

Monthly Briefing

World Economic Situation and Prospects

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Summary

- Net export growth and government spending are driving the recovery in the major economies, while China's economy is acting as the engine of the global upturn in 2010
- Most of the unconventional monetary stimulus measures undertaken in 2009 are being phased out in line with improved conditions in credit markets
- Donors pledged \$9.9 billion at the UN international aid conference on Haiti to support post-disaster reconstruction

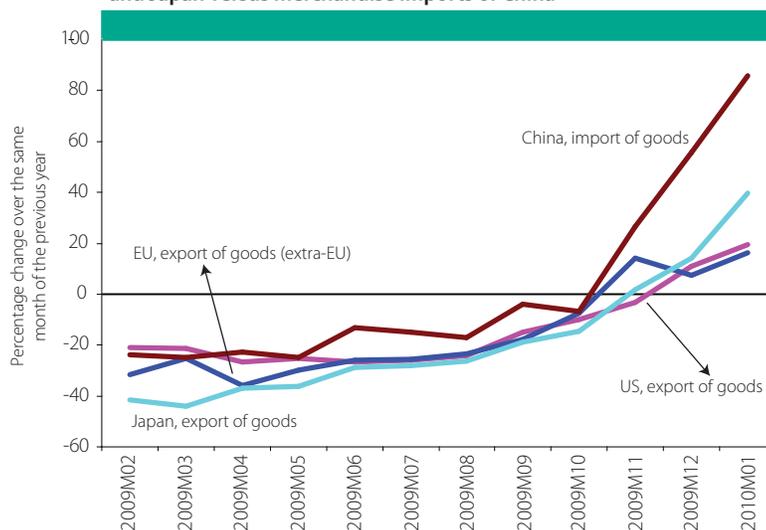
Global issues

Net export growth, along with government spending have led the economic recovery in developed countries since the second half of 2009, according to the most recent economic indicators. The United States, the EU and Japan all reported positive net export growth. Among the major economies, only Australia and China were exceptions to this trend. The indicators further confirm that China has been the leading force behind the global recovery (see figure 1). The pattern of recovery, though, suggests more challenges could lie ahead. In order to sustain the global recovery, more surplus countries would need to strengthen their domestic demand, as imports of Australia and China combined account for less than 10 per cent of world trade.

Central banks of the major economies are reviewing their policy stance in view of the ongoing recovery. In response to the global financial crisis, central banks in major developed economies adopted a wide range of unconventional monetary measures in addition to the drastic reduction of policy interest rates, such as massive short-term liquidity injections into the banking system, direct liquidity provisioning to borrowers and investors in key credit markets, and the purchase of long-term securities. Policy interest rates have been kept so far at very low levels, but most unconventional measures are being phased out now that central bankers see credit market conditions have improved sufficiently. In the outlook, modest increases in policy rates are expected to take place in most major economies in late 2010. At the same time, however, large amounts of long-term securities are expected to remain on the balance-sheets of the central banks.

While monetary policies are tightening, fiscal deficits are expected to continue to increase with the continued implementation of the existing fiscal stimulus packages during 2010. Concerns over mounting public debt are increasing, yet in most major economies governments are expected to continue fiscal stimulus during the year as the recovery in the real economy is far from solid and unemployment rates remain high.

Figure 1: Growth of merchandise exports of US, EU and Japan versus merchandise imports of China



Source: National statistical offices. Trade is reported in value terms.

Developed economies

United States and Canada: job growth in US

The United States Bureau of Economic Analysis revised its final estimate of the 2009 fourth-quarter GDP growth slightly downward from previous reports, but still showing a strong annualized rate of 5.6 per cent. The total employment level increased in March 2010, even though the unemployment rate remained at 9.7 per cent, mainly due to the edging up of participation ratio. Many monthly indicators for the first two months of 2010, especially those for industrial sector, suggest the recovery has continued during the first quarter though at a moderate pace. It remains to be seen whether this will be enough to induce further improvement in the labour market. Housing construction activity has stabilized from the end of 2009. Trends in housing prices remain ambiguous as the two key housing price indices (Case-Shiller and FHFA) show different directions of change. The Case-Shiller housing price index increased for 8 consecutive months up to January 2010, though its current level is still 29 per cent below its peak value observed in 2006. The FHFA index, in contrast, suggests prices were declining again in December 2009 after three quarters of stabilization.

