



# World Economic Situation and Prospects

## Monthly Briefing

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### Global issues

#### *Policy initiatives to deal with slowing growth in emerging economies*

A number of indicators point to slowing growth in emerging economies, partly due to protracted weak external demand from developed countries, but also due to domestic factors. Differing in their policy space, as well as policy intention, a number of major emerging economies have taken steps to deal with the slowdown. While the efforts are not nearly as extensive as those undertaken during the eruption of the financial crisis, they still demonstrate the necessity of supporting growth. These measures have also come into effect at the same time that many emerging markets have had to deal with significant capital outflows and currency depreciation (see Monthly Briefing Note, No. 56).

China has tried some supply-side measures, including a temporary cut in taxes on small firms and simplification of administrative procedures for businesses, plus a modest increase in approving projects for railway development. The People's Bank of China also resumed reverse repurchase operations for the first time in six months.

The Mexican Government announced a plan of 1.3 trillion pesos (US\$ 1.2 billion) to upgrade the transportation and communications infrastructure. With the inclusion of private sector infrastructure contributions, total spending will be around 4 trillion pesos through 2018. Both the government deficit and the current-account deficit remain low in Mexico.

The Central Bank of Russia has undertaken a medium-term refinancing operation through which banks will be able to exchange assets that the money market would not normally accept for funds that can be borrowed for twelve months. This should help reduce the demand for short-term financing and extend possible medium-term financing at somewhat lower rates. The expectation is that the spread between money market and policy rates should narrow as more conventional collateral is freed up for traditional repo funding. In addition, the Government announced additional spending on infrastructure using resources from the National Wealth Fund. The plan announced at the end of June calls for 450 billion rubles (US\$ 13.7 billion) in investment, particularly for railroads, half of which will come from the National Wealth Fund.

On the other hand, countries such as Brazil that were already dealing with slowing growth rates last year have had to work to counteract rising inflation by raising policy rates. The Reserve Bank of India (RBI), in an attempt to forestall the depreciation of the rupee and prevent further increases in its current-account deficit announced a series of measures to tighten liquidity. The RBI stopped short of raising the repo rate, but it raised the emergency liquidity mechanism rate by 2 percentage points to 10.25 per cent, increased the rate at which it lends to banks by 2 percentage points, limited the funds available from its liquidity adjustment facility and sold government securities to further reduce liquidity. The rupee has continued to depreciate since then by 1.6 per cent, particularly after the RBI failed to raise the repo rate at its meeting at the end of July. The Reserve Bank of South Africa has held rates steady at 5 per cent despite inflation remaining close to the upper limit of 6 per cent for fears of further curtailing already slowing growth. Indonesia also raised rates to combat depreciation and rising inflation (see below). As well, Turkey has spent a significant amount of reserves and raised the overnight lending rate in order to rein in rising inflation and a falling lira (see below).

### Developed economies

#### *The United States: revised data emphasizing the role of research and development*

The United States Bureau of Economic Analysis has finished a comprehensive revision of the National Income and Product Accounts statistics in accordance with the current international standard (SNA2008). The most significant change is the classification of expenditures on research and development as fixed investment. Expenditures by private enterprises for the creation of entertainment, literary, and artistic originals are also classified as fixed investment, as they contribute to building intangible assets. As a result,

### Summary

- Emerging economies enact policy measures to forestall slowing growth
- US GDP statistics revised
- Drought conditions affect Southern Africa

nominal gross domestic product (GDP) was revised to be about 3 per cent higher than in the original statistics. The revision has increased the average real annual GDP growth rate for the current century by 0.1 percentage points. At the same time, the peak-to-trough drop in GDP in the recent recession is revised down from 4.7 per cent to 4.3 per cent.

The latest data also show that GDP grew at the annualized rate of 1.7 per cent in the second quarter of 2013; while the growth rate for the first quarter has been revised down from 1.8 per cent to 1.1 per cent. Private consumption and private fixed capital formation both expanded noticeably, especially the latter. However, an even stronger increase in imports and the decline in federal government outlays due to the fiscal sequestration have undercut total growth.

