Global issues

The US Fed delays tapering the QE programme…

Contrary to expectations, the United States Federal Reserve (Fed) announced no changes in its monetary policy stance at the Federal Open Market Committee (FOMC) meeting on 17-18 September, maintaining the federal funds rate near zero and keeping the size of its monthly purchases of long-term assets at $85 billion. Three major factors may explain why the Fed decided to delay tapering the purchase of assets. First, recent data did not confirm a sufficiently strong economic recovery; for instance, the marginal improvement in the unemployment rate in recent months was largely due to a decline in labour force participation. Second, financial conditions have tightened considerably after the Fed’s previous announcement in June, with long-term interest rates increasing by more than 100 basis points. Third, government financing conditions remain uncertain, especially regarding the debt ceiling and fiscal sequestration.

… giving respite to emerging markets

Consequently, pressures on financial markets should ease in emerging economies, at least temporarily. In June 2013, after the Fed provided guidance on how the pace of its purchases of long-term assets—the so-called quantitative easing (QE)—might be adjusted, financial markets expected that the tapering strategy would start in September. As a result, emerging markets went through significant financial turbulence in July and August, including reversal of capital inflows, sharp depreciation of local currencies, increases in interest rates, and selling-off in equity markets. However, with no changes by the Fed at present, emerging economies will benefit from the unexpected continuation of the QE programme. After the Fed’s announcement, the dollar fell a little more than 1 per cent against the euro and the yen, and on the following day, several currencies in emerging markets rebounded from the sharp falls of previous months (figure 1). For instance, after hitting an all-time low of 68.8 rupee/dollar at the end of August, the Indian rupee had rebounded by about 10 per cent at the end of September. (Admittedly, domestic policies there had also played an important role.) Despite temporary relief for emerging economies, however, exchange rates are expected to remain volatile, particularly for those emerging economies that have been facing serious current-account deficits.

Figure 1: Exchange rate index for selected developing countries
(2 January 2013 = 100, higher value means appreciation against the United States dollar)

Source: UN/DESA
Volatility in oil prices amid geopolitical tensions

After surging in July-August, oil prices retreated in September as political tensions eased in Syria. During the first half of 2013, oil prices had been on a downward trend as global demand for oil weakened along with a deceleration of global output, particularly in emerging economies, which are the major sources for the increase in global oil demand. However, oil prices surged in July-August as geopolitical tensions over Syria escalated. For instance, the Brent price increased during these two months by about $18/bbl, reaching more than $117/bbl. Shortly afterward, when progress was made in Syria’s agreement to surrender its chemical weapons, the Brent price retreated to $108/bbl in September (figure 2). In addition to high-risk premiums, related to geopolitical tensions in Syria, oil prices have been also underpinned by tighter global oil supply. Oil supply declined in the North Sea, while oil production collapsed in Libya, which was only partly counterbalanced by higher supply in North America and in Saudi Arabia.

![Figure 2: Daily price for Brent crude oil (Dollars per barrel)](source: UN/DESA)

Developed economies

The United States: the housing market continues to improve, while the debt ceiling is looming

The housing market in the United States continues to improve. The latest data showed that new home sales in August increased by 12.6 per cent from a year ago, and the Federal Housing Finance Agency monthly House Price Index rose 8.8 per cent annually in July, marking the eighteenth consecutive monthly price increase. The S&P/Case-Shiller National U.S. Home Price Index also posted an annual increase of 12.4 per cent for the twenty-city composite index, although it is still about 21 per cent below the peak registered in July 2006. Meanwhile, the Pending Home Sales Index decreased slightly. Nevertheless, the results of Freddie Mac showed average fixed mortgage rates moving lower, following the September 18 announcement by the Fed, which is encouraging new mortgage applications. On a negative note, the Government has been in a partial shutdown since 1 October as the Congress failed to reach an agreement on the budget. If Congress does not raise the national borrowing limit (i.e., the debt ceiling, which currently stands at $16.7 trillion) by 17 October, the consequences will likely be devastating for the U.S. economy and global financial markets.

Developed Asia: New Zealand’s economy affected by serious drought

New Zealand has suffered its worst and most widespread drought since 1945. As a result, agricultural output declined on a seasonally adjusted basis by 4.3 per cent and 6.4 per cent during the first two quarters of 2013, respectively. The loss in the agricultural sector brought down the quarter-over-quarter growth rates of GDP to 0.4 per cent and 0.2 per cent, respectively. During the second quarter of 2013, total expenditure on GDP increased by 0.1 per cent, quarter on quarter. The drought has affected the trade sector primarily; exports of dairy products, meat products, and agricultural primary products, which account for almost half of goods exports, plunged in the second quarter. Total exports declined by 5.9 per cent, quarter on quarter, reducing the GDP growth rate by 1.8 percentage points. On the domestic side, housing prices have been on an upward track in New Zealand. As a macroprudential measure, the Reserve Bank of New Zealand has decided to impose a constraint on the high loan-to-value ratio mortgage, starting from 1 October 2013 onwards.
**Western Europe: economy continues to strengthen**

