Global issues

Recent data tend to confirm a marked deceleration of global trade

Monthly data of global and regional trade confirm that a marked deceleration of international trade is underway. During the first four months of this year, global trade volume was at a stand-still, contracting 0.1 per cent from December 2011 to April 2012, according to the latest data published by the Netherlands Bureau of Economic Policy Analysis (CPB). While short-term trade data fluctuated significantly, a decelerating trend emerged starting in December 2011, where monthly growth of 0.9 per cent was followed by weak growth and subsequent contractions of 0.2 and 0.8 per cent in the last two months.¹

This deceleration mirrors weakening global demand, reduced industrial production and interconnected slowdowns among trading partners resulting from macroeconomic uncertainties and policies in developed countries. Imports of the developed regions have barely grown since June 2010, reflecting a contraction of import volume in the European countries of almost 7 per cent in the last twelve months (figure 1). Imports of developing regions have also slowed, where growth of 2.8 per cent over the last twelve months contrasts with growth of 5.4 per cent during the same period one year earlier. Imports of the developing countries in South and East Asia contracted by 2 per cent throughout the first four months of the year. Both imports and exports have contracted in the CIS in the same period, by 1 per cent and 3 per cent, respectively. Exports in Latin America and the Caribbean have contracted 1 per cent this year as well. Average unit prices of exports in the CIS, Latin America and the Caribbean have also declined consistently over the past 12 months, by about 5 per cent in both cases. Thus, the combination of demand and price shocks stemming from the weakening of global trade activity is likely to have noticeable income effects on these developing regions.

EU Summit: progress made in bank recapitalization and a growth pact

In the latest EU Summit at the end of June, an agreement was made to establish a single supervisory body for euro area banks, after which funds from the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM) will be held and used by the European Central Bank (ECB) and the national supervisory authorities, respectively. Additional funds from the ESM will be used to recapitalize euro-area banks. The agreement also involves a growth pact to boost economic performance, a new fundamental resilience framework, and a crisis management plan.

Sources:
Netherlands Bureau of Economic Policy Analysis (CPB).

¹ For global trade volume to grow at the annual rate of 4.1 per cent forecast in World Economic Situation and Prospects 2012: Update as of Mid-2012, an average monthly growth of 0.8 per cent would be required until the end of the year, which now seems unlikely.
European Stability Mechanism (ESM) could be used to directly recapitalize euro area banks (thus breaking the link between bank bailouts and increasing sovereign debt burdens for individual countries).

The Summit also agreed on a “European Growth Pact” worth €120 billion. The pact includes an increase of €10 billion for the capital of the European Investment Bank (EIB), which will expand the bank’s overall lending capacity by €60 billion. The capital increase comes with a pledge to make sure EIB loans reach the most vulnerable countries. It also includes reallocation of unused structural funds (€55 billion) to measures for small and medium-sized enterprises and youth employment, and a pilot phase for new project bonds (€5 billion) for initiatives in energy, transport and broadband infrastructure.

Developed economies

North America: Fed extended the “twist operation” amid economic softening

Most macroeconomic indicators pointed to a continued deceleration of economic growth in the United States. Growth in employment has slowed from an average above 200,000 jobs per month in the first quarter to only about 70,000 per month currently. Initial jobless claims increased to above 380,000 in June, the most so far in 2012. Meanwhile, the three-month average for changes in job openings turned negative for the first time in more than a year. Growth in manufacturing output has slowed significantly, from a pace of 9.8 per cent (seasonally adjusted annual rate) in the first quarter to below 2 per cent at present. Household spending is also increasing at a slower pace. The housing market remains depressed, despite some signs of bottoming out.

At its most recent policy meeting in June, the Fed decided to extend the “twist operation” beyond its expected expiration at the end of June to the end of 2012. This extension came in response to the slowdown in the domestic economy as well as heightened economic uncertainty in Europe. Through this operation, the Fed will continue to purchase Treasury securities with remaining maturities of 6 years to 30 years at the current pace and sell or redeem an equal amount of Treasury securities with remaining maturities of approximately 3 years or less. The total amount of assets held by the Fed will remain the same, the purpose being to keep the longer-term interest rates in capital markets at low levels. The Fed, however, did not launch a new round of quantitative easing, namely, to purchase extra assets, as anticipated by some analysts.

Developed Asia and the Pacific: household and government consumption support Japanese growth

The final statistics for the first quarter of 2012 revealed the Japanese economy expanded at the annualized rate of 4.7 per cent from the previous quarter. The growth was mainly supported by household and government consumption, while investment and international trade only provided feeble supports. Although three continuous quarters of growth has brought the Gross Domestic Product (GDP) for Japan back to the level before the catastrophic first quarter of 2011, it is still more than 2 per cent lower than before the Great Recession.

The available monthly data for the second quarter show that industrial production declined over April and May. Export volume also declined from April to May while import volume kept on rising over the past few months until May. The sustained increasing demand for mineral fuels for power generation still counted towards a significant proportion of the import increase.

During the first quarter of this year, in Australia and New Zealand, the expenditure on GDP expanded at the annualized rate of 5.3 per cent and 3.3 per cent, respectively. For both countries, growth was supported by strong activity in fixed capital formation.