In July, the unemployment rate declined from the previous month from 7.6 per cent to 7.4 per cent. This improvement was induced by higher employment as well as a slight decline in the labour force participation ratio.

### **Japan: employment as the key to reflation**

Escaping deflation is the most important target for current economic policies in Japan. In June 2013, the national consumer price index (CPI) increased by 0.2 per cent year on year for the first time in 12 months. The Tokyo-area CPI also increased by 0.4 per cent compared to July 2012. However, both positive changes were induced by higher energy prices, which were partially caused by the depreciation of the yen. The core CPIs were still lower than one year ago, although the magnitudes were declining. One reason for this is the decreasing unit labour cost.

Parallel to the inflation situation, growth in household income was also weak. The average total cash earnings for workers increased by 0.1 per cent from one year ago in June, mostly due to the higher bonuses paid out in that month. The average regular cash earnings actually declined from one year ago by 0.2 per cent, the thirteenth continuous decline. Unemployment also declined to 3.9 per cent in June from 4.1 per cent in May. This was wholly the result of a reduction in the labour force; the level of employment remained the same as in May.

Tepid wage dynamics and employment growth have jointly constrained increases in disposable income, which in turn limited the growth of consumption. In June, total family consumption expenditure declined nominally by 0.1 per cent from one year ago following the 1.9 per cent decline in May.

### **Western Europe: activity finally picking up?**

Survey data suggest that an upturn in activity in the region began at the beginning of the third quarter. In July, the Markit PMI Composite Output Index for the euro area finally breached the neutral 50 mark for the first time since July 2011 (50 is the level that demarks expansion from contraction), marking the fourth successive monthly increase. The manufacturing sector is the main driver, with the service sector stabilizing. At the country level, Germany, Italy and the Netherlands all had readings above 50, with France and Spain just below. The United Kingdom of Great Britain and Northern Ireland does not have a combined index, but both the manufacturing and service PMI's are above 50.

The European Commission's Economic Sentiment Indicator is also increasing, with July marking the third consecutive monthly increase, but the level remains well below its historical average. In their quarterly manufacturing survey, capacity utilization increased to 78.3 per cent at the beginning of the third quarter.

So far, hard data available through May (the middle of the second quarter) is consistent with a slight further decline in GDP. Industrial production dipped in May but had improved for the three previous months; construction remains very weak; retail sales picked up sharply in May but had been weak in the early part of the year. Unemployment has stabilized, remaining at 12.1 per cent in June for the fifth consecutive month in the euro area.

### **The new EU members: continuing monetary easing in Hungary**

For many of the new European Union (EU) members, especially those in Central Europe, growth in the first half of 2013 was much weaker than anticipated. As a consequence, the budget deficits in Hungary and Poland in the first half of the year have already reached around 80 per cent of the initially planned annual deficit targets. However, in July, forward-looking indicators of economic sentiment showed some positive signs, and industrial output in Poland increased by 4.5 per cent year on year. A convincing turnaround in the economy has yet to materialize, however. In Croatia, which joined the EU in July, the economy remains in recession and industrial output fell by 1.5 per cent year on year in June. The initial impact of the country's EU membership may be contractionary, as it will face tougher budget spending requirements and its exports will become subject to tariffs in some of its important trading partners, as Croatia leaves the Central European Free Trade Agreement.

As inflationary pressures in most of the region remain very weak, the Hungarian National Bank continued monetary easing, taking its policy rate to a new record low of 4 per cent in July.

Some positive trends emerged in the labour market in Hungary, where the unemployment rate declined to 10.3 per cent in the second quarter from 11.3 per cent in the first quarter, largely reflecting the impact of the public works programmes.

