumption and will likely have an adverse effect on business investment decisions.

Under these circumstances, if employment growth and private spending do not pick up strongly before the fiscal stimuli are fading or trade activity weakens, the few positive signs of the past few months may not translate into a robust recovery. It is therefore critical to continue to be vigilant and to strengthen policy action until it becomes clear that the world economy is on a solid recovery path.

## Developed economies

### *United States and Canada: US household savings reach record levels*

In August, there has been an increasing number of signs pointing to a stabilization of the US economy. The Case-Shiller 20-city home price index increased by 0.7 per cent from May to June, the first positive month-to-month change since May 2006. Other indicators (new home sales and existing home sales) also point to the bottoming-out of the housing sector. The revised estimation of second quarter GDP did not differ significantly from the data released earlier. Increased government spending was the main factor driving the slowdown in the contraction of GDP as compared with that in the first quarter of the year. The decline in import demand (hence a smaller import leakage) also helped slow the decline in total output. Personal income data show that households have kept much of the increased social benefit payments in their own pockets as personal savings increased to an all-time high in the second quarter. Notably, household savings increased despite declining employment incomes through three consecutive quarters. The increased labour force and lower employment have pushed the unemployment rate up to 9.7 per cent in August. While the initial jobless claims numbers are still recovering from the historical peak reached in the first quarter of 2009, the online job advertisements has increased in July and August. If sustained, it might point to the stabilization of the employment level in the coming few quarters.

In Canada, GDP declined by an annualized rate of 3.4 per cent in the second quarter, which is less severe than the 6.1 per cent drop in the first quarter. The relative improvement was mainly driven by growth of private and government consumption. One major factor for private consumption growth is the increased purchase of motor vehicles. Monthly GDP statistics revealed that growth has resumed in June 2009 after 11 months of contraction.

### *Western Europe and the EU: tentative recovery is taking shape*

Hard data is beginning to show that the trough of the recession in Western Europe is passing and a tentative recovery could be shaping up. The precipitous decline of economic activity in the first quarter of 2009, with GDP in the Euro area falling by 2.5 per cent quarter over quarter, has gradually abated, with GDP contracting by only 0.1 per cent in the second quarter. Germany and France have exited recession, both reporting growth of 0.3 per cent, but the Spanish economy continued to contract, as did the economies of the United Kingdom and Italy. Survey data had already signalled the turn-around for several months, with Germany's IFO business climate index, for example, rising for the fifth month in a row in August. The overall index is now at levels comparable to the trough of the previous recession in 2002. Unemployment, however, continues to increase. The rate of unemployment reached 9.5 per cent in the Euro area in July, the highest level since May 1999. In Germany, the unemployment rate has increased by only 0.5 percentage points during the past year. This is mostly due to a government subsidized program that diverts newly unemployed workers into training programs and that is probably a significant factor behind the resilience of private consumption in Germany. In contrast, the unemployment rate has increased by about 2 per cent in France and the United Kingdom, and even more in countries such as Ireland and Spain.

### *The new EU member States: signs of stabilization emerge*

Preliminary GDP figures for the second quarter present a mixed picture. The Polish economy, which is less dependent on exports, has expanded by 1.4 per cent year-on-year. In the Czech Republic, quarterly output dropped by a record 4.9 per cent year-on-year, but increased by 0.3 per cent compared to the first quarter and the country is formally out of recession. Second quarter GDP declined by 16.6 per cent in Estonia, 7.6 per cent in Hungary, 19.6 per cent in Latvia, 8.8 per cent in Romania, and 5.3 per cent in Slovakia in year-on-year terms, but the quarterly dynamics indicates that the worst of the recession could be over. There are signs of stabilization and even growth in industrial production across the region and leading indicators point to a possible recovery in the third quarter. With their currencies stabilizing, the Central Banks of the Czech Republic, Hungary and Romania cut interest rates to boost bank lending. However, increases in the value-added tax and excise taxes, undertaken to fill the budget gaps throughout the region, may suppress domestic demand. Most of the government stimuli in the region consist of efforts to promote exports and foreign direct investment by extending export credit guarantees and adopting more business-friendly legislations, providing liquidity assistance to the financial sector and improving absorption of the EU funds. The economic recession, along with the return of migrants from the EU-15, has led to higher unemployment in the region, especially in the Baltic States, where unemployment rates reached 14 -15 per cent in the first half of 2009. Even in Poland, which

is relatively less affected by the global recession, the unemployment rate has increased from 9.5 per cent at the end of 2008 to 10.6 per cent in mid-2009. The total loss of employment in the region as a result of the recession may reach 2 million people.

