WORLD ECONOMIC SITUATION AND PROSPECTS FOR 1999

DEPARTMENT OF ECONOMIC AND SOCIAL AFFAIRS

AND

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

As part of the Secretary-General's programme for reform which included proposals to improve the coherence of the work of the United Nations, it was decided that the Department of Economic and Social Affairs (DESA) and United Nations Conference on Trade and Development (UNCTAD) should produce a joint report on the world economic situation and prospects that would examine the performance of the world's economies and developments in the international economy.

This is the first joint report. By providing an overview of current macroeconomic developments and issues, it is intended to serve as a common point of reference for related work on such matters by the different United Nations entities in the economic and social area. It is based on information available to the Secretariat as of 1 December 1998.

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I. OVERVIEW

The world economy is now growing at its slowest rate since the early years of the decade (see table 1). The recession in Japan, the East Asian crisis and the Russian crisis—along with contagion through the financial markets—combined in 1998 to halve the rate of growth of the world economy and to raise concern about global recession. At some points during the year there was fear of serious damage to major financial markets. The number of countries that saw an increase in output per capita in 1998 was 23 less than in the previous year and no significant improvement is expected in 1999. Moreover, world trade in 1998 grew at less than half the pace of 1997 and about the same growth rate is foreseen for 1999. International prices in dollars of crude petroleum fell about one third and non-fuel commodity prices about one eighth in 1998 (see table A.10). With no acceleration expected in the growth of world output and thus demand, commodity prices are forecast to remain depressed in 1999.

The world economic situation, however, is not uniformly bleak. Not only did output per capita rise in over 100 countries in 1998, but economic growth was relatively strong in North America, much of Europe, including some transition economies, China and India. Together these countries account for about half of world population while economic growth will be slowing in many of these countries in 1999, the catastrophic declines in output and employment in the Asian crisis countries are expected to end.

None the less, the bottoming-out of decline in the Asian crisis countries is not the same as recovery, and the latter does not seem to be a short-term prospect. Nor are the rates of economic growth in much of the world satisfactory. In particular, economic growth in the least developed countries is projected to be 3¼ per cent in 1999 (see table A.7), which will be barely sufficient to raise per capita output (since population growth in these countries averages about 2.5 per cent a year). More rapid growth on a sustained basis is needed for a significant rise in living standards in these countries.

The countries that have been especially vulnerable to the recent wave of financial and economic crises were countries that had taken relatively greater steps to liberalize their economies and integrate them into the global system. Since discovering the benefits and opportunities of external opening, these countries have recently been learning at high cost that these policies also have challenges and dangers, requiring a more careful approach to national strategies of policy reform.

Table 1. Growth of world output and trade, 1981-1999
(Annual percentage change)

	1981-1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998* [a]	*1999* [b]
World output [c]	2.8	0.8	1.7	1.3	2.9	2.6	3.4	3.3	1.7	2
of which:										
Developed economies	2.9	0.7	1.6	0.8	2.7	2.2	2.9	2.7	1.8	1½
Economies in transition [d]	1.6	-8.2	-13.2	-9.3	-7.1	-0.8	-0.1	2.8	1.1	¾
Developing economies	2.4	3.2	5.0	5.2	5.6	4.6	5.7	5.7	1.6	3
World trade [e]	4.5	4.1	5.7	4.5	10.4	8.6	5.4	9.5	4.1	4
Memorandum items:										
Number of countries with rising per capita output	106	70	75	68	99	109	120	124	101	104
Number of countries in sample	127	128	142	143	143	143	143	143	143	143

Source: UN/DESA.

a Partly estimated.
b Forecast, based in part on Project LINK.
c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 1993 prices and exchange rates.
d Based on reported GDP.
e Average of growth rates of the volume of exports and imports.

From Asian financial crisis to global economic crisis

Immediately following the Thai crisis, the intensive trade and finance linkages, together with changes in lenders' perceptions of risk and willingness to extend credit, spread the shock to other economies in the region and beyond, even though many of them had strong macroeconomic fundamentals.

One channel of transmission was through global financial markets. Increased perceptions of risk resulted in a sharp decline in capital flows to emerging markets that rely on foreign borrowing to finance their fiscal or current account deficits (or both). Net private capital flows to developing countries in 1998 fell to about half of the peak level registered in 1996. Foreign direct investment was relatively stable, but portfolio investment and private lending fell substantially and net commercial bank lending fell to almost zero. The Asian economies in crisis suffered large net outflows. Other developing countries that received net capital inflows earlier in the decade suffered not only a decline in volume but also a sharp rise in the cost of external finance.

Another transmission channel involved international commodity trade. The reduced world demand for commodities, coupled with the incentives that producers of commodities in the crisis countries had to increase supply in response to devalued exchange rates, pushed commodity prices lower. Prices of crude petroleum and many other raw materials dropped to their lowest levels in decades (see chapter V). Export revenues in the many developing countries that remain heavily dependent on the production and export of these commodities declined significantly, leading to a deterioration in both their external and their fiscal positions (since these sectors are typically important sources of government revenue). This, in turn, led to further cutbacks in government expenditure, and thus further contractions in demand as part of action to curb imports and restore fiscal balance.

The sharp contraction in import volume in Japan and East Asia resulted in a significant slowdown in the growth of the overall volume of trade in the world (see table A.9). Import demand in several Asian economies declined by over 20 per cent, reflecting their deflationary adjustment to reduced capital inflows and significantly devalued currencies. An anticipated recovery in the region's exports, which was expected to be stimulated by the devaluations, failed to materialize. This was partly because of the credit squeeze faced by manufacturers and partly because of reduced demand, especially from Japan and the crisis countries in the region.

In Japan, the weak economy and the prevailing high levels of bad debt pushed more financial institutions into insolvency. This worsened the credit crunch, aggravating both the decline in domestic spending and the problems of bad debt and insolvency. The continued deterioration in the East Asian economies further worsened the position of Japanese banks. The Government took a succession of measures to stimulate the economy, but they failed to achieve the desired results.

The decline in commodity prices was an important factor in triggering the financial crisis in Russia in August, even though domestic factors were also responsible for the build-up of financial fragility in that country (see chapter VI). Following the Russian crisis, the global financial instability attained new heights as the developed countries discovered serious fragilities in their own financial systems. There was a resulting global deterioration in investor confidence, financial losses in developed countries, steep sell-offs in equity markets in the United States and elsewhere, and an increase in risk premiums to unusually high levels. For several weeks, emerging markets were unable to issue new debt or equity in international capital markets and even the borrowing plans of large corporations were affected. The "credit crunch" thus had spread from the Asian crisis countries to the Russian Federation and, finally, to developed countries.

The potentially deflationary impact of rising cost of finance and falling equity prices by heavily indebted firms and households gave rise to widespread concern by the third quarter of 1998 that the prevailing financial fragility could lead to a global recession. In response, the final weeks of the year saw several policy actions that reduced, but did not eliminate, this possibility. In recognizing that avoiding a liquidity crunch should be a major objective, the Group of Seven agreed in the last quarter of 1998 to focus their immediate attention on limiting the economic slowdown and giving momentum to their longer-term initiatives to strengthen the international financial system. Most of these countries cut interest rates in the last quarter, the most notable cases being the United States, Canada, the United Kingdom and the countries scheduled to adopt the Euro as a common currency. In addition, interest rates in some of the crisis countries, which had been declining for about half the year, approached pre-crisis levels. Other developments included new packages of fiscal stimulation and support for the banking sector announced by Japan, agreement by the United States Congress to the US contribution to the International Monetary Fund (IMF), and an IMF loan to Brazil.

As the year ended, a degree of confidence had returned to international financial markets. Nevertheless, this confidence remained susceptible to erosion by new shocks that may arise from any of a variety of sources. Recent experiences make it clear that such shocks are capable of triggering further negative developments in the real as well as in the financial economy. Thus, given the vulnerability that is now built into the structure of the global financial system, ensuing developments could produce downward spirals with substantial and widespread negative effects on the world's economies.

Recent economic performance and outlook[1]

The most dramatic change in economic circumstances in 1998 took place in the developing economies. Having grown by more than 5 per cent annually for much of the decade, output in the developing countries as a group expanded by only 1.6 per cent in 1998 and only 3 per cent growth is forecast for 1999, largely owing to the end of the economic free fall in the Asian crisis countries (see table A.7 for more detail on these and other developing countries and regions). In 1998, output in some countries contracted by double-digit figures, causing soaring unemployment, declining real wages and large increases in poverty. At best, only the slow beginnings of recovery are forecast for 1999, in association with some strengthening of export growth, easing of the credit crunch and reduction of excess capacity.

International developments in 1998 had profound, although less extreme, consequences in many other developing countries, notably those most integrated into global financial markets and those dependent on exports of commodities whose prices had plummeted. Thus, after attaining its highest growth rate for a quarter of a century in 1997, Latin America registered no tangible gain in per capita income in 1998. In 1999, per capita output in Latin America as a whole is forecast to fall (the population growth rate being about 1.7 per cent a year): Brazil has slipped into outright contraction and further slowdowns in economic growth in other countries are expected owing in some cases to strong trade linkages to Brazil and more generally to a need to reduce fiscal and external deficits.

In Africa, the main international transmission channel was commodity trade. Nevertheless, international financial instability made South Africa subject to intense downward pressure on its currency in mid-1998, and the deleterious effects on South African expenditure spilled over to several smaller trading partners in the sub-region that had negligible connections with international financial markets. Growth in Africa as a whole is expected to improve marginally in 1999, assuming no further deterioration in commodity prices, moderate growth in export volumes and more favourable weather conditions.

Severely weakened oil prices gave West Asia a substantial external shock, leading, as in the case of Iran and Saudi Arabia, to output contraction. Here too, only a slow improvement is forecast for 1999, given the prospect of no significant strengthening in oil prices.

In the developed economies, consumers and producers generally benefited from the lower international prices. Governments saw little inflationary pressure and increasingly became concerned about the possibility of deflation. There was also a decline to exceptionally low levels in long-term interest rates on government securities in the major economies, as the turmoil in world financial markets generated a "flight to quality", fed in part by capital retreating from many developing and transition countries. However, shrinking expenditure in developing and transition economies and Japan began to be reflected in declining exports and corporate earnings.

Japan slipped into a recession in the fourth quarter of 1997, and output has declined in every quarter since (see table A.2). Output is forecast to continue to contract in 1999 (see table A.1). The sources of Japan's difficulties have been largely domestic. The lack of credit, particularly to small and medium-sized enterprises, owing to the paralysis of the under-capitalized banking system, continues to depress business activity. Little stimulus is expected from the government spending programmes, not because of their size, but because of their limited effectiveness. Finally, weak export sales will continue to aggravate the domestic recessionary conditions.

In Europe, the attention of macroeconomic policy makers shifted in 1998 from reducing budget deficits to meet the criteria for joining the single currency area to bringing interest rates to a common level. As aggregate demand was weakening, *inter alia*, owing to lost exports to Asia, interest rates of all countries were reduced to the level in the country with the lowest rates. The introduction of the Euro at the beginning of 1999 should boost economic growth both in Europe and in the world as a whole over the longer term. In 1998, output in the EU grew almost 3 per cent. It is forecast to slow in 1999, largely because of weak export markets, to approximately 2 per cent.

Output grew in a range of about 3-4 per cent in Australia, Canada and the United States in 1998, despite the international turbulence. Output growth in each country is expected to ease in 1999, but to remain above 2 per cent. In the United States,

1 Subsequent chapters elaborate on the material summarized here.

the major cause of deceleration is expected to be weaker domestic demand, while in the other economies the main factor is lower commodity exports as a result of falling global demand. Several of the economies in transition, most significantly, the Russian Federation, were hurt by the collapse in commodity prices. The Russian financial crisis, itself partially triggered by developments in the oil market, had negative spillover effects on countries. However, growth in many Central and Eastern European economies and the Baltic States held up well in 1998, although some countries were undergoing macroeconomic adjustment contractions. While reduced export demand—associated with the slow down in Western Europe and the Russian crisis—will soften overall economic conditions, these economies are expected to grow in 1999. However, output in four countries in the Commonwealth of Independent States—notably the Russian Federation—is forecast to contract (see table A.5).

The foregoing forecast of prospects in 1999—prepared with the assistance of Project LINK[2] and referred to as the "baseline" forecast—assumes that world financial markets will remain stable, with equity markets and exchange rates among major country currencies sustaining levels that prevailed at the end of 1998. It is also assumed that oil and other commodity prices maintain their mid-November levels (which were 1-4 per cent higher than their average for the first ten months of 1998). Monetary policy in the United States and Europe is assumed to stay neutral, with those interest rates that are determined by the central banks remaining at the levels prevailing at the end of November 1998. In the same spirit, the baseline forecast assumes no fiscal stimulus in the developed countries beyond what had already been announced by Japan as of end October.[3]

In addition, the forecasting exercise makes no provision for natural or man-made disasters such as those which had significant adverse economic effects in 1998. A hurricane caused severe damage to the peoples and economies of Central America. El Niño had—and may continue to have—major consequences for several countries, while other extreme climatic events have caused misery elsewhere. A number of countries had to cope with outright conflict and political unrest in 1998, which ineluctably disrupted economic performance.

Alternative scenario one: consequences of a global financial crash

International and some national financial markets remain fragile and vulnerable to panic, even though steps were taken at the end of 1998 to ease financial conditions and boost liquidity and confidence. New financial shocks are thus possible and their potential consequences worrisome. To investigate the consequences, an alternative scenario was run using the LINK system.

To trace the implications of a renewed bout of financial turbulence, certain assumptions and relationships were adjusted to allow for the effects of four inter-related financial setbacks, each of which could feed into the others. First, it was assumed that there is an increased aversion to risk and a renewed increase in liquidity preference on the part of the public and the banks, and that the shift to less risky assets produces a 40 per cent decline from the peaks of 1998 in stock market prices in the United States and Western Europe. Such a fall in share prices would be twice as large as that in mid-1998, but would bring the price-earnings ratio back to its historical average.

Secondly, it was assumed that there is an increase of a further two percentage points in the spreads between risk-free interest rates and borrowing rates for the business sector, prompted, for example, by the failure of another major financial institution or similar event. The assumed spreads would be roughly double those that prevailed in the crisis period of the autumn of 1998.[4]

The third assumption is that of a renewed "flight to quality" in international credit markets, such as occurred following the Russian crisis. The result would be a sharp decline in international capital flows to emerging market economies, particularly to Asia and Latin America.[5]

Finally, it was assumed that the Japanese rescue of its financial system is not successful and that the domestic credit crunch continues, with official institutions providing only lim-

2 LINK is an economic modeling network comprising over 70 national centres around the world, with shared headquarters at the University of Toronto and the United Nations Department of Economic and Social Affairs.

3 The forecasts also did not take account the European interest rate cuts in December. These developments, however, do not alter the baseline outlook, owing to other offsetting factors.

4 Following the Russian crisis, spreads rose by more than one percentage point.

5 For the purposes of the modeling exercise, this impact is represented as follows. Foreign investment in China is reduced by $30 billion (to around two thirds of the 1997 level). This represents a decline in total investment of about 9 per cent. This fall in capital inflows, along with the negative impact on Chinese exports of the decline in incomes in the rest of the world, is assumed to result in China's taking a decision to devalue the renminbi by 15 per cent. Brazil's current account deficit is reduced by $10 billion more than in the baseline, translating into a corresponding cut in imports, and the Brazilian real is assumed to be devalued by 20 per cent against the dollar.

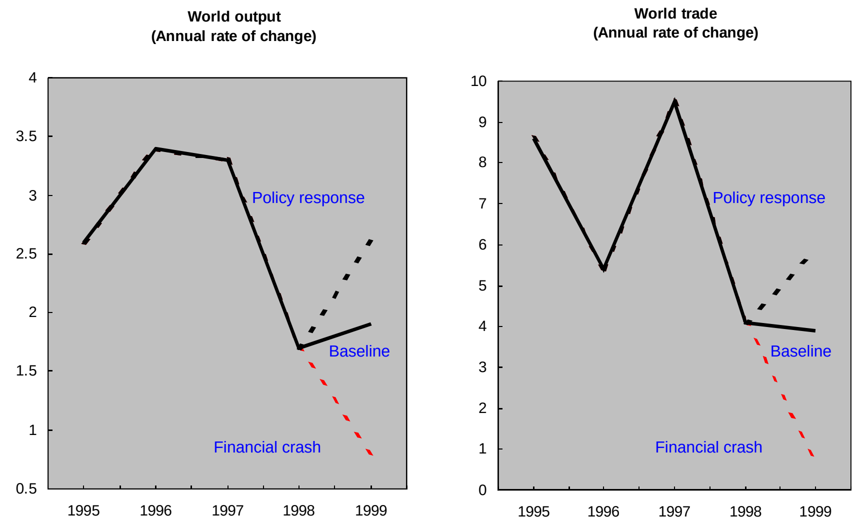
ited supplements to the credit available from banks.

In Western Europe and North America, no special changes in monetary policy as a result of the collapse in equity markets are assumed, although endogenous mechanisms in the models include responses by the monetary authorities that reduce rates between 50 and 100 basis points in reaction to the deteriorating economic circumstances.

The result of these financial shocks would be a significant loss in global output. Even with the endogenous relaxation of monetary policy, the rate of growth of world output would sink to less than one per cent in 1999 (see figure 1). The main shock to growth would be in 1999, but growth rates in 2000 and beyond would also be less than in the baseline, albeit by smaller amounts. Moreover, the output lost in 1999 would not be made up, and world output in 2000, for example, would be almost $500 billion less than in the baseline (see table 2).

Although the crisis in this scenario originates in the developed countries, the impact is relatively greater in the developing countries: their loss of output would be about $120 billion in 2000, equivalent to 2 per cent of baseline output, whereas the equivalent proportion for the developed countries would be some 1.5 per cent.[6] Unemployment in the developed countries as a whole would rise by half a percentage point in 1999 and by more than 1 percentage point in 2000. World trade would also suffer: the total value of merchandise trade in 2000 would be 5 per cent below the baseline—or a loss of over $300 billion.

Figure 1: Three scenarios for the world economy in 1999



Source: UN/DESA (1999 based on Project LINK).

Note: Underlying data are in 1993 prices and exchange rates.

Alternative scenario two: a coordinated policy stimulus

The baseline scenario assumed the continuation of existing policy stances in the major economies. These were somewhat easier positions than had been held 3 months before, but more aggressive steps to stimulate demand are also conceivable. A second scenario was thus constructed to examine the consequences of implementing a set of policy measures that would improve prospects by strengthening global demand and bolstering investor confidence. Policies to this end would be in the spirit of measures already taken in 1998 and, in the present environment of low inflation, would not compromise the objective of maintaining macroeconomic stability in the developed economies.

In order to examine the possible impact of a coordinated set of macroeconomic policy measures by the major economies, a second simulation was run with the LINK system. In this case, it was assumed, firstly, that there would be coordinated interest rate cuts of 1.5 percentage points in North America and one percentage point in Europe in early 1999 (but no further cut in Japan since its interest rates were already close to zero).

Japan would contribute to the policy package by undertaking a dual fiscal stimulus. First, a new package of

6 The impact of the scenario on transition economies is limited, in part because the Russian Federation was already cut off from foreign financing and in crisis in 1998.

fiscal measures was assumed to be implemented in early 1999.[7] In addition, in the spirit of the scheme of financial assistance proposed by Japan's Minister of Finance, Japan was assumed to provide a $17 billion net transfer of financial resources in 1999 to Indonesia, the Republic of Korea, Malaysia, the Philippines and Thailand, and a further $13 billion in 2000.[8] The assistance would be allocated among the countries in proportion to their estimated loss of GDP in 1998.

Table 2. Consequences of alternative scenarios on world output and trade, 1999 and 2000

	Financial crash		*Coordinated policies*	
	1999	*2000*	*1999*	*2000*
Change in output				
World				
Billions of 1993 dollars	-320	-470	190	220
Percentage of baseline	-1.1	-1.5	0.7	0.8
Developing countries				
Billions of 1993 dollars	-80	-120	40	55
Percentage of baseline	-1.4	-2.0	0.7	0.8
Change in world trade				
Billions of current dollars	-185	-310	104	150
Percentage of baseline	-3.2	-5.0	1.8	2.4

Source: UN/DESA, based on Project LINK.

Based on these assumptions, the simulation of the LINK system indicates that the gain in world output would be almost $200 billion (see table 2). Since the monetary easing is assumed to occur mainly in the developed economies, their growth of output would increase by 0.8 percentage points above the baseline and their unemployment rate would fall by half a percentage point. Inflation in Europe and North America would rise by no more than 0.2 percentage points. In Japan, the increase would be about 0.5 percentage points by 2000, but inflation would nevertheless remain less than 1.5 per cent.

The gain in GDP for the developing economies would be around 0.5 per cent, mainly from increased import demand in the developed economies and secondary feedback effects through trade (including among the developing countries themselves). However, for the aid-receiving countries, the additional financial transfers would combine with increased external demand to provide greater momentum to their recovery. Output in 1999 would be 4.6 per cent higher than the baseline in Indonesia, 3.1 per cent higher in the Republic of Korea, almost 2 per cent higher in the Philippines and over 1 per cent greater in Malaysia and Thailand. By 2000, the gains in these countries grow to 5.3 per cent above the baseline in Indonesia, 3.6 per cent in the Republic of Korea, 2 per cent in Philippines and almost 1.5 per cent in Malaysia and Thailand.[9]

The higher economic growth also leads to an increase in world trade of about $150 billion, or 2.4 per cent over the baseline, by 2000. Exports of South and East Asia (excluding China) rise by $28 billion in 1999 and $40 billion in 2000 relative to the baseline (3.4 and 4.5 per cent respectively).[10] These gains are large because the region's highly integrated trading relationships multiply the benefits of the components of the stimulus.

7 The package was assumed to involve additional public works spending of ¥8. 1 trillion in 1999 and ¥7. 5 trillion in 2000, along with a tax cut of ¥2 trillion in each of these two years and a "shopping voucher" of ¥0. 7 trillion. It was also assumed that monetary policy in Japan would accommodate this increase in fiscal expenditure (so that interest rates would remain at their current levels) and that the bank-rescue package would be successful in preventing further deterioration in the financial sector.

