

Monthly Briefing

World Economic Situation and Prospects

No. 13

UN/DESA

9 October 2009

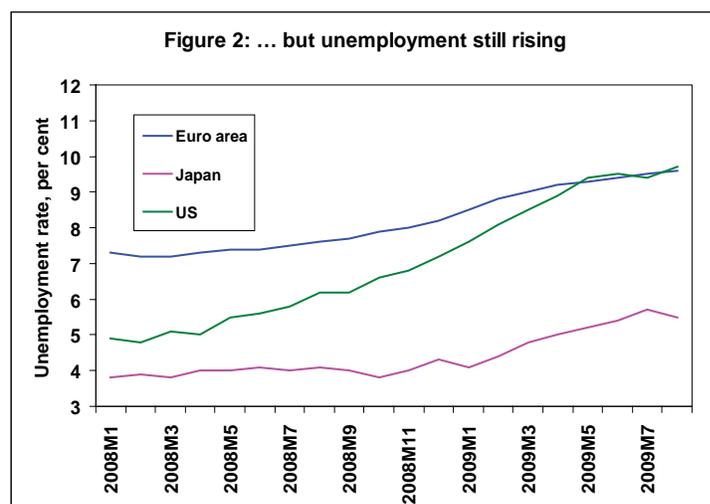
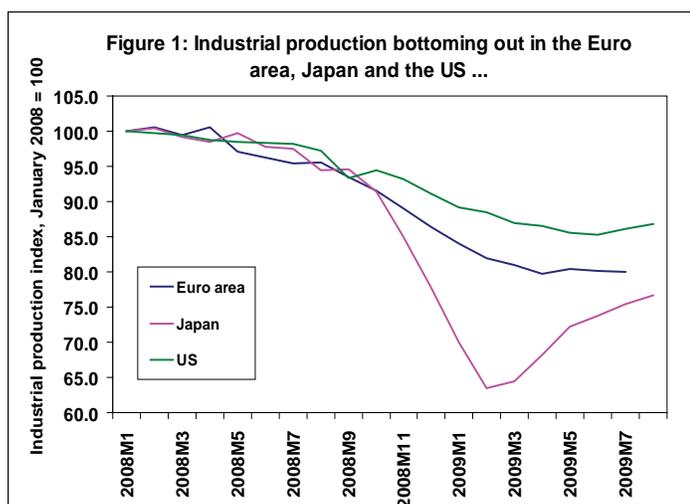
Summary

- The global recovery remains fragile and requires sustained policy support, as agreed by G-20 leaders at the Pittsburgh Summit.
- The recovery in some Asian economies has lost some of its momentum, as reflected in weaker exports and imports.
- Unemployment continues to rise worldwide.
- Widespread hunger is looming in East Africa.

Global issues

Outcome of the G-20 Pittsburgh Summit

G-20 leaders have recognized that the global recovery remains fragile over concerns that the modest signs of recovery are almost entirely on account of the fiscal stimulus, that there are still important financial sector problems to be resolved and that unemployment remains on the rise worldwide (see figures 1 and 2). The leaders pledged to sustain a strong policy response and avoid a premature withdrawal of stimulus. In order to avoid the re-emergence of unsustainable global imbalances and untenable levels of public indebtedness, G-20 leaders launched a Framework for Strong, Sustainable, and Balanced Growth, which is meant to guide coordination of national policies in order to avoid a return to the unsustainable patterns of growth and financial disequilibrium that led to the global crisis.



Source: EUROSTAT and national websites.

The Framework still needs to be detailed. One big question is how exactly to avoid a return to the previous pattern of global imbalances. Over the past year, these imbalances have narrowed considerably, but in a recessionary fashion with deficit countries retrenching in imports and surplus countries losing export revenue. The challenge for the new framework for policy coordination will be to find ways to strengthen domestic demand growth in the surplus countries and export growth in the deficit countries in the short as well as in the medium run and without causing disruptive shifts in exchange rates. This will not be easy and is not likely to be achieved through demand management alone.

Developed economies

United States and Canada: housing market bottoming out, but labour market still sluggish

The revision of the second quarter GDP data showed the United States economy shrank by 0.7 per cent, after a drop of 6.4 per cent the first quarter.

In the housing market, both the Case-Shiller and FHFA indexes showed that housing prices had bottomed out in July. Other statistics also indicated an improvement in housing activity over the summer season.

The labour market remains weak. Although the initial jobless claims maintained a downward trend over the past few months, other indicators show a continued rise in joblessness. During the month of September, non-farm employment dropped by 263,000 and the unemployment rate climbed to 9.8 per cent. Since the start of the economic downturn in December 2007, about 8 million jobs have been lost in the United States.

Recent indicators for the Canadian economy showed signs of stabilization. Monthly GDP for July was unchanged from the previous month, and non-farm payroll employment increased slightly by 0.5 per cent. Also, the number of workers receiving regular employment insurance declined in July by 3.8 per cent.