### ***Japan: record unemployment and sluggish household consumption dampen recovery hopes***

The economic situation in Japan remains mixed: a continued rebound in real exports contrasts with a further weakening of the household sector. Data released in August showed a rebound of GDP in the second quarter of 2009, by an annualized rate of 3.7 per cent, after a double-digit pace of decline in the previous two quarters. Real exports also rose in July, for a fifth consecutive month, though at a more moderated pace compared to the previous months. As a result, the outlook for manufacturing continues to improve, as reflected in the latest business surveys. On the other hand, household consumption remains sluggish, along with a continued deterioration in labour market conditions and income. The unemployment rate reached a record 5.7 per cent in July, compared with the previous high of 5.5 percent registered in May 2003. The total number of jobless persons in July jumped by 40.2 percent from a year earlier to 3.6 million, and total employment fell by 2.1 percent to 62.7 million. The ratio of job offers to job seekers in July fell to an all-time low of 0.42, meaning 42 jobs are available for every 100 job seekers. The ratio is down from its peak of over 1.0 in 2006. Meanwhile, deflation intensified, as core consumer price inflation fell by an annual rate of 2.2 per cent in July.

### ***Australia and New Zealand: downside risks remain amid signs of a recovery***

In Australia, increased public spending and relatively resilient household spending have so far prevented the economy from falling into recession, but significant downside risks remain in the absence of new policy stimuli. New Zealand's economy is still in recession, although business confidence has lately been improving. In both countries, the unemployment rate is on the rise.

## **Economies in transition**

### ***CIS: economic activity declines at a slower pace***

In year-on-year terms, GDP continues to contract in most CIS economies, although at a declining rate. In the first half of 2009, GDP fell by 10 per cent year-on-year in the Russian Federation and by 2.3 per cent in Kazakhstan. In Ukraine, economic activity had contracted by more than 20 per cent in the first quarter of 2009. While private consumption continues to decline - retail sales contracted by 6.5 per cent, 15.5 per cent, and 19.7 per cent (year-on-year) in June in the Russian Federation, Kazakhstan and Ukraine, respectively - the Russian Federation and Kazakhstan are using their national oil fund to absorb part of the oil price shock. In the Russian Federation, government consumption increased by 1.3 per cent of GDP in the first quarter, partially offsetting the 3.2 percent decline in private consumption. According to official sources, unemployment in the region fell in the second quarter: in Kazakhstan by almost half a percentage point to 6.6 per cent, in Ukraine to 2.2 per cent in July. High unemployment in the Russian Federation (8.3 per cent in June 2009) continues to spill over to the region as large numbers of returning migrant workers are increasing pressures on labour markets and social services, while remittances are decreasing.

### ***South-Eastern Europe: fiscal expenditure cuts weigh heavily on the economies***

The Albanian economy is reported to have grown by 6 per cent year-on-year in the first quarter of 2009, mainly owing to the government's efforts to push forward with investment projects. Industrial output, however, continued to decline, while the services sector and construction expanded. On the other hand, there are indications that in Serbia GDP in the second quarter declined at a faster rate than in the first quarter. In Croatia, the budget was revised for the third time to reflect falling revenues, and temporary new taxes were introduced, including the so called "crisis tax", together with new excise taxes and increases in the value added tax rate. In addition, the Government decided to sell most of its stake in the country's shipyards. If, despite these measures, the budget gap remains large, the country may eventually turn to the IMF. The countries of South-eastern Europe missed an opportunity to build up fiscal reserves in previous years and the assistance from the IMF and other institutions is mostly limited to supporting the financial sector to prevent capital flight. Earlier in the year, the governments in the region adopted measures to increase public spending, but they have had to revise their budgets repeatedly and are now sharply cutting expenditures. The labour markets have deteriorated markedly in 2009, with the unemployment rate increasing by 3 to 5 percentage points in all countries.