## Economies in transition

### *CIS: measures initiated to support growth in the Russian Federation*

The economy of the Russian Federation expanded by a disappointing 1.2 per cent year on year in the second quarter, dragged down by weak investment. This brings total annual growth for the first half of the year to a mere 1.4 per cent. The Government intends to bolster the economy and announced a number of planned measures, including infrastructure spending utilizing the resources of the National Wealth Fund. In parallel, the Central Bank announced measures aiming to expand credit supply (see above); however, high interest rates are likely to constrain the effects of those measures. As annual inflation rates slowed to 6.5 per cent in July from 6.9 per cent in June, an interest rate cut is likely later in the year. The economy of Ukraine, strongly exposed to Europe, remains weak, shrinking in the second quarter by 1.1 per cent year on year, as exports, industry and consumption declined. Among the CIS oil exporters, the economy of Azerbaijan has registered an acceleration of growth, as GDP for the first half of the year has increased by 4.5 per cent, mostly driven by the non-energy sector. Most of the Central Asian economies sustained strong growth in the second quarter, despite weaker inflows of remittances from the Russian Federation. In Kyrgyzstan, GDP grew by 7.9 per cent year on year in the first half of 2013, boosted both by a pick-up in gold production and by strong performances of the construction and services sectors.

### *South-Eastern Europe: interest rates cut to record low in Albania*

The earlier estimate for the first quarter GDP growth in Serbia was revised up, from 1.9 per cent to 2.1 per cent year on year. Although domestic demand remains stagnant, improved export performance, boosted by the car industry, helped to reduce the country's large current-account deficit by over 50 per cent year on year in January-May. However, in the second quarter, GDP grew by only 0.7 per cent year on year. Inflation remained in the single digits, at 9.8 per cent in June, but the planned rise in electricity prices in August may feed into consumer price inflation and production costs. In Albania, economic growth has remained modest since the beginning of the year. Exports did manage to rebound in May, however, despite a slowdown in Italy, an important export destination. As annual inflation slowed to 2.2 per cent in the second quarter, Albania's central bank cut its policy rate to a record low level of 3.5 per cent in late July to boost lending to the private sector.

## Developing economies

### *Africa: Egypt receives significant assistance from gulf countries; protestors caused a significant drop in Libyan oil output*

In South Africa, the unemployment rate rose to 25.6 per cent in the second quarter from 25.2 per cent in the previous quarter, as growth in the labour force outpaced employment growth. Food and water shortages caused by drought conditions have affected one million people or almost 5 per cent of the total population in Angola, and 350,000 people or about 15 per cent of the total population in Namibia.

In the wake of the uncertain political transition in Egypt, a group of countries including Saudi Arabia, the United Arab Emirates and Kuwait has all stepped in to provide a combined \$12 billion in assistance in the form of deposits at the central bank, grants, and shipments of petroleum products. This should ease some of the pressure that Egypt was facing to cut subsidies in order to secure a loan from the International Monetary Fund. In addition, the deposits will boost foreign reserves, which have been fluctuating below the precarious level of three months of import coverage.

In Libya, strikes at a number of oil fields and export terminals reduced output by over 70 per cent for a number of days and limited exports to less than half of normal. A return to more regular operations is anticipated in the coming days, but negotiations with the protestors are ongoing.

## ***East Asia: economic growth in China and Indonesia slowed further***

Economic growth slowed further in the second quarter of 2013 in China and Indonesia, East Asia's most populous countries. China's GDP expanded by 7.5 per cent year on year, slightly down from 7.7 per cent in the first quarter, as growth in exports and industrial production weakened. In Indonesia, GDP grew by 5.8 per cent year on year, the slowest pace since 2010, as investment activity lost strength. Despite slowing growth, Indonesia's central bank raised interest rates in June and July by a total of 75 basis points in an attempt to reduce the depreciation pressure on the domestic currency and keep inflation under control. Since the Government hiked the administered prices of petrol and diesel in June, upward price pressures have increased notably. In July, year-on-year consumer price inflation accelerated to 8.6 per cent, the highest level since January 2009.