Evidence continues to accumulate that Western Europe is finally on a more durable, albeit subdued, economic growth path. In September, the European Commission’s Economic Sentiment Indicator (ESI) increased significantly in both the European Union (EU) and the euro area for the fifth consecutive month. The ESI achieved its long-term average for the EU and measured slightly lower in the euro area. All business sectors contributed to this result. The Markit Eurozone PMI Composite Output Index rose to a 27-month high in September, well above the level demarking expansion from contraction. However, short-term hard data for July were less robust. Construction increased for the fourth month in a row, but industrial production fell sharply after rising in the previous month. Retail sales increased, but again, they have been very erratic over the previous months.

**The new EU members: economic sentiment continues to strengthen**

Economic sentiment continued to strengthen in the countries of Central Europe in September, mirroring positive trends in the key euro area economies. Green shoots are also emerging on the domestic demand front: retail sales in Poland grew by 3.5 per cent year on year in August and household consumer sentiment index reached a one and a half year high. Consumer spending also remained strong in the Czech Republic, supported by low inflation, and the composite confidence indicator for the Czech economy has noticeably strengthened. However, much stronger real wage growth is needed to guarantee an upturn in consumer demand, while investment is still likely to remain subdued. Inflationary pressures in the region remain weak. In Croatia, for instance, which joined the EU in July, inflation declined to 1.9 per cent, despite higher tobacco and excise taxes that were introduced to boost public revenue. The Croatian currency depreciated further in August and September, despite strong foreign exchange revenues, against the backdrop of worries about the country’s fiscal deficit. In late September, the Hungarian National Bank further cut its policy rate by 20 basis points to a new record low of 3.6 per cent.

**Economies in transition**

**CIS: boost expected in Kazakhstan’s oil production**

In the Russian Federation, industrial production continued to stagnate in August, growing only by 0.1 per cent year on year. The manufacturing sector declined by 0.2 per cent, curbed by weak domestic demand. Although the private sector is calling for looser monetary policy, an interest rate cut in the near term is unlikely, as annual inflation remains above the official target. Facing lower than expected budget revenue and weak prospects of raising funds through privatization, the Government is considering freezing public sector salaries in 2014. The Government intends also to freeze the state-regulated tariffs for gas, electricity and railways in 2014, aiming to increase disposable incomes to boost the economy. In Ukraine, the country’s foreign exchange reserves fell in August to $21.7 billion, equivalent to about 2.3 months of 2012 imports, as a consequence of the massive debt repayment. However, sharp cuts in gas imports from the Russian Federation helped to mitigate the trade deficit and devaluation concerns. In Moldova, economic growth accelerated in the second quarter, 6.1 per cent year on year, as the economy benefited from the abundant harvest and strong growth in services. In Azerbaijan, growth also picked up between January and August to 5.2 per cent year on year, owing to stronger oil output. In September, the Government of Kazakhstan announced that commercial production from the giant Kashagan oil field in the Caspian Sea will start within one month.

**South-Eastern Europe: strong second quarter growth in the Former Yugoslav Republic of Macedonia**

In the Former Yugoslav Republic of Macedonia, GDP increased by 3.9 per cent year on year in the second quarter, bolstered by large-scale publicly funded construction projects. Employment also continued to grow, reflecting positive trends in the economy, and the unemployment rate, while remaining precariously high, declined slightly, from 29.9 per cent in the first quarter to 28.8 per cent in the second quarter. In Serbia, by contrast, the second quarter GDP growth was revised down to a meagre 0.2 per cent year on year. Nevertheless, industrial activity across all major sectors was stronger in August, compared with the same month a year earlier, and total industrial output increased by 5.7 per cent year on year. Bosnia and Herzegovina remains dependent on external finance, and will have to comply with IMF requirements to keep its budget deficit under control in order to receive the next tranche of the Stand-by loan.

**Developing economies**

**Africa: Sudan cuts fuel subsidies; second quarter GDP growth in Nigeria down slightly on oil pipeline attacks**

Violent protests erupted in Sudan as the price of cooking gas and petrol almost doubled following the Government’s decision to cut fuel subsidies, which totalled over $3 billion per year. There are fears that this will drive inflation back up, which had recently come down from 37.1 per cent in May of this year to 22.9 per cent in August. South Sudan has recently increased its oil production to a rate of 240 thousand barrels per day (bpd), the highest level since it resumed production. That should alleviate significant government spending constraints both in South Sudan, which relies on the oil for most of its revenue, and in Sudan, which collects significant revenue from pipeline fees for transporting South Sudan’s oil.
Nigeria registered real GDP growth of 6.2 per cent in the second quarter, year on year, compared to 6.6 per cent in the first quarter of this year. The economic slowdown was underpinned in particular by the oil sector, which contracted by 1.2 per cent following attacks on oil pipelines. Meanwhile, the central banks of Nigeria and Ghana both held their policy interest rate unchanged, at 12 per cent and 16 per cent, respectively. In Malawi, the end of the tobacco marketing season came with a sharp increase in tobacco sales. Following a fall by about two thirds last year due to adverse weather conditions, revenues from the tobacco sector more than doubled this year, to $361 million.

