



# World Economic Situation and Prospects

## Monthly Briefing

No. 64

March 2014

### Global issues

#### *World economy is struggling to gain momentum*

The global economy seems to have hit a speed bump in recent months amid colder than expected weather in the United States of America, a softening manufacturing sector in China and financial turbulence in many emerging economies. High-frequency data on industrial activity and trade suggest that the recovery of the world economy is struggling to gain momentum. According to data from the CPB Netherlands Bureau for Economic Policy Analysis, global trade activity lost strength towards the end of 2013. Global trade volume declined by 0.4 per cent month on month in December, after remaining flat in November. In September and October, global trade had expanded by 0.6 per cent and 1.6 per cent, respectively. In the United States, recent data from the housing sector, the labour market and the retail sector point towards a soft patch in growth. A key question is how much of the weakness in the United States can be attributed to the unusually harsh weather conditions that prevailed in January and February and how much reflects more fundamental factors. In China, different measures of the Purchasing Managers Index (PMI) for January all suggest that industrial activity is on a moderating trend. However, due to the timing of the Chinese New Year holiday, China's monthly statistics for January and February are somewhat distorted and a more accurate and comprehensive picture will only emerge over the next few weeks. While the recovery of the world economy—following two years of sluggish growth—does not yet seem to be at risk, significant uncertainties over the strength and robustness of the recovery remain.

#### *Higher interest rates in emerging economies help stabilize currencies, but may weigh on economic growth*

As discussed in the previous monthly briefing (February 2014), many emerging economies faced renewed pressure on their currencies throughout January. Financial investors re-evaluated their financial positions in emerging economies, moving funds to presumably safer assets in developed economies. This triggered large capital outflows, which led to falling equity markets and, in some cases, sharp currency depreciations against the U.S. dollar. In order to contain further depreciations and restore investor confidence, several central banks in emerging economies raised their benchmark interest rates. In Turkey, for instance, the central bank's emergency action (see February 2014 Monthly Briefing) helped to stabilize the lira. Similarly, interest rates were lifted in several other major emerging economies, such as in Brazil, India and South Africa, in the second half of January, with a view to containing exchange-rate volatility and inflationary pressures. These monetary policy meas-

### Summary

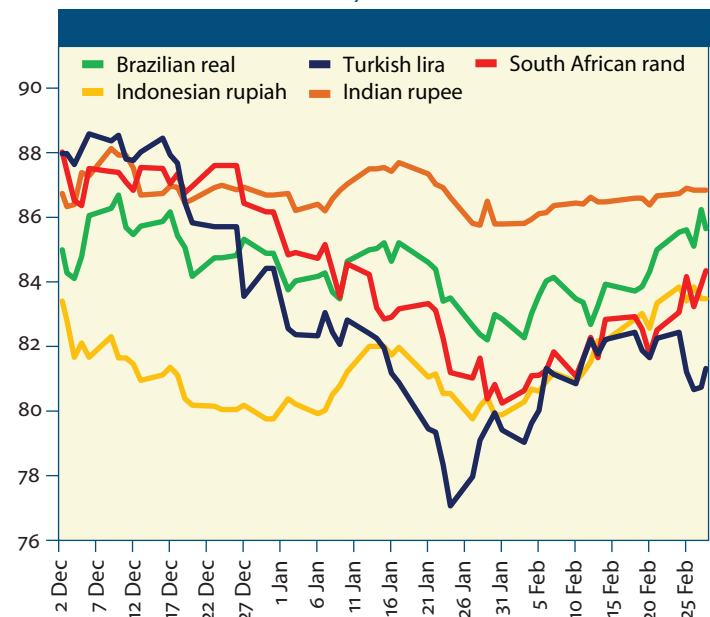
- World economy is struggling to gain momentum
- Emerging economies face policy dilemma in trying to stabilize currencies
- G20 meeting makes call for new measures to lift growth and create jobs

ures have, at least temporarily, helped ease the pressure on emerging economies, with most currencies and equity markets recovering moderately in February (figure). However, higher interest rates will likely further weigh on economic growth, which has been below expectations in recent years.