8 The package in the present scenario differs from the officially proposed package, which comprised $15 billion in trade credits, guarantees and co-financing of multilateral assistance and $15 billion in short-term swap arrangements with partner country central banks, to be available in case of need (see "Statement by The Hon. Kiichi Miyazawa" Joint Meeting of the Boards of Governors of IMF and the World Bank, 6-8 October 1998).

9 The distribution of gains reflects the assumed distribution of aid (which was based on the size of the shortfall in 1998 output) and the patterns of trade of the affected countries.

10 China's exports would rise 3.6 per cent above the baseline amount in 1999 and 5.0 per cent in 2000.

II. DEVELOPED ECONOMIES: A SLOWING ENGINE OF WORLD ECONOMIC GROWTH

Almost every developed economy is expecting slower economic expansion—and in Japan possibly continued contraction with increasing unemployment—in 1999 (see table A.1). This follows on the mixed results in 1998, in which the United States economy outperformed and the Japanese economy underperformed most forecasts. The net result was that the aggregate growth of the developed economies fell in 1998 compared to 1996 and 1997. Some of the high unemployment developed countries will be hard pressed to reduce domestic unemployment (see table A.4). Inflation continues to be very low (see table A.3). With presently predicted rates of growth for 1999—of over 2 per cent in North America and Europe—policy makers would not be expected to push for the immediate relaxation of monetary conditions in their countries, although as the scenario described above suggests, a relaxation of monetary policy in 1999 as part of a coordinated package could be advantageous.

The shrinking Japanese economy

In 1998, Japan had its first annual fall in output since the 1974 oil crisis. Moreover, a further fall is foreseen for 1999. This reflects the severe slump in private consumption and corporate investment, amid continued uncertainty about economic prospects, as well as weak exports owing mainly to the recession in key Asian markets. The unemployment rate is forecast to reach 4¾ per cent in 1999, which will mark another post-war high.

At the end of 1998, the Japanese Government was discussing its third stimulus package since April 1998. The earlier budget packages provided little stimulus to aggregate demand, as considerable funds were devoted to bolstering real estate prices and construction projects in remote areas. Meanwhile, the enlarged Government outlays have raised the level of public debt to over 100 per cent of GDP.

There is negligible room for further action in the area of monetary policy, the target overnight rate is now only 0.25 per cent. The yield on Government bonds became even briefly negative. Even so, investors have sought the safety of government securities, mirroring the public at large.

To a large extent, the Japanese economic woes can be attributed to the highly reduced ability of the banks to extend credit owing to deep liquidity problems due mainly to a huge amount of non-performing loans. The Government efforts to boost liquidity have had only limited effect. The Japanese economy is bank-centred, with relatively small equity markets and many banks have been in deep crisis for a long time.

Much of the liquidity problem of Japanese banks derives from a huge amount of non-performing loans as well as their holding equity shares in other Japanese companies, typically firms with which they have ongoing relations. A portion of the value of those shares is considered as part of the capital of the banks, making their capital highly dependent on the market value of those shares. With the stock market in 1998 down to pre-1985 levels, most Japanese banks had to curtail the expansion of loans—or even call in loans—in order to meet minimum capital-asset ratios.

A banking bill passed in early October 1998 is the latest in a series of attempts to solve the banking crisis. The bill increased the proposed injection of public funds for re-capitalizing banks to ¥25 trillion from ¥13 trillion in legislation passed earlier in the year. The new legislation also provided ¥17 trillion to protect depositors and another ¥18 trillion to deal with the liquidation of failed financial institutions.

Optimism that the bill would speed resolution of the banking crisis, however, was cut short. The nationalization under the new banking bill of Long-Term Credit Bank and, more recently, the Nippon Credit Bank suggested that many financial institutions that had appeared to be in a liquidity crisis might instead be insolvent. One way or another, however, the situation must be resolved and the credit crunch alleviated so that economic recovery may begin to take hold.

Suddenly, even the United States appeared vulnerable

The economy of the United States grew more strongly than expected in 1997 and it has done so again in 1998. Inflation has slipped below 2 per cent, the federal government budget has returned to a surplus for the first time since 1969 and unemployment has fallen to levels not seen since the 1960s.

Despite these universally sound fundamentals, the devaluation of the rouble in August 1998 triggered a broad-based aversion to risk within the financial sector and in September the spectre of a credit crunch was raised in the United States. To restore order to financial markets, the Federal Reserve System made three preemptive interest rate cuts (25 basis points each on 29 September, 15 October and 17 November) driven by concern about the impact on future growth of deteriorating conditions in financial markets.

By November, the panic had dissipated. Stock and bond prices recovered from the low levels reached in September and October and the exposure of the financial system as a whole to risk was deemed to have been reduced significantly, as complex financial positions began to be unwound.

The outlook is, nevertheless, for slowing growth of GDP in 1999. Intense competition, slumping demand abroad, a lack of pricing power and rising wage costs have resulted in a deteriorating outlook for profits since mid-1998. In addition, credit availability became constrained in the fall months. These factors point to a slowing of investment spending. Also, household saving dropped close to zero and consumer debt has risen to levels that may be unsustainable, especially if the value of household assets in real estate and equity shares seriously weakens. Consequently, new declines in the stock market or weakening job markets could force many households to cut back on consumption, further weakening aggregate expenditure.

All in all, the low unemployment rate, still rising wages and salaries, relatively high levels of consumer confidence and historically low levels of inflation and interest rates point to a modest slow-down in growth in the near term. But should the slow-down give evidence of being larger than anticipated, the Federal Reserve has significant room to respond with further interest rate cuts.

Slow-down in Canada, Australia and New Zealand

Canada, Australia and New Zealand share certain economic similarities, in particular being significantly dependent on large commodity export sectors. In all three countries, the exchange rate fell in 1998 on weak exports revenues and concern about associated contractionary factors feeding through the economy.

In the case of Canada, output is forecast to continue to decelerate and the jobless rate, which has been slowly falling from its 1992 peak of 11 per cent, is expected to stall at above 8 per cent in 1998 and 1999. To a large extent, the slow-down in growth is associated with curtailed output in several large resource-based sectors as a result of falling global demand. Canada raised short-term interest rates by almost 3 percentage points from May 1997 until August 1998 to defend the currency as the Canadian dollar plunged to record lows against the US dollar, and long-term rates rose as well. The situation began to ease in late August and the Bank of Canada was able to follow the reduction in interest rates in the United States. Nevertheless, high real interest rates will likely dampen consumer and business spending in 1999, while residential housing investment may weaken further. As in the United States, low inflation and a healthy fiscal situation give the monetary and fiscal authorities some room for manoeuvre.

In the case of Australia, the impact of the Asian crisis was immediately seen in its exports, 43 per cent of which have been sent to East Asia in recent years (20 per cent to Japan and 9.5 per cent to the Republic of Korea). The Australian dollar sank at one point to a record low against the US dollar and the economy weakened during the first half of 1998. However, redirection of Australian exports to European and United States markets brought about a rebound in the third quarter, limiting the impact of the Asian slow-down on Australian GDP. In New Zealand, the impact of the Asian crisis was more quickly felt, owing to trade effects.

The euro launched after monetary easing

Economic growth in Western Europe improved in 1998. Inflation remained under 2 per cent. Unemployment eased but was still over 10 per cent. Net exports fell significantly in most countries in 1998, but GDP growth was sustained by strong domestic demand, in part boosted by enthusiasm that EMU would come into effect on time and would include most member States of the European Union. But Europe was not immune to the financial crises in East Asia and Russia and their cumulative effect on net exports and domestic demand is expected to contribute to a slow-down in 1999 to a rate of slightly above 2 per cent.

Exports to some East Asian markets and other emerging countries were reduced during 1998, with the manufacturing sector suffering most. Moreover, European industry has had to face greater competition both at home and in third markets from countries that had devalued their currencies. In addition, the series of negative developments in emerging economies, in Japan, and in financial markets worsened business sentiment in Europe. This is likely to affect investment in the manufacturing sector in 1999. However, as in the United States, the manufacturing sector is now a relatively small and shrinking sector of most of these economies.

As consumer and business confidence appeared to falter in the course of 1998, European policy makers became increasingly concerned. Interest rates had to be harmonized by 1 January 1999 when monetary union began, and having interest rates converge to the lowest levels within EUR11—the rates of slightly less than 3½ per cent obtaining in France, Germany and some other smaller economies concerned—became a mechanism for easing overall monetary policy in the EUR11. The reduction in interest rates required for harmonization was especially helpful for Italy as its economic upswing faded sharply in 1998. Italy has had the lowest growth rate in the EU in 1998, reflecting not just the crisis-related damage to Italian foreign trade, but also the effects of a high tax burden, imposed in recent years to ensure Italy's qualification to join monetary union. In 1999, its economic growth is expected to accelerate modestly, owing to the lower interest rates and measures to increase labour market flexibility. On the other hand, 1998 was a less propitious time for such fast-growing countries as Portugal, Spain and especially Ireland to reduce interest rates. These countries would need to compensate the inflationary pressures from monetary easing mainly through fiscal tightening in 1999, which might not be easy politically.

In the United Kingdom, which is not a member of EUR11, monetary policy was also eased in the course of 1998 as growth slowed down. This fall in interest rates also allowed sterling to weaken. The degree of easing needed to achieve harmonization within EUR11 was, however, not deemed sufficient for the area as a whole and on 3 December, after a meeting of the ECB Governing Council, the EUR11 central banks reduced their key rates to 3.0 per cent, with the Italian rate cut to 3.5 per cent being the only exception (Italy reduced its rates to 3.0 per cent on 23 December). According to the European Central Bank, the move has to be seen as a *de facto* decision on the level of interest rates which are to apply "for the foreseeable future" after the start of monetary union. The launching of the euro will take place in reassuring circumstances of low interest rates, low inflation and restrained fiscal positions.

III. ECONOMIES IN TRANSITION: REVERBERATION OF THE RUSSIAN FINANCIAL SHOCK

On 17 August 1998, the Government of the Russian Federation, confronted by climbing borrowing costs, shrinking tax revenues, debt-servicing obligations that rose to almost 50 per cent of budget receipts, as well as by a large loss of foreign-exchange reserves incurred in defending the currency, announced it would restructure its rouble-denominated debt maturing before the end of 1999. It also imposed a unilateral 90-day moratorium on the repayment of external debt by Russian companies and allowed the rouble to depreciate. This was despite having received approval for a package assembled by the International Monetary Fund (IMF) of $22.6 billion in mid-July.

This Russian crisis, like the earlier Asian developments, was an exogenous shock to other transition economies. Other set-backs in the transition process and some prior financial crises, as in the Czech Republic in May 1997, could be traced primarily to domestic factors, but now there were various sharp changes in the external environment. The responses of the different countries reflect not only their different initial starting positions, but also the advances they have made since the transition began.

Russian Federation: aftermath of the Asian crisis tips it over the edge

Russia's macroeconomic situation began to deteriorate seriously in the second quarter of 1998, when output was almost 1 per cent lower than the same period of 1997. Interest rates were sharply raised to defend against a loss of confidence in the rouble. Coupled with the effect of low international prices for key export commodities and a continuing fall in investment, Russia's short-lived economic stabilization was nipped in the bud.

This was the culmination of seven years and multiple programmes intended to transform the collapsed centrally planned economy into a functioning market economy. These reform plans were not always consistent or fully implemented and did not establish the viable and accountable corporate, government and financial institutions that are essential to the effective functioning of a market economy. Thus, in August 1998, the Russian economy was still an inefficient, vulnerable and largely demonetized economy that mainly operated by barter and by switching non-payment from one group—whether it be pensioners, workers, enterprises or the Government—to another.

The immediate result of Russia's financial crisis will be a decline in GDP, from the second half of 1998 through at least 1999. The sharp devaluation of the rouble is eroding real incomes and consumer purchasing power and consumer spending is expected to fall. Meanwhile, a collapse in the banking sector, high interest rates, low sales prospects, the loss of capital by those enterprises which had held treasury bills and escalating losses at most enterprises will force further declines in investment. Moreover, no significant relief is expected on the side of export earnings in the face of continuing weakness in international prices of oil and other commodities in 1999. Unemployment may rise to close to 15 per cent, accompanied by an acceleration in inflation to above 50 per cent, depending on policy developments.

The August 1998 crisis may have marked a turning point in economic policy making, as well as economic performance. The financial turmoil highlighted the weaknesses of policies that were narrowly aimed at combatting inflation. Extremely high interest rates and tight money supply succeeded in bringing inflation to relatively low levels (see table A.6), but at the cost of suppressing economic activity, undermining industrial restructuring, tearing the social safety net and demonetizing the real economy. Since the crisis, policy priorities shifted towards greater state intervention to revive Russia's stalled industries. Also, given the continued lack of competitive market structures, strengthening and broadening the regulatory functions performed by the Government is seen as critically important.

At least in the short run, Russia will likely have to rely almost entirely on domestic financial resources. As of late 1998, further disbursements from the July 1998 IMF package were in doubt, as the Government's anti-crisis plan was quite unconventional. It includes price controls on certain essential goods, tighter state regulation of key industries, currency controls (including an obligation on exporters to convert 75 per cent, instead of 50 per cent, of their hard-currency earnings into roubles), and indexing of wages for inflation. Furthermore, given the unilateral decision on domestic Government debt, as well as a need to reschedule the country's foreign debt, there are only very slight prospects that the Government or commercial companies would be able to raise new foreign capital. Under these circumstances, the Government has turned to the central bank for partial funding of budget expenditures, restoring a practice which had been abolished in 1995.

Other member countries of the Commonwealth of Independent States

Russia's devaluation of the rouble and deepening economic recession has had a negative effect on economic growth in other CIS member countries (see table A.5), with those with stronger Russian trade links, relatively weak economic fundamentals and heavy reliance on commodity exports suffering the most. In addition to declining exports owing to falling demand in Russia and plummeting world commodity prices, those economies are being adversely affected by higher borrowing costs and diminished investors' confidence in emerging markets.

In the aftermath of the Russian crisis, the economic prospects of Moldova and Ukraine deteriorated significantly. In 1998, after seven years of recession, Ukraine is estimated to have registered another decline in GDP. An incipient recovery in industrial production and services did not offset the effects of a bad harvest and initial fallout of the Russian crisis. Moldova had begun to recover in 1997. However, GDP appears to have fallen in 1998. In 1999 the economies of both states may further slip into recession, as higher inflation following depreciation of their currencies will erode real incomes and cause consumer demand to contract. Heavy trade exposure to Russia will cause exports to shrink, further constraining economic growth.

Belarus' policy of making relatively few changes to its centrally planned economy and not developing extensive financial and trading links with the international economy, appeared to protect it during the crisis. However, the future is not so assured. Given falling demand in the Russian market, the destination for more than 70 per cent of Belarusian exports, there could be a significant slow-down in subsequent years. Moreover, the over-stimulative policy has produced visible inflation of around 70 per cent because tight price controls have led to shortages of goods and growing black-market prices.

The Russian financial crisis has added to the unfavourable external factors facing the economies of Central Asia, namely a slump in prices of their key export commodities—oil, gas, metals, cotton and gold. Economic growth in the region is expected to decelerate or turn into contraction, as lower exports feed through into lower production and investment. Besides, declining revenues from commodity exports and privatization are likely to exacerbate the imbalances in the fiscal and current accounts. Plummeting commodity prices have also led to a slow-down in foreign direct investment, which had been an important growth factor in several countries, especially in Kazakhstan and Kyrgyzstan.

In Azerbaijan, the Government's strategy has been to allow a further build-up of the huge current account deficit that resulted from massive oil-equipment purchases financed by foreign direct investment in anticipation of the future increase in oil revenues. Both falling oil prices and the Russian economic meltdown make the time-frame less certain in which the current account position can be corrected. Nevertheless, despite some slow-down, growth will likely continue, fuelled, as before, mainly by oil-sector investment. The financial crisis in Russia has had little immediate impact on the economies of Armenia and Georgia. However, a long-term downturn in Russian demand may exacerbate their widening trade and current account deficits, as Russia accounts for about 20-25 per cent of the trade of each of the Transcaucasian states.

The Baltic States: the Russian crisis helps slow down over-heating economies

The growth of the economies of the Baltic states is set to moderate from a rate of 6-11 per cent, driven by a strong recovery in manufacturing as well as a retail boom, to 3-4 per cent (see table A.5). This is a result not just of the Russian crisis, but also of policy tightening aimed at cooling down these economies. This notwithstanding, as Russia slid back into recession, the Baltic region saw one of its major export markets collapse. Food-processing, chemicals, machine-building and consumer goods industries, as well as services related to transit trade, were hit the hardest. In light of the Russian downturn, there could also be some decline in foreign direct investment, as a significant part of it had been attracted to the region because of its perceived role as a transport hub in East-West trade and a gateway to the larger markets to the East.

Central and Eastern Europe: limited effects of the Russian crisis

Favourable demand trends in the European Union have so far outweighed the adverse impact of the Asian and Russian crises. For the CEETEs, sales to the East now account for a relatively small share of exports as a result of which the damage from the Russian currency has been largely confined to some worsening of borrowing conditions on international financial markets and a less sanguine climate for privatization.

The Russian crisis came at a time when these economies had made considerable progress with their transitions, including the creation of more robust financial systems. Several of them, however, were in danger of over-heating. Thus, primarily domestic factors—the need in many cases to make further progress in reducing inflation—will determine the pace of economic output in the medium term.

The four CEETE countries—Poland, Hungary, the Czech Republic and Slovenia—that, together with Estonia and Cyprus, began negotiations for entry into the European Union in November 1998, expect a moderate slow-down in growth in 1999 or, in the case of the Czech Republic, a recovery from the 1998 recession. The crisis, in sum, did not blow them off course.

Bulgaria and Romania belatedly paid a heavy price for earlier delays in enacting crucial reforms and recovery is taking time. However, the currency board arrangement in Bulgaria has helped strengthen confidence, sharply reduce inflation and restore public finances. Investment has been the driving force in the early stages of recovery. The momentum of growth is likely to pick-up, underpinned by macroeconomic stability, economic restructuring and rapid privatization, as well as growing foreign investment inflows. In Romania, sharp subsidy cuts, price liberalization, the downsizing of the State sector and a significant devaluation of the national currency contracted domestic demand. Monetary and fiscal policies are likely to continue to be austere in order to combat inflation and so economic recovery is expected to be slow.

In the Slovak Republic, strong growth of domestic demand over the past several years has been accompanied by a large current account deficit that became unsustainable. The resulting currency slide, which began in September 1998, will push up foreign debt servicing costs as well as inflation. This, together with very tight monetary policy and limited ability to borrow abroad, is forecast to significantly slow down growth.

Except for Slovenia, and, to a lesser extent, Croatia, economic transition in most former Yugoslav states, as well as in Albania, has been lagging behind other countries in Central and Eastern Europe. Persistent security problems, in particular, have been hindering trade and investment. Given the large measure of instability, relatively low investment levels are likely to persist and official flows will remain by far the major source of capital inflow for quite some time.

IV. DEVELOPING ECONOMIES: FINANCIAL CRISES AND ECONOMIC CONTAGION

The shock of the "Asian crisis" on the developing countries became manifest in 1998. Output of the developing countries as a whole grew by the smallest amount since 1983, following six successive years of robust expansion (see table A.7). The improvement forecast for 1999 is more a statistical artifact than a resumption of dynamic growth, as it mainly reflects the end of the sharp contraction in several East Asian economies.

The level of output fell in 1998 in 15 countries out of the 95 developing countries monitored by DESA, compared to only five countries in 1997. Of the 15, two were least developed countries—the Democratic Republic of Congo and Zambia. Most of the remaining countries were in East Asia and Western Asia, where the impact of financial crisis and the plunge in the price of oil were most directly felt.

Gross domestic product (GDP) per capita declined in 35 developing countries in 1998, compared to 15 in 1997, encompassing about a quarter of the total population of developing countries monitored. Even more striking was the drop by half in 1998 in the number of countries (17) that achieved the informal benchmark rate of growth of per capita GDP of 3 per cent or higher (see table 3). Given the size of China, this left 58 per cent of the population of the developing world in countries with substantial growth; a somewhat smaller share is forecast for 1999. From 1994 to 1997 in contrast, the proportion averaged over 70 per cent or more. Moreover, only three least developed countries achieved the benchmark growth rate in 1998, accounting for just 5 per cent of the population in the 40 least developed countries. This is a particularly disappointing result for this group of countries, as the corresponding numbers were 11 and 50 per cent in 1997.

In 1999, substantial rates of GDP growth will remain limited to a small number of countries (see table 3). In addition, there is a high degree of uncertainty in this outlook, as the current situation is outside recent experience. While considerable policy easing has relaxed the liquidity squeeze to some extent in East Asia, serious financial and corporate weaknesses keep the region vulnerable to negative shocks.

Africa: The growth impulse is not sustained

As in 1997, growth in Africa in 1998, at 2.6 per cent, was barely sufficient to prevent a deterioration in output per person. Growth slowed in the majority of African countries. Only seven countries recorded growth rates of 3 per cent or higher in per capita GDP in 1998, down from 12 in 1997 (see table 3). Although 1998 was the fourth consecutive year that GDP per capita did not fall, an event that has not occurred since the late 1970s, the modest growth of GDP per capita is far too slow to reduce poverty in the region. Presently, it does not even appear that the recent peak growth rate of 4.5 per cent attained in 1996 will be achieved again soon.

The slowdown in output growth in 1998 was primarily a result of external factors: slow growth in the world economy, declining commodity prices, particularly of oil, and to a lesser extent, financial contagion. Moreover, adverse weather, civil strife and political turmoil disrupted economic activity in a number of countries. At the same time, most countries maintained prudent monetary and fiscal policies and deepened structural reforms. Inflation in Africa reached its lowest average rate since 1973, mainly as a result of generally good food harvests and lower import prices for food, fuel and manufactured goods.