The Canadian economy remained on the recovery track. The monthly GDP indicator for January 2010 showed an increase at the annualized rate of more than 7 per cent, which is the fifth consecutive monthly expansion. Employment also continued on an upward trend and the rate of unemployment fell by 0.1 percentage points to 8.2 per cent in February.

Western Europe and the EU: improving business sentiment

Survey evidence for March showed upbeat business sentiment after the sluggishness depicted in February, suggesting that the harsh winter in parts of Europe may have led economic agents to be overly concerned about the slowdown at the turn of the year.

The European Commission's business climate index for March showed significant improvement after pausing in February. Germany reported the strongest increase, while solid gains were also reported in the United Kingdom and the Netherlands. Industry was the main driver of the improvement and has nearly reached its long-term average. Confidence in services and construction also improved. Industrial production figures for January were stronger than the marginal increase in December. Revised data now shows a continuous improvement in activity since the low point in April 2009.

Unemployment rose marginally to 10 per cent for the euro area in February, but, overall, jobless rates seem to be stabilizing across the region.

Europe's fiscal crisis eased in March as euro area countries in principle backed a financing plan to help Greece, which offers up to €22 billion with IMF involvement in the funding as a last resort if market lending would dry up. But the crisis still simmers. As a reflection of that, Fitch Ratings downgraded Greece sovereign debt rating by two notches (from BBB⁺ to BBB⁻). Fitch also downgraded Portugal's sovereign debt rating, while the euro further weakened against the dollar during the month.

The new EU member States: loose monetary conditions, tight fiscal stance

Among the new EU member States, Hungary, Poland and Slovenia registered monthly increases in industrial production of between 3 and 8 per cent at the beginning of 2010. Improvements were predominantly in export-oriented sectors. The sectors oriented towards domestic demand, including construction and retail trade, remain weak. Growth prospects of the new EU members continue to depend heavily on external factors. Unemployment rates continue to increase. Latvia's jobless rate reached 19.7 per cent at the end of the fourth quarter of 2009.

Governments of the new EU member States remain focused on restoring public balances. IMF programs for Hungary, Latvia and Romania remain on track despite these being conditioned to onerous cuts in public spending. Monetary policies, in contrast, are becoming more accommodative, as monetary authorities seek to restart private lending and to encourage mortgages in domestic currency. In March, the National Bank of Romania cut its main policy rate for the third time this year by 50 basis points. However, although banks in many of the new EU countries remained profitable in 2009, they remained cautious and tightened conditions on new loans and lending to the non-banking sector remains depressed.

Developed Asia and Pacific: budget deficit of Japan still manageable

Deflation continued in Japan, as the core consumer price index declined by 1.2 per cent in February. Exports continued to recover in the first quarter of 2010, but at a slower pace than in the previous quarter. Imports, in contrast, accelerated in the same period. Nonetheless, net exports continued to increase.

The annual budget for fiscal year 2010 was passed in March. The size of the budget was slightly smaller than the previous one, which contained large fiscal stimulus packages. Public investment was cut in the new budget in favour of new measures worth about 0.5 per cent of GDP including the increases in child allowances and elimination of public high school fees.

The recession has led to a widening of Japan's budget deficit of Japan to over 6 per cent of GDP in 2009, up from 2.2 per cent in

2008. So far, the increase in the government deficit has been matched by increases in corporate and household savings and Japan continues to be a net exporter of capital to the rest of the world.