Western Europe and the EU: improving economic confidence, but lagging upturn

There are continuing signs of improvement in economic activity in the Euro area, but they are weak at best. The European Commission's Economic Sentiment Indicator for the Euro area increased for the sixth month in a row, but at a diminished pace compared to earlier months, and it remains well below its historical average (since 1990). The improvement registered in industrial production in May stalled in June and July, but industrial new orders rose in both months with Germany, France and Italy seeing significant rebounds and the United Kingdom continuing to languish. Euro area unemployment continues to drift slowly upwards, reaching 9.5 per cent in July (figure 2). Headline inflation in the area was negative in August, marking three months in a row of declining prices, but this can mostly be attributed to strong negative base effects resulting from the high oil prices of one year ago, which will reverse their impact in the months ahead. Core inflation in the euro area remained steady at 1.3 per cent in July and August.

The new EU member States: an uncertain outlook

Economic decline continued in many of the new EU member states until the mid-year. In the Czech Republic, GDP declined by a record 5.5 per cent (year-on-year) in the second quarter of 2009. In Bulgaria, it fell by 4.8 per cent and in Slovenia by 9.3 per cent. Monthly indicators for July-August, however, point at some stabilization of output. Several carmakers in these economies intend resuming full production and hiring additional labour. Output in many other industrial sectors is still declining, however.

Also, labour market indicators continued to weaken. The rate of unemployment increased in August to 13.5 per cent in Estonia, and 18.3 per cent in Latvia. The IMF, which provided funds to Latvia's stabilization programme, has agreed to raise the ceiling for the 2009 budget deficit to 13 per cent of GDP. This allows Latvia's Government to increase spending on social protection.

Governments of many of the new EU members are considering further austerity measures for 2010. The prospects for recovery in the rest of 2009 and for 2010 seem slim as external demand remains weak and households are trying to consolidate their finances.

Developed Asia and the Pacific: huge output gap in Japan

Business sentiments in Japan continued to improve in September, presaging a positive growth in the second half of the year. Recovery will be modest at best and is not expected to close the huge output gap any time soon. Unemployment will also remain high by Japanese standards. Consequently, the risk of the economy entering into a deflationary spiral remains considerable. In response, the Bank of Japan will likely keep its policy interest rate at near zero until late 2010.

New Zealand's prolonged recession came to an end, as - for first time since the end of 2007 - GDP growth turned positive in the second quarter of 2009. Net exports are driving the recovery, although household consumption and business investment also increased, stimulated by record-low interest rates.

Economies in transition

CIS: fragile recovery

There are signs that the CIS countries are slowly climbing out of the deepest part of the recession. Recovery is still fragile, however. Industrial output of the CIS increased over the period May to August, mainly owing to recovery in the Russian Federation. Also, investment spending and exports were on the rise again. In Ukraine and Azerbaijan, industrial production is increasing. However, in Ukraine, despite the recent increase, the production level was still 23 per cent lower in August than it was a year ago.

Higher oil prices are fuelling the output recovery in the Russian Federation, but consumer demand remains weak as real wages are unstable and real household incomes are still on the decline. In Ukraine, real wages fell 4.2 per cent in August to end a short-lived upward trend, signalling continued weak consumer demand. The turnover in retail trade has fallen by 16 per cent between January and August of 2009. In Azerbaijan, in contrast, domestic demand has remained surprisingly resilient. Despite weak GDP growth of 2.7 per cent in the first seven months of 2009, rising real wages pushed up retail sales and demand for services.

South-Eastern Europe: impediments to recovery

The Croatian economy contracted by 6.3 per cent in the second quarter of 2009. In Serbia, the decline was 4 per cent, dragged down by the continued slump in industrial and construction sectors. Recovery is not yet in sight. External demand remains weak, while the road to recovery is hindered further by a persistent credit crunch, rising unemployment rates and declining house prices.

Shrinking tax revenues have forced Governments in the region to make further budget revisions for the rest of 2009. Projected expenditures have been adjusted downwards, despite the agreement with the IMF allowing Serbia to raise the ceiling for the budget deficit to 4.5 per cent in 2009. This was agreed during the ongoing second performance review of Serbia's stand-by arrangement.

Developing economies

Africa: some signs of recovery, but worries for the two largest sub-Saharan economies

Several sub-Saharan economies, whose mining industries represent a significant part of their GDP and government revenues, show some signs of recovery. Botswana's economy, for instance, expanded 1.3 per cent year-on-year in the second quarter of 2009, having contracted by 18.8 per cent in the previous quarter. The diamond mines reopened and farming surged. Zambia also recorded a trade surplus in August for the third month in a row, mainly owing to the rise of copper export revenues. Moreover, Zambia's largest cobalt producer, which had suspended activity since last December, is expected to restart production by mid-October.

Economic difficulties remain for sub-Saharan Africa's two major economies. In South Africa manufacturing activity remains depressed and unemployment continues to rise. In Nigeria, the banking system is under severe distress and is affecting other parts of the economy. Nigeria's financial sector woes have led a generalized liquidity crunch and sharp increases in the interbank lending rates during September.