#### *G20 targets global growth, shifting focus away from fiscal consolidation*

On February 22, the G20 summit in Australia ended with a call to boost global growth. Leaders of the biggest economies agreed to develop measures aimed at lifting global gross domestic product

**UNITED STATES DOLLAR EXCHANGE RATES FOR SELECTED EMERGING MARKET ECONOMIES, DECEMBER 2013 - FEBRUARY 2014**  
(INDEX, 1 MAY 2013 = 100, HIGHER VALUES INDICATE APPRECIATION VIS-À-VIS THE UNITED STATES DOLLAR)



Source: JPMorgan Chase, indexed by UN/DESA.

(GDP) in the next five years by more than 2 per cent above projections under current policies. If successful, this could add over \$2 trillion to the global economy over this period and lead to significant job creation, thus helping to address some of the main concerns in both developed and developing countries. This recent agreement on targeting necessary reforms to boost economic growth at national and global levels indicates an important shift in national leaders' priorities. The debate in previous G20 meetings had focused more on the need for fiscal consolidation, while it has now prioritized economic growth. However, concrete reforms to achieve the growth target have yet to be discussed and agreed upon. The next meeting in November 2014 will show if this initiative gains ground. Despite a common position on the need to boost economic growth, exit strategies from expansionary monetary policies in developed countries remain a point of contention. Some central bankers from emerging economies reiterated the importance of better coordinating monetary policies, but no concrete measures were discussed, other than agreeing on the need to carefully calibrate and clearly communicate monetary policies.

## Developed economies

### *The United States: inclement weather conditions may have slowed economic activities*

High-frequency statistics for recent months revealed relatively tepid growth of the United States economy, partly because of the inclement weather conditions. On the supply side, the production of manufacturing and mining industries declined by more than 0.8 per cent in January 2014 from the previous month. On the other hand, production in the utility industry increased by more than 4 per cent owing to the extreme cold in large parts of the country. Shipments of manufactured goods also declined, partly because of disruptions from the winter storms. On the demand side, retail sale value has declined for two consecutive months, mainly owing to weak vehicle sales. In addition, higher gasoline prices and heating expenditures have had a negative impact on the consumption of other categories of goods. New orders for durable goods also declined in December and January, while non-defense orders for capital goods excluding airplanes remained almost flat over the same two months. The poor weather has also noticeably impacted the housing sector; construction activity has been declining since December 2013. Home sales, however, displayed a mixed pattern: new home sales increased by 9.6 per cent from December to January, while the sales of existing homes declined by 5.1 per cent.

### *Developed Asia: prospects of higher taxes in Japan bring consumption and production forward*

In January 2014, the headline consumer price index (CPI) for Japan increased by 1.4 per cent year over year, down from 1.6 per cent in December. Core CPI inflation, which excludes food and energy items, remained stable at 0.7 per cent. In February, the headline CPI for the Tokyo area, a widely accepted leading indicator for the national CPI, increased by 1.1 per cent year on year, after rising by 0.7 per cent in January. Core CPI inflation for the Tokyo area also accelerated. Industrial production increased by a seasonally ad-

justed 4 per cent in January and industrial shipments increased by more than 5 per cent. The increase in production and shipments is especially significant in the household electronic machinery and passenger car industries. This can be mainly attributed to the fact that consumers are bringing forward purchases of durable goods to avoid paying higher consumption taxes from April 2014 on. Correspondingly, retail sales and household consumption spending also increased notably in January. Recent labour market trends have been less dynamic than production trends; the employment level actually declined by 0.5 per cent in January. Nevertheless, the prevailing trend of declining labour participation kept the unemployment rate at 3.7 per cent, unchanged from December. Wages have not increased sufficiently to compensate for higher prices. The average disposable income of workers' households actually declined 0.5 per cent from a year ago.

