

Monthly Briefing

World Economic Situation and Prospects

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Summary

- Unemployment, trade and capacity utilization face sharpest deterioration since World War II
- Widening gaps in external financing for developing countries call for large international transfers
- G20 reaches agreement on provision of \$1.1 trillion in additional funding for emerging and developing countries, on substantial reform of financial regulation and on full commitment to ODA pledges
- Countries continue to scale up policy measures to stabilize the financial sector and stimulate the real economy

Global issues

World trade is collapsing

According to the WTO, the volume of world goods trade faces its largest decline since World War II, plunging by 9 per cent in 2009. In addition to factors in the real economy, the collapse in trade activity results from a drastic reduction in the availability of trade finance.

Developing countries' woes require transfers of financial resources

As the global financial and economic crisis deepens, the impact on developing countries is rapidly worsening, particularly in terms of rising unemployment and a widening external financing gap. A sharp decline in international trade flows, a collapse in commodity prices, a drop in international tourism, and a moderation in remittances have contributed to a significant deterioration in the current account balances of many developing countries. Meanwhile, a substantial reversal of private foreign capital inflows to developing countries, combined with a surge in the costs of external financing in global capital markets, have led to mounting financing problems.

The World Bank estimates that in 2009, 104 developing countries will have inadequate current account surpluses to cover their private foreign debt coming due, and total financing needs are expected to exceed \$1.4 trillion. In order to address financing needs in developing countries, the World Bank proposed the creation of a “vulnerability fund”, to be financed from 0.7 per cent of each developed country’s stimulus package. The United Nations, in a letter from the Secretary-General to the leaders of the G20, called for transferring financial resources of about \$1 trillion to developing countries in 2009–2010.¹

G20 agreement secures additional funding for the IMF and calls for its reform

Amidst worsening news about the global economy, the leaders of the G20 met in London on 2 April 2009 and pledged to do whatever is necessary to restore confidence, growth, and jobs; repair the financial system to restore lending; strengthen financial regulation to rebuild trust; fund and reform the international financial institutions to overcome the crisis and prevent future ones; promote global trade and investment and reject protectionism, to underpin prosperity; and build an inclusive,

¹ See also UN-DESA Policy Brief No. 13: <http://www.un.org/esa/policy/policybriefs/policybrief13.pdf>.

green, and sustainable recovery. They agreed on an additional \$1.1 trillion programme of support, which includes a tripling of resources available to the IMF to \$750 billion, a new SDR allocation of \$250 billion, additional lending by multilateral development banks of at least \$100 billion, and support of trade finance of \$250 billion. At the same time, they pledged to reform and modernize the international financial institutions to strengthen their longer term relevance, effectiveness, and legitimacy. The G20 also reaffirmed all existing commitments to provide more aid and debt relief to the poorest countries and stated that the resources promised would include \$50 billion set aside to support social protection, boost trade and safeguard development in low-income countries.

The agreement marks an important step forward in the process of bringing the global economy out of recession. Furthermore, it lays out a plan for improved financial regulation and reform of the Bretton Woods Institutions. This may help restore some of the lost confidence in markets. The agreement seems to fall short of more effectively coordinating the national fiscal stimuli and their financing, as proposed in recent editions of the World Economic Situation and Prospects and previous issues of these monthly briefings. Also, committed official development assistance may fall well short of providing sufficient financial resources to developing countries, especially low-income countries. Such resources are vital to allow these countries to engage in significant countercyclical fiscal policies for economic recovery and long-term investments towards the Millennium Development Goals, as well as to enhance food security and adapt to climate change.²

Yet, the government efforts are significant. During March, many countries continued to scale up their policy measures to stabilize the financial sector and stimulate the real economy. So far, the total value of these policy measures announced by some 40 (mostly developed) economies reached approximately \$21 trillion, or one third of the annual world gross product (WGP) (see Table 1). By far, most of these resources are for financial bailout packages. The fiscal stimulus plans total about \$2.6 trillion or 4 per cent of WGP, but most of this stimulus is to be spent over the three-year period 2009 to 2011. This may fall short of what is needed, especially if the stimulus efforts are not coordinated adequately. Most experts estimate that a total stimulus of around 3 per cent of WGP per annum is required.³