Western Europe: contracting

At least seven euro members are in recession, with both manufacturing and services weakening significantly. Business and consumer sentiment in the euro area has been falling since March and has reached its lowest level since October 2009. Germany, the largest economy and the engine for the region, has also shown signs of weakening; business confidence fell to the lowest level in more than two years and the rate of unemployment (on a national measure) is rising, an indication that the economic contraction has spread from the sovereign debt-afflicted economies to the region as a whole.

On June 25, Spain officially requested European aid of up to 100 billion euro ($125 billion) to recapitalize its indebted banks. Spanish banks have been badly hit by the bursting of the housing bubble four years ago and need more capital since the economy has fallen back into recession. Meanwhile, the rating agency Moody’s downgraded the ratings of Spanish banks after it cut Spain’s sovereign rating to just above junk status earlier in June, exacerbating the vicious cycle.

On the same day, Cyprus also asked for aid to finance its debt payments and rescue its banks, largely because of the growing spillover effects from the Greek economy. The Greek election in mid-June has resulted in a coalition government, which reportedly will negotiate constructively with the Troika in a hope to extend the fiscal target for two additional years.
New EU members: growth versus austerity dilemma

Following a strong start in the first quarter of 2012, when Latvia registered the fastest economic growth in the EU, the economies of the Baltic States cooled down in May, in response to the weakness in the euro area. In Lithuania, industrial output dropped by 14.6 per cent year on year. In Central Europe, economic growth in Poland slowed to 3.5 per cent year on year in the first quarter, while in the Czech Republic and Hungary quarterly GDP growth was negative. In April, industrial output in Hungary shrunk by 3.1 per cent year on year. In most economies in the region, inflation decelerated in May. Nevertheless, the National Bank of Poland raised its benchmark rate in May as inflation persistently fluctuated around the top of its target range. The Czech National Bank, by contrast, lowered its key policy rate to a record low of 0.5 per cent in June.

The Governments of the new EU member States remain committed to fiscal austerity. In June EU finance ministers voted to lift the earlier suspension of EU funds for Hungary earmarked for 2013, as the country presented a credible budget deficit reduction plan. However, weak first quarter performance in many of the new EU members raised questions about the scope and timing of the austerity measures. If economic weakness continues, political consensus about austerity may become harder to reach.

Economies in Transition

CIS and Georgia: Russian Federation to set aside funds

The economy of the Russian Federation expanded in May by 4.2 per cent year on year, on the back of strong domestic demand. Consumer spending was robust owing to domestic credit growth and also to increased wages, which were 15.1 per cent higher in May year on year, resulting mainly from rises in public sector wages. Meanwhile, unemployment declined to 5.4 per cent. Corporate investment in May surged by 7.7 percent year on year, in part because the Government lowered social security contributions for employers. Facing the prospect of lower than anticipated oil prices, the Government of the Russian Federation decided to create a reserve mechanism worth $15.4 billion for 2013 to finance preventive anti-crisis measures, such as support for socially vulnerable groups and important enterprises.

In Ukraine, by contrast, growth was slow, and industrial production has increased in the period from January through May by only 0.7 per cent year on year, while the agricultural sector grew by 1.5 per cent. The economy of Azerbaijan expanded by a meagre 0.7 percent year on year in the first five months of 2012 as oil production continued to fall. Most Central Asian economies registered strong growth in the first quarter; however, in Kazakhstan, growth decelerated to 5.6 per cent year on year from 7.5 per cent in the fourth quarter.

South-Eastern Europe: output weakens, in part because of budget cuts

The combined effect of weak external demand and domestic fiscal tightening has led to a contraction in output throughout the region. The economy of Croatia shrank by 1.3 per cent year on year in the first quarter, with a continuing drop in investment. In the first four months of 2012, industrial output contracted by over 9 per cent. Similarly, in the former Yugoslav Republic of Macedonia, GDP in the first quarter declined by 1.4 per cent year on year with a sharp contraction in investment as the Government began budget cuts. In June, the National Bank of Serbia reversed its monetary loosening stance by increasing the key policy rate by 50 basis points to 10 per cent and also adopted measures to stabilize the foreign exchange market, expecting higher import prices and increases in regulated prices in the second half of the year.

Developing economies

Africa: Sudan enacts austerity programme and the Tanzanian current account deficit more than doubles

Sudan has enacted austerity measures in order to fill an unexpected $2.4 billion (3.5 per cent of GDP) increase in the budget deficit, including phasing out fuel subsidies, raising import, value added and banking taxes, and cutting local government budgets by 45 to 50 per cent. At the same time the Sudanese pound has undergone a de facto devaluation with exchange bureaus and banks now allowed to trade the pound at a rate of 5.48 per dollar, up from the official rate of 2.70 per dollar. Burundi is also enacting austerity measures asking State programmes to suspend payments other than wages and debt; they are also contemplating raising tax rates on some products. By contrast, Kenya, Tanzania and Uganda all plan to increase government spending in next year's budgets by 26.3, 11.7 and 16.7 percent, respectively.