GDP growth is expected to strengthen to about 3½ per cent in 1999, with improved oil prices, stable non-oil commodity prices and some recovery of demand for exports. Less unfavourable weather conditions and improved political conditions would provide a further boost. A slow recovery of growth in South Africa is anticipated for 1999, reflecting higher production of tradables, due to the lower exchange rate, and some reduction in interest rates in late 1998. Growth in Nigeria is also forecast to strengthen on stable oil prices and an improved political environment.

External shocks and economic growth

As Africa is the region with the smallest access to international financial markets, it was least affected by the international financial crisis. Nonetheless, African economies have felt the impact of the crisis: total export revenues of Africa declined by about $14 billion (11 per cent) in 1998, mainly as a result of price declines.

The largest impact was on the oil-producing countries, where trade deficits and budget deficits increased (or surpluses declined) as a result of the lower revenues from fuel exports. GDP in most fuel-exporting countries grew more slowly in 1998 than in 1997 as the effect of lower oil prices filtered through the economy.

Table 3. Number of developing countries[a] with GDP per capita growth of 3 per cent or more, 1992-1999

	Number of countries monitored	1992		1993		1994		1995		1996		1997		1998[a]		1999[b]	
		N	P	N	P	N	P	N	P	N	P	N	P	N	P	N	P
Developing countries	95	33	45	28	48	34	72	32	69	37	73	35	72	17	58	16	54
of which																	
Latin America	24	9	20	9	27	9	56	5	17	7	33	8	37	4	12	3	4
Africa	38	8	12	4	12	8	12	8	11	14	28	12	29	7	11	7	17
Eastern and Southern Asia (incl. China)	18	12	58	13	61	14	93	14	93	13	94	12	90	4	75	5	75
East Asia (excl. China)	12	10	88	10	88	7	87	9	87	10	99	8	76	2	18	3	18
Western Asia	15	4	32	2	29	3	3	5	33	3	35	3	37	2	37	1	9
Memo items:																	
Least developed countries	40	9	23	8	46	11	42	12	46	12	53	11	50	3	5	4	8
Sub-Saharan Africa	31	7	18	4	21	7	14	8	18	12	38	10	32	5	10	6	15

Source: UN/DESA.

Note: N: Number of countries that achieved 3 per cent per capita growth; P: Percentage of total population of monitored countries in a given group accounted for by countries in this group that achieved 3 per cent per capita growth.

a Comprise 95 countries that are regularly monitored.
b Forecast, based in part on Project LINK.

Declining prices for non-fuel primary commodities also had a depressing effect on export revenues, despite higher volumes in certain cases. In other cases, mining output declined as a result of previously inadequate investment and insecurity, while agricultural output was negatively affected by adverse weather in some countries.

African countries, Kenya, Mauritius and Zimbabwe in particular, have also faced increased competition from Asian manufactured exports because of the steep devaluations in Asia and excess supplies in global markets stemming from the reduction in demand and increased supply.

The direct financial contagion of the Asian crisis has mostly been felt by South Africa. Between May and August 1998, the exchange rate came under speculative attacks. Despite generally good macroeconomic fundamentals and a sound banking system, South Africa was vulnerable, because its small current account deficit was mostly financed by portfolio investment and reserve levels were low. Authorities raised interest rates significantly, despite slow GDP growth and high unemployment. GDP growth is expected to be barely positive in 1998. The slow growth and fall of the exchange rate in South Africa also triggered exchange rate devaluations, higher inflation, increased competition and slower output growth in neighbouring countries.

Impact of uneven weather patterns

Stronger growth in northern and western Africa was fuelled by agricultural output that benefited from favourable weather conditions. Agricultural production in Algeria and Morocco returned to normal levels from the drought-affected harvests of 1997, and agricultural growth was similarly strong in Madagascar, Malawi, Mauritius and several other countries.

However, agricultural output was lower than normal in several countries in eastern and southern Africa because of adverse weather. This reduced output in related manufacturing sectors, raised inflation and increased imports of food.

Adverse weather also had consequences for non-agricultural sectors in some countries. Low rainfall in Ghana in late 1997 and early 1998 lowered the production of hydroelectricity, which hampered economic activities not only in Ghana, but also in Benin and Togo, to which Ghana exports power.

Political instability and civil strife

Political turmoil, civil strife and border conflicts are again having significant economic consequences in several countries in central, eastern and western Africa. These conflicts remain direct critical obstacles to economic and social development and divert scarce resources from development-oriented expenditures to the military.[1]

The eruption of civil war in the Democratic Republic of the Congo in August 1998 has severely disrupted economic activity, rehabilitation and prospects for economic reform in that country. At least eight countries were drawn into the conflict.

The impact of such conflicts is only partly captured by economic indicators. GDP in Angola, for example, has continued to grow during the country's civil disturbance because the oil sector is relatively isolated. Other indicators present a more comprehensive picture of the situation. For example, there are about 1.3 million internally displaced persons in Angola and the mortality rate of children under five years of age is about 30 per cent. In Sudan, the long-running civil war, combined with inadequate rainfall, led to widespread hunger and starvation in 1998, necessitating substantial emergency food assistance.

In contrast, in Burundi, the Congo, Mozambique, and Rwanda, GDP growth was fuelled partly by a revival of economic activities after civil strife. Mozambique and Rwanda achieved growth rates of 10 per cent in 1998. Mozambique's performance also reflects substantial inflows of foreign direct investment for large-scale projects in infrastructure, construction and industry, following decades of civil war that ended in 1994.

Political uncertainty and civil unrest, on top of low oil prices and energy shortages, were among the factors that affected oil exports and economic activity in Nigeria in 1998. However, the new President's revitalization of economic and political reforms could lead to renewed assistance from the international community, debt relief and a lifting of sanctions.

East Asia: economic fallout from a financial crisis

In East Asia, the financial crisis shaped economic developments. Indonesia, the Republic of Korea, Malaysia and Thailand were hit by financial panic, exchange-rate collapse and

1 See Report of the Secretary-General on the causes of conflict and the promotion of durable peace and sustainable development in Africa (S/1998/318), 13 April 1998.

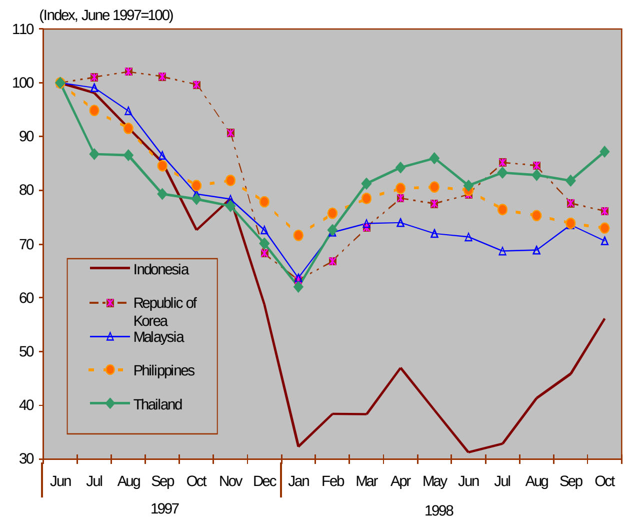
credit crunch, while the contraction in Hong Kong (China) was primarily due to sharply higher interest rates necessary to maintain its currency peg to the dollar. The Philippines managed barely positive growth on the surprising strength of exports (mostly to the United States and Europe), in spite of a drought-induced decline in agricultural production. The Singapore economy started to decline in the second half of 1998, as measures to strengthen domestic demand were unable to offset the impact of collapsed intraregional trade and investment flows and its deteriorating price competitiveness. Taiwan Province of China was the only major economy in the subregion to withstand the spillover effects, largely by devaluing early.

In most of the afflicted economies, the downward spiral of production began in late 1997 or early 1998. The situation was aggravated by the rapid deterioration of already precarious financial positions of the heavily indebted corporate and financial sectors owing to the plunge in exchange rates and the strategy of raising interest rates in order to rebuild confidence, and financial inflows. However, asset prices plunged as a result of high domestic interest rates, and the very large post-devaluation foreign debt servicing obligations caused a large number of corporate and banking failures. Not only did fixed investment plummet in this situation but consumption also contracted markedly, as incomes shrank with soaring unemployment and declining real wages, along with substantial loss in private wealth resulting from the collapse of asset prices. Even in Hong Kong (China), the Philippines and Singapore, where the banking systems are more robust and corporate debt manageable, domestic demand was severely depressed by high interest rates, declining incomes and loss of private wealth.

The take-off in export growth that was expected as a result of the currency devaluations in the region (see figure 2) did not occur because intraregional trade collapsed and the credit crunch denied access to working capital and trade financing. However, interest rates were brought down during the year and there were some signs of strengthening export volume by late 1998 in Indonesia, the Republic of Korea and Thailand.

The current account positions of Indonesia, Malaysia, the Republic of Korea and Thailand have turned around dramatically in adjustment to the reversal of capital flows, mainly as a result of substantial import compression (see table 4).[2] Indeed, export earnings in dollar terms generally stagnated or declined

Figure 2: Real effective exchange rates of selected Asian countries, June 1997 to October 1998



Source: Morgan Guaranty Trust Company, *World Financial Markets.*

because of the fall in the dollar prices of some of major exports, such as electronics, electrical equipment and commodities.

Inflation rose in most of the economies in the region in 1998 owing to the impact on domestic prices of the large devaluations, but in most cases remained below 10 per cent. Price increases were mitigated by tight monetary policy early in the year and weak demand. The exception was Indonesia, where food prices in particular rose exorbitantly, owing to a drought and a breakdown of the food distribution system, as well as the drastic depreciation of the currency and a large money supply increase early in the year.

Prospects for 1999

By the end of 1998, it appeared that the period of economic contraction was ending and that a resumption of growth might begin in the latter part of 1999 in a number of countries.[3] Employment and wages in the region will lag the return of economic growth, leaving little change or even a slight increase in unemployment in 1999. Inflation in the region is expected to moderate in 1999, as the favourable conditions in late 1998 are maintained. The return of agricultural production in drought-affected countries to normal levels will further reinforce the trend.

2 In the Philippines, however, import growth remained robust for most of the year.

3 This outlook is subject to particular uncertainty as the economies in question are not operating in a familiar manner. For example, the banking systems in the region remain a particular vulnerability.

Table 4. Selected macroeconomic indicators for Indonesia, the Republic of Korea, Malaysia, the Philippines and Thailand, 1996-1999

	GDP growth rate (percentage)				*Current account balance (percentage of GDP)*				*Inflation (percentage)*				*Unemployment (percentage)*				*Fiscal balance (percentage of GDP)*			
	1996	*1997*	*1998* [a]	*1999* [b]	*1996*	*1997*	*1998* [a]	*1999* [b]	*1996*	*1997*	*1998* [a]	*1999* [b]	*1996*	*1997*	*1998* [a]	*1999* [b]	*1996*	*1997*	*1998* [a]	*1999* [b]
Indonesia	8.0	4.6	-15.0	-2	-3.5	-2.3	2	2	8.0	6.6	80	30	4.5	5.0	15	18	0.8	0.0	-9.0	-10
Republic of Korea	7.1	5.5	-6.2	1½	-4.9	-1.9	9.0	4½	4.9	4.5	7.5	5	2.0	2.6	7.1	7½	0.0	0.0	-4.0	-5
Malaysia	8.2	7.8	-6.0	1	-5.0	-5.1	3.0	1½	3.5	2.7	6.0	7	2.6	2.7	7	7	0.7	1.6	-4.0	-4
Philippines	5.5	5.1	1.0	2½	-4.7	-4.3	-2.6	-1¾	8.4	5.5	9.7	8	7.5	8.7	9.5	10½	0.3	0.1	-2.2	-1¾
Thailand	6.7	-0.4	-7.0	-½	-7.9	-1.9	7.0	5	5.9	5.6	10.0	8	2.6	4.5	10.0	12	2.2	-0.9	-3.5	-4

Source: UN/DESA.

a Estimate.

b Forecast, based in part on Project LINK.

The major factors behind the expected improvement in economic growth are the end of financial panic, continued relaxation of the credit crunch owing to easing monetary policy and some initial results of financial restructuring and recapitalization measures. Export earnings growth is expected to strengthen somewhat with the stabilization of international prices of commodities and manufactures. There would be some revival of intraregional trade, including with Japan, but this will be partly offset by dampened export growth to other developed countries as economic growth there slows significantly.

Easing of macroeconomic policy stance

Behind the recovery outlook is a shift to a more stimulative macroeconomic policy stance in the second half of 1998 in most economies in the region, facilitated by the stabilization of exchange rates and lower than anticipated inflation. The reductions in international interest rates late in the year provided further leeway for monetary easing. In Malaysia, priority was placed on reflating the economy and capital controls were put in place in September 1998 to enable interest rates to be cut without engendering massive capital outflows.

Fiscal policy became more expansionary in Hong Kong (China), the Republic of Korea, Malaysia, Singapore and Thailand in mid-1998. Further increases in budgeted expenditures, particularly on infrastructure investment, and some tax cuts were subsequently enacted in some countries. In a number of countries, such as Indonesia, the Republic of Korea, the Philippines and Thailand, additional public resources have been allocated to social services to help buffer the impact of the economic recession. In Indonesia, the Republic of Korea, Thailand and Malaysia, large amounts of public resources are also needed for the restructuring of the seriously undercapitalized financial sectors. In recognition of these factors, the fiscal deficit targets previously agreed with IMF were eased for the three countries with IMF agreements.

Financial and corporate restructuring

Given the role of financial sector weakness in the crisis,[4] Indonesia, the Republic of Korea, Malaysia and Thailand have been implementing measures to restructure and reform these sectors. The recapitalization of the banking sector is difficult in the face of acute shortage of financial resources and collapsed asset prices. Attempts to reduce corporate debt have also yielded limited results so far, partly owing to concern over aggravating already high unemployment and the lack of an effective bankruptcy mechanism.

Human impact of the crisis

In a region that had grown accustomed to rising income and declining poverty, open unemployment has doubled or even tripled in several countries (see table 4). Displaced workers and new job seekers have had to seek employment in the informal sector, while many unemployed urban workers returned to rural areas, putting pressure on the rural economy as well.

The drastic rise in unemployment, decline in wages and higher inflation have led to substantial real income declines, with the poor and near-poor being the hardest hit. The extent of social distress is reflected in the higher incidence of suicides, illicit activities and domestic violence in the region.[5] Furthermore, if the crisis conditions are not soon reversed, the progress East Asia had made in human resource development could be eroded by the declines in health conditions and enrollment rates at all levels of education.

The deterioration has been particularly wrenching in Indonesia, where the purchasing power of the lower income strata has collapsed because of soaring prices of staples, particularly rice. The economic shock is estimated to have raised the number of people in poverty to 100 million, or 48 per cent of the population, compared to 11 per cent in 1996. A further rise in the poverty rate in 1999 to 66 per cent of the population is anticipated if there is no improvement in nominal income and inflation.[6]

South Asia

One of the more encouraging developments in the recent period is that the Asian sub-continent has maintained a certain momentum of economic growth, particularly in India, Bangladesh and Sri Lanka. The region has had to cope with both conventional and unusual constraints on growth, including

4 See *World Economic and Social Survey 1998* (United Nations publication, Sales No. E.98.II.C.1), pp. 40-46.

5 See World Bank, *East Asia: Road to Recovery*, Washington, D.C., 1998, pp. 80-85.

6 The definition of poverty is based on the official poverty line of $0.55 and $0.40 daily real income for urban and rural areas, respectively, in 1996, and adjusted for inflation and exchange rate changes in 1998 and 1999. (See ILO, Employment Challenges of the Indonesian Economic Crisis, Jakarta, June 1998, pp. 44-49.)

in 1998, sanctions on India and Pakistan following their nuclear tests.

In 1999, as some of the sanctions imposed on both countries have been lifted, some relief for the Indian and especially the Pakistan economy is expected. In addition, the recent aid package from the International Monetary Fund should help Pakistan avoid defaulting on its large external debt, as falling foreign investment and official flows after the imposition of sanctions, together with a sharp fall in the prices of its exports and lower workers' remittances, had caused unusual debt servicing difficulties.

In India, foreign institutional investors moved funds out of the country in the wake of the nuclear tests, which placed downward pressure on the Indian rupee and forced the authorities to raise interest rates in August 1998. This affected business confidence and investment. Moreover, as in Pakistan, India's export earnings in dollar terms have been hit by the recession in East Asia and the competitive gains from a 17 per cent depreciation of the Indian rupee have been limited by the large declines in the exchange rates of India's competitors in the region. These factors are likely to keep Indian industrial growth sluggish.

The Pakistani economy, in particular, is passing through a difficult period. At the heart of the country's problems lies a fiscal deficit of about 6 per cent of GDP, partly related to the large external debt burden. A tighter fiscal stance can be expected during 1999, which is likely to further slow economic activity. Other countries in the region are under comparable fiscal pressures.

Monetary policy is also constrained in the region. In India, for example, the authorities have limited scope for cutting interest rates because of inflationary pressures. Inflation rose late in 1998 owing to a new import surcharge, the large depreciation of the rupee and weather-related shortages in certain food commodities. In addition, the continued downward pressures on the currency will also make the authorities hesitant to lower interest rates.

Besides monetary and fiscal constraints, in Bangladesh economic activity slowed during the second half of 1998, as floods severely damaged agricultural production and affected industrial output. Economic activity will slow down further in 1999 as rising inflation, caused by a shortfall in food supplies owing to the floods, will force the authorities to maintain higher interest rates. Nevertheless, as the effects of the floods wear off and as foreign direct investment into the energy sector increases, industrial growth is likely to recover during the second half of 1999.

China: Sustaining fast growth

Growth in China weakened early in 1998 but strengthened in the second half, boosted by a succession of stimulative monetary and fiscal measures that began in late 1997. Moreover, after devastating summer floods, which limited agricultural production, reconstruction boosted spending. Fixed investment, which had slowed early in 1998, rebounded by the third quarter. Similarly, consumer demand had been depressed in the first half owing to slow income growth and increasing urban unemployment resulting from state-owned enterprise (SOE) restructuring; however, it also strengthened in the second half.

The weakness of domestic demand was reinforced by tepid export growth as intraregional trade collapsed. Export growth slowed to less than 2 per cent, from about 20 per cent in 1997. However, as import growth also stagnated during the period of slow growth of domestic demand, the trade balance recorded a substantial surplus.

One concern of international financial markets and neighbouring countries during 1998 was whether China would devalue its currency. However, with more than $140 billion of foreign exchange reserves and the tightening of foreign exchange controls in August to prevent capital flight, the Government was able to reduce interest rates and withstand devaluation pressure. In late 1998, the depreciation of the dollar (which the Chinese currency closely tracks) alleviated devaluation pressure for the time being.

Continuing the momentum of the second half of 1998, economic growth is expected to strengthen slightly in 1999, as the Government maintains its stimulative monetary and fiscal policy stance, increasing public investment in infrastructure particularly. However, unemployment will remain high, as enterprise retrenchment continues. The rate of inflation is expected to be contained below 4 per cent, owing to excess capacity, stable food prices and restrained import prices.

There is another dimension to the Chinese outlook that warrants comment. Deeply rooted weaknesses of the financial sector and financial problems in the enterprise sector, aggravated by economic slowing, have now begun to be addressed. Coupled with the slower growth of the economy and the spillover from the regional economic crisis, policy makers have, however, become cautious in implementing reform, so as to avoid sharp increases in unemployment and declines in income. Any significant financial fallout from the systemic weaknesses can result in caution on the part of foreign investors and, thus, smaller financial inflows, limiting financing for public as well as private investment.

Western Asia: Plunge in price of oil disrupts growth

Economic growth in Western Asia fell sharply in 1998 reflecting the central role of oil in the regional economy. Oil export earnings fell by over one-fourth from the 1997 level, or about $30 billion, the largest annual fall in revenues since the price collapse of 1986. GDP contracted in many of the region's oil exporters and budget forecasts were disrupted by revenue shortfalls, leading to lower government expenditures and the cancellation or postponement of a large number of construction and development projects.

As oil prices are expected to increase only marginally in 1999, barring major supply disruptions, the outlook is for continued low growth on average. Fiscal consolidation remains high on the agenda, with expenditure cuts and measures aimed at diversifying government revenues expected to intensify. There is more acceptance of the need to streamline large and costly welfare systems in most countries of the region, but the abolition of subsidies or the introduction of new taxes remain politically difficult. Accelerated privatization and increased borrowing will help cushion but not offset the impact of lower oil tax revenues, most notably in Saudi Arabia, but the fiscal and external deficits of all oil exporters are expected to remain large.

The fall in oil prices led to some terms-of-trade gains in the oil-importing countries of Western Asia. On the other hand, the downturn in the oil-exporting countries has negatively impacted workers' remittances, trade and foreign investment in the other countries. In addition, the continuing sanctions on Iraq and uncertainties over the Middle East peace process continued to limit trade and investment.

Slow growth in Israel was also the result of a discouraging environment for foreign investors and retrenchment, tight macroeconomic policies and restructuring in response to international competition. The West Bank and Gaza continued to suffer from very high unemployment. Prospects for the economy are highly dependent on success in the peace process, financial assistance from abroad, and remittances of Palestinians working in Israel.

The second wave of international financial turmoil in August 1998 triggered large capital outflows from Turkey. Interest rates were raised sharply to stem the outflow and stabilize the exchange rate, further dampening private investment and consumption which had begun to weaken early in 1998. In addition, previously strong export growth has been tempered by increasing price competition from East Asian exporters. Thus, GDP growth in 1998 slowed significantly, while the inflation rate was about 85 per cent. GDP growth is forecast to slow further in 1999, as monetary and fiscal policies will remain tight to discourage capital outflows and reduce inflation.

Latin America and the Caribbean: spillover from international financial crises

After a relatively strong performance in 1997, economic conditions in Latin America and the Caribbean worsened markedly in 1998, as a result of spillover effects from the financial crises and damage from severe weather.

The deceleration was especially evident in the largest economies—Argentina, Brazil, Mexico, Peru and Venezuela (see table A.7). Domestic demand was depressed by macroeconomic tightening to counter the loss of confidence from financial contagion and by declines in exports.[7] The political uncertainty associated with impending elections in several countries also slowed private spending and contributed to the slow-down. A few economies in Central America and the Caribbean, however, were less affected by the international financial turmoil and benefited from the drop in oil prices.