By contrast, some of the region's higher-income economies, including the Republic of Korea, Singapore and Taiwan Province of China, saw a mild pick-up in growth in the second quarter of 2013 despite the challenging external environment. In the Republic of Korea, economic activity grew by 2.3 per cent year on year, driven by stronger government consumption and a recovery in fixed capital formation, especially construction investment. In Taiwan Province of China, year-on-year growth of 2.3 per cent was supported by a moderate strengthening of exports and private consumption.

## ***South Asia: solid growth in Bangladesh and Sri Lanka; inflation surges in the Islamic Republic of Iran***

Economic activity continued to expand at a robust pace in Bangladesh and Sri Lanka despite challenging global conditions and slower agricultural output growth. In Bangladesh, GDP increased by 6.0 per cent in the fiscal year 2012/13, slightly down from the previous 12 months. While the manufacturing sector recorded rapid growth of 9.3 per cent, agricultural output rose by only 1.2 per cent. On the expenditure side, domestic consumption remained the main growth driver, supported by a 13 per cent increase in remittance inflows. Sri Lanka's economy expanded at a solid pace of 6 per cent in the first quarter of 2013 as strong manufacturing output largely offset lower growth in agriculture and services.

In India, by contrast, industrial production continues to be sluggish; the combined output in April/May increased by only 0.1 per cent from a year ago. Despite ongoing weak growth and moderating inflation, the central bank left its key policy rates unchanged in June and July as downward pressures on the rupee persisted. The authorities introduced several measures to tighten liquidity and support the rupee, including a higher overnight borrowing rate for banks (see above).

In the Islamic Republic of Iran, inflation further accelerated, with consumer prices rising by nearly 50 per cent year on year in June. In early July, the central bank devalued the official rial rate against the dollar by more than 50 per cent.

## ***Western Asia: Turkey tightens monetary policy***

Oman registered a small budget deficit during the first five months of the year. However, excluding a one-off payment of expenditures under settlements, the budget resulted in a surplus of 3.8 per cent of GDP. In Bahrain, a sharp recovery of the oil sector nurtured yearly economic growth of 4.3 per cent in the first quarter of 2013. The two major non-oil economic sectors, financial services and manufacturing, expanded by only 2 per cent and 3 per cent over the same period, respectively.

Since end of May, the Turkish lira depreciated by 3.5 per cent against the United States dollar. After unsuccessfully tapping into its foreign reserves and spending over \$7 billion to defend the lira, the Turkish central bank raised its overnight lending rate for the first time in two years, by 75 basis points to 7.25 per cent in July. While this move may contribute to reining in yearly inflation, which soared to 8.9 per cent in July, it may also weaken Turkey's recovery. In Israel, the Parliament finally approved a biannual budget, which projects a reduction of the budget deficit from 4.7 per cent of GDP in 2013 to 3.0 per cent in 2014.

## ***Latin America and the Caribbean: merchandise exports continue poor performance; inflation still low with some exceptions***

Export performance continues to be meagre in Latin America and the Caribbean. In the first quarter, merchandise exports for the whole region decreased by 7.0 per cent year on year. More recent data for specific countries confirms a lacklustre export performance. In the first half of 2013, the export of goods in Brazil and Mexico decreased by 2.4 and 1.6 per cent year on year, respectively. In Colombia, the fall in exports reached 6.3 per cent between January and May, in comparison to the same period in 2012.

Regional inflation remains low, although with some exceptions. In June, annual consumer price inflation in Chile and Colombia reached 1.9 and 2.2 per cent, respectively, while in Ecuador and Mexico it reached 2.7 and 4.1 per cent, respectively. By contrast, inflation in Venezuela is mounting considerably: the consumer price index has already increased by more than 25 per cent in the first half of 2013. In Brazil, the consumer price index in June raised by 0.26 per cent, year on year, the lowest rate since June 2012. However, annual consumer price inflation reached 6.7 per cent, thus it continues to be above the upper limit of the central bank's target range. In July, the Central Bank of Brazil raised the Selic interest rate—the second time in 2013—by 50 basis points to 8.5 per cent.