Current accounts have come under increasing pressure. In South Africa, the current account deficit increased to 4.9 per cent of GDP in the first quarter, as a result of weaker exports to Europe. In Tanzania, the current account deficit more than doubled in the twelve months to March, driven mainly by oil imports and imports of machinery for gas and oil exploration. Meanwhile, the country
tripled its estimate of recoverable gas reserves following significant recent discoveries in the country’s deep-water offshore area. In this context, the Government announced its intention to design a more comprehensive policy framework concerning the use of the country’s natural gas resources.

**East Asia: inflation falls amid slowing economic growth**

Growth in most East Asian economies moderated further in the second quarter of 2012 as the euro area crisis continued to weigh on the region’s export sectors. In the Republic of Korea, year-on-year export revenues contracted in May for a third consecutive month as shipments to the European Union, the United States and China declined by more than 10 per cent. This outweighed robust growth in exports to Latin America and the Middle East. In China, the HSBC Purchasing Managers Index for June signaled a significant decline in export orders and weakening domestic demand.

In most economies, inflation decelerated in May as food and commodity prices eased. Year-on-year consumer price inflation slowed to 3.0 per cent in China, the lowest level in almost two years and to 8.3 per cent in Viet Nam, down from 23 per cent in August 2011. In response to the economic slowdown and reduced inflationary pressures, Governments and central banks are increasingly moving towards more accommodative policy stances. The People’s Bank of China cut its main policy rates for the first time since 2008, lowering the benchmark one-year lending rate by 25 basis points to 6.31 per cent. The State Bank of Viet Nam has reduced its main policy rates five times since the beginning of the year.

**South Asia: weak investment drags down growth in India and Pakistan**

Economic growth in India slowed to a nine-year low of 5.3 per cent in the first quarter of 2012, as manufacturing contracted by 0.3 per cent and agricultural production rose by only 1.7 per cent. The services sector showed some resilience, with financial services growing by 10 per cent. On the expenditure side, the sharp drop in growth from almost 10 per cent in the aftermath of the global financial crisis to the current level mainly reflects a slowdown in investment, following aggressive monetary tightening by the Reserve Bank of India (RBI) in 2010/11 and a fall in business confidence. Despite the slowdown in growth, the RBI kept its main policy rates unchanged in June in view of a renewed rise in consumer price inflation and ongoing downward pressure on the rupee. Over the past year, the rupee has depreciated by almost 30 per cent against the dollar owing to the weakening economy, a widening current account deficit and slowing capital inflows.

In Pakistan, GDP is estimated to have grown by 3.7 per cent in the fiscal year 2011/12. Strong growth in household and government consumption helped offset a sharp contraction in investment and net exports.

Sri Lanka’s economy, by contrast, continued to expand at a strong pace in the first quarter of 2012. Compared to the same period in 2011, GDP grew by 7.9 per cent on the back of double-digit growth in industrial and agricultural output.

**Western Asia: weakening fiscal balances**

Weak global growth and regional turmoil are negatively affecting fiscal balances in the region. For Gulf Cooperation Council countries as a whole, the break-even price of oil is estimated to have increased from $49 per barrel in 2008 to $79 in 2012, caused mainly by the turmoil of 2011. Bahrain and Oman are most vulnerable to the recent oil price drop. In response to weaker than expected revenues, the Jordanian Government endorsed an austerity package to limit a widening fiscal deficit. Announced measures include a 15 per cent cut in all government institutions’ operational expenditures, an end to the general sales tax exemption for a host of goods and services, a 25 per cent hike in the subsidized fuel price as well as an increase in the price of electricity for industry.

The situation in the Syrian Arab Republic is negatively affecting neighboring countries. In Lebanon, however, the conflict entails mixed effects on certain sectors. Traffic through the port of Beirut over the first four months of the year has increased by 10 per cent compared to last year. Similarly, deposits at banks in Lebanon increased by 7 per cent year on year at the end of the first quarter, while deposits at Syrian affiliates of Lebanese institutions decreased by 27 per cent.

**Latin America and the Caribbean: growth drags as investment slows down**

The region’s economy continued to be negatively affected by Brazil’s slowdown in June, with the country’s GDP declining in the twelve months to April according to the Central Bank. The largest demand shortfalls hit exports of primary commodities, because of the slowdown in Asia and Europe, and investment, which was weakened by soft prospects for consumption growth and tensions in the banking sector. Non-performing loans in Brazil hit a record high in May while credit rating agencies downgraded eight major banks. In order to stimulate the economy, the central bank cut the SELIC rate for the seventh time in a year, to 8.5 per cent, while the Government expanded expenditure by 1.5 per cent in the first quarter, a rate three times that of the previous quarter.

Colombia and Peru signed a trade deal with the European Union, to be ratified by the European Parliament, which will lower duties on imports of EU manufactures, such as auto parts, textiles and chemicals, in exchange for lower duties on exports of agricultural and mining commodities to the EU. The customs union MERCOSUR, comprising Argentina, Brazil, Paraguay and Uruguay, suspended Paraguay and admitted the Bolivarian Republic of Venezuela.