## Developing economies

### *Africa: prospects for the region's largest economies differ sharply*

Economic data for the second quarter of 2009 present a mixed picture regarding the shape of a potential recovery in Africa. Egypt recorded higher-than-expected growth of 4.7 per cent during the fiscal year that ended in June 2009 owing to resilient domestic demand and strong government spending. Although revenues from the Suez Canal fell 22 per cent in July year on year, the Egyptian Government is currently considering an additional \$2.7 billion stimulus package for the new fiscal year. South Africa, however, is expected to lag behind a recovery in the region as Africa's biggest economy registered a third consecutive decline of quarterly GDP, which fell by a seasonally adjusted annualized rate of 3.0 per cent in the second quarter. The country's manufacturing industry and other sectors continued to decline significantly, while the construction industry and government services grew moderately. Economic conditions continue to be fragile, with growth in demand for credit by South Africa's private sector falling to its lowest level in over five years. South Africa's unemployment rate remained at 23.6 per cent in the second quarter, although this figure does not include the sharp increase of discouraged work-seekers who are no longer considered as economically active, as well as the decline of employed people in the informal sector. As inflation slowed to a 23-month low of 6.7 per cent, the Central Bank further cut its main policy rate by 50 basis points to 7.0 per cent.

### *East Asia: despite strong rebounds in the second quarter, significant risks remain*

The East Asian economies have rebounded strongly in the second quarter of 2009, following sharp downturns since the middle of last year. Nonetheless, there are significant risks to the economic outlook as export demand from developed economies remains subdued, unemployment rates in most countries in the region continue to rise, and further increases in the prices of oil and other commodities may dampen private consumption demand. In year-on-year terms, GDP continued to decline across the region in the second quarter, with the exceptions of China, Indonesia, and Viet Nam. However, compared to the first quarter, economic activity increased in all East Asian economies. Higher government spending on both consumption and fixed capital formation has been a major driver of the recovery in the larger East Asian economies, most notably in China, Indonesia, the Philippines, and Thailand. In Indonesia, government consumption increased by 19.2 per cent year-on-year in the second quarter of 2009, contributing about 1.3 percentage points to total GDP growth of 4 per cent. In the strongly export-oriented economies, such as Hong Kong Special Administrative Region of China, the Republic of Korea, Singapore, Taiwan Province of China, and in Malaysia, the direct contribution of increased government spending to GDP growth has been low, but measures such as tax rebates, the extension of credit lines to households and companies, and cash grants to employers to subsidize wage bills have provided strong support for private consumption. In most East Asian countries, unemployment continued to increase over the past few months, albeit at a slower pace than at the beginning of the year when the manufacturing sectors across the region suffered dramatic contractions. Compared with many developed economies and other developing countries, unemployment in most East Asian economies remains, however, relatively low (the exceptions being Indonesia and the Philippines).

### *South Asia: economies show resilience but erratic monsoon rains cloud outlook*

Economic growth in India accelerated in the second quarter of 2009, as increased government spending helped mitigate the adverse impact of the global financial crisis. In year-on-year terms, GDP expanded by 6.1 per cent, following 5.8 per cent growth in each of the previous two quarters. Government consumption expenditure was 10.2 per cent higher than a year ago, while tax cuts and the easing of credit delivery to specific economic sectors contributed to growth of private consumption and fixed capital formation. Technically, the external sector also provided support for second quarter growth as imports declined more rapidly than exports. However, India's economic outlook has been clouded by late and erratic monsoon rains that have also affected Bangladesh and Pakistan. Weaker agricultural output could trigger renewed food price inflation and have significant knock-on effects on incomes and private consumption. In Pakistan, the Central Bank reduced its key policy rate by a further 100 basis points to 13 per cent as year-on-year inflation fell to its lowest level since the beginning of 2008. The country will receive an additional \$3.2 billion loan from the IMF, with total support now amounting to \$11.3 billion.