### *Western Europe: positive growth in the fourth quarter of 2013*

Western Europe accelerated modestly in the fourth quarter of 2013, registering its third consecutive quarter of positive growth. In the euro area, GDP grew by 0.3 per cent (quarter over quarter) after expanding by 0.1 per cent in the third quarter. Germany continued to grow at a moderate pace, while France picked up after stalling in the third quarter. The United Kingdom of Great Britain and Northern Ireland registered a third consecutive quarter of strong growth. Spain grew for a second consecutive quarter, while growth in Italy was just positive after stalling in the third quarter, confirming that the recessions have ended for both countries. Portugal registered a third consecutive quarter of growth. For the year as a whole, however, GDP in the euro area declined by 0.4 per cent, owing to the strong negative momentum at the end of 2012. Going forward, growth is expected to remain weak. Inflation continues to stay worryingly low, hovering just below 1 per cent since October, while extremely high rates of unemployment persist in most countries of the region.

### *The new European Union members: recovery becoming more solid*

The recovery in the new European Union (EU) members is firming against the backdrop of the stronger EU-15 economic activity. For the fourth quarter of 2013, both Hungary and Poland reported year-on-year growth of 2.7 per cent. Hungary saw increased inflows of EU funds to the investment and construction sectors. Poland recorded a further upturn in January, when seasonally adjusted industrial output expanded by 6.3 per cent year on year. However, in Estonia, fourth quarter GDP remained flat, as the impact of stronger manufacturing was offset by declining construction. The Croatian economy has yet to show signs of a revival. In January and February, the strength of economic sentiment was uneven across the region. Labour markets are still slow to improve. In Croatia and Slovakia, unemployment rates increased in early 2014, mostly in line with seasonal trends. Inflationary pressures remain subdued. In January, inflation in Croatia was virtually zero, while in Slovakia a cut in household electricity prices led to a negative inflation rate. In Poland, producer prices fell by 0.9 per cent year on year in January. Low inflation, in turn, supported consumer spending. In January,

retail sales in Poland grew by 5 per cent year on year. The emerging market sell-off in early 2014 has led to a weakening of the currencies in the countries with flexible exchange rates. The weaker currencies may further support exports, but may also increase debt-service costs and dampen domestic demand. The Central Bank of Hungary cut its policy rate further by 15 basis points in mid-February, although the currency dropped to a two-year low against the euro.

## Economies in transition

### *CIS and Georgia: economic toll of the crisis in Ukraine; currency devaluations in Ukraine and Kazakhstan*

The ongoing political standoff in Ukraine contributed to a deterioration of the country's short-term economic prospects. Industrial production contracted by 5 per cent year on year in January. The second tranche of the \$15 billion loan from the Russian Federation was delayed, and consequently the cost of foreign borrowing for Ukraine has increased sharply. At the end of February, foreign-exchange reserves fell to a critically low level of two months of import coverage, despite reduced prices for natural gas imports in early 2014. Financing the budget deficit has become increasingly difficult, as domestic banks scaled back their bond-buying operations. Facing a currency crisis, the National Bank of Ukraine had to devalue the currency in early February and impose further capital controls. The discount on the price of Russian natural gas will be abolished in April, and the country's need for external financial assistance is urgent. The economy of the Russian Federation remains sluggish. The December PMI Index reading was extremely weak, and in January industrial production contracted by 0.2 per cent year on year, while fixed investment dropped by 7.0 per cent. Consumer prices meanwhile were up by 6.1 per cent. The global pressures arising from the tapering of the United States Federal Reserve stimulus have exerted pressure on the Commonwealth of Independent States (CIS) currencies, including on the Russian rouble. The rouble dropped to a several-year low against a basket of the euro and the dollar in early 2014 as the Central Bank of Russia announced a scaling down of currency interventions, the current-account surplus diminished, and capital outflows continued. As the crisis in Ukraine intensified, the rouble plunged even further. In response, the central bank hiked its key policy rate in early March, from 5.5 to 7.0 per cent, which will further weigh on the recovery. The Russian stock market lost about 13 per cent in early March against the backdrop of potential economic sanctions against the country. The National Bank of Kazakhstan also devalued the domestic currency—by 18.9 per cent against the dollar—in early February to maintain competitiveness. Some sectors of the economy (the energy sector in particular) are likely to gain from the devaluation, but the banks and households may sustain losses.