Destructive weather phenomena spared neither Central nor South America. El Niño, which lasted from April 1997 to June 1998, was one of the most severe episodes ever and took a toll of over 1,000 lives and caused more than $15 billion in damage. It ravaged infrastructure and led to output losses, especially in the agricultural and fishing sectors, particularly in Ecuador and Peru, but also in Chile, Colombia, Guyana and Brazil. In October 1998, in one of the worst natural disasters ever to hit Central America, heavy tropical storms severely hit Honduras, Nicaragua, El Salvador and Guatemala, causing floods that left some 11,000 people dead and hundreds of thousands homeless. It also heavily damaged agricultural production and infrastructure.

After a moderate reduction in unemployment in 1997 and the first months of 1998, unemployment began to rise in the second half of 1998, especially in Brazil and Colombia, while weaker labour demand also negatively affected the growth of real wages. Inflation interrupted its decline and has been creeping back up in Ecuador, Nicaragua, Paraguay and a few other countries hit by devaluations, by food price increases caused by natural disasters, or by rate increases for

7 See ECLAC, "Economic Survey of Latin America and the Caribbean, 1997-1998", (LC/G.2036-P), September 1998.

public utilities. In addition, the region's current account deficit widened further, reaching over $80 billion for 1998, or about 4 per cent of GDP (compared to 3.2 per cent in 1997). Current account deficits deteriorated particularly in Chile, Colombia, Ecuador, Mexico, Peru and Venezuela.

The prospects for economic growth in Latin America worsened after the August round of global turmoil in financial markets. A major uncertainty is the outlook for Brazil, generally seen as most vulnerable to a run on the currency. In any case, it will not avoid a recession. Moreover, Latin America's current account deficit will need to shrink in 1999, forcing a policy tightening that will compress domestic demand and imports. The outlook also abruptly worsened for Central America, where recovery from the damages of hurricane Mitch may take years.

Impact of the international financial crises

Following a temporary recovery in early 1998, stock markets in the region declined and currencies came under renewed pressure from large outflows of capital, especially following the Russian crisis in August 1998, which increased fears of devaluation and default in several countries, including Brazil, Colombia, Ecuador and Venezuela. Foreign reserves decreased, especially in Brazil and Venezuela. However, market conditions eased somewhat for Latin American borrowers after the reduction of international interest rates in October.

With primary commodities representing around 45 per cent of Latin American exports, export revenues fell in 1998, as a result of the decline in commodity prices (see table A.10). Dependence on a few commodity exports proved a major liability for several countries. The oil exporters, particularly Ecuador, Venezuela and Colombia, were affected the most, together with copper exporters (e.g. Chile and Peru). In 1999, competition from Asia could become a larger threat to Latin American, and especially Mexican, labour-intensive exports of manufactures.

In response to these financial and trade effects, a large number of countries changed their mix of monetary, fiscal and trade measures. To stem the loss of reserves and the flight of deposits from the banking system or to defend local currencies, domestic interest rates were raised steeply and steps were taken to reduce liquidity on the interbank market. After reaching a peak in the third quarter of 1998, however, interest rates started to decline in most countries (including Argentina, Brazil, Chile, Mexico and the Andean economies). Yet, by the end of 1998, they were still much higher than earlier in the year in most countries.

Some countries adjusted their exchange rates or allowed them to depreciate. In September, Colombia and Ecuador widened the trading band of their currencies, effectively devaluing. The Mexican peso, which is freely floating, fell sharply during 1998. In Brazil and Chile, as capital inflows dwindled, the authorities relaxed restrictions on short-term capital inflows. Moreover, a few countries adopted anti-dumping measures to improve the current account and to protect domestic producers threatened by competition from Asia.

Faced with declining tax revenues from commodity exports, Ecuador, Mexico, Venezuela and, to a lesser degree, Chile and Colombia, cut government expenditures and introduced measures aimed at boosting other revenues and diversifying the tax base. Brazil adopted after the election in October 1998 new fiscal measures, which aim to stabilize the ratio of public debt to GDP by the year 2000.

Such policy tightening in the region will inevitably aggravate the already poor social conditions. The economic slowdown is already pushing up unemployment, while pressure to cut fiscal spending is limiting their capacity to mitigate labour-market deterioration, and to expand much-needed social expenditures.

V. INTERNATIONAL TRADE AND TRADE POLICY

Momentum eroded from world trade growth

With an estimated growth rate of only 4 per cent in 1998 and a forecast of about the same rate of growth in 1999, world trade has lost much of the momentum of the middle 1990s (see table A.9). The major factor in the slowdown in 1998 was the contraction in the volume of imports in Japan of about 10 per cent and in South and East Asia (excluding China) of over 6 per cent. However, the growth of imports slowed appreciably in all other major geographic groupings of developing as well as developed countries.

While some of the factors that account for these results are expected to ease in 1999, the net effect will be no improvement in the volume of trade flows. In the case of Japan, the contraction in import volume is expected to continue, albeit at a much reduced rate, as recovery from recession is slow to appear. Meanwhile, the import surge in the United States, which imparted much of the limited momentum in world trade in 1998, is expected to ease considerably. It had been boosted by the strong growth of output and real income in the United States, which is expected to slow in 1999, as well as by a higher real effective exchange rate of the dollar (see table A.11).

Most other countries, particularly developing countries, reduced imports or compressed import demand in 1998, owing to new, tightly-binding constraints on import capacity. For the crisis countries of Asia, in particular, the withdrawal of inflows that had earlier financed significant trade deficits required urgent import compression. Other countries found that declines in commodity prices seriously reduced export earnings and thus import capacity. Without compensating financing, there was no short-term alternative to curtailing imports in commodity-dependent countries.

The high degree of regional trade interdependence, once a source of strength, has exacerbated the decline in the exports of the countries of the region.[1] For example, exports to Asian partners, which accounted for about 60 per cent of the value of China's export sales in 1997, fell 8.6 per cent in the first 10 months of 1998, compared to the same months in 1997. Japanese exports to Asian countries have also declined; e.g., they were almost 24 per cent lower in October 1998 than in the same month in 1997. In the case of the Republic of Korea, the value of merchandise exports to Japan, to the member countries of the Association of South-East Asian Nations and to China were down by 20, 28 and 9 per cent respectively for the first 9 months of 1998.

In addition, various countries outside the region that rely heavily on exports to East Asia have been disproportionately affected by the contraction of import demand in the region. For example, Asia accounts for some 10 per cent of the merchandise exports of Latin America, but has a much higher proportion for countries such as Peru and Ecuador, and as much as around 35 per cent in the case of Chile. In Africa, the impact of the Asian crisis has been felt particularly in Zambia, the United Republic of Tanzania and Congo, since over a quarter or more of the exports of these countries go to Asia. Among the economies in transition, Kazakhstan, the Russian Federation, Ukraine and Romania experienced a reduction in the volume of their Asian exports.

Furthermore, it was anticipated by many that the sharp devaluations of Asian currencies in 1997 and 1998 would strengthen the competitiveness of the exports of the East Asian region and prompt a major export expansion. Indeed, the real effective exchange rate fell from 1996 to 1998 by about a fifth in the Philippines and Thailand, by about one quarter in Malaysia and the Republic of Korea, and by more than half in Indonesia (see table A.11).[2] In the event, the overall volume of exports from East and South Asia rose only 1 per cent in 1998, (see table A.9), owing to the credit crunch in the region. Only a further small increase in export volume is forecast for 1999. At some point, however, an export surge may be anticipated, which will force other developing country exporters into sharper competition with the region in third markets.

Commodity markets

Oil and non-oil commodity markets were plagued by adverse conditions during 1998, as weak demand, ample supply and

1 For a discussion of intraregional trade in East and South-East Asia, see *Trade and Development Report, 1998* (United Nations publication, Sales No. E.98.II.D.6), Part One, chap. II.

2 In fact, because many of the exports are themselves import-intensive, the extent of devaluation, even in real effective terms, exaggerates the price advantage received by regional exporters.

rising stocks all combined to exert considerable downward pressure on prices. Most commodity prices measured in dollars had actually peaked at mid-decade and have fallen since, albeit irregularly, with the decline in petroleum prices having begun later than other commodities. However, almost all broad classes of commodity prices fell sharply in 1998, measured both in dollars and against the prices of a basket of manufactures exported by developed countries (see table A.10).

Oil prices on average have been about one third lower in 1998 than in 1997 (based on data for the first three quarters of the year), in the face of continued sluggish demand and rising inventories. While lower oil prices benefit oil-importing countries, some 25 countries are dependent on petroleum for 20 per cent or more of their foreign exchange earnings, including, for example the Russian Federation (25 per cent of merchandise exports), Norway (48 per cent) and Venezuela (79 per cent).[3]

At the same time, the overall dollar index for non-oil commodities of developing countries was 12 per cent lower in 1998, reflecting weakening tendencies in all major commodity categories, except vegetable oilseeds and oils (see table A.10). Several individual commodities of particular importance to developing countries, however, have seen especially sharp price declines.

Vagaries of weather, which were particularly marked in 1998 owing to the effects of El Niño, induced surges in the prices of many agricultural commodities, albeit only temporarily. High coffee prices had prevailed up to the beginning of 1998 and were responsible for a marked decline in purchases in both 1997 and the early part of 1998. By September 1998, however, due to subsequent good production prospects, especially in Brazil, prices dropped by 50 per cent from their levels in December 1997 (see table 5). El Niño-induced price increases were also observed in the case of fats and oils, notably both coconut and palm oil, with concomitant reductions in exports owing to lower production. Similarly, grain production, notably rice, was adversely affected by El Niño, especially in East and South Asia where poor harvests resulted

Table 5. International commodity export prices, 1995-1998
(Percentage change in dollar prices over previous year)

	1995	*1996*	*1997*	*Sept. 1998*[a]	*Sept. 1998*[b]
All commodities[c]	9.9	-4.2	0.0	-13.5	-18.4
Food and tropical beverages	4.5	2.1	2.8	-20.5	-22.1
Tropical beverages	1.1	-15.2	33.3	-26.0	-32.5
Coffee	0.7	-19.1	54.7	-37.0	-49.6
Cocoa	2.7	1.6	11.2	-2.9	-0.1
Tea	-10.3	8.8	25.8	-23.4[d]	-10.9[d]
Food	5.9	6.8	-3.5	-19.3	-18.3
Sugar	10.8	-9.9	-4.9	-41.4	-36.7
Beef	-31.2	-6.4	4.0	-11.0	-6.4
Maize	15.5	25.0	-25.3	-22.4	-22.2
Wheat	18.5	16.2	-22.6	-20.5	-21.6
Rice	-10.1	5.0	-10.7	22.0	1.6
Bananas	0.1	7.5	4.3	7.0	-15.2
Vegetable oilseeds and oils	10.3	-4.2	-0.9	5.3	10.2
Agricultural raw materials	15.0	-9.9	-10.3	-2.5	-12.0
Hides and skins	4.3	-23.7	-19.8	-4.6[e]	-2.0[e]
Cotton	22.3	-17.4	-1.5	-12.2	-18.2
Tobacco	-11.2	15.6	15.6	-10.8	-10.2
Rubber	38.6	-11.9	-28.3	-5.8	-37.4
Tropical logs	5.4	-20.1	-5.5	4.4	2.2
Minerals, ores and metals	20.2	-12.1	0.0	-6.8	-21.6
Aluminium	22.3	-16.6	6.2	-12.3	-14.4
Phosphate rock	6.1	8.6	7.9	4.9	4.9
Iron ore	5.8	6.0	1.1	2.8	2.8
Tin	13.7	-0.8	-8.4	-0.5	-1.5
Copper	27.2	-21.8	-0.8	-6.5	-36.9
Nickel	29.8	-8.8	-7.6	-31.0	-41.9
Tungsten ore	49.6	-17.9	-9.3	-6.5	-14.0
Lead	15.2	22.7	-19.4	-1.1	-15.4
Zinc	3.4	-0.6	28.4	-9.2	-26.1

Source: UNCTAD, *Monthly Commodity Price Bulletin*, various issues.

a Change from December 1997.
b Change from June 1997.
c Excluding crude petroleum.
d Data to June 1998.
e Data to July 1998.

3 3 See IMF, *World Economic Outlook*, May 1998, Annex II, table 27. and OECD, *OECD Economic Outlook*, November 1998 (Preliminary edition), Box 1.5.

in marked increases in imports.

In addition to developments that reflected exogenous weather-related factors predominant in agriculture, commodity markets have been subjected to pressures stemming from the crisis in East Asia. Several of the East Asian economies are major suppliers of commodities, such as vegetable oilseeds and oils, coffee, bananas, tea, cocoa bean, natural rubber, tin and copper. The large currency devaluations in 1997 and 1998 produced large price incentives to increase exports, to which exporters responded, except in some crisis countries where difficulties were encountered in obtaining letters of credit from local banks.

Also, many of the fast-growing economies in Asia had become major markets for a wide range of internationally traded commodities, including high-value foodstuffs, agricultural raw materials, metals and fuel and the decline in their commodity imports was very substantial. Thus, despite relatively strong demand in both Western Europe and the United States, metals prices have remained weak on account of sharp declines in consumption in Japan and the East Asian developing countries in crisis. Thus, between June 1997 and September 1998, aluminum prices dropped by 14 per cent, copper by 37 per cent, nickel 42 per cent, and lead and zinc by 15 per cent and 26 per cent respectively.

Aggregate demand at the global level is expected to remain weak, as described above, and as credit constraints ease on East Asian crisis countries it can be expected that they will seek to expand their supplies. Thus, although commodity prices are notoriously difficult to forecast, the expectation assuming no unforeseen supply shocks is that the dollar prices of internationally traded commodities will remain more or less at their levels at the end of 1998. This means that for 1999 as a whole, commodity prices would be about the same or slightly higher than the average for 1998, which is to say, another year of a difficult environment for commodity producers.

The international policy agenda for 1999 and beyond

Trade flows in the short run reflect the trade policy environment as it exists at the moment. That environment is perpetually changing, however, as pressures build and opportunities evolve to change trade barriers and incentives. Indeed, one of the concerns in the present conjuncture is that pressures for protective measures and inappropriate recourse to anti-dumping actions do not lead to back-tracking on international commitments to trade liberalization. In this regard, as well, the multilateral discussions on trade policy to take place in 1999 do not have a foregone conclusion.

Multilateral trade negotiations

The Uruguay Round of Multilateral Trade Negotiations created a new multilateral trading system with much wider scope, in terms of the sectors covered, the number of countries bound by the "single undertaking", and the range of domestic policy measures which could affect the trade interests of other countries. It also provided for a more effective dispute settlement mechanism where small countries have been successful in challenging the actions of major trading powers. Indeed, one of the challenges to the WTO system in 1999 will be to demonstrate the credibility of the rules and mechanisms as a framework for further trade liberalization initiatives, in a manner in which all countries can effectively pursue their interests. Already, proposals to renegotiate the rules or incorporate extraneous concepts within the rules are under discussion in certain capitals.

A process has been launched in the WTO aimed at preparing an agenda for future multilateral trade negotiations in the expectation that a decision will be taken at the next WTO Ministerial Conference, scheduled to be held in the United States in November-December 1999. Various approaches have already emerged at this early stage of the process. Some developing countries are preoccupied with problems arising from the implementation of the WTO obligations. They find that they have considerable administrative and financial problems in meeting their own obligations, and are often disappointed with the manner in which their developed trading partners have departed from at least the spirit of their own obligations, including those relating to differentiated and more favourable treatment.[4] On the other hand, some developed countries are advocating that another major round of multilateral negotiations covering a wide range of issues (e.g. investment, competition, environment, etc.),[5] the so-called "Millennium" round, be initiated at

4 For example, the review of the implementation of the Agreement on Textiles and Clothing identified that notwithstanding the fact that the legal requirements (i.e., the percentages of products to be integrated) had been met, the integration programmes of importing countries for the two Stages were not commercially meaningful for developing exporting Members. The backloading of integration, with meaningful integration being left to the last three years, meant that the process was not progressive as envisaged in the Agreement.

5 At Marrakesh some developing countries proposed subjects for inclusion on the agenda such as trade and immigration, trade and monetary and financial issues etc.

the third WTO Conference. Other developed countries appear to be aiming at a more short term, narrow approach, along the lines of the negotiations on financial and telecommunications services and information technology products (ITA) that were carried out successfully within the WTO framework. Many countries, both developed and developing, are opposed to the idea of limited sectoral negotiations, as they consider these will not provide a sufficient balance of interests and probably neglect their own.

The world financial crisis has also led some to have second thoughts as to the wisdom of entering into commitments in the area of financial services. Some countries affected by this crisis consider that the major trading countries have profited from their misfortune to extract access to their markets that they were unable to achieve in the context of reciprocal negotiations in the Uruguay Round. Moreover, the trading system has had to bear the burden of the failure of the financial system. Countries must export their way out of their financial difficulties, but at the same time are being obliged to accept draconian macroeconomic measures which shrink imports dramatically.

The current international environment is thus not propitious for the negotiation of new trade rules. Such negotiations could backfire, with the perverse result of unravelling much of the accomplishments of the Uruguay Round. The negotiators of the Uruguay Round were, however, enlightened enough to take the unprecedented step of incorporating commitments to enter into future negotiations as an inherent element of the final package. This built-in agenda already provides for negotiations on trade and investment in services, and agriculture, and for the consideration of investment and competition policy in the context of the TRIMs Agreement, as well as certain actions on subsidies, rules of origin, etc. If industrial tariffs were added to this, the potential for a balanced package of interest to most countries would seem to exist.

Agriculture

Developing countries require greater market access in precisely those areas singled out for immediate negotiation in the built-in agenda, i.e., agriculture and services. Developing countries' trade in *agricultural products* remains severely hampered by massive domestic support and export subsidy programmes, peak tariffs, (which also apply in certain industrial sectors), and difficulties in the operation of the mechanisms of the Agriculture Agreement, notably the tariff quota system. The recent signs of renewed export subsidy competition have highlighted the need for much more stringent disciplines than those contained in the Uruguay Round commitments. The continued reform of trade in the agricultural sector will also have to take account of non-trade concerns, including the contribution of the agricultural sector to employment, food security, etc. A further reduction of the massive domestic support provided to developed country agriculture would liberate resources that could be used for more constructive purposes, including assisting agricultural production in net-food importing countries.

Studies carried out jointly by UNCTAD and WTO have identified tariff peaks which seriously impede the exports of developing countries. These are found not only in the agricultural sector, where they can exceed 300 per cent ad valorem, but also in the fisheries, textiles, leather, leather goods and footwear, automotive and electronic sectors. Market access is also impeded by the targeting of anti-dumping actions and other contingency measures at certain sectors of interest to developing countries, as has traditionally occurred and is happening again in the steel sector. This will require that the relevant WTO Agreement, and perhaps the concept of anti-dumping itself, be addressed.

Certain WTO agreements also address the problems of market access arising from standards and technical regulations, including sanitary and phytosanitary regulations, and these have already become the subjects of dispute in the WTO. Increased public awareness of food safety issues is leading to a greater proliferation of standards with the potential for increased trade barriers against those developing countries whose products are not able to conform to them. Developing countries need to make more effective use of the existing instruments, but ways should be found to enable them to participate more effectively in the formulation of international standards and to gain access to mutual recognition agreements.

Services

In services, trade continues to be hampered by restrictions imposed on the movement of natural persons to supply services coupled with other barriers, including anti-competitive practices, notably in transportation and professional and business services. The forthcoming negotiations will need to take these into account. Commitments relating to movement of persons need to become more specific at the level of service sub-sectors or categories of professions. Article VI work on general disciplines on professional services in relation to recognition of qualification and licensing requirements could be accelerated. The reference paper approach providing for competition safeguards used in the basic telecommunication protocol could be adapted to the situation of other sectors, such as tourism and transport.

There is a risk that the proposals for a horizontal framework for investment could undermine further liberalization in this area. The General Agreement on Trade in Services (GATS) is based on the positive list approach to making commitments on market access and national treatment in which concessions are negotiated in particular sectors/subsectors and in relation to particular modes of supply. This allows for progressive liberalization adapted to an individual country's stage of development and possibility of tradeoffs and obtention of reciprocal benefits. By contrast, the OECD draft MAI and NAFTA are based on the negative list approach, which provides for market access/national treatment as obligations, subject to reservations.

The GATS has provided a framework for major liberalization of investment and can play the same role for the movement of persons and electronic commerce. In the context of trade negotiations, electronic commerce would appear to be primarily an issue of trade in services, as only services can actually be transmitted through electronic networks. As such, it greatly expands the possibilities for cross-border trade in services, and will become a subject for negotiation in that context. Studies by UNCTAD have found that in most service sectors, the benefits from liberalization can only be derived by developing countries if accompanied by supportive capacity building measures, notably through access to information networks and access to technology as recognized in GATS Article IV.

"TRIMs"

The Uruguay Round Agreement on Trade-related Investment Measures (TRIMs) simply confirmed that certain performance requirements (i.e. local content and trade balancing) in the area of goods were inconsistent with GATT Articles III and XI. However, its built-in agenda ambitiously provides that it should be reviewed to determine whether it should be "complemented" with provisions on investment policy and competition policy. The review could be confined to performance requirements or could deal with broader aspects of investment policy.[6] Broader aspects of investment policy could relate to consideration of GATS-style market access commitments and/or negotiating disciplines on investment in the context of other WTO Agreements. Even the relatively "like-minded" countries of the OECD were unable to agree to a comprehensive agreement covering all aspects of investment policy. France withdrew from MAI negotiations in October and opposition is being mobilized particularly at the provincial and state levels in federal countries. Difficulties relate inter alia to proposals to include labour and environmental standards, cultural exception, exception for regional integration agreements and the issue of extraterritoriality of US legislation.

As regards competition policy, a number of developing countries have argued that since TRIMs are used to combat the anti-competitive practices of foreign corporations, liberalization of investment measures should be accompanied by multilateral rules on competition policy. Effective competition policy is clearly a stimulus to investment, as it ensures that investment will provide effective market access. On the other hand, competition policy can block investment where such investment is deemed to create dominant market power. Competition policy can also affect trade by providing an alternative to anti-dumping actions. Rules on competition policy therefore have a large role to play in a multilateral trading system in a globalizing world and the negotiating agenda will need to take this fully into account. Such rules would need to provide the necessary flexibilities for developing countries.