### *Western Asia: increased government spending cushions the impact of the crisis*

Israel saw a return to growth in the second quarter of 2009, with its economy expanding by 1.0 per cent year-on-year driven by private consumption and exports. This, and an inflation rate that exceeded the upper limit of the target range of 1-3 per

cent, led the Central Bank to increase its key interest rate from 0.50 per cent to 0.75 per cent. In Turkey, with inflation easing from 5.7 per cent year-on-year in June to 5.4 per cent in July, the benchmark overnight borrowing rate was lowered by 50 basis points to 7.75 per cent. The general picture of lower inflation rates is also confirmed by data in a number of other countries such as Jordan and Saudi Arabia. Meanwhile, increased government spending has been cushioning the adverse effects of the crisis in the region. In Saudi Arabia, for example, government spending, along with business investment, is expected to be the main factor in offsetting a sharp decline in exports in 2009. Accordingly, the share of government spending in GDP will increase from around 30 per cent in 2008 to almost 40 per cent this year, while the budget balance will move into deficit for the first time in many years.

### ***Latin America: trends and recovery prospects increasingly diverge***

In Latin America and the Caribbean, signs of recovery continue to emerge in several countries such as Brazil, Chile, Colombia and Peru, whose economies may bounce back in the second half of 2009. In some of these countries, domestic demand, supported by countercyclical fiscal policies, explains the improved performance of the industrial sector and the stabilization of unemployment rates. In Brazil, for instance, industrial production increased in July by 2.2 per cent compared to June, while unemployment fell to 8.0 per cent in July, from a peak of 9.0 per cent in March 2009. In Chile, a sense that the worst of the recession may be over, led the government to announce that it has no intentions to launch a new economic stimulus plan; in the first half of 2009 government consumption had increased by 7.8 per cent year-on-year, partly offsetting a decline in private consumption. However, countries such as Mexico, Argentina and the Bolivarian Republic of Venezuela continue to see their economies in recession. In the Bolivarian Republic of Venezuela, the economy contracted by 2.4 per cent in the second quarter of 2009, following 22 consecutive quarters of growth. The economic deterioration in the Bolivarian Republic of Venezuela will have a negative impact on several small economies in the region, which were benefiting from special economic cooperation agreements, including the Caribbean oil initiative, Petrocaribe, which includes 17 Caribbean and Central American countries.

### ***Least Developed Countries: East African countries are facing a major food crisis***

In East Africa, the current situation has reached an alarming level with many least developed countries (LDCs) facing a major food crisis. More than half of Somalia's population of 7.5 million is in need of humanitarian aid as the country has been struck by escalating hunger, civil war and piracy of ships carrying food aid. Other LDCs such as Ethiopia, Djibouti and Uganda are also in need of increased food aid as the extended period of drought may lead to one of the worst food crises in decades. Yields of maize, a staple of the diet, are expected to be about 15 per cent below the five year average in many parts of East Africa and conditions are predicted to get worse over the coming months. In addition, the current rise in food prices will accentuate the crisis. In Bangladesh, the most populous LDC, economic risks have also increased in the second quarter. Exports have started to decline in year-on-year terms and agricultural output may weaken due to poor monsoon rains.