Economies in transition

CIS: recovery constrained by weak domestic demand

Economic activity in the CIS increased in early 2010. In January, industrial output expanded by 7.8 per cent year on year in the Russian Federation and by 10.3 per cent in Kazakhstan, where manufacturing increased by 24.5 per cent due to a large increase in the output of refined products. Industrial output was also 8.8 per cent higher in Ukraine in the first two months of 2010 year on year. These figures are, however, in part driven by a weak base-year effect. Domestic demand in general remains anaemic in the CIS countries. Retail trade increased by only 0.3 per cent year on year in the Russian Federation in January and contracted by 4.7 per cent in Ukraine in the first two months of 2010, despite higher real wages. In contrast, in Kazakhstan, retail trade increased 11.8 per cent year on year in January.

Unemployment and tight credit conditions continue to constrain the recovery in domestic demand. In the Russian Federation, unemployment increased in January by one percentage point to 9.2 per cent. These conditions have contributed to lower inflationary pressures, with annual inflation continuing its decline in January, falling to 8 per cent in the Russian Federation and 11.5 per cent in Ukraine.

South-Eastern Europe: trying to boost business activity

The countries of the region continue with anti-recession policies. In the FYR of Macedonia, the Government unveiled in March its fourth package of anti-crisis measures, containing simplification of business regulations, including those for obtaining construction permits, and easier access of companies to credit lines from the European Investment Bank. In Serbia, the Government will provide state guarantees for public investment in road building and energy. The National Bank of Serbia in March cut foreign currency reserve requirements from 45 per cent to 25 per cent and, together with the Government, it intends to channel €1.3 billion to the business sector in the form of loans at a subsidized lending rate.

Developing economies

Africa: some green shoots but food crises and uncertainties remain

Aiming to strengthen the ongoing recovery by stimulating lending, several central banks, including those in Kenya, Rwanda and South Africa, have cut key policy interest rates in March.

In South Africa, recent quarterly data showed that employment in the formal non-agricultural business sector had increased by about 0.2 per cent from September to December 2009 while the gross earnings paid to employees had increased by 12 per cent.

In Nigeria, since the new acting President took over in February, the Government has approved disbursement of about \$3 billion out of its oil revenues to the country's 36 states and other government agencies. The account of excess oil earnings stood at over \$20 billion in 2007, but has gradually declined and currently stands at about \$4 billion.

After suffering severe droughts last year, various East African countries enjoy more favourable weather conditions which are forecast to boost agricultural production and exports. In February, Kenya's tea production was more than 60 per cent higher than a year ago. However, in Niger and Zimbabwe, hunger situations continue to be alarming, requiring massive emergency aid. In Niger, the food crisis threatens more than half of the population. In Zimbabwe, about 2 million people are in urgent need of food aid.

East Asia: China's trade surplus continues to narrow

The recovery of the East Asian economies remains robust as indicated by strong growth in industrial production and trade. In response to the improved domestic and global economic environment, several central banks have signalled a gradual normalization of monetary conditions in the quarters ahead. Malaysia's central bank increased its benchmark rate by 25 basis points to 2.25 per cent, indicating the monetary authorities no longer see record-low borrowing costs being warranted as the economy has emerged from recession and deflationary pressures have abated. China's trade surplus continued to narrow during the first two months of 2010. The combined surplus for January and February amounted to \$21.8 billion, about half the level recorded in the same period last year. In 2009, the total current account surplus had declined by 35 per cent to \$284 billion mostly owing to a smaller surplus in the trade balance as domestic demand was supported by the massive monetary and fiscal stimulus measures.

Chinese Government authorities have recently hinted at a change in the development strategy by focusing more on improving standards of living instead of mainly aiming at high GDP growth. The Government intends to rebalance the economy by gradually

reducing the role of exports and investment in output growth and increasing that of private consumption. Following the fiscal stimulus measures implemented earlier, the new budget includes measures to further increase spending on social infrastructure and transfers, particularly on education, healthcare, social security and pensions. The Government also allocated about \$6.5 billion to stimulate employment.