### *South-Eastern Europe: another interest rate cut in Albania*

Gross domestic product in Serbia increased by 2.6 per cent year on year in the fourth quarter of 2013, despite some slowdown in December. Consumer price inflation in Serbia, which drastically decelerated over the course of 2013 to a level below the official target, reached 3.1 per cent in January, returning to the central bank's

target tolerance band. In Albania, the central bank further cut its key policy rate in late February to a new record low of 2.75 per cent, as annual inflation in January stood at just 1.7 per cent.

## Developing economies

### *Africa: weaker annual growth in South Africa; Egypt enacts further stimulus measures*

In South Africa, year-on-year growth increased to 2.0 per cent in the fourth quarter of last year compared to 1.7 per cent in the previous quarter. For 2013 as a whole, growth fell to 1.9 per cent, after reaching 2.5 per cent in 2012. This slowdown was based on a number of factors such as labour strikes, weaker consumer demand and continued constraints in the power sector. The official unemployment rate stood at 24.1 per cent in the fourth quarter. The Bank of Ghana increased its policy interest rate by 200 basis points to 18 per cent to rein in inflation, which stood at 13.8 per cent in January. Egypt enacted a second round of stimulus measures of 33.9 billion pounds (\$4.87 billion) in early February. Nearly 20 billion pounds will be spent on development projects and around 12 billion pounds will go to financing social programmes, including a rise in the minimum wage. In addition, the central bank plans to put aside 10 billion pounds to provide low-interest loans for the purchase of low-cost housing. There have also been steps to reform the country's extensive subsidy system with pilot projects for direct cash transfers and for the use of smart cards to distribute subsidized bread. A smart card system was implemented last year to distribute subsidized fuel.

Libya has been forced to put some government departments on special spending arrangements that allow for expenditures to be approved month by month. Parliament has still not approved a budget and government revenues have been significantly impacted by ongoing oil production and export disruptions. Oil production rose to 600 thousand barrels per day (bpd) at the beginning of February, but fell back to 230 thousand bpd by the end of the month, owing to renewed disruptions.

### *East Asia: political unrest in Thailand takes a severe toll on the economy*

In Thailand, continuing political unrest is taking a severe toll on the domestic economy. Year-on-year GDP growth slowed to 0.6 per cent in the fourth quarter of 2013, down from 2.7 per cent in the previous three months. Domestic demand contracted sharply, with household consumption falling by 4.5 per cent year on year and total investment plunging by 11.3 per cent. A surge in net exports, which rose by 25.3 per cent, and a significant increase in inventories helped prevent an even sharper slowdown. Full-year growth in 2013 was 2.9 per cent, well below the 6.5 per cent recorded in 2012. Several domestic agencies, including the Bank of Thailand, have already reduced their 2014 growth forecasts as high-frequency indicators show a sharp decrease in tourist arrivals and a drop in consumer confidence. The sluggish performance of Thailand's economy stands in contrast to robust growth in other East Asian economies. In Indonesia, Malaysia and Viet Nam, year-on-year GDP growth picked up in the fourth quarter as stronger demand in developed

economies led to a recovery in exports. Full-year growth in 2013 reached 4.7 per cent in Malaysia, 5.4 per cent in Viet Nam and 5.8 per cent in Indonesia. The Chinese yuan weakened considerably over the past few weeks, dropping from 6.04 yuan per dollar in mid-January to 6.12 yuan per dollar at the end of February. The largest depreciation of the yuan in recent years mainly reflects efforts by the People's Bank of China to alter the market trend of one-way bets on the appreciation of the yuan.