**East Asia: exports gather steam; China’s economy strengthens**

Recent high-frequency data indicate that China’s economy strengthened in the third quarter of 2013. Industrial output rose by 10.4 per cent year on year in August, the fastest pace in 17 months. Growth in retail sales, fixed asset investment and pre-tax industrial profits also accelerated, suggesting that domestic demand has picked up. At the same time, exports continued to gather steam, rising by 7.2 per cent year on year in August, up from 5.1 per cent in July. Shipments to ASEAN member countries jumped 31 per cent from a year ago, and exports to the United States increased by 6.1 per cent.

Export growth also picked up in other East Asian economies, including Taiwan Province of China and the Republic of Korea, where it reached a seven-month high of 7.7 per cent year on year in August. In Viet Nam, the economy expanded by 5.5 per cent in the third quarter, up from 4.9 per cent in the first half of 2013. Growth was supported by a rebound in exports and strong foreign direct investment. Non-performing loans remain a major economic constraint, however, preventing further bank lending, which expanded by only 6.5 per cent in the first eight months of the year. Indonesia’s central bank again hiked its policy interest rates, as higher fuel prices and depreciation of the rupiah pushed year-on-year inflation up to 8.8 per cent in August.

**South Asia: Iranian economy in deep crisis; strict conditions attached to IMF loan for Pakistan**

According to the Statistical Centre of Iran, the economy contracted by 5.4 per cent in the fiscal year that ended on 21 March 2013. This sharper-than-expected decline primarily reflects the impact of Western sanctions, which have caused oil production to drop by about 35 per cent. With year-on-year inflation estimated at 39 per cent in August and unemployment rising, the new President described the economic situation as “critical”. The IMF approved a $6.6 billion loan programme for Pakistan that aims at stabilizing macroeconomic conditions and solving the balance-of-payments problems. The funds will be released over a three-year period and come with strict conditions attached. The programme envisages a gradual decline in the budget deficit from about 8.0 per cent of GDP in the fiscal year 2012/13 to 5.8 per cent in 2013/14 and 3.5 per cent in 2015/16. The Government is also expected to restructure or privatize public sector enterprises and tackle the current energy crisis. After Pakistan’s consumer price inflation accelerated to 8.5 per cent in August, the central bank raised its benchmark interest rate from 9.0 per cent to 9.5 per cent. Economic conditions in Sri Lanka remain favourable, with GDP growth accelerating to 6.8 per cent year on year in the second quarter of 2013. Growth was driven by strong expansions of the industrial and service sectors, whereas agricultural output contracted owing to a drought in early 2013.

**Western Asia: Turkey’s current-account deficit is high, but fiscal performance is positive**

Turkey’s financial markets and national currency have been under pressure, amid concerns about the current-account deficit, which widened to 6.8 per cent of GDP in the first eight months of 2013. However, on a positive note, Turkey’s fiscal position is in good shape, which can provide the Government with ample fiscal policy space to support economic growth, if needed. Turkey ran a primary surplus of 2.0 per cent of GDP, in the first eight months of the year, which should anchor investors’ confidence in Turkish financial assets.

**Latin America and the Caribbean: trade deficits are increasing in South America, despite some positive results**

In Latin America and the Caribbean, economic growth and trade have been disappointing this year. Despite growing faster than the two major economies (see Monthly Briefing 58, September 2013), the medium-sized economies have been affected by weaker global demand and the easing of some commodity prices. For the first time in several years, Chile, Ecuador, and Peru registered trade deficits during January-July of 2013, widening their current-account deficits. For instance, in Peru, the current account shows a gap of 5.7 per cent of GDP, the worst quarterly result since 1999. On the positive side, coffee exports have soared in Colombia, increasing by 58 per cent, year-on-year in August, widening the trade surplus. In Peru, quinoa exports have also increased considerably, by 61 per cent during the first seven months of the year, which may have been stimulated by the United Nations declaration of 2013 as the International Year of Quinoa.

Despite environmental concerns and the need to diversify exports in the region, new investments in the mining and oil sectors in Bolivia, Ecuador, Uruguay, and Peru are expected to boost GDP growth in the next few years. Conversely, in Colombia, President Juan Manuel Santos decided to proscribe some mining, oil and deforestation activities by enlarging the Chiribiqueta natural park from 1.3 million hectares to 2.8 million hectares—an action he considers will better enable sustainability and the well-being of all Colombians.