## **Part 2: Global Vulnerability to Food and Energy Price Shocks**

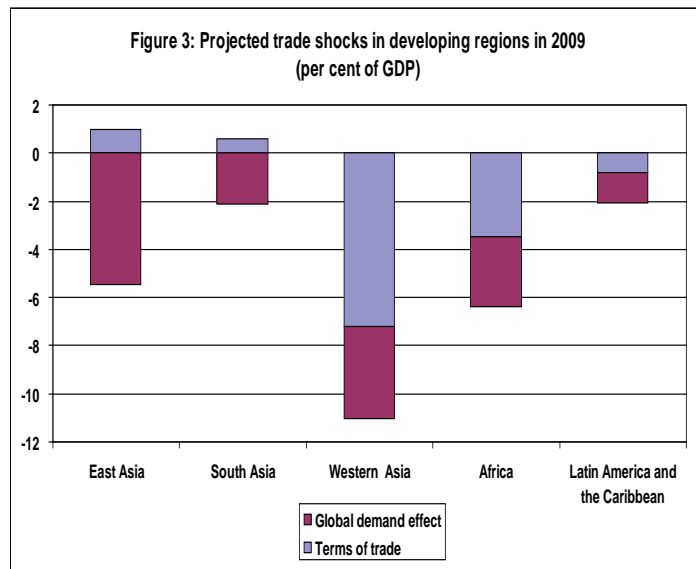
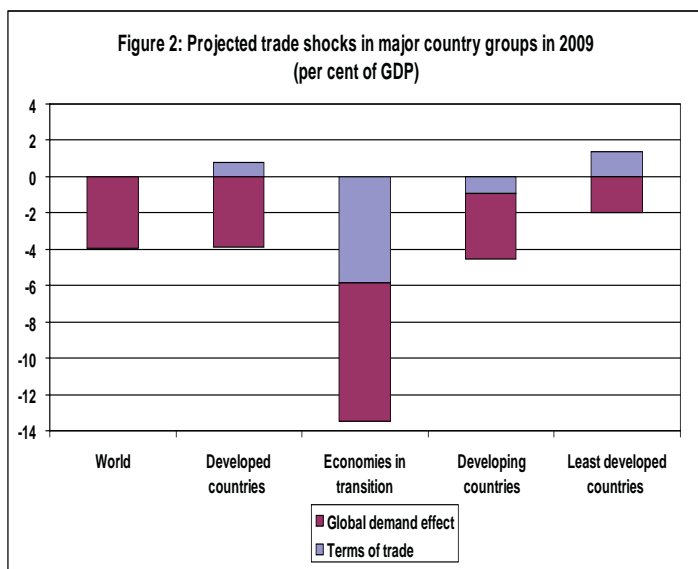
### ***Update: slight recovery in global trade does not alter picture of large negative trade shocks for most countries in 2009***

The previous Monthly Briefing (Monthly Briefing No. 11, August) analyzed the vulnerability of developing countries to the decline of global trade and shifts in export and import prices as a consequence of the crisis. The analysis has been updated with data to July 2009. The update, despite some recovery in global trade, does not visibly alter the projected size and pattern of trade shocks in 2009 as reported in the previous briefing (see Figures 2 and 3). Economies in transition will face the largest trade shocks (expressed as a share of their GDP), especially as a consequence of the decline in commodity prices as compared with their average levels in 2008. Countries with high degree of concentration of exports of primary commodities (oil and gas in particular) are hit hardest because of deteriorating terms of trade, while exporters of manufactures are hit mostly because of the decline in global demand. On average, the trade shock to developing countries is about as big as that to developed countries, but as analyzed in the Monthly Briefing No. 11, the precise nature and magnitude of the shock varies greatly across countries. Notably, the world's poorest countries, the LDCs, according to the UN classification, are expected to witness trade shocks of smaller magnitude. Also within this group there are large differences: most oil and mineral exporters are suffering adverse terms-of-trade shocks, while some others are even registering small net trade gains thanks to the drop in import prices

of food and energy products. Where there are gains, however, these may be a blessing in disguise. The same countries seeing some improvement in their terms of trade suffered severe negative shocks in the preceding year, as an expression of the high vulnerability of their economies to the continued volatility in world commodity markets.

Such volatility tends to be harmful for economic growth in the long run as most LDCs lack sufficient resources and financial reserves to absorb even mild external shocks and also tend to have weak social protection schemes to insulate their population from the consequences of such shocks on incomes and access to basic social services.

In this briefing we take a further look at this vulnerability and assess the impact of the shifts in global commodity prices on domestic inflation across countries and country groups.<sup>1</sup>



### Poorest countries may see milder trade shocks in 2009, but these come on top of bigger adversity in 2008

Most LDCs and other developing countries that suffered strongly adverse trade shocks in the preceding year as a consequence of the steep rise in world food and energy prices are expected to face below-average trade shocks in 2009.

Stark rising world market prices for food and energy prices pushed up headline inflation worldwide in 2008, in particular, most significantly among LDCs. Figure 4 shows the correlation between the size of the import shocks as a share of GDP and the inflation rate in those countries in 2008 and 2009. The “pass-through” to domestic prices appears to have been strong in 2008 when world market prices surged, but much weaker when they dropped in 2009,<sup>2</sup> this pattern also seems to hold for developing countries as a group (Figure 5). Such asymmetry in adjustment appears as a worrisome additional vulnerability as the negative consequences of rising world market prices for domestic consumers do not seem to subside quickly. The burden of higher international prices of food and energy on working poor seem to be tenacious and persistent, compounding by the fact that unemployment tends to respond with significant lags during economic recovery.