Special and Differential Treatment

Future trade negotiations would need to deal with the development dimension in a more integrated fashion than has been the case in the past. Negotiators will need to find a basic consensus on which measures are crucial to the development process, rather than embark on another exercise of constructing transitional periods, devoid of any particular economic criteria. Developing countries have in the past benefited from special and differential (S&D) treatment in the form of market access (e.g. GSP) and in terms of flexibility in the use of trade measures, on both the import and supply side. The Uruguay Round, however, resulted in an erosion of GSP, an extensive binding of tariffs, and restrictions on the scope for subsidies, TRIMs, etc. Some developing countries have therefore expressed concern that they have been deprived of essential tools for strengthening their supply capacity to face a more competitive world.

Negotiations would also need to take into account that whereas the positive list approach of the GATS has enabled developing countries to maintain the flexibility needed for implementing their industrial policies (including for example, performance requirements), transitional periods and special

6 Recent empirical research demonstrates that certain performance requirements (e.g. export performance) contributes positively to building export capacity.

and differential treatment provisions contained in other Agreements (e.g. the TRIMs transitional period) have not dealt effectively with development concerns e.g. in relation to implementation difficulties. Moreover, although it is a positive development that there are no more "free riders" in the system, a danger to that system now arises from the inadequate capacity of many developing countries to comply fully with their obligations, enforce their rights or even simply participate in WTO meetings.

The negotiations need also to recognize that, although the GSP is becoming less important as MFN tariffs are reduced and more developing countries enter into free trade areas with developed countries, it remains crucial for many developing countries and should be preserved. In this context, it is odd, to say the least, that the representatives of countries which normally laud the economic benefits of unilateral free trade describe the GSP as a "burden" and a drain on fiscal revenue. One concrete possibility in this regard would be to apply also to GSP the standstill that is normally applied at the beginning of the negotiating process.

Finally, the idea of attaching financial windows to multilateral trade agreements has traditionally been considered anathema in GATT. However, it is becoming increasingly apparent that developing countries have difficulty in meeting their obligations, and benefiting from their trading opportunities without targeted financial support. For example, it is clear that opportunities in trade in services will only materialize with INTERNET access, that the liberalization of environmental services will contribute to environmental protection only if developing countries have the resources to purchase them, and that developing country producers are unable to meet environmental standards if the equipment required costs more than their annual income. It has been pointed out that under the non-actionable provision for R&D subsidies, developed countries are able to subsidize their firms inventions which then become patentable and benefit from protection under the TRIPS Agreement, whereas developing countries do not have such resources. Hence the importance of targeted financial support.

Lomé Convention negotiation issues

Over the past 25 years, the stable, contractual and non-reciprocal trade preferences and other instruments of development and financial cooperation instituted under the Lomé Convention between the EU (European Union) and the ACP (African, Caribbean and Pacific) Group constituted a major innovation in international development policy and North-South trade relations.[7] Today, the Lomé Convention is at a crossroads. On 30 September 1998, official negotiations commenced between the 15 EU States and the 71-member ACP Group on a successor agreement that would take effect upon the expiry of the Fourth Lomé Convention on 29 February 2000. Whilst the European Union Council encourages a fundamental review of the Lomé Convention and greater mutual obligations including reciprocity in trade relations,[8] the ACP Group endeavours to preserve its core development principles such as the ACP Group's recognized geographical coverage and homogeneity, non-reciprocity in trade relations with preferences, and adequate development assistance, among others.[9]

The negotiations between the EU and the ACP Group over the coming months will address certain principal negotiating issues. These have, to a large extent, been influenced by a world economic setting which has greatly changed. In particular, the concept of non-reciprocal trade relations has been affected by an ever expanding multilateral trade liberalization process and the tightening of trade rules under the WTO. Also, the EU and other developed countries are increasingly concentrating non-reciprocal trade preferences on LDCs only and relying on reciprocal trade agreements with other developing countries.

One major negotiation issue would be the concept of differentiated treatment for ACP States, with the most favourable treatment reserved for the most needy countries, namely the 38 LDCs and other island and landlocked countries. Lomé non-reciprocal trade preferences and the commodity protocols for banana, beef and rum would be important for these countries. The sugar protocol has an unspecified life and has been included in the EU's schedule of commitments under the Uru-

7 For an analysis on the Lomé instruments of cooperation and their impact, see for example, "Green Paper on Relations between the European Union and the ACP Countries on the Eve of the 21st Century: Challenges and Options for a New Partnership" (Commission of the European Communities, Brussels, 20.11.1996, COM(96) 570 final).

8 See speeches by Ms. Ferrero-Waldner, President of the Council of the European Union, and Mr. Pinheiro, Commissioner in the European Commission, on the occassion of the official opening of negotiations on 30 September 1998.

9 See the speech by the Hon. Ms. Billie A. Miller, Deputy Prime Minister of Barbados and President-in-Office of the ACP Council of Ministers, on the occassion of the official opening of negotiations on 30 September 1998.

guay Round. The differentiated approach could undermine the unity and solidarity of the ACP Group, however.

The concept of differentiation also emerges in terms of the negotiation of the economic partnership agreements between the EU and the three regions of the ACP Group or individual countries, modelled along the lines of the EU-South Africa free trade agreement (currency being negotiated). This is intended to strengthen the regional integration processes in each ACP region. However, the formation of fully-fledged free trade areas and customs union within different ACP regions will be a formidable task; it took several decades to construct the customs union arrangement among the more developed EU States. Also, the different regional agreements could eventually lead to a break-up of the ACP Group's homogeneity and weaken its collective bargaining position against the EU.

The large number of regional trade agreements—over 50—would impose a major burden on the EU and involved ACP States in terms of preparing and participating in WTO examination and review processes. Ensuring the WTO compatibility of the EU-ACP regional trade agreements with GATT 1994 Article XXIV and the relevant Understanding, as current practice indicates, would require the parties to engage actively and negotiate forcefully in the WTO discussions.

Other possibilities exist. The formation of an ACP-wide free trade area in the very distant future has been contemplated to rationalize the many different existing ACP regional trade agreements. This option does not at present appear feasible owing to difficulties for the ACP countries to agree on a single plan and schedule for mutual free trade with similar commitments for each partner country in view of the wide differences in their levels of development and factor endowments. Alternatively, non-LDC ACP States that by deliberate choice or for other reasons refrain from the regional economic partnerships agreements could be integrated into the GSP scheme of the EU. This option requires, in the first place, the maintenance of unilateral EU GSP scheme and, in the second place, an improvement of the scheme so that the affected ACP States' market access conditions are not eroded. It represents however a downgrading of preferential access as these ACP countries may actually have to pay duties on some products which previously entered duty-free. Accordingly, it does not appear to be a realistic proposition.

Another principal negotiating issue pertains to the erosion of Lomé non-reciprocal trade preferences from MFN improvements (liberalization) in EU market access conditions under its WTO obligations. The erosion will be slight however as the imports from ACP States are either already bound duty-free or subjected to very low MFN rates (less than 3 per cent for instance).[10] Nonetheless, even after all Uruguay Round concessions are fully implemented by the EU and other major industrialized countries, significant tariff barriers in the form of high tariff peaks (exceeding 12 per cent *ad valorem*) will affect an important percentage of agricultural and industrial products of crucial export interest to developing countries such as agricultural staples; fruit, vegetables and fish; processed (especially canned) food; textiles and clothing; footwear, leather and leather goods; automobiles, other transport equipment and electronics.[11] The ACP States' trade in these sectors could continue to be stimulated by way of the preservation and better utilization of non-reciprocal trade preferences.

Full reciprocity in trade relations between ACP States and the EU is likely to be a major negotiation issue. Reciprocity presupposes that the participating ACP economies have already reached a high level of international competitiveness and maturity in their production and administrative structures in order to be able to face the intra-regional competition, forego some development policy instruments and in general be able to absorb reciprocal arrangements and commitments. These conditions do not yet exist in many ACP States and moreover are difficult to develop in the short run. A very long transition period would thus be required, and during the adjustment period, the non-reciprocal preferences would need to be preserved and continued.

Prolonging in one form or another the application of non-reciprocal Lomé preferences to all ACP States would require validation by the WTO. The Fourth Lomé Convention benefits from a multi-year waiver under GATT Article XXV, accorded in December 1994 until the expiry of the Convention. These provisions compel the EU and the ACP States to mobilize support for the waiver from three fourths of the total WTO membership, i.e., about 100 members at present WTO member-

10 See "Strengthening the Participation of Developing Countries in World Trade and the Multilateral Trading System," Paper prepared by the UNCTAD Secretariat and the WTO Secretariat, with the assistance of the International Trade Centre UNCTAD/WTO, as a contribution to UNCTAD IX (TD/375/Rev.1, 1996).

11 See "Market Access: Developments since the Uruguay Round, implications, opportunities and challenges, in particular for developing countries and the least developed among them, in the context of globalization and liberalization," Report prepared by the Secretariats of UNCTAD and the WTO (E/1998/55, 22 May 1998).

ship of 133 countries. This could be difficult but not impossible, since the 55 ACP States which are WTO members together with the 15 EU members could have the numerical strength to negotiate the required support from other WTO members .

Whatever options are chosen , the negotiations between the EU and ACP Group over the next two years to elaborate common language and unifying themes on the principal negotiating issues will be difficult and complex, requiring substantial financial, technical and analytical resources as well as political capital.

VI. FINANCIAL MARKETS AND PRIVATE CAPITAL FLOWS

A year of volatile financial markets

The difficulty that financial markets have faced in assessing the regional and global impact of the Asian crisis has been evident during 1998 in volatility of asset prices and in declines in major categories of international financing for most developing regions which have become severer and more widespread since the middle of the year. The agreement that the Republic of Korea reached in February with its creditor banks to reschedule outstanding short-term debt led to a sharp recovery in asset prices and a strengthening of exchange rates across East Asia. A stronger than expected performance of the United States economy and improved prospects for a European recovery, which suggested that the developed economies might escape contamination from the crisis and provide the expanding export markets required for adjustment in East Asia, reinforced the positive impact of the debt restructuring, and by the beginning of April it was widely believed that conditions in the region had stabilised and that recovery was imminent.

This favourable view of recovery in Asia received a sharp reversal in May, as political unrest in Indonesia eventually brought down the Government and refocused investor attention on the political risks of the adjustment policies that were being pursued in the region. Attention was not limited to Asian financial markets; other emerging markets including those as far apart as South Africa, Russian Federation and Brazil faced a rapid exit of foreign capital accompanied by strong selling pressure on their currencies. In response to its loss of some $25 billion in reserves, Brazil announced a package of spending cuts in excess of 3 per cent of GDP and increased interest rates to above 40 per cent, while in Russia official rates were raised to triple digit figures. Although the measures introduced in Brazil succeeded in halting and eventually reversing the capital outflows, Russian Federation was obliged to raise overnight rouble rates to 200 per cent to support the exchange rate and avoid financial meltdown as stock prices fell and the trading was suspended on the Moscow stock futures market.

International currency and equity markets were also disturbed by the nuclear tests in India and Pakistan and the subsequent announcement of international sanctions, as well as by what appeared to be a free fall of the yen in June as rumours of weakness in the banking sector were reinforced by the difficulties at the Long Term Credit Bank. The rapid decline in the Japanese currency created selling pressure in equity markets in the rest of the Asian region as investors feared the erosion of their competitiveness vis-à-vis Japan. It also provoked the Chinese Government to announce that its policy of exchange rate stability could not survive a sustained devaluation of the region's other currencies in response to weakness in the yen. Although coordinated central bank intervention led by the United States in support of the yen and a political agreement on a rescue plan for the troubled Japanese banking sector led to stabilisation of the currency markets and a recovery in the Japanese stock market, this calm was relatively short-lived and both currencies and asset prices were again in rapid decline later in the summer. As commodity prices continued to decline, financial markets shifted attention towards the impact of the crisis on fiscal and trade balances in commodity producing countries, in particular certain Latin American countries and Russia. As a result, in August and September there was a marked resurgence of financial instability as international investors fled emerging markets irrespective of local conditions and deserted riskier assets in developed markets in a "flight to quality". Increased instability was accompanied by falls in major categories of external financing for developing and transition economies.

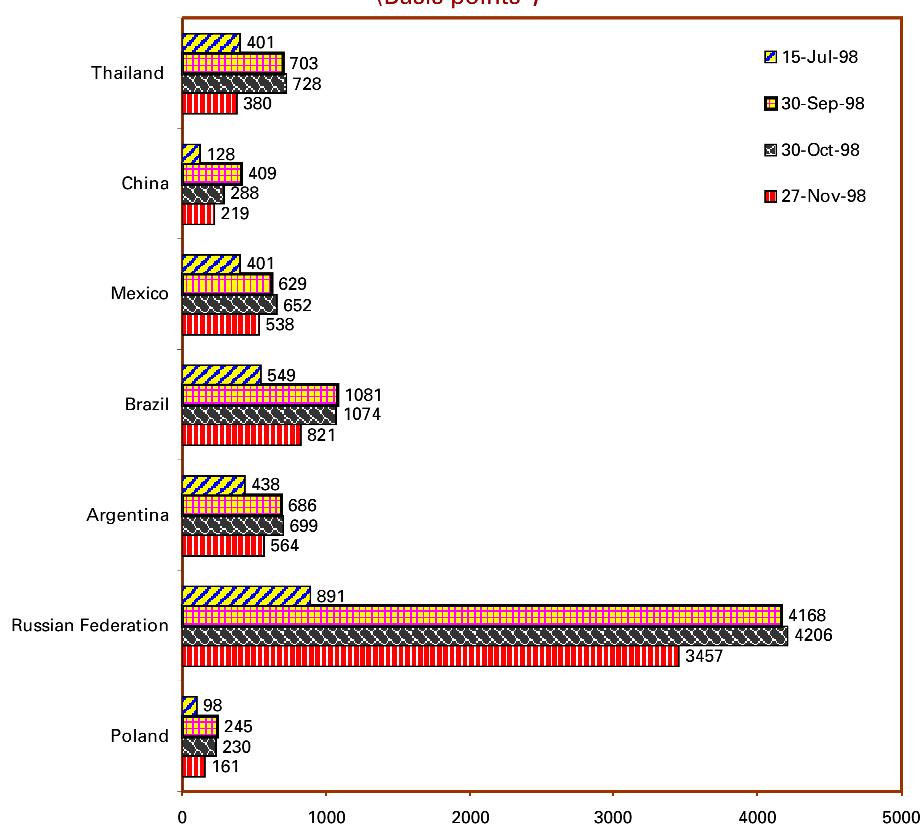
Conditions in the Russian Federation were of particular importance in the rapid re-emergence of volatility and the rush to liquidity in the late summer. As noted above, signs of difficulty first arose in June; extremely high interest rates had to be employed to defend the rouble and there were problems in attracting investors to debt auctions and for the privatisation of a large state enterprise. But by August the difficulties spread to other rouble-denominated assets, leading to the *de facto* default of some $30 billion in rouble-denominated government debt, accompanied by a 90-day moratorium on private foreign debt servicing, and preclusion of holdings of short-term money market instruments by foreigners. The clearing and payments difficulties that this created for foreign investors led to the bankruptcy of a large United States hedge fund that had specialised in investing in Russian government securities and a rapid rush to liquidity. Underlying this turmoil was the attempt by some large Western banks that had lent directly or indirectly against the collateral of Russian government debt to unwind positions and realise profits to cover losses. These difficulties in what were considered to be well-managed and supervised institutions led to a radical reassessment of risk and a flight to the most liquid, least risky instruments such as certain government bonds and related exchange-traded (as opposed to customized, OTC) interest-rate derivatives..

The sharp rise in credit spreads between non-investment grade paper and United States Treasury securities produced massive losses in the arbitrage positions of another (even larger) United States hedge fund whose share of the market in such securities was so large that the Federal Reserve felt it necessary to coordinate a rescue of the fund in order to avoid the possible breakdown of market liquidity in response to the sale of the fund's portfolio to pay creditors. Equity prices reacted with steep declines in 25 emerging financial markets in August (in 13 cases—Argentina, Brazil, Chile, Hungary, Indonesia, Malaysia, Mexico, Peru, Philippines, Poland, South Africa, Turkey and Venezuela—the declines amounting to 25 per cent or more). Latin American markets generally experienced larger declines than those of East Asia after the crisis in that region. Between mid-August and mid-October international bond issues by entities from developing and transition economies were extremely rare: the only such issues by entities other than those of Hong Kong (China) and Taiwan Province of China were two by Lebanon.

Yield spreads[1] on internationally issued bonds of developing and transition economies had already tended to rise during the first half of 1998, but as shown in figure 3, they have been subject to further sharp increases since August. Amongst countries which experienced large outflows of capital during this period Brazil lost approximately one-third of its international reserves in little more than two months, and both Argentina and Chile experienced severe pressure on their currencies. Mexico, with a flexible exchange-rate policy designed to raise the risks of speculation against the currency, was forced to increase interest rates sharply in order to prevent capital outflows of a magnitude that would have threatened a collapse of the currency.

There was also a reversal of the trend towards a stronger dollar, and sharp downwards revisions in forecasts for private capital inflows to developing and transition economies. However, not all developing economies were equally affected: in South and East Asia, for example, while Hong Kong (China) experienced a sustained attack on its currency, elsewhere, in countries such as Indonesia, Republic of Korea, Malaysia and

Figure 3: Selected internationally issued emerging market bonds: yield spread over United States treasury bonds[a]
(Basis points[b])



Source: UNCTAD, based on *Financial Times*, various issues.

a Differential between the yield on US dollar bonds issued by the borrowing country and those of the same maturity issued by the United States Government.

b 1/100th of one per cent.

1 For the definition of yield spread for the case of dollar bonds, see the notes to figure 3.

Thailand exchange rates remained relatively stable and the trend towards lower interest rates continued. Nonetheless, the events of the summer and autumn of 1998 provide another stark reminder of the potency of contagion in today's international financial markets as investors unwind positions often characterized by high degrees of leverage in response to shocks frequently originating in markets in which the share of their global exposure is relatively small.

Anatomy of the financial crisis in the Russian Federation

Like the East Asian crisis, the Russian crisis combines banking and currency crises, linked through excessive currency exposure and domestic lending funded by foreign borrowing and capital inflows. However, the underlying causes of this crisis are quite different from those in East Asia, since domestic macroeconomic imbalances and structural and institutional weaknesses played a much greater role.

As part of its efforts to achieve stabilization through control of the money supply, the Russian Government financed it fiscal deficit by increased issue of short-term treasury bills (known by the acronym, GKO). This led to a rapid increase in debt service that reached about one-third of federal spending in the first quarter of 1998. Russian banks were the major buyers of this paper, borrowing dollars from foreign banks through repo contracts[2] and generating arbitrage profits from the substantial differential between Russian and foreign interest rates. Russian banks thus assumed the risk of a devaluation of the rouble, but in view of the IMF's support for a stable exchange rate this risk was considered to be low.

About a quarter of the subsequently defaulted government debt was purchased directly by foreign investors, some of whom financed their purchases with roubles received on repo agreements with Russian banks. These investors hedged their associated currency risks with non-deliverable forward contracts worth about $40 billion purchased from Russian as well as from Western banks. They were faced with losses of 100 per cent of their positions when the suspension of payment on the bonds became *de facto* default and resolution of the forward contracts was prohibited. The situation was aggravated by the suspension of payment on forwards by Western banks as well.

While domestic factors were responsible for the Russian Federation's increased vulnerability, the Asian crisis played a crucial role in triggering the crisis through its impact, firstly, on perceived international lending risk and, secondly, on commodity prices, particularly those of oil and other primary products which constitute the majority of the Russian Federation's exports. The fall in commodity prices reversed the Russian payments balance from a surplus of $3.9 billion in the first half of 1997 to a deficit of around $6 billion for the first half of 1998. In the absence of other sources of foreign exchange, rouble stability required intervention that resulted in a decline in reserves and higher interest rates to attract capital inflows. However, when interest rates on government securities rocketed to above 100 per cent, the decline in the value of government securities led to margin calls on Russian banks for additional collateral on their repo loans from foreign creditors. Russian banks thus had to find funds to purchase additional government securities to restore the collateral for their loans at just the time when the central bank was draining liquidity from the market to defend the exchange rate and foreign lenders were unwilling to increase their exposure to Russian banks. The banks' efforts to borrow more were transferred to the interbank money market, but lacking central-bank support for its liquidity, this market proved unable to meet these additional demands for funding and ceased to function.

Thus, the only remaining alternative for the banks was to close their repo positions by repaying the borrowed dollars. This created additional demand for dollars and increased downward pressure on the exchange rate and international reserves, provoking further monetary tightening by the central bank and further falls in the prices of government securities. These in turn generated additional margin calls and a further demand for dollars in what became an unsustainable spiral that reduced reserves at the rate of approximately $4 billion a month. A wider band for the rouble/dollar exchange rate was introduced in the third week in August around a new central rate corresponding to a rouble depreciation of more than 25 per cent and was accompanied by various emergency measures including a 90-day moratorium on obligations on selected private foreign debts with a maturity of more than 180 days and on those due to margin calls and foreign exchange contracts as well as other capital controls. The government also announced a moratorium on its own debt in anticipation of a

2 A "repo" or repurchase agreement is a contract between a seller and a buyer of securities (usually those issued by a government) under which the former repurchases them from the latter at a higher price some time in the future. These contracts are used in many financial markets as a vehicle for short-term financing of inventories of securities, where the securities being financed serve as collateral for the loans.

forced conversion of GKO's and other bonds maturing in 1999 into longer-term debt instruments.

The moratorium produced large losses for foreign investment funds and banks as the full value of the defaulted securities had to be written off, and additional losses resulted from the suspension of payment of forward exchange contracts.[3] For Russian banks the losses associated with the crisis are estimated at 40 per cent of their assets and all are considered to be technically insolvent.[4] On the other hand, the losses for Western banks were not substantial,[5] although they were an important factor in initiating the global liquidity crisis that pushed financial markets to the point of breakdown.