Developed economies

United States: Federal Reserve takes bold action

The US Treasury and Federal Reserve have announced an expanded Term Asset-Backed Securities Loan Facility (TALF) that will provide financing to investors to support their purchases of certain AAA-rated asset-backed securities. The scale of the facility was initially set at \$200 billion and is designed to “catalyze the securitization markets”.

The Federal Reserve decided to purchase up to \$750 billion additional agency mortgage-backed securities and up to \$100 billion additional agency debt. Most importantly, it also decided to buy up to \$300 billion of long-term Treasury securities within six months to “help improve conditions in private credit markets”.

In order to cleanse the balance sheets of banks and resume the flow of private credit, the US Treasury announced a Public-Private Investment Program. Under this programme, multiple funds will be set up to purchase legacy real estate-related assets, up to \$1 trillion. The programme will combine public money and capital from private investors, while the Government will provide debt guarantees as an incentive for private investors. However, critics point out that under this scheme the Government will bear almost all risks and that the rescued banks may not resume lending promptly.

The final estimate for the United States economy shows a contraction by 6.3 per cent of GDP (at an annualized rate) during the fourth quarter of 2008. Initial jobless claims have remained at very high levels in March 2009, while recent housing market data show a slight recovery from the lows of January.

Western Europe and the EU: inflation falls rapidly as outlook remains bleak

The economic outlook in Western Europe remains gloomy. Economic indicators continued to fall in March even though the pace of decline has diminished significantly since the fourth quarter of 2008. The European Commission’s Economic Sentiment Indicator dropped only slightly in the first three months of the year, after the sharp declines of 2008. However, measures of confidence across the region remain at historic lows and indicate continuing economic contraction. Mean-

² For further detail, see UN/DESA’s Policy Brief No. 13 (ibid).

³ The G20 communiqué indicates agreement to increase fiscal expansion to \$5 trillion by the end of 2010 in order to “raise output by 4 per cent”, but without providing further detail. Such expansion would amount to about 8 per cent of WGP, and hence likely includes financial sector support, not just stimulus for the real economy.

Table 1: Public funds^a committed between 1 September 2008 and 31 March 2009 to address the global financial crisis

Country	Ratio of GDP (%)		Amount (US\$ billions)		
	Total	of which: Fiscal stimulus	Total	of which: Fiscal stimulus	Years to spend fiscal stimulus
Argentina	7.3	6.4	25	22	1
Australia	0.7	0.0	7	0	
Belgium	30.9	0.0	164	0	
Brazil	5.1	3.6	85	60	1
Canada	25.3	3.3	396	52	2
Chile	2.8	2.8	5	5	1
China	4.5	4.0	190	169	2
France	23.0	4.0	685	119	3
Germany	28.0	6.3	1 069	241	3
Greece	11.6	0.0	43	0	
Hong Kong SAR ^b	2.4	2.4	5	5	1
Hungary	6.2	0.0	10	0	
Iceland	263.0	0.0	50	0	
India	7.5	1.9	93	24	1
Indonesia	1.6	1.5	8	7	1
Italy	4.5	0.7	108	17	3
Japan	27.7	14.8	1 342	717	1
Kazakhstan	11.1	11.1	16	16	2
Korea, Republic of	19.8	5.5	189	52	1
Malaysia	9.1	2.8	18	5	2
Mexico	1.5	1.5	17	17	1
Netherlands	39.8	0.0	362	0	
Norway	13.8	0.0	66	0	
Peru	2.5	2.5	3	3	1
Philippines	3.1	3.1	5	5	1
Poland	3.6	0.0	20	0	
Portugal	14.4	0.0	37	0	
Russian Federation	15.1	8.0	269	142	1
Saudi Arabia	9.4	0.0	50	0	
Singapore	8.0	8.0	15	15	1
South Africa	3.7	3.7	11	11	3
Spain	27.3	4.5	460	76	3
Sweden	70.0	0.0	359	0	
Switzerland	12.1	0.0	60	0	
Taiwan Province of China	2.1	2.1	9	9	1
Thailand	3.4	3.4	9	9	1
Turkey	0.2	0.0	2	0	
United Kingdom	51.6	4.1	1 438	114	3
United States	92.9	5.2	13 255	742	3
World	33.8	4.3	20 955	2 655	