East Asia: pace of recovery likely to slow in export-oriented economies

After a strong rebound in the second quarter of 2009, the pace of recovery seems to have slowed in parts of East Asia, most notably in the heavily export-oriented economies. In August, industrial production declined slightly in the Republic of Korea, Singapore and Taiwan Province of China. Trade activity also weakened in several countries in July and August. In the Philippines, export earnings and import spending fell in July after registering two consecutive months of double-digit gains. In the Republic of Korea, the trade balance and current account surpluses shrank considerably in August, mainly owing to lower shipbuilding and automobile exports. In China, exports and imports also declined in August, but a strong expansion in industrial production, fixed asset investment and retail sales suggests that economic growth accelerated further in the third quarter. Growth could exceed the government target of 8 per cent for the year 2009.

Viet Nam is among the countries that have best weathered the global crisis, with GDP growth accelerating from 4.5 per cent in the second quarter to 5.8 per cent in the third.

The decision of the United States Government to impose tariffs on imported Chinese-made tyres has created concerns in China and among international observers. However, a major trade conflict between the two countries appears unlikely in light of their mutual dependence.

South Asia: trade remains weak, but lower inflation and increased remittances are supporting demand recovery

Export sectors across South Asia continue to be hard hit by the global crisis, but lower inflation and increased remittance inflows are keeping up domestic demand. In India and Pakistan, export earnings declined sharply in recent months as demand from developed economies remained sluggish. Bangladesh's export sector is also increasingly being hurt by the weakness in global demand. Nonetheless, trade deficits have narrowed as import bills are down compared with the previous year, especially owing to lower oil prices. The weakness in exports contrasts sharply with the ongoing strong growth in remittance inflows, especially those originating from migrant workers in the Gulf Cooperation Council countries. Remittance flows to Bangladesh increased by 22.4 per cent in the fiscal year 2008-09, which ended in June 2009, contributing to a significant current account surplus. In Pakistan, remittance inflows were 25 per cent higher in July-August than a year ago. Domestic demand has also been fuelled by sharply lower inflation rates. In India, Nepal and Pakistan, inflation has recently declined to about 10 per cent, while in Bangladesh and Sri Lanka to 3 per cent and 1 per cent, respectively.

Western Asia: output decline slowing and inflation receding

Economic conditions in the region remain challenging, although there were further indications that the speed of economic contraction has slowed. In Turkey, for example, the economy shrank by 7 per cent year-on-year in the second quarter, after a decline by 14.3 per cent year-on-year in the first. At the same time, annual inflation continued to recede, amounting to 5.3 per cent in August and providing the background for a further cut in the benchmark policy interest rate by 50 basis points. In Bahrain, the central bank also loosened monetary policy, reducing its key interest rate by 25 basis points to 0.5 per cent in support of credit lending and operations of the banking sector. Meanwhile, despite the global crisis, the Syrian Arab Republic saw its tourism sector expand.

Latin America: only few countries are recovering; others see deeper recessions

The picture in Latin America and the Caribbean is mixed. Brazil has officially come out of recession. Its economy grew by 1.9 per cent in the second quarter, driven by rising industrial production and household consumption. The economies of Panama and Uruguay are also showing resilience, growing respectively by 2.4 per cent and 0.35 per cent in the first half of 2009. In contrast, Argentina's economic woes continue. In July, GDP dropped by 1.5 per cent year-on-year, on the back of sharp declines in consumer spending and industrial production. The Bolivarian Republic of Venezuela saw its GDP decline by 2.8 per cent (year-on-year) in the second quarter of 2009 and the rate of unemployment increased to 8.5 per cent in July. This will restrain private consumption and forebodes further economic contraction in the near future.

Government budgets for 2010, presented in several countries in September, suggest fiscal tightening is ahead as countries have little or no financing space left for additional stimulus. On August 31, Ecuador decided to borrow against its increased quota with the IMF drawing an extra \$398 million to cover gaps in its public finances.

Least Developed Countries: food crisis still affecting East Africa

Recent trends among the least developed countries are rather diverse. In some, there are signs of a lessening of the crisis impact. As mentioned, LDCs in Africa that are mineral exporters benefited in recent months from higher export prices. Also, inflation continues to decelerate in many least developed countries, including in Burundi, Malawi, Nepal and Rwanda. Economic growth in Rwanda received a major push as total investment was up by 50 per cent during the first six months of 2009 from a year earlier, principally in the renewable energy and telecommunication sectors.

Elsewhere, Bangladesh and several East African countries, including the United Republic of Tanzania and Uganda, in contrast, registered stark rises in domestic food prices owing to poor domestic harvests. In particular, the ongoing food crisis remains extremely alarming in East Africa. Widespread hunger is looming. Support by the World Food Programme is affected by a shortage of funds, and the programme has already had to cut the size of food rations it provides to the people in the region. ■