Exchange rate movements

As noted above, exchange-rate changes brought about substantial shifts in the relative competitiveness of different countries and regions as markets reacted to the Asian crisis. In addition to the sharp fluctuations in the exchange rates of the Asian countries affected, 1998 has also witnessed increased volatility in the foreign exchange markets of several other developing countries as well as in the major internationally traded currencies, the dollar, the yen and the European currencies, notably the mark. Given Japan's linkages to the rest of Asia and its internal economic difficulties, the yen was especially hard hit, and by the late spring market participants were selling the currency aggressively in what appeared to be a total collapse of confidence. As already noted, the resulting depreciation was halted only by combined intervention in support of the yen in the early summer.

Since the Russian crisis was initially considered as a threat to the stability of the German banking system, the major lender to the area, initial reactions included a strengthening of the dollar against the mark. This tendency was soon reversed as large United States hedge funds[6] were asked for increased collateral on their Russian positions and had to reduce the size of their balance sheets. Since many institutions had been arbitraging the large differential between yen and dollar interest rates, the increased need for liquidity caused firms to extinguish these positions, thus buying yen and selling dollars. Moreover, the continued deterioration in the United States trade balance and the slowing of the country's economy created expectations that the Federal Reserve would move quickly to cut interest rates, thereby reinforcing the downward movement of the dollar against the yen and the mark. While the weakness of the dollar is likely to be associated with market volatility and make expansion in Japan[7] and Europe more difficult, it can also be expected to reduce the likelihood of a devaluation in Hong Kong and China owing to its affects on the competitiveness of their currencies vis-à-vis the yen, and ease pressures on the Latin American economies that have formal or informal links to the dollar. It will also ease some of the pressure on commodity producers, the majority of primary commodities being priced in dollars, while imported goods are priced in a wider variety of currencies.

Thus the behaviour of exchange rates in developing countries has been influenced by the movements in the major currencies.[8] The Hong Kong dollar, the Chinese renminbi and the Argentinian peso have remained stable at their fixed rates to the dollar. The Brazilian real has followed a path of gradual

3 Credit derivatives, another instrument to which banks had recourse to control risks associated with their investments in the short-term debt of the Russian government, have also been the subject of difficulties since the moratorium. These are designed to provide protection against credit risks, payouts being triggered by events such as defaults, downgrading of a borrower's credit rating or changes in the yield spread of debt in relation to some reference asset. The difficulties have resulted from disagreements over the interpretation of clauses specifying the default events triggering payouts, in particular whether the Russian moratorium constitutes such an event.

4 For further detail see, "The Russian Crisis", a paper prepared jointly by the secretariats of the United Nations Conference on Trade and Development and the United Nations Economic Commission for Europe, Geneva, October, 1998.

5 In the case of German banks, for example, whose lending to Russia amounts to more than 50 per cent of the total by international banks, their assets in Russia are less than 5 per cent of their total foreign assets.

6 Hedge funds are private investment pools which originally acquired their name because they used a form of spread trading in which long positions in investments expected to increase in value were balanced by short positions in the same type of assets that were expected to decline in value. These funds now typically follow more aggressive strategies based on high levels of leverage and remuneration of managers consisting primarily of percentages of investment profits. The most widely discussed case of recent difficulties among such funds is that of Long-Term Capital Management (LTCM), for which the United States Federal Reserve organised a consortium of creditors and investors for the purpose of an injection of emergency financing to prevent the fund from becoming insolvent owing to losses on highly leveraged positions in such instruments as United States government bonds and the shares of companies involved in takeover activity, as well as Russian securities. But difficulties were also experienced by a number of other hedge funds, in many cases owing to the movements in asset prices following the Russian financial crisis.

7 A stronger yen is, however, beneficial to the capital position of Japanese banks since it reduces the capital requirement on the yen value of foreign assets while the rise in equity prices that has accompanied yen appreciation increases their unrealised profits on equities in the investment portfolio that are part of tier-2 capital.

8 For a composite indicator of exchange rates for selected countries, see table A.11.

depreciation according to an adjustable peg formula, despite heavy speculative pressure, at the cost of a substantial loss of reserves. In Chile external pressures have led to changes in the fluctuation band for the peso/dollar rate and to a new rule for the central rate to accommodate a more rapid depreciation. Reserve requirements on capital inflows have also been relaxed to alleviate the pressure on the currency. In Colombia the fluctuation band for the peso/dollar rate was shifted by an amount corresponding to a 9 per cent depreciation of the central rate for the peso. In Venezuela, where the effects of weak oil prices have been accompanied by an uncertain political outlook, the Government has so far managed to withstand downward pressures on the bolivar without altering its currency regime of a fluctuation band around a central rate subject to small monthly adjustments. In Mexico, which has a floating exchange rate, the peso has experienced a substantial depreciation during 1998 which at one point exceeded 25 per cent.

Currencies in Asia have continued to fluctuate widely but on a generally improving trend. Exchange rates in the region have been influenced both by factors specific to individual countries, and by the movement of the yen relative to the dollar. A number of currencies have achieved a measure of stability after mid-summer turbulence. The Indonesia rupiah went from 8000 at the beginning of the year to above 15000 at the height of the political crisis, but has now returned to a range around 8000. The Taiwanese dollar, backed by substantial reserves and a relatively strong economic performance, nonetheless fell from 28 to around 35 to the dollar in mid-year before strengthening more recently. The Malaysian ringgit fell steadily throughout the year to more than 4.20 to the dollar until the introduction of exchange controls in September when the rate was fixed at 3.8 to the dollar. Two currencies have improved steadily over the year. The Thai baht has appreciated by around 30 per cent against the dollar, but with a setback during the summer. The Korean won has also appreciated, stabilising in a range around 1300 to the dollar compared with 1800 at the beginning of the year. The apparent return of stability in exchange rates in countries such as Indonesia, Thailand and the Republic of Korea has also been associated with erosion of some of their increased competitiveness achieved since 1997 and thus may presage future currency adjustments in the region. However, other developing countries that have been dependent on commodity earnings to preserve current-account balance have been especially hard hit by recent developments. Russia and several Latin American economies are outstanding examples, as are some OECD countries such as Canada, Australia and New Zealand which have also experienced depreciations of approximately 10 per cent.

Some policy responses

Policy responses in developing countries to recent conditions in international financial markets have varied. Some governments have felt constrained to take measures aimed at restoring capital inflows, whilst others have been concerned mainly to shield their domestic economies from the impact of volatile capital flows or have been able to maintain the overall thrust of their macroeconomic policies largely unchanged.

Hong Kong (China) and Malaysia, for example, have moved in different ways to prevent capital flows from threatening domestic macroeconomic stability. In a series of measures starting in mid-August, the authorities in Hong Kong (China), the location of one of the world's freest financial markets, acted to squeeze or restrict short selling of equities and thus limit speculative strains on its currency and on share prices. A major target of this intervention was the so-called "double play", in which speculators combined short sales of stock or stock futures with the purchase of United States dollars against Hong Kong dollars. Under Hong Kong's Currency Board system, the purchase of dollars automatically reduces domestic liquidity and puts upward pressure on interest rates, increasing the costs of financing long stock positions and thus producing pressure to sell shares and causing prices to fall. This creates the possibility to profit by closing the prior short sales of stock at the lower prices. To diminish the profitability of such trades the Hong Kong Monetary Authority purchased stock (estimated at about US $15 billion) to prevent the fall in stock prices and create losses for short sellers forced to close positions at higher prices. Other steps taken to curb speculation were margin surcharges on large positions in the stock futures market and a temporary moratorium on short selling of three of the most important shares traded in Hong Kong (China).

At the beginning of September, with the objectives of keeping interest rates low to counter deteriorating prospects for growth and to lessen the pressure of non-performing loans on its banking sector, Malaysia introduced stringent new exchange controls affecting current as well as capital transactions. These controls are designed to restrict trading outside Malaysia of financial assets denominated in ringgit. Official approval will now be required for most cross-border capital, and some current, transactions, and ringgit deposits held offshore were to be repatriated within a month of the announcement of the measures.

In China a number of international trust and investment corporations have failed to meet interest payments to creditors and one, Guangdong International, had to be closed down when it could no longer meet its external obligations, reaching $3 billion. This has been taken as an indication of the determination of the authorities not to bail out insolvent financial institutions. The country generally requires approval of foreign indebtedness by its financial and non-financial institutions in order to guarantee repayment, and closure of Guangdong International is likely to entail considerable losses for unguaranteed foreign lenders. Elsewhere in East Asia the turbulence in international financial markets has not in most cases seriously disrupted movements towards lower interest rates and the more stable exchange rates already mentioned. However, the trend towards more favourable financial conditions is taking place in the context of forecasts of slow or negative GDP growth in 1998-1999 and low capital inflows (discussed below).

In Latin America, as already noted, in the aftermath of the Russian financial crisis Brazil has experienced sustained currency attacks. The Government had earlier relaxed existing controls on capital flows in order to facilitate inflows, but these have subsequently been tightened as the crisis persisted. At the time of writing the Government has just announced new measures of fiscal austerity supported by a $41.5 billion external financial package mobilized by the IMF. It would be premature to attempt to evaluate their prospects for success in maintaining the exchange rate. But it is generally expected that the rescue plan will lead to a recession, and the crucial question is whether international investors and lenders can be persuaded to support a shrinking economy.

Elsewhere in Latin America a number of countries continue to be adversely affected by weakness of demand for primary commodities. The adverse effects of such weakness on trade and fiscal balances are capable of disrupting external financing and perhaps of eventually leading to large shifts in the pattern of regional exchange rates. The policy responses to recent pressures in Mexico (which included the sharp depreciation of the peso/dollar exchange rate mentioned above) have included tighter monetary policy and a drawing of the full $2.6 billion available under a credit line arranged with 33 international banks in November 1997 (shortly before the credit line became due for renewal on terms which were expected to be less favourable to the country). Conscious of the strain to which international financial turbulence periodically subjects its currency-board regime (strains so far successfully withstood) and of the difficulties of meeting over the next several months its anticipated external financial needs from the capital markets, Argentina has negotiated an additional package of loans from multilateral financial institutions. The country was also the first in the region to arrange an international bond issue since the Russian financial crisis.

Prospects for private capital flows to emerging markets

More unfavourable conditions in international financial markets since mid-1997 initially had uneven effects on different regions. In East and South Asia major categories of external financing declined sharply in 1997, and this trend accelerated in the first half of 1998: the exposure of BIS-reporting banks to the region, for example, actually decreased by more than $50 billion (after adjustment for the effect of changes in exchange rates), a large part of the contraction being concentrated in the four countries, Indonesia (by $8.9 billion), Republic of Korea ($20.6 billion), Malaysia ($4.3 billion), and Thailand ($13.8 billion).[9] Elsewhere the main initial manifestations of the more unfavourable environment were periods of turbulence in currency and stock markets but external financial flows were less affected.

During 1998, however, there has also been a deceleration of these flows to most emerging financial markets outside East and South Asia. For example, the (exchange-rate-adjusted) exposure of BIS-reporting banks to Latin America actually contracted in the second quarter of 1998 (after increasing by $15.6 billion in the first quarter), as did their exposure to Africa. The increase in their exposure to the transition economies of Eastern Europe and of the former USSR fell from $6.5 billion in the first quarter of 1998 to $4.2 billion in the second, and only for West Asia of the major developing regions did the level of bank lending actually increase in the second quarter (sustained to a significant extent by syndicated loan facilities for Saudi Arabian oil companies). Net flows to developing and transition economies from new external bond issues remained relatively buoyant in the first two quarters of 1998 for Latin America (at $20.6 billion) and for the transition economies of Eastern Europe and the countries of the former USSR (at $7.6 billion). However, net issues by countries of East and South Asia amounted to only $3.3 billion, much of this being due to those of Republic of Korea.

9 See "International Banking and Financial Market Developments", *BIS Quarterly Review*, November 1998, table 6A. The BIS's alternative semi-annual reporting system for the consolidated international claims of reporting banks shows similar figures for exchange-rate-adjusted changes in exposure.

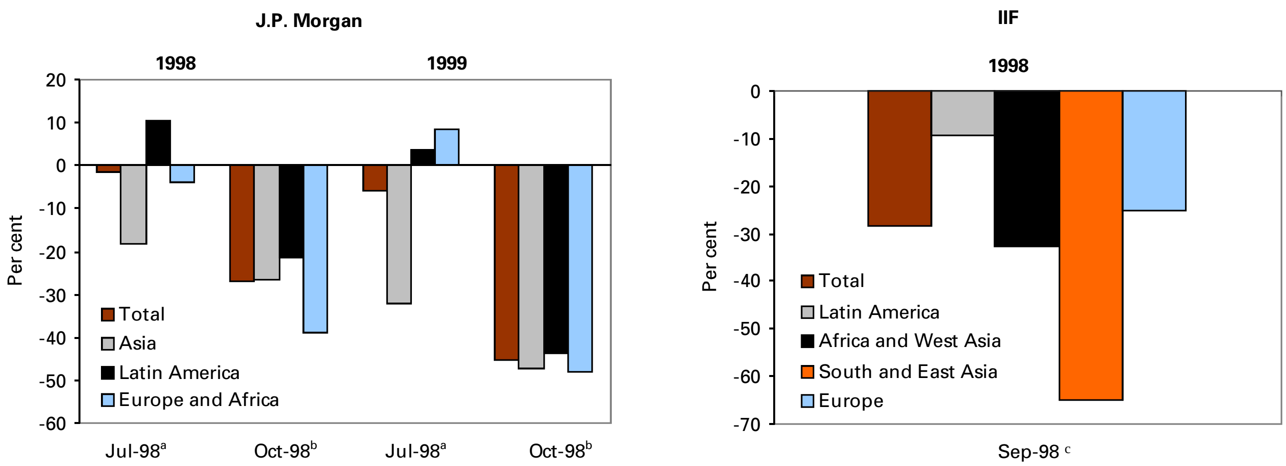
Flows in this form contracted sharply in the third quarter, in part as a reflection of the virtual halt in new external bond issues by developing and transition economies after the Russian crisis discussed above: net flows to Eastern Europe and countries of the former USSR, the only region not experiencing a fall, were due almost entirely to the Russian Federation's exchange of domestic Treasury bills for Eurodollar bonds.

After the middle of 1997 forecasts for private capital flows to developing and transition economies were initially less affected than those for GDP by the deterioration in the economic outlook. However, as shown in the accompanying charts, since the middle of 1998 this has changed: recent estimates of the Institute of International Finance (IIF) and J.P. Morgan of the out-turn for total net capital flows to emerging markets for the year as a whole have been revised downwards by about 25 per cent (figure 4), and the most recent forecast of J.P. Morgan for 1999 is of a reduction of almost 50 per cent in such flows (though the IIF forecast somewhat earlier little change in comparison with its lower estimate for 1998) (figure 5).

The largest downward revisions for 1998 involve bank lending and portfolio investment, and all major regions are affected. The one category of financing that has been relatively little affected by these revisions is FDI (figure 4), whose relative buoyancy may reflect the influence of increased acquisition of businesses in East and South Asia in response to lower prices in foreign exchange due to currency depreciation and the liberalization of some controls on inward investment. J.P. Morgan's forecast downturns for 1999 apply to all major regions (figure 5). Moreover all categories of financing are expected to contract, though the forecast reduction for FDI (at 17 per cent) is less than for the others.

However, in view of the severity and the duration of the current global liquidity crunch, even these downward revisions may understate the eventual decline in capital flows for the coming year. Given that the new-issue market for United States corporations has recovered very slowly from a virtual halt in activity in the autumn of 1998, it is unlikely that emerging markets will fare much better. If firms have difficulty raising funds for domestic investment, this is likely to extend to their cross-border direct investment as well. Commercial banks in the United States have stepped in to replace some of the financing slack, but only for better-grade borrowers. Also indicative of the current reluctance of banks to commit additional funds to emerging-market borrowers is the failure of any private lenders to participate in the Brazilian rescue package, although they have agreed to an informal rollover of the country's short-term debt.

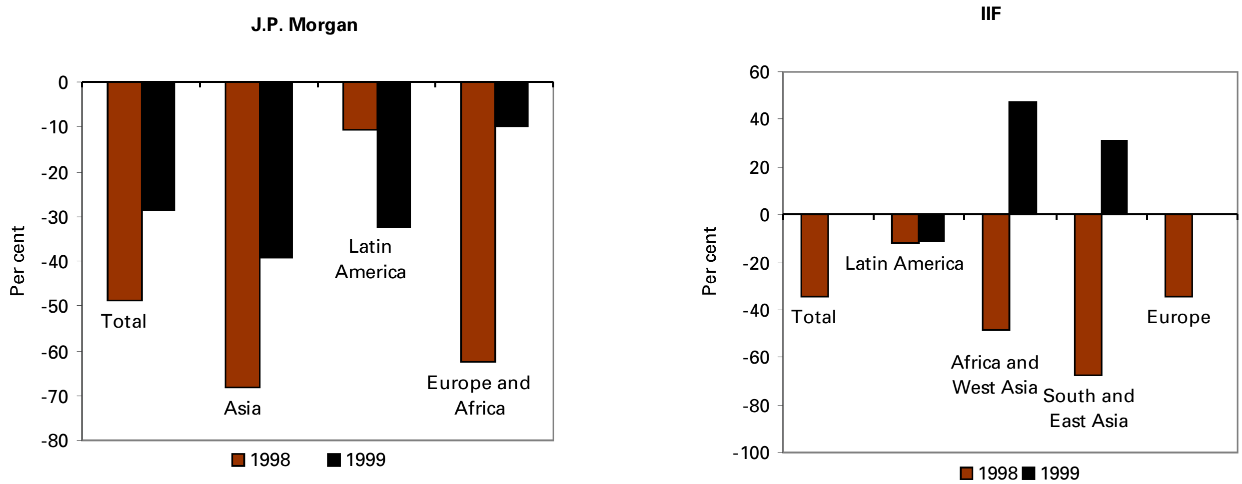
Figure 4: Revisions in forecasts of capital flows to selected developing and transition economies, 1998-1999



Source: UNCTAD, based on J.P. Morgan, *World Financial Markets* and Institute of International Finance, Inc. (IIF) *Capital Flows of Emerging Market Economies*.

a Change between end-March and end-June in net capital inflows.
b Change between end-June and end-September in net capital inflows.
c Change between end-April and end-September in net private inflows.

Figure 5: Forecast changes in capital flows to selected developing and transition economies, 1998-1999



Source: UNCTAD, based on J.P. Morgan, *World Financial Markets*, 7 October 1998, and Institute of International Finance, Inc. (IIF), *Capital Flows to Emerging Market Economies,* 29 September 1998. (See figure 4 for types of flows included.)

VII. OFFICIAL DEVELOPMENT FINANCE AND DEBT

Recent trends in official finance

Official development assistance (ODA) and other development finance from the main aid-giving industrialised countries have declined significantly since the beginning of the 1990s. Long before the threat of more limited access to credit, in the wake of the Asian financial crisis, there has been an "ODA crunch". Poor countries that rely heavily on ODA are experiencing reduced aid flows as they now confront falling commodity prices and possibly decreasing export earnings. Meanwhile, their access to private finance for investment remains limited. If this situation persists, adjustment and reform programmes in a large number of low-income countries would be at risk. So would their agendas for poverty reduction and social and human development.

Official resource flows

ODA flows started to decline in nominal terms in 1995. Available estimates indicate a particularly sharp drop in the level of such assistance in 1997, to $49 billion from almost $58 billion in the previous year. Falling bilateral flows accounted for most of this decline. Official aid to countries in transition and higher-income developing countries peaked at $8.5 billion in 1995, before falling to $5.7 billion in 1996 and recovering again to a projected level of $7 billion in 1997. Other development finance flows fluctuated around a declining trend during the first half of the 1990s, before undergoing a marked contraction in 1996-1997. The decline of ODF has parallelled the decline of ODA.

The least developed countries (LDCs) and other low-income countries have been particularly affected by the decline in ODA, and have not as a general rule been able to compensate the shortfall in official development finance by recourse to private financing. Official flows still accounted for over 90 per cent of total resource flows to the LDCs in 1997, and about 55 per cent in the case of other low-income countries.[1] ODA flows to the LDCs peaked at $16.6 billion in 1995. They have since contracted sharply, falling to $12 billion in 1997 according to provisional estimates. The net flow of other development finance to these countries has been negligible. ODA flows to other low-income countries dropped from $32 billion in 1995 to an estimated $25 billion in 1997 (see table 6).

Official development finance overall declined by almost $20 billion over 1996-1997. On the other hand, total official resource flows, which include IMF non-concessional lending, showed significant increase in 1997, as a result of IMF rescue packages for East Asian countries.

Donors' aid budgets

Preliminary estimates for 1997 of aid provided by the countries that are members of the Development Assistance Committee (DAC) of OECD indicate that, as a percentage of these donors' combined GNP, ODA has fallen for five consecutive years. The share of ODA in GNP fell from 0.33 per cent in 1992 (the level maintained during the first three years of the decade) to 0.22 per cent in 1997. This is the lowest ratio recorded since 1970, when the United Nations adopted the overall ODA target of 0.7 per cent of donor countries' GNP.[2] Moreover, the share of ODA to LDCs as a percentage of DAC donors' GNP has contracted sharply. It fell from 0.09 per cent of at the start of the decade to 0.05 per cent in 1996.

The recent fall in ODA was largely the result of cuts in the aid budgets of the G-7 countries. The United States (0.08 per cent in 1997) and Japan (0.11 per cent) record the lowest ODA/GNP ratios. Japan remains the most important donor in dollar terms, followed by France, the United States and Germany. Together these four countries accounted for some 58 per cent of total DAC ODA in 1997. Among the G-7 countries, the United Kingdom has reaffirmed its commitment to meeting the 0.7 per cent ODA target and reversing the decline in its aid.