Source: UN-DESA, based on information from: IMF, 6 March 2009, "The state of public finances: outlook and medium-term policies after the 2008 crisis"; Credit Suisse, 19 March 2009, "Fiscal policy around the world"; UN/DESA database.

Note: Definition and contents of the policy measures vary from country to country. The size of these packages may not be comparable across countries.

a Includes financial bailout packages (including government guarantees on bad debts), liquidity injections into financial systems and fiscal stimulus packages.

b Special Administrative Region of China.

while, Ireland's economic woes deepened as Standard & Poor's downgraded its AAA status and warned it could be lowered further if the country's public finances continue to weaken.

Headline inflation continues to drop, reaching its lowest level since August 1999, and is likely to turn negative by mid-2009. The sharpness of the decline is mostly due to the fall in energy prices. Core inflation is higher and decelerating far more slowly. However, the dramatic slowdown in economic activity is providing underlying deflationary pressures. In Spain, headline inflation has already turned negative.

The European Central Bank (ECB) announced that it would continue its current policy of supplying unlimited liquidity to the market at its fixed refinancing rate through at least the end of 2009. In early April, the ECB lowered its main refinancing rate by 25 basis points to a record low of 1.25 per cent, but the cut was smaller than most market participants had expected.

The new EU member States: continuing fears of external vulnerabilities

Several new EU member States revised their estimates of growth for the fourth quarter of 2008; contractions were larger than initially expected in Estonia, Hungary, and Lithuania. Slovenia reported its worst performance in 15 years, with GDP declining by 0.8 per cent in the last quarter of 2008. Preliminary data for industrial production covering the month of February 2009 indicate a continuing weakness in most countries. Governments and central banks continued to pursue countercyclical policy measures by cutting taxes, providing liquidity to recapitalize banks and supporting exports and foreign direct investment.

Many countries in the region remain vulnerable to their external financing conditions and have to roll over short-term debt, thus depending on the continuing flow of credit from the parent banks in the EU-15. After pledging to assist countries in Eastern Europe that experience balance-of-payment problems, EU leaders decided to double the financial facility for assisting non-euro zone countries to €50 billion. Meanwhile, the Government of Romania has concluded an agreement with the IMF, the European Commission, the European Investment Bank and the World Bank on a €20 billion loan, becoming the third EU country to receive international assistance.

Japan: increased monetary easing amid a deep contraction

Latest data indicate that the Japanese economy is still in a deep contraction. While consumption continues to weaken, corporate profits are falling sharply. Both exports and imports declined at an annual pace of about 60 per cent during the first quarter of 2009. As corporate financial conditions have tightened drastically, the Central Bank of Japan has scaled up credit easing, most recently by focusing on the purchase of commercial paper.

Canada: unemployment is rising rapidly as the economy shrinks

The Canadian economy shrank in the fourth quarter of 2008 at an annualized rate of 3.4 per cent, with deep falls in exports and domestic spending. A further decline of 0.7 per cent in January brought the GDP level in real terms back to that of January 2007. Employment fell for the fourth consecutive month, raising the unemployment rate from 6 per cent in October 2008 to 7.7 per cent in January 2009.