South Asia: main policy rates raised in India

In an unannounced move, the Reserve Bank of India raised its main policy rates by 25 basis points in March 2010 – the first interest-rate hike in more than two years. With the economic recovery consolidating, the central bank has shifted its focus to controlling inflation, which increased sharply over the past year. The move is expected to mark the beginning of an extended cycle of monetary tightening. Driven by robust domestic demand and a recovery in exports, Sri Lanka's economy expanded by 6.2 per cent year on year in the fourth quarter of 2009, bringing full-year growth to 3.5 per cent. For the first time since 1977, the country's current account registered a surplus, as the deficit in the trade balance, which declined by 52.5 per cent in 2009, was more than offset by the net inflows of worker remittances, which rose by 14.1 per cent. Export earnings have also started to recover in Bangladesh and Pakistan, although activity in garment and textile sectors remains weak.

Western Asia: further signs of economic recovery

West Asia largely continued on a trend of recovery. In Turkey, industrial output increased by 12.1 per cent year on year in January, with the manufacturing sector registering an expansion by 14.4 per cent. This was underpinned by the effect of a low base in the previous year and particularly strong growth in the automotive sector. Israel's GDP growth estimate for 2009 was revised upward, from 0.5 per cent to 0.7 per cent, as growth in private consumption and investment turned out to be higher than previously estimated. At the same time, inflation for February fell slightly to 3.6 per cent year on year from 3.8 per cent in the previous month, keeping the rate of price increases above the target range of the central bank of 1-3 per cent. This was one reason for the Bank of Israel to increase its policy interest rate by 25 basis points to 1.5 per cent. Besides the need to control inflation, policy makers also reiterated their general intention to tighten monetary policy.

Latin America: data in early 2010 reason for optimism

The Venezuelan economy contracted sharply by 5.8 per cent year on year in the last quarter of 2009. This brought the decline in GDP to 3.3 per cent for 2009 as a whole. Oil exports fell by 38 per cent year on year in 2009. Brazil's economy also contracted, by 0.2 per cent, in the year 2009 and despite a rebound by 2 per cent year on year in the last quarter. Argentina and Uruguay, in contrast, posted positive GDP growth by 0.9 and 2.9 per cent, respectively, in 2009. Both economies also witnessed strong rebounds in the last quarter. In the case of Argentina, the rebound was explained to a large extent by rising public expenditures. In most parts of the region, economic recovery is expected to continue during 2010, especially among the primary exporters which are benefiting from the rebound in commodity prices. In Chile copper exports increased by 106 per cent in the first two months of 2010, year on year. Copper production was unaffected by the recent earthquake, as mines are located far away from the earthquake epicentre. The Chilean government estimated that economic damage of the earthquake could represent \$30 billion and revised down its economic growth forecast for 2010. In the Bolivarian Republic of Venezuela fiscal revenues increased 16 per cent in January year on year, reflecting higher oil prices. In Mexico, favourable conditions for vehicle exports have led to a 75 per cent year-on-year increase in their production during the first two months of 2010.

Least Developed Countries: \$9.9 billion pledged for Haiti

The international community pledged \$9.9 billion to support Haiti in reshaping the post-earthquake economy at the UN donor conference held in March in New York. Of this, \$5.3 billion will be made available over the next two years to finance reconstruction after the massive earthquake of January 12, which killed more than 220,000 people and caused a total damage estimated at about 120 per cent of GDP. The challenge for Haiti now is to implement a long-term sustainable development plan that addresses its vulnerabilities, and to deal with the adverse macroeconomic trade-offs that the large inflow of resources will entail.¹

The Paris Club cancelled all of Afghanistan's external debt owed to its 19 members after the country reached the 'completion point' under the heavily indebted poor country (HIPC) initiative. With the debt cancellation by the Paris Club, Afghanistan's public external debt will be halved to about \$1 billion. The United Nations Office of the High Commissioner on Human Rights recently warned that the over-emphasis on short-term security issues rather than targeted long-term development strategies had been exacerbating the already dire poverty situation. It is estimated that some nine million Afghans (36 per cent of the population) still live in absolute poverty while a further 37 per cent just manage to meet their basic needs. ■

¹ See UN-DESA Policy Brief No. 28 on *Is sustainable recovery possible for Haiti?*, available at <http://www.un.org/esa/policy/index.html>