A number of smaller donor countries have steadfastly implemented their ODA programmes. Aid from countries that are not members of the G-7 has remained broadly stable since 1992. The ODA programmes of Ireland, Luxembourg, New Zealand and Portugal have indeed been growing strongly. Four DAC members, Denmark, the Netherlands, Norway and Sweden have maintained their aid above the 0.7 per cent target. In addition, they have met the special targets for ODA to the LDCs set at the Second United Nations Conference for the LDCs in 1990.

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1 OECD, *External debt statistics: Resource flows, debt stocks and debt service, 1986-1997*, Paris 1998.
2 Information on donor countries' aid performance in 1997 is from press release SG/COM/NEWS(98)64, DAC/OECD, 18 June 1998.

The outlook and role of ODA

Prospects for a reversal of the trend of declining aid and renewed ODA growth are highly uncertain. The financial crisis that has spread from East Asia increases claims on global resources, especially to cover unexpected debt arrangements, and could contribute to a further reduction in traditional aid programmes in the long run. This could have important implications for, *inter alia*, the resource base of multilateral institutions, including the concessional windows of the development banks. For example, already the replenishments of the African Development Fund in 1996 and of the Asian Development Fund in 1997 fell below initial targets. Another example is the decline in IBRD net income at the same time as potential demands on this income are increasing[3]. This might reduce World Bank resources supporting special programmes for the poorest countries, including debt reduction and the HIPC Trust Fund.

Table 6. Official finance for development: 1990-1997
(Billions of dollars)

	1990	*1995*	*1996*	*1997* [a]
Official development assistance (ODA)	50.6	59.8	57.9	49.0
of which to least developed countries (LDCs)	15.4	19.6	14.2	12.0
of which to other low-income countries	26.5	32.0	29.0	25.0
Other official aid	2.3	8.5	5.7	7.0
Other development finance (non-concessional)	23.7	21.1	14.5	14.0
of which to LDCs	0.9	0.0	0.0	0.0
of which to other low-income countries	5.5	3.3	4.0	3.0
Total official development finance	76.5	89.3	78.1	70.0
Net use of IMF credit [b]	-2.2	11.6	-2.9	14.4
Total official resource flows, including IMF credit	74.3	100.9	75.2	84.4
Memorandum items:				
Total ODA as percentage of DAC donors' GNP	0.33	0.27	0.25	0.22
ODA to LDCs as percentage of DAC donors' GNP	0.09	0.06	0.05	..

Source: OECD *External Debt Statistics: Resource Flows, Debt Stocks and Service, 1986-1997* and OECD, *Development Co-operation*, 1996 and 1997 reports.

Note: ODA, as recorded by the Development Assistance Committee of the OECD, excludes official aid to a number of higher-income countries, which together with aid to countries in transition is included in the item "other official aid" above.

a Provisional.

b Non-concessional flows from the IMF General Resources Account (GRA).

In this respect, two particularly important issues were on the international agenda at the end of 1998. One was the long outstanding issue of securing the long-term financing of ESAF operations, the centrepiece of IMF support for low-income countries. The other was the conclusion of the negotiations of the twelfth replenishment of the IDA. The latter was successfully resolved as representatives of 39 donor countries reached a replenishment agreement in November 1998. This will allow IDA to provide concessional lending of $20.5 billion to the poorest developing countries over FY2000-2002. New contributions from donor countries to this package amount to some $11.6 billion.[4]

The current ODA crunch may force a reconsideration of the role of aid in encouraging the mobilisation of private finance for investment in the developing countries, in particular in the low-income countries. ODA could be used as a leverage for mobilisation of private finance, especially in developing the infrastructure in these countries. Improved infrastructure facilities can be seen as a precondition for growth and overall development in the poorest countries, and for improving their prospects of attracting private capital. Contributing to infrastructure project financing in the form of partial funding on concessional terms or grants, or through partial risk guarantees, could play a role as a catalyst for such financing.[5]

Adequate resources are also needed to achieve the development policy goals set by the international community, in areas such as poverty reduction, improved education, health and gender equality, environmental sustainability and governance. An example is the DAC target to reduce by one-half the proportion of the world's population living in extreme poverty by the year 2015.[6] More recently, similar objectives for Africa were set in the agenda for action endorsed by the Second Tokyo International Conference on African Development in October 1998. To be effective, such targets need to be supported

3 See paragraph 12 of the communique of the Development Committee dated 17 April 1998. See also *Financial Times*, "World Bank 's loans to prop up Asia leave little for the poor ", 2 April 1998.

4 The rest of the package comes mainly from repayment of earlier credits and contributions from the World Bank itself.

5 See UNCTAD, *The Least Developed Countries 1998 Report*, Part one, chapter II.

6 See *Shaping the 21st Century: The contribution of development co-operation*, OECD, May 1996.

by new aid flows and strong commitments to eliminate the poorest countries' debt overhang.

Implementation of the HIPC initiative, and new challenges to the international debt strategy

In 1998, the international community pursued its efforts to provide a lasting solution to the poorest countries' debt problems within the framework of the HIPC (heavily indebted poor countries) initiative. At the same time, new challenges such as the need to provide debt relief for poor countries in a post-conflict situation and to the countries struck by natural disaster in Central America, have appeared.

Progress in the HIPC initiative

By the end of 1998, 10 HIPCs—out of 40 currently included in this category[7]—had seen their cases reviewed under the initiative. Benin and Senegal have both concluded exit agreements with the Paris Club. Their debts are deemed sustainable and hence will not be considered for further relief. Uganda, Bolivia, Burkina Faso and Guyana were declared eligible for HIPC assistance in 1997, and Côte d'Ivoire, Mozambique and Mali qualified in 1998. Arrangements for Guinea-Bissau were delayed by the conflict in that country. The actual delivery of full HIPC assistance, notably relief on debts to multilateral institutions, takes place later after a period of up to three more years after eligibility is declared.

The first countries to complete the HIPC process were Uganda (in April 1998) and Bolivia (in September 1998). Three others are expected to follow in 1999, and two additional countries in 2000 and 2001 respectively. Among the first HIPCs to go through the process, several have been given credit for a good track record of economic performance before entry, and have benefited from a shortening of the set of two three-year periods of satisfactory performance foreseen in the initiative.

Possible HIPC financing constraints

Most recent estimates of required debt relief for the seven HIPCs so far declared eligible amount to $6.1 billion in nominal terms, the bulk of which is accounted for by Mozambique ($2.9 billion). Altogether, relief requirements under the HIPC initiative for the 20 countries included in preliminary cost estimates could be in the order of $20 billion in nominal terms. This figure notably excludes countries such as Liberia, Somalia and Sudan, which could potentially have large costs if they became eligible for assistance under HIPC.

Financing packages for individual HIPC countries are being put together case by case. Experience so far indicates that this can be a time-consuming and difficult process. Securing the necessary financing for the full and expeditious implementation of the initiative emerges as a key issue. Not only would any shortfall in funding slow down further implementation, it may also lead to setting debt sustainability targets too high. If insufficient levels of debt relief were to incorporate into the operation of the Initiative, its aim of providing an exit strategy would be jeopardised. It should be noted that rescue packages for some of the countries caught in the crisis in 1997-1998, of a magnitude far greater than that implied by the full implementation of HIPC, have been arranged within fairly short time spans. Although these undertakings are not directly comparable, since HIPC involves a substantial degree of concessional finance including outright debt cancellation, both involve resource mobilisation efforts by official agencies and public funding. The present value (in 1998 dollars) of HIPC relief is currently estimated at less than $10 billion. In comparison, the total amount of financial rescue packages for East Asian countries and recently, the Russian Federation and Brazil, was close to $200 billion. Assuring sustainable debt positions and thereby the development prospects for the poorest countries should not be seen as a lesser priority than lending public resources to middle-income countries in crises.

The multilateral institutions holding claims on the HIPCs have made various arrangements for participation in the initiative, although some of them face constraints in covering the full cost of their participation from their own resources. Special funds have been set up at the IMF (the ESAF/HIPC Trust) and the World Bank (the HIPC Trust Fund).[8] However, IMF resources currently available for new commitments might be exhausted after the middle or end of 1999. To date, eight countries have made special contributions to the ESAF-HIPC Trust for around SDR 36 billion, while fifteen bilateral donors have for their part made contributions or pledged resources to the World Bank's trust fund totalling about $300 million.

As stressed during the annual meetings of the IMF and the World Bank in October 1998, additional contributions are needed to assist all multilateral institutions to meet their share of the cost of the HIPC initiative. This concerns in par-

7 Excluding Nigeria, which is not IDA-only, but was on the original list of 41 HIPCs.

8 The HIPC Trust Fund can also be used by others institutions for help in the delivery of HIPC relief, enabling them to receive additional contributions from interested donors.

ticular the African Development Bank. Decisions regarding the longer-term financing of the ESAF-HIPC Trust are also urgently needed.

Extension of the HIPC entry period

Initially, support under the HIPC initiative was made available to countries embarking on IMF- and World Bank-supported programmes before October 1, 1998. Following a comprehensive review by the Boards of these two institutions at the end of the first two-year period since the setting up of the scheme, it was decided to extend the entry period to the end of the year 2000. At the same time, it was noted that HIPC should not be seen as a permanent facility, and potential eligible countries, including those emerging from conflict, are encouraged to begin the required programmes as early as possible.

Of the 40 HIPCs, 31 had actually met the formal entry requirement during the first two years of HIPC.[9] There are thus nine remaining HIPCs that may benefit from the extension of the entry period, all of them being LDCs and nearly all being involved in, or emerging from, civil conflict. Some of them have very large debts, many of them have arrears to the IMF and the World Bank, and preliminary analysis indicates that most of them have potentially unsustainable debt ratios and would be candidates for HIPC relief.

Debt relief for post-conflict countries and other emergency situations

A group of eleven countries in sub-Saharan Africa has been identified as representing exceptional needs for economic rehabilitation assistance. All are HIPCs as well as LDCs, and the group includes some countries that have already embarked on IMF- and World Bank-supported economic programmes, as is required for consideration under the HIPC initiative. The external debt of the group at end-1996 amounted to some $58 billion, according to World Bank data. Arrears are estimated to represent $28 billion, almost 50 per cent of total public and publicly guaranteed debt. Mechanisms for clearing arrears at a sufficiently early stage after these countries emerge from conflict thus appear to be of crucial importance. This problem is especially acute for those having large and protracted arrears to multilateral institutions as well as bilateral creditors. They typically find themselves in a difficult financial situation, where large financing needs for reconstruction and re-establishing basic social services compete with the urgency of establishing a track record of debt servicing in order to normalise relations with their creditors and access new resources. The adequacy of existing mechanisms needs to be examined, and new approaches developed for providing earlier assistance to post-conflict countries by the institutions concerned and for lending into or providing assistance under arrears.

At the 1998 annual meetings of the IMF and the World Bank, the international community was called on to explore additional ways to provide assistance more quickly and effectively to post-conflict countries. Emphasis was also given to the need to provide and where needed increase positive net transfers from official creditors to such countries that are adopting sound economic and social policies.[10] The IMF and World Bank in co-operation with other major creditors will continue to work on these issues. In this context, the link to HIPC support also needs to be examined. A first step in facilitating the access of post-conflict countries to HIPC relief has already been taken. The IMF Board, following the review of the first two years of the implementation of the HIPC initiative mentioned above, has agreed to broaden the programmes which could qualify as part of the first three-year stage leading up to the decision on eligibility for HIPC relief. Programmes supported by post-conflict emergency assistance may now be counted in, on a case-by-case basis.

Other exceptional measures beyond the HIPC framework may also be needed. The "post-catastrophe countries" in Central America have seen their economies devastated by the hurricane Mitch in late 1998. Their reconstruction needs must take precedence over external debt-servicing obligations. In this case, several creditor countries rapidly announced debt relief actions, and the international financial institutions have taken steps to reassess their debt situation.[11] On a general level, such an event raises the question of the definition of debt sustainability in economies vulnerable to exogenous shocks, and of finding suitable mechanisms to deal with the aftermath of severe shocks. The still evolving international debt strategy needs to be sufficiently flexible to respond to various types of crisis affecting the debtor countries.

9 A few of them may not enter the process, e.g., Ghana, Kenya and Lao People's Democratic Republic have never received a concessional rescheduling from the Paris Club, a condition for consideration under the initiative.

10 See Communiqué of the Development Committee, October 5, 1998, para. 17 and Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund, October 4, 1998, para. 4b.

11 Apart from undertaking a comprehensive assessment of the external debt situation and related requirements for debt relief of Honduras and Nicaragua, both HIPCs, the World Bank, IMF and the IDB were also working to establish a trust fund to help these countries cover multilateral debt service obligations.

ANNEX TABLES

Table A.1. Developed economies: rates of growth of real GDP, 1989-1999
(Annual percentage change[a])

	1989	1990		1991	1992	1993	1994	1995	1996	1997	1998[b]	1999[c]
All developed economies	3.7	2.7	♦	0.7	1.6	0.8	2.7	2.2	2.9	2.7	1.8	1½
Major industrialized countries	3.7	2.7	♦	0.7	1.7	0.9	2.7	2.1	2.9	2.6	1.6	1½
Canada	2.5	0.3		-1.9	0.9	2.3	4.7	2.6	1.2	3.8	2.9	2½
France	4.3	2.5		0.8	1.2	-1.3	2.8	2.1	1.6	2.3	3.0	2½
Germany	3.3	4.7	♦	1.2	2.2	-1.1	2.9	1.9	1.4	2.2	2.7	2¼
Italy	2.9	2.2		1.1	0.6	-1.2	2.2	2.9	0.7	1.5	1.7	2
Japan	4.8	5.1		3.8	1.0	0.3	0.7	1.4	4.1	0.8	-2.7	-1
United Kingdom	2.2	0.4		-2.0	-0.5	2.1	4.3	2.7	2.2	3.4	2.3	1½
United States	3.4	1.2		-0.9	2.7	2.3	3.5	2.3	3.4	3.9	3.4	2¼
Other industrialized countries	3.8	2.8		0.9	1.1	0.5	3.0	2.9	2.6	3.3	3.3	2¾
Australia	4.2	1.2		-1.3	2.7	4.0	5.3	4.1	3.7	2.8	3.8	3
Austria	4.2	4.6		3.4	1.3	0.5	2.5	2.1	1.6	2.6	3.0	2¾
Belgium-Luxembourg	3.7	3.0		1.7	1.5	-1.1	2.5	2.2	1.6	3.1	2.9	2½
Denmark	0.3	1.2		1.4	1.3	1.3	3.5	3.1	3.5	3.4	2.4	2
Finland	5.7	0.0		-7.1	-3.6	-1.2	4.6	5.1	3.6	6.0	4.9	3½
Greece	3.5	-0.6		3.5	0.4	-0.9	1.5	2.0	1.8	3.2	3.4	3½
Iceland	0.3	1.2		1.1	-3.4	1.0	3.7	1.0	5.5	5.0	5.6	4¼
Ireland	6.1	7.8		2.0	4.2	3.1	7.3	11.1	7.4	9.8	9.1	6¾
Malta	8.2	6.3		6.3	4.7	4.5	3.4	7.3	3.6	2.9	3.8	4½
Netherlands	4.7	4.1		2.3	2.1	0.3	2.6	2.3	3.5	3.7	3.6	2¾
New Zealand	-0.6	0.3		-2.3	0.6	5.1	5.5	3.3	2.7	3.1	0.2	-1
Norway	0.9	2.0		3.1	3.3	2.7	5.5	3.9	5.5	3.4	2.3	2¼
Portugal	4.9	4.1		2.1	4.2	7.8	1.9	2.0	3.2	3.7	4.1	3½
Spain	4.8	3.7		2.3	0.7	-1.2	2.1	2.8	2.2	3.6	3.7	3½
Sweden	2.4	1.4		-1.1	-1.4	-2.2	3.3	3.6	1.3	1.8	3.0	2¼
Switzerland	4.4	3.7		-0.8	-0.1	-0.5	0.5	0.6	0.0	1.7	1.7	1½
Western Europe	3.4	2.9	♦	0.7	1.1	-0.4	2.9	2.4	1.7	2.6	2.8	2¼
of which:												
European Union (15)	3.4	2.9	♦	0.7	1.1	-0.5	2.9	2.5	1.7	2.7	2.8	2¼
EUR11	3.8	3.5	♦	1.2	1.4	-0.9	2.7	2.4	1.6	2.5	2.8	2½

Source: UN/DESA; based on IMF, *International Financial Statistics*.

♦ Indicates discontinuity in the series: from 1991, Germany includes eastern Lander (states).

a Data for country groups are weighted averages, where weights for each year are the previous year's GDP valued at 1993 prices and exchange rates.
b Preliminary estimates.
c Forecast, partly based on Project LINK.

Table A.2. Major industrial countries: quarterly indicators, 1996-1998

	1996 Quarters				1997 Quarters				1998 Quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Growth of gross domestic product[a]										
Canada	1.3	0.6	2.9	2.3	5.2	5.2	4.4	2.8	3.1	1.4	1.8
France	5.1	-0.5	3.1	0.6	0.8	4.5	3.6	3.2	2.8	3.2	2.0
Germany	-0.4	6.1	3.0	0.3	1.8	4.1	3.2	1.1	5.7	0.4	3.6
Italy	2.4	-3.5	2.9	-0.1	0.1	8.0	2.2	1.0	-0.6	2.3	2.0
Japan	8.4	-1.1	-1.6	4.3	8.3	-10.6	3.2	-1.5	-5.3	-3.3	-2.6
United Kingdom	4.1	1.2	2.4	2.8	4.5	4.1	3.6	3.8	1.9	1.9	1.9
United States	2.0	4.7	1.0	4.3	4.9	3.3	3.1	3.7	5.4	1.8	3.7
Total	3.7	2.2	1.0	3.2	4.8	0.4	3.2	1.9	1.9	0.5	1.7
	Unemployment rate[b, c]										
Canada	9.5	9.6	9.8	9.9	9.6	9.4	9.0	8.9	8.6	8.4	8.3
France	12.1	12.4	12.5	12.6	12.5	12.5	12.4	12.3	12.1	11.9	11.9
Germany	8.9	8.9	8.8	9.1	9.4	9.9	10.1	10.3	10.0	9.8	9.5
Italy	12.0	12.0	12.0	12.0	12.2	12.1	12.1	12.1	12.1	12.3	12.3
Japan	3.3	3.5	3.3	3.3	3.3	3.5	3.4	3.5	3.6	4.2	4.3
United Kingdom	8.4	8.3	8.2	7.8	7.5	7.3	6.8	6.6	6.4	6.3	6.3
United States	5.6	5.4	5.3	5.3	5.2	4.9	4.9	4.7	4.7	4.4	4.6
Total	6.9	6.9	6.8	6.8	6.7	6.7	6.6	6.5	6.5	6.4	6.5
	Growth of consumer prices[d]										
Canada	1.8	3.3	0.3	2.8	2.1	1.1	1.0	-0.3	2.1	1.4	0.4
France	2.9	3.2	-1.1	1.8	2.1	0.7	0.7	1.1	0.0	2.4	-1.0
Germany	2.5	2.1	1.4	-0.3	3.8	1.4	3.1	-0.7	0.7	2.0	1.0
Italy	4.4	4.6	0.9	1.8	2.7	2.1	0.6	2.7	2.7	1.7	0.1
Japan	-1.1	3.0	-0.8	1.1	-1.1	8.9	0.0	1.1	-1.8	2.2	-2.2
United Kingdom	2.0	5.5	0.7	2.3	2.3	5.3	3.9	3.2	1.3	7.8	1.2
United States	2.3	4.1	2.0	3.0	2.7	1.6	1.6	1.6	1.0	2.3	1.5
Total	1.6	3.7	0.8	2.0	1.8	3.5	1.4	1.3	0.4	2.5	0.2

Source: UN/DESA, based on data of IMF, OECD and national authorities.

a Percentage change in seasonally adjusted data from preceding quarter, expressed at annual rate (total is weighted average with weights being annual GDP valued at 1993 prices and exchange rates).
b Percentage of total labour force, seasonally adjusted data as standardized by OECD.
c For some countries, 1997III is an estimate.
d Percentage change from preceding quarter, expressed at annual rate.

Table A.3. Developed economies: consumer price inflation, 1989-1999
(Annual percentage change[a])

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998[b]	1999[c]
All developed economies	4.3	4.9	4.3	3.2	2.8	2.2	2.3	2.2	2.1	1.3	1¾
Major industrialized countries	4.2	4.7	4.1	3.0	2.6	2.1	2.1	2.1	2.1	1.3	1½
Canada	5.1	4.7	5.6	1.5	1.9	0.2	2.2	1.5	1.7	1.0	1¾
France	3.4	3.4	3.2	2.4	2.1	1.7	1.7	2.1	1.1	0.8	1¼
Germany	2.8	2.7	3.6	5.1	4.4	2.7	1.9	1.5	1.8	1.0	1
Italy	6.2	6.5	6.3	5.1	4.5	4.0	5.3	3.9	2.0	2.0	2
Japan	2.2	3.1	3.3	1.7	1.2	0.7	-0.1	0.2	1.7	0.3	-½
United Kingdom	7.8	9.5	5.9	3.7	1.6	2.5	3.4	2.5	3.1	2.8	2½
United States	4.9	5.4	4.2	3.1	3.0	2.5	2.8	2.9	2.4	1.6	2¾
Other industrialized countries	5.3	6.2	5.5	4.3	3.9	3.3	3.4	2.6	1.8	1.7	2
Australia	7.5	7.3	3.2	1.0	1.8	1.9	4.7	2.6	0.3	0.3	2½
Austria	2.5	3.3	3.3	4.1	3.6	3.0	2.3	1.8	1.3	1.0	1¼
Belgium	3.1	3.4	3.2	2.4	2.7	2.4	1.4	2.1	1.6	1.2	1½
Denmark	4.7	2.7	2.4	2.1	1.3	2.0	2.0	2.2	2.1	2.0	2¼
Finland	6.6	6.2	4.1	2.6	2.2	1.1	0.9	0.6	1.3	1.5	1¾
Greece	13.8	20.3	19.5	15.8	14.5	10.9	8.9	8.2	5.5	4.6	3
Iceland	20.8	15.5	6.8	3.9	4.1	1.6	1.6	2.3	1.8	1.9	2
Ireland	4.1	3.3	3.2	3.1	1.4	2.3	2.5	1.7	1.5	2.7	3¼
Malta	0.8	3.0	2.5	1.7	4.1	4.2	4.0	2.6	3.2	3.9	3¼
Netherlands	1.0	2.5	3.1	3.2	2.6	2.8	2.0	2.1	2.1	2.2	2
New Zealand	5.7	6.0	2.6	1.0	1.4	1.7	3.8	2.6	0.9	1.5	1½
Norway	4.5	4.2	3.4	2.3	2.3	1.5	2.5	1.2	2.6	2.4	3¼
Portugal	12.6	13.4	11.4	8.9	6.8	4.9	4.1	3.2	2.1	2.6	2¾
Spain	6.8	6.7	5.9	6.0	4.6	4.8	4.6	3.6	2.0	2.0	2¼
Sweden	7.1	9.9	9.0	2.8	4.5	2.6	2.5	0.0	0.8	0.6	1
Switzerland	3.2	5.4	5.8	4.1	3.4	0.8	1.8	0.9	0.4	0.1	1
Western Europe	4.7	5.3	4.9	4.4	3.6	3.0	3.0	2.4	2.0	1.6	1¾
of which											
European Union (15)	4.8	5.3	4.9	4.4	3.6	3.1	3.0	2.5	2.0	1.7	1¾
EUR11	4.0	4.2	4.3	4.4	3.7	3.0	2.8	2.4	1.7	1.4	1½

Source: UN/DESA, based on data of IMF, International Financial Statistics.

a Data for country groups are weighted averages, where weights for each year are consumption expenditure for the year valued at 1993 prices and exchange rates.
b Partly estimated.
c Forecasts.