Australia and New Zealand: some positive policy effects

Australia is in economic recession, the first since the early 1990s. While exports remain a drag, some positive signs have emerged in the retail sector, which has benefited from the Government's cash payments to low- and middle-income families. New Zealand registered a decline in GDP in four consecutive quarters, even though increased government spending has partly offset the weakness in other sectors.

Economies in transition

Financing needs increase as recession deepens

The situation in the Commonwealth of Independent States (CIS) continues to deteriorate as more economies are being hit by the global crisis, especially by massive declines in trade, foreign direct investment, and workers' remittances inflows as well as reduced access to credit.

In the Russian Federation, GDP for January–February 2009 contracted by 8 per cent year-on-year, largely owing to a double-digit drop of industrial output, a severe contraction of investments, and weakening consumption. Exports also fell at a double-digit rate despite the continued depreciation of the ruble. Political uncertainties and tightened credit conditions exacerbate the deep economic recession in Ukraine. Industrial output dropped by over one third in the first two months of 2009, construction fell by over 50 per cent, and exports of metals declined sharply. Recent adjustments in economic policy, including suspension of a 13 per cent tax on imported goods and strengthening of the independence of the Central Bank, aim at speeding up the release of the second tranche of the IMF loan.⁴

While a few countries continued to scale up their policy measures to tackle the economic crisis—for example, Russia announced anti-crisis measures in March with a price tag of 9.1 per cent of GDP—some smaller economies have turned to the IMF. A \$540 million stand-by arrangement with the IMF was recently approved to support Armenia’s financial and economic system.

Governments in South-eastern Europe intend to implement stimulatory measures but are experiencing financing difficulties. The Government of Serbia reached an agreement with the IMF on a €3 billion stand-by arrangement that is subject to a number of conditions, while the Government of Bosnia and Herzegovina has indicated that it will seek a loan from the IMF. The economic slowdown and the continuing return of migrants to their home countries have led to an increase in unemployment across the region.

Developing economies

Africa: new data reveal the extent of the crisis

As the economic situation continues to deteriorate, several African countries and international organizations drastically revised their growth forecasts downwards. Weakening global demand severely affected South Africa’s manufacturing output, which in January contracted by 11.1 per cent year-on-year in volume terms. With the economy heading towards its first recession in 17 years and the inflation outlook improving, the Central Bank cut its repurchase rate by 100 basis points, to 9.5 per cent.

Negative developments in Nigeria, including declining oil revenues, caused Standard & Poor’s to lower the country’s rating from “stable” to “negative”. Recently, the Nigerian Central Bank cut its main policy rate by 50 basis points to 9.75 per cent and embarked upon a series of unorthodox measures to rescue the banking industry, which is suffering a major liquidity crisis due to the global credit crunch. Meanwhile, the Nigerian Government allocated \$1.5 billion from its savings from oil revenues to federal, state and local governments.

Adverse weather conditions and political instability exacerbated the economic crisis in some countries. For instance, Zambia and Namibia faced their worst floods in at least 40 years, and coups took place in Guinea Bissau and Madagascar.

East Asia: signs of stabilization in China amid deep regional downturn

Newly released data show a continued weakening of economic conditions across East Asia. However, some tentative signs of stabilization have emerged in China, where fixed asset investment, property transactions and retail sales recorded significant year-on-year growth in the first two months of 2009. While the resilience in investment and consumption spending suggests that the Government’s large fiscal stimulus package is starting to work, it contrasts sharply with the ongoing weakness in the external sector. China’s total exports in January and February dropped by 21 per cent compared to the same period in 2008, with import spending declining even more rapidly. Industrial production expanded by only 3.8 per cent year-on-year during the first two months of 2009. As the largest foreign holder of US Treasury bonds, China remains concerned about the long-run stability of the dollar.