More specific factors can be identified by looking into individual cases in different regions and countries (see Figure 6). For example, in many African countries, such as in Guinea, Kenya and Sao Tome and Principe, a strong adverse food and energy import price shock pushed up domestic inflation in 2008. However, while international prices of food and energy moderated in 2009, domestic inflation has remained high. In several cases, the “pass-through” effect of the international commodity price surge in 2008 could be initially mitigated through price controls and subsidies, but many Governments phased out these measures at the end of 2008 in response to the drop in world market prices. For instance, Seychelles abolished the rice subsidy it had introduced during 2008. Senegal also eliminated all budgetary subsidies on food products, including the elimination of the subsidy on rice, the reinstatement of the previously suspended duties and taxes on other food products, the removal of the specific

<sup>1</sup> For detailed country information please see [http://www.un.org/esa/policy/publications/wespmmbn/sngnote\\_12h.xls](http://www.un.org/esa/policy/publications/wespmmbn/sngnote_12h.xls)

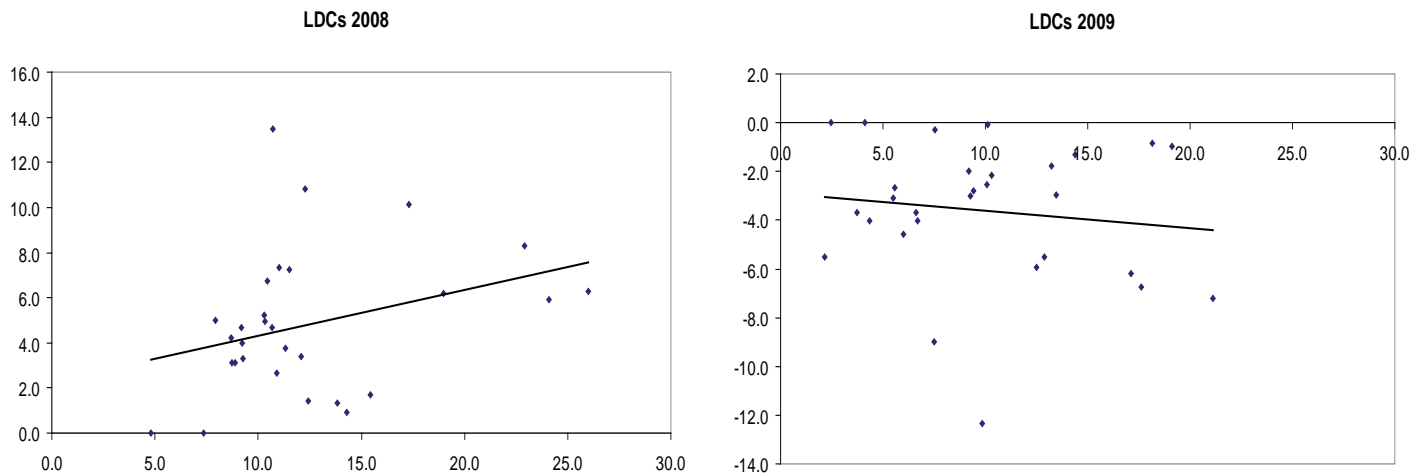
<sup>2</sup> The sign of the shock is positive when the prices of imports rise and negative when import prices fall. The shocks are estimated by groups of commodities but Figures 3-6 show the total import price shocks for the observed (2008) and projected (2009) change in world market prices for food, energy, agricultural raw materials.

tax on vegetable oils, as well as the elimination of the subsidy on butane gas. Burkina Faso, Côte d'Ivoire and Niger also discontinued the suspension of import duties and taxes on sensitive foodstuffs. All these policy reversals seem to have contributed to the asymmetric influence of world market prices on consumer price inflation during the upward and downward cycles.