### ***South Asia: weak domestic demand continues to hold back India's growth***

India's economy continued to grow at a lacklustre pace in the fourth quarter of 2013. Gross domestic product expanded by 4.7 per cent year on year, down from 4.8 per cent in the previous three months. This marks the fifth consecutive quarter of growth below 5 per cent. Domestic demand was sluggish in the fourth quarter, following large capital outflows in June and July of 2013 and the Reserve Bank of India's two policy rate hikes in September and October. Household consumption grew by only 2.5 per cent year on year and gross fixed capital formation fell by 1.1 per cent. A significant increase in net exports provided some support for growth. A weaker rupee, along with a recovery in India's main trading partners, helped exports rise by 11.4 per cent, while imports declined by 3.4 per cent. The near-term prospects for India's economy remain subdued, even as recent data show an easing of inflationary pressures. Consumer price inflation declined to a two-year low of 8.8 per cent in January and wholesale price inflation fell to 5.1 per cent as food prices cooled. Inflation also slowed in other South Asian countries in January, with consumer prices up by 4.4 per cent year on year in Sri Lanka (compared to 4.7 per cent in December) and by 7.9 per cent in Pakistan (compared to 9.2 per cent in December).

### ***Western Asia: Turkey's monetary policy steps help the lira to recover***

Following the financial turmoil of January, the Turkish lira has started to recover, bouncing back to near its December value against the dollar by the end of February. The monetary policy steps implemented in January, such as hiking the interest rates, were effective in promoting financial stability. The main challenge though is that those same policies will weigh on domestic demand and GDP growth in 2014. On a positive note, as Turkey is also facing an increasing current-account deficit, standing at about 8 per cent of GDP in 2013, higher interest rates may help to reverse this

trend by curbing domestic demand and consequently imports. In the region's oil-exporting countries, government spending has been crucial in compensating for weaker external demand for oil. The Government of the United Arab Emirates announced that it will boost public expenditure by 15 per cent to Dh140 billion (\$38 billion) during the period 2014 to 2016. Public spending will prioritize the provision of better services to the citizens, in particular in the education and health sectors. The Second Arab Forum for Development and Employment took place in Riyadh to discuss options to boost job creation, in particular for the youth, as the overall Arab unemployment rate had risen to 16 per cent. The major point under discussion is the alignment of training and education programmes with labor market requirements. For instance, in Saudi Arabia, over 48 per cent of the unemployed Saudi males and over 71 per cent of the unemployed Saudi females are university graduates with at least a bachelor's degree.

### ***Latin America and the Caribbean: growing political and social turmoil in the Bolivarian Republic of Venezuela; new inflation index in Argentina***

The political turmoil intensified significantly in the Bolivarian Republic of Venezuela amid growing unrest, violence and polarization within the society. This added more pressure to an already struggling economy characterized by high inflation and a chronic lack of foreign exchange. The recent developments have further dampened the outlook for the economy, which might enter into recession during 2014. In an additional attempt to reduce foreign-exchange flight, the Government banned remittances to people living in Colombia. In February, Argentina launched a new nationally representative inflation index, in an effort to provide a more accurate measure of price fluctuations. The previous index, which only covered the Buenos Aires urban area and whose reliability was questioned by the International Monetary Fund, provided inflation figures that were less than half the estimates of most private analysts since 2007. In January, the new inflation index reported an increase in consumer prices by 3.7 per cent from December. According to some private forecasts, annual inflation may reach 25 per cent in 2014. In January, Brazil recorded a record-high current-account deficit, amounting to more than \$11 billion and continuing the upward trend observed in late 2013. Last year, the current-account deficit reached 3.6 per cent of GDP. Still, foreign direct investment (FDI) inflows have remained robust and the FDI prospects for 2014 are fairly positive, playing a key role in financing the deficit.