In the meantime, the Central Banks of Indonesia and the Philippines further lowered their benchmark rates and several Governments in the region stepped up efforts to revive economic activity. The Malaysian Government announced a second fiscal stimulus package that accounts for 9 per cent of GDP and includes direct measures to support employment. The Government of the Republic of Korea unveiled a new fiscal package equivalent to about 3.5 per cent of GDP.

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For details, see Monthly Briefing on the WESP No. 6 (5 March 2009): http://www.un.org/esa/policy/publications/dpad_wespmbn.html.

South Asia: countries suffer increasingly from deteriorating external positions

Against the backdrop of weakening external demand and rapidly slowing inflation, Governments and central banks in South Asia increased their efforts to support economic growth. In Bangladesh, India, and Sri Lanka, merchandise exports registered year-on-year declines in December 2008. The Central Banks of India and Sri Lanka continued to cut their main policy rates to boost lending activities.

Facing a foreign exchange crisis, the Government of Sri Lanka is currently negotiating a \$1.9 billion emergency loan with the IMF. Between July and December 2008, the country's international reserves declined rapidly as the current account deficit widened, investors pulled out portfolio capital, and the Central Bank sold dollars to support the domestic currency. Meanwhile, the IMF approved the disbursement of the second tranche (\$847 million) of its loan to Pakistan. The country will also receive significant new loans from the World Bank as well as the Asian Development Bank, which recently announced a doubling of its support programme for Pakistan.

Western Asia: manufacturing output contracts sharply as global trade falters

Economic activity in the region is expected to slow significantly this year and remain weak in 2010 owing to lower oil prices and oil output, a sharp fall in asset prices, especially in the real estate sector, and credit constraints.

Oil-exporting countries are struggling with a sharp fall in fiscal revenues at a time when they face increased spending needs to stimulate their economies and create jobs; at the same time, non-oil producers are increasingly being hit by the dramatic contraction in global trade that results in a virtual collapse of their manufacturing sectors. In Turkey, industrial output declined by 21.3 per cent year-on-year in January, driven in particular by a collapse in the production of motor vehicles, which dropped by 60.3 per cent year-on-year. At the same time, unemployment in Turkey rose to 13.6 per cent in the three months ending in January from 12.3 per cent in the previous three months.

Meanwhile, non-oil producing countries in particular continue to benefit from lower oil and commodity prices in the form of lower inflation rates, creating space for monetary policy makers to maintain their accommodative stance in an effort to support credit markets and economic growth.

Latin America: fiscal and external balances deteriorate

As the external environment deteriorates, signs of vulnerability in Latin American economies become more evident. Sharply lower commodity prices and weaker demand for manufactured goods are severely affecting trade balances in many countries. In Chile, the trade surplus fell by 72 per cent year-on-year in the first two months of 2009, while Peru registered a deficit in January mainly owing to a steep drop in metal prices. In Mexico, the trade deficit worsened in January-February 2009 as oil export revenues declined by more than 50 per cent. In response, several countries in the region are starting to adopt protectionist measures; most recently, Ecuador imposed import restrictions.

Deteriorating fiscal accounts are another major concern for Latin America. Facing a severe drop in public revenues owing to much lower oil prices, the Government of the Bolivarian Republic of Venezuela announced a cut in this year's budget by 6.7 per cent and an increase in the value added tax. The Brazilian Government also announced a significant spending cut, following a fall in tax revenues. Meanwhile, the Central Bank of Brazil lowered its main policy rate by 1.5 basis points to 11.25 per cent, after GDP in the final quarter of 2008 contracted by 3.6 per cent from the previous quarter, the steepest quarterly decline since 1996.

Least Developed Countries: new IMF loans required as foreign reserves dwindle

Facing increasing current account deficits due to the collapse in export prices, several commodity-exporting LDCs spent much of their foreign reserves to support their currencies. Angola has used more than \$3 billion since the end of November to keep its rate stable against the dollar. In the Democratic Republic of the Congo, reserves hit a low of \$36 million (equivalent to only one week of imports) prior to receiving funds of about \$200 million from the IMF. ■