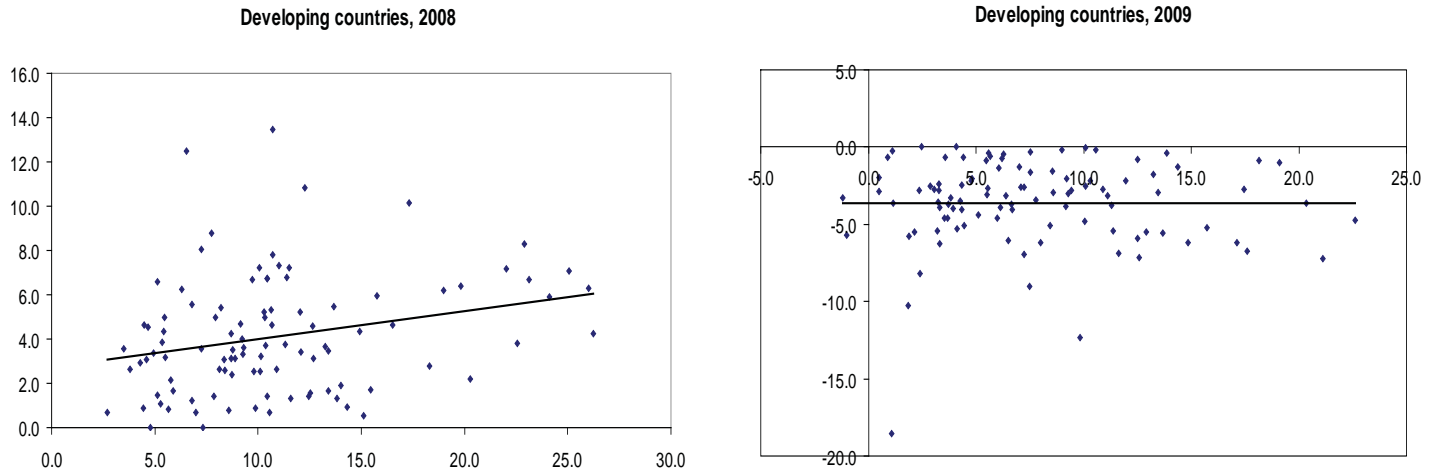
In Latin America and the Caribbean (see Figure 7), the drop in international food and energy prices seems to have had a somewhat stronger effect in reducing domestic inflationary pressures in 2009, particularly among the net food and energy importing countries in Central America and the Caribbean. Nicaragua, for instance, consumer price inflation is expected to drop to 8.5 per cent in 2009, down from 19.6 per cent in 2008. Lower inflation is explained in part by falling food prices, but also by a contraction in domestic demand and in the money supply since late 2008. Jamaica, which also registered a high inflation rate in 2008, 22.0 per cent, is expected to reduce its inflation rate in 2009 to 12.6 per cent. In this case, headline inflation remains higher than might be expected from the drop in import prices as a consequence of new tax measures that were recently introduced and of currency depreciation. In Barbados and Trinidad and Tobago, however, domestic inflation in 2009 is expected to remain close to 2008 levels. Despite falling international prices of food and energy, downward rigidity in domestic price adjustment have impeded consumers to benefit from cheaper imports.

In East and South Asia (see Figure 8), a majority of economies are experiencing disinflation during 2009, in part on account of the decline in the international prices of primary commodities. For example, inflation rate in China dropped by more than 5 percentage points during 2009, in line with the size of the import price decline relative to the size of the economy (3.6 per cent of GDP). Domestic factors have also played a role in reducing consumer price inflation, including the recovery in the supply of pork meat during 2009. Supply shortages were an important factor in driving up domestic food prices in China during 2008. India, in contrast, is among the few cases in Asia where the moderation in international food and energy prices in 2009 has not resulted in lower domestic inflation. The measure for the import price shock dropped by 6.9 per cent during 2009, but India's domestic inflation rate increased from 8.3 per cent in 2008 to 9.2 per cent in 2009. Drought and consequent poor harvests have been a key factor in driving up domestic food prices in India in this year. ■

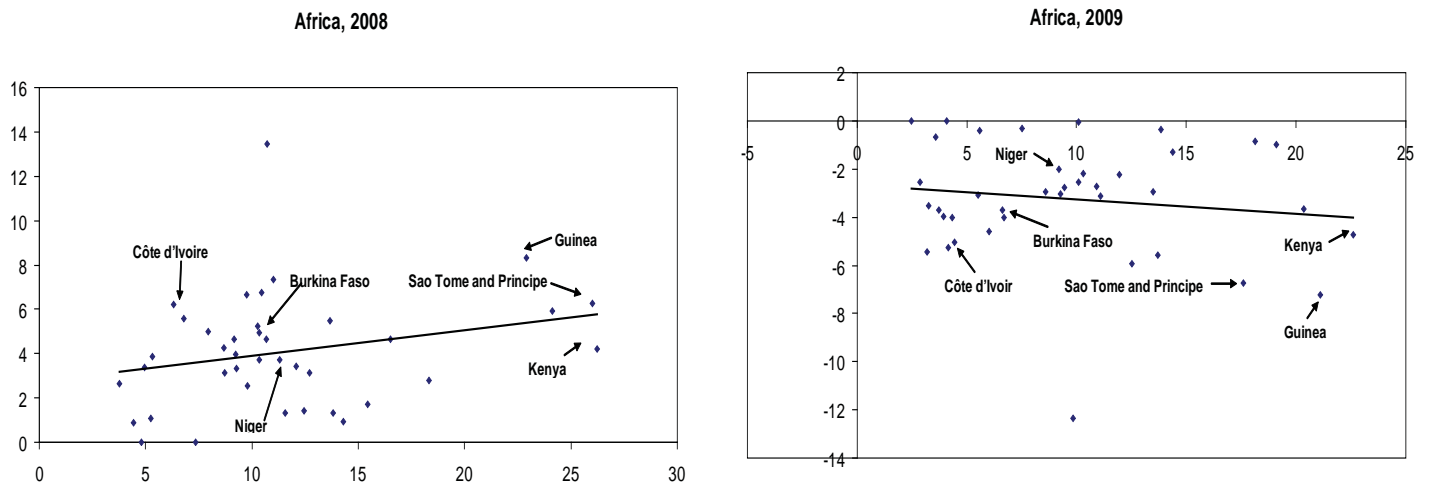
**Figure 4: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



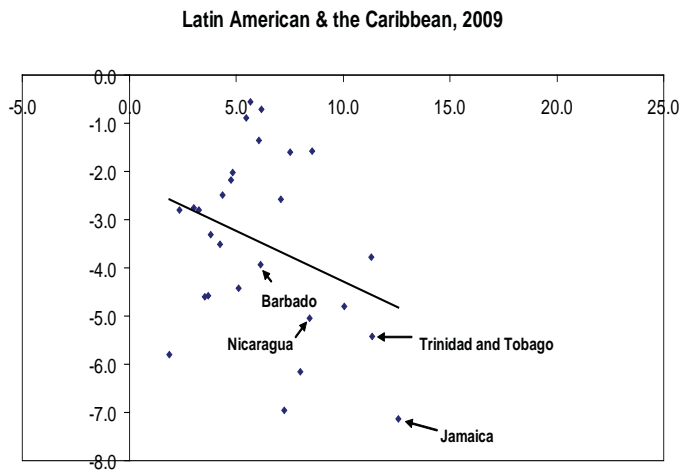
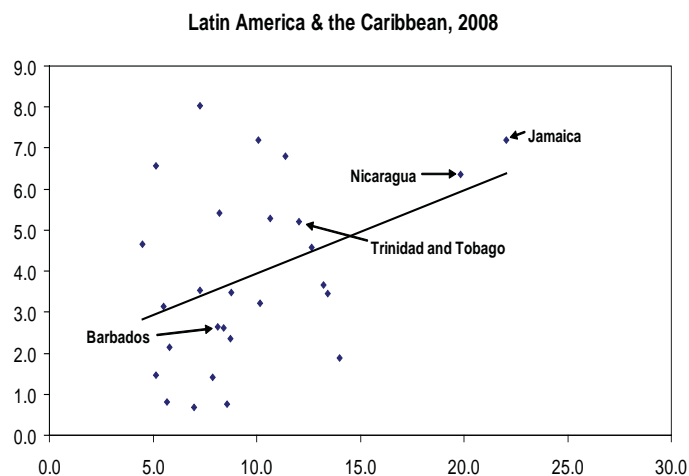
**Figure 5: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



**Figure 6: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



**Figure 7: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**



**Figure 8: Import price shock on agricultural, food and energy products as per cent of GDP (vertical axis) and rate of domestic price inflation (horizontal axis)**