Table A.4. Developed economies: unemployment rates, 1989-1999
(Percentage of total labour force[a])

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998[b]	1999[c]
All developed economies	6.1	6.0	6.6	7.3	8.0	7.9	7.5	7.6	7.3	7.0	7
Major industrialized countries	5.7	5.6	6.2	6.8	7.2	7.1	6.7	6.8	6.6	6.5	6½
Canada	7.5	8.1	10.4	11.3	11.2	10.4	9.5	9.7	9.2	8.5	8¼
France	9.3	9.0	9.5	10.4	11.7	12.3	11.6	12.4	12.4	11.7	11
Germany [d]	5.6	4.8	4.2	4.5	7.9	8.4	8.2	8.9	10.0	9.9	9½
Italy	10.0	9.1	8.8	9.0	10.3	11.4	11.9	12.0	12.2	12.0	12
Japan	2.3	2.1	2.1	2.2	2.5	2.9	3.1	3.4	3.4	4.2	4¾
United Kingdom	7.3	7.1	8.8	10.1	10.5	9.6	8.7	8.2	7.0	6.4	7¼
United States	5.3	5.6	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4¾
Other industrialized countries	8.1	7.8	8.7	10.0	11.9	12.1	11.4	11.2	10.7	9.8	9¼
Australia	6.2	7.0	9.5	10.8	11.0	9.8	8.6	8.6	8.7	8.2	8
Austria	2.8	3.1	3.4	3.5	4.0	3.8	3.9	4.3	4.4	4.4	4¼
Belgium	7.5	6.7	6.6	7.3	8.9	10.0	9.9	9.7	9.2	8.5	7¾
Denmark	7.4	7.7	8.5	9.2	10.1	8.2	7.2	6.8	5.5	4.8	4½
Finland	3.3	3.2	7.2	12.4	16.9	17.4	16.2	15.3	13.1	11.6	10½
Greece[e]	7.5	7.0	7.7	8.7	9.7	9.6	10.0	10.3	10.4	10.2	10
Iceland[e]	1.7	1.8	1.5	3.1	4.4	4.8	5.0	4.3	3.9	3.1	2¾
Ireland	14.7	13.4	14.8	15.4	15.6	14.3	12.3	11.6	10.1	8.7	8
Luxembourg	1.8	1.7	1.7	2.1	2.7	3.2	2.9	3.3	3.7	3.1	3
Malta[e]	3.7	3.8	3.6	4.0	4.5	4.0	3.6	3.7	4.4	4.6	4½
Netherlands	6.9	6.2	5.8	5.6	6.6	7.1	6.9	6.3	5.2	4.3	4
New Zealand	7.1	7.8	10.3	10.3	9.5	8.1	6.3	6.1	6.7	7.4	7
Norway	5.0	5.3	5.6	6.0	6.1	5.5	5.0	4.9	4.1	3.3	3¾
Portugal	4.9	4.6	4.0	4.2	5.7	7.0	7.3	7.3	6.8	6.4	6
Spain	17.2	16.2	16.4	18.5	22.8	24.1	22.9	22.2	20.8	19.1	18
Sweden	1.6	1.8	3.3	5.9	9.5	9.8	8.8	9.6	9.9	8.6	8½
Switzerland	0.5	0.5	2.0	3.1	4.0	3.8	3.5	3.9	5.2	4.2	3½
Western Europe	8.1	7.4	7.8	8.6	10.6	11.0	10.5	10.7	10.5	9.9	9¾
of which:											
European Union (15)	8.3	7.6	7.9	8.8	10.8	11.2	10.8	10.9	10.7	10.1	10
EUR11	8.9	8.0	7.9	8.6	11.0	11.7	11.4	11.7	11.8	11.2	10¾

Source: UN/DESA, based on data of OECD.

a Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Office (see OECD, Standardized Unemployment Rates: Sources and Methods (Paris, 1985)); national definitions and estimates are used for other countries.
b Partly estimated.
c Forecast.
d Prior to January 1993, data refer to Western Germany only.
e Not standardized.

Table A.5. Economies in transition: rates of growth of real GDP, 1993-1999
(Annual percentage change [a])

	1993	1994	1995	1996	1997[b]	1998[c]	1999[c]
Economies in transition	-9.3	-7.1	-0.8	-0.1	2.8	1.1	¾
Central & Eastern Europe and Baltic States	-7.8	3.6	5.4	4.1	4.3	3.2	3¼
Central & Eastern Europe	-5.9	3.9	5.7	4.1	4.0	3.1	3¼
Albania	9.7	9.4	8.0	9.1	-7.1	8.0	7
Bulgaria	-1.5	1.8	2.1	-10.9	-6.9	1.5	2
Croatia	-7.9	5.9	7.0	4.3	6.5	5.0	4
Czech Republic	0.6	2.7	6.4	3.9	1.0	-0.8	1¼
Hungary	-0.6	2.9	1.5	1.3	4.4	4.8	3½
Poland	3.9	5.1	7.1	6.1	6.9	5.4	5
Romania	1.5	3.9	7.1	4.1	-6.6	-5.0	1
Slovakia	-3.9	4.9	7.4	6.9	6.5	4.5	1
Slovenia	2.9	5.3	4.2	3.0	3.8	4.0	3½
TFYR of Macedonia	-9.1	-1.9	-1.2	0.8	1.5	4.0	4
Fed. Rep. of Yugoslavia	-30.8	2.7	6.0	5.8	7.4	2.0	2
Baltic States	-22.3	0.2	2.2	3.8	7.1	5.7	3¼
Estonia	-8.5	-1.8	4.2	4.1	11.4	6.0	4
Latvia	-14.9	0.8	-1.0	2.9	6.5	5.0	3
Lithuania	-30.3	0.8	3.2	4.1	5.7	6.0	3
Commonwealth of Independent States	-10.5	-15.5	-6.7	-4.6	1.1	-1.5	-2¼
Armenia	-8.8	5.4	6.9	5.8	2.5	4.0	6
Azerbaijan	-23.1	-19.7	-11.7	1.1	5.9	5.0	4
Belarus	-7.7	-12.6	-10.3	2.8	10.3	9.0	5
Georgia	-29.3	-10.3	2.6	8.8	11.1	10.0	9
Kazakhstan	-9.1	-12.7	-8.2	0.5	2.0	1.0	-2½
Kyrgyzstan	-15.5	-20.1	-5.3	7.0	6.5	5.0	3½
Republic of Moldova	-1.2	-31.0	-1.8	-7.8	1.3	-6.0	-3
Russian Federation	-8.6	-12.8	-4.1	-4.8	0.8	-4.5	-5
Tajikistan	-16.3	-21.3	-12.5	-16.7	2.0	3.0	3½
Turkmenistan	1.4	-16.7	-7.6	0.1	-25.9	1.5	6
Ukraine	-14.2	-22.8	-12.2	-10.0	-3.2	-1.5	-2
Uzbekistan	-2.3	-5.2	-0.9	1.6	5.3	3.0	2½

Source: UN/DESA and ECE.

a Country group aggregates are averages weighted by GDP in 1993 dollars (for methodology, see *World Economic and Social Survey, 1992* (United Nations publication, Sales No. E.92.II.C.1 and corrigenda), annex, introductory text.)
b Partly estimated.
c Forecast, based in part on Project LINK.

Table A.6. Economies in transition: consumer price inflation, 1993-1999
(Annual percentage change)

	1993	1994	1995	1996	1997[a]	1998[b]	1999[b]
Central and Eastern Europe							
Albania	85.0	21.5	8.0	12.7	33.1	27.0	18
Bulgaria	72.9	96.2	62.1	123.1	1 082.6	25.0	12
Croatia[c]	1 516.6	97.5	2.0	3.6	3.8	5.5	4
Czech Republic	20.6	10.0	9.1	8.9	8.4	11.0	7
Hungary	22.6	19.1	28.5	23.6	18.5	14.5	10½
Poland	36.9	33.2	28.1	19.8	13.2	11.0	9
Romania	256.2	137.1	32.2	38.8	154.9	55.0	35
Slovakia	23.1	13.4	10.0	6.0	6.5	7.0	8
Slovenia [c]	31.8	19.8	12.7	9.7	9.4	8.0	7
TFYR of Macedonia [c]	353.1	121.0	16.9	4.1	4.4	3.0	4½
Yugoslavia	.. [d]	.. [d]	71.8	90.5	23.2	50.0	30
Baltics States							
Estonia	89.6	47.9	28.9	23.1	11.1	10.6	5¼
Latvia	109.1	35.7	25.0	17.7	8.5	6.0	6
Lithuania	410.1	72.0	39.5	24.7	8.8	8.2	9
Commonwealth of Independent States							
Armenia	3 731.8	47.9	32.0	5.7	21.9	17.0	9
Azerbaijan	1 129.7	1 663.9	411.5	19.8	3.6	5.3	7¼
Belarus	1 190.9	2 219.6	709.3	52.7	63.9	69.0	80
Georgia	4 084.9	22 470.0	177.6	39.4	7.3	7.0	6½
Kazakhstan	1 662.7	1 879.5	175.9	39.1	17.4	12.0	17
Kyrgyzstan	1 208.7	278.1	42.9	30.3	25.5	11.0	10
Republic of Moldova	1 751.0	486.4	29.9	23.5	11.2	20.0	25
Russian Federation	875.0	309.0	197.4	47.8	14.7	40.0	60
Tajikistan	2 884.8	350.3	682.1	422.4	85.4	35.0	18
Turkmenistan	1 630.5	2 714.0	1 005.0	992.0	87.0	25.0	30
Ukraine	4 734.9	891.2	376.7	80.2	15.9	8.5	25
Uzbekistan	1 231.8	1 550.0	315.5	64.4	27.6	21.0	32

Source: UN/ECE and UN/DESA.

a Partly estimated.
b Forecast.
c Retail prices.
d Annual rates of hyperinflation of over 1 trillion percentage points.

Table A.7. Developing countries: Rates of Growth of GDP, 1981-1999

	1981-1990	1991-1998	1991	1992	1993	1994	1995	1996	1997	1998[a]	1999[b]
Developing countries [c]	2.4	4.6	3.2	5.0	5.2	5.6	4.6	5.7	5.7	1.6	3
of which:											
Africa	1.9	1.8	0.8	-0.4	-0.6	2.0	2.8	4.5	2.7	2.6	3½
Eastern and Southern Asia	7.2	6.7	6.9	7.8	7.9	8.6	8.2	7.4	6.3	0.8	4¼
Region excluding China	6.6	5.1	6.2	5.6	5.9	7.0	7.3	6.5	5.2	-2.2	2¼
of which:											
East Asia	7.1	5.2	7.2	6.0	6.5	7.6	7.6	6.6	5.2	-4.2	1½
South Asia	5.3	4.8	2.9	4.2	3.9	5.2	6.2	6.0	5.3	4.4	4½
Western Asia	-2.2	2.5	-5.0	5.5	4.3	-0.9	4.1	4.8	5.9	1.7	2½
Latin America and the Caribbean	1.0	3.3	3.4	2.9	3.5	5.5	-0.1	3.7	5.4	2.6	1¼
Memo Items:											
Sub-Saharan Africa (excluding Nigeria and South Africa)	1.7	1.6	-0.3	-1.2	-2.9	1.8	4.2	4.9	4.2	2.7	4
Least developed countries	2.1	2.1	-0.5	0.5	-1.1	1.9	4.7	4.7	4.4	2.3	3¼
25 largest developing economies											
Algeria	3.0	1.5	0.1	1.4	-1.2	-1.1	3.9	3.8	1.3	3.7	4
Argentina	-1.4	5.4	8.9	8.7	6.0	7.4	-4.6	4.4	8.4	4.5	2
Brazil	1.5	2.5	0.1	-1.1	4.1	5.8	4.1	3.0	3.0	0.5	-1½
Chile	2.6	6.8	7.1	10.5	6.0	4.1	8.2	7.2	7.1	4.5	3
China	9.1	10.7	9.2	14.2	13.5	12.6	10.5	9.6	8.8	7.5	8
Colombia	3.7	3.8	1.6	4.0	5.1	6.3	5.7	2.1	3.0	2.5	2
Egypt	6.3	3.3	2.3	2.5	2.0	2.3	3.2	4.0	5.3	4.9	5
Hong Kong, China	6.7	4.2	5.1	6.3	6.1	5.3	4.7	4.8	5.3	-4.0	0
India	5.3	4.8	2.0	4.0	3.9	5.4	6.7	6.4	5.5	4.8	5
Indonesia	5.5	3.9	7.0	6.5	6.5	7.5	8.1	8.0	4.6	-15.0	-2
Iran (Islamic Republic of)	2.8	3.3	6.0	6.0	2.6	1.8	4.2	5.0	3.5	-2.5	½
Iraq	-11.1	-3.1	-45.0	3.0	1.5	-5.0	-1.0	0.0	25.0	15.0	8
Israel	2.8	4.7	6.2	6.6	3.4	6.6	7.1	4.5	2.1	1.1	2
Republic of Korea	9.1	5.4	9.1	5.1	5.8	8.6	8.9	7.1	5.5	-6.2	1½
Malaysia	6.0	6.4	8.6	7.8	8.3	9.2	9.5	8.2	7.8	-6.0	1
Mexico	1.7	3.0	4.3	3.7	1.9	4.6	-6.2	5.1	7.0	4.3	3
Pakistan	6.0	4.5	6.7	5.1	3.1	4.2	4.9	5.2	4.2	3.0	2
Philippines	2.1	2.8	0.0	0.0	2.1	4.4	4.8	5.5	5.1	1.0	2½
Saudi Arabia	-2.9	1.5	6.0	3.0	1.6	-2.7	-0.2	4.0	3.0	-2.0	1
Singapore	7.0	7.2	6.7	6.0	9.9	10.1	8.9	7.0	7.8	0.0	½
South Africa	1.5	1.2	-1.0	-2.2	1.3	2.7	3.4	3.2	1.7	0.5	2
Taiwan Province of China	7.9	6.3	7.6	6.8	6.3	6.5	6.1	5.6	6.7	4.5	5
Thailand	7.8	5.0	8.5	7.8	8.3	8.7	8.6	6.7	-0.4	-7.0	-½
Turkey	4.3	4.3	0.8	5.0	8.1	-6.1	8.0	7.0	6.8	4.5	3¾
Venezuela	0.8	2.2	9.7	6.1	0.7	-2.5	2.2	-1.5	5.0	-1.5	0

Source: UN/DESA.

a Preliminary estimates.
b Forecast, based in part on Project LINK.
c Covering countries that account for 98 per cent of the population of all developing countries.

Table A.8. Developing countries: Consumer price inflation, 1989-1999[a]
(Annual percentage change)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998[b]	1999[c]
All developing countries	361.2	532.0	81.6	132.9	254.1	134.6	20.9	16.8	11.1	13.3	9½
by region:											
Latin America	1 128.6	1 679.6	210.6	354.1	757.8	326.4	23.4	19.5	11.7	9.4	8½
Africa	19.8	16.1	96.0	172.3	112.5	244.7	40.6	36.6	14.3	10.8	11½
Western Asia	27.7	23.9	27.9	29.0	27.0	41.6	40.7	33.0	30.8	38.9	19½
Eastern and Southern Asia	6.2	7.8	9.5	7.2	5.7	7.1	6.8	6.2	5.0	14.5	8½
China	18.0	3.2	3.3	6.4	14.7	24.1	17.1	8.3	2.8	0.7	3½
Memo item:											
Sub-Saharan Africa	25.7	22.8	283.3	532.6	342.4	780.2	87.0	94.8	31.5	20.1	20½
Least developed countries	33.2	27.9	366.0	687.1	440.8	997.6	103.6	118.9	37.3	24.4	26

Source: UN/DESA, based on IMF, *International Financial Statistics*.

a Weights used are GDP in 1993 dollars.
b Preliminary estimates based on data for part of the year.
c Forecast.

Table A.9. World trade: rates of growth of volumes, 1989-1999
(Annual percentage change)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998[a]	1999[b]
World trade [c]	7.2	5.2	4.1	5.7	4.5	10.4	8.6	5.4	9.5	4.1	4
Volume of exports											
Developed market economies of which:	7.0	4.9	3.1	3.8	2.5	9.4	7.3	4.2	9.2	4.6	4¼
North America	7.8	6.6	5.0	6.7	5.3	9.0	9.0	6.2	10.9	4.4	5¼
Western Europe	7.4	4.2	2.2	3.3	2.5	11.4	7.6	3.9	8.4	6.4	4½
Japan	4.3	5.3	2.5	1.5	-2.4	1.7	3.3	0.6	9.6	-3.7	-½
Economies in transition of which:	-0.7	-9.8	-18.0	11.0	..	..	..	..	..	..	..
Eastern Europe	-1.5	-6.3	-8.1	8.5	..	..	..	..	..	..	..
Former USSR	0.1	-13.0	-27.7	14.2	..	..	..	..	..	..	..
Developing countries of which:	9.1	13.9	10.6	9.1	8.7	13.6	13.6	6.6	11.1	1.9	2¼
Latin America & Caribbean	4.6	5.1	4.7	6.3	10.3	9.2	9.9	9.3	13.3	8.8	5½
Africa	8.0	8.2	1.0	1.5	-0.1	6.2	6.8	8.0	3.9	0.3	5½
Western Asia	9.3	7.2	2.9	8.0	7.3	8.1	6.0	9.0	4.2	-3.0	1½
South & East Asia	11.0	18.7	15.8	10.5	10.6	14.5	16.5	6.0	10.3	1.0	1½
China	8.3	25.9	18.2	15.7	6.8	31.0	18.9	2.4	26.4	4.6	1¼
Volume of imports											
Developed market economies of which:	7.0	4.5	2.6	4.2	1.2	11.1	7.1	4.7	9.0	6.6	4¼
North America	4.3	1.3	-0.9	7.9	9.6	12.0	7.2	5.6	13.3	13.1	4½
Western Europe	7.9	6.3	4.1	3.2	-3.0	10.0	6.0	4.3	7.6	5.7	5
Japan	7.9	5.7	4.0	-0.4	2.9	13.6	12.5	3.5	2.7	-10.0	-1¾
Economies in transition of which:	6.9	-4.6	-22.5	0.8	..	..	..	..	..	..	..
Eastern Europe	4.1	-8.4	-2.5	12.0	..	..	..	..	..	..	..
Former USSR	9.3	-1.4	-38.5	-13.4	..	..	..	..	..	..	..
Developing countries of which:	9.1	3.9	14.7	11.7	15.5	9.5	9.6	8.5	11.1	-0.5	3½
Latin America & Caribbean	4.9	9.4	20.8	22.5	10.8	14.4	4.2	8.4	26.6	11.6	-1¾
Africa	-0.6	3.0	-1.9	3.0	0.1	2.1	9.6	3.4	8.2	2.4	4½
Western Asia	4.3	2.8	12.3	9.0	12.7	-11.1	11.3	11.8	7.4	4.1	1
South & East Asia	14.8	6.4	16.8	9.7	17.4	14.8	12.5	8.1	8.4	-6.2	5½
China	7.7	-16.1	21.4	23.1	36.4	9.1	0.1	11.4	10.3	4.2	5½

Source: UN/DESA, based in part on data of regional commissions of the United Nations and IMF.

a Preliminary estimates.
b Forecast, based in part on Project LINK.
c Average of the growth of the volume of world exports and exports.

Table A.10. International prices of non-fuel commodities exported by developing countries, 1988-1998

(Annual percentage change [a])

		Food	Tropical beverages	Vegetable oil-seeds and oils	Agricultural raw materials	Minerals and metals	Combined index: Dollar	Combined index: SDR	Manufactured export prices[b]	Real prices of commodities[c]	Memo item: crude petroleum[d]
1988		29.9	1.2	31.5	8.4	45.1	26.2	21.4	8.2	16.6	-19.7
1989		5.9	-14.6	-11.5	0.0	0.0	0.0	4.9	-1.1	1.1	21.6
1990		-6.2	-11.4	-12.9	4.7	-9.8	-5.9	-11.2	9.9	-14.4	28.6
1991		-6.6	-8.1	8.1	-0.7	-9.5	-6.3	-7.4	0.0	-6.3	-16.4
1992		-2.1	-14.0	7.5	-3.7	-3.7	-3.4	-5.7	3.0	-6.2	-1.0
1993		0.7	6.1	0.0	-6.2	-14.7	-3.5	-2.4	-5.8	2.5	-11.4
1994		10.1	75.0	24.4	15.7	12.7	18.0	13.6	2.1	15.6	-4.9
1995		5.9	1.1	10.3	15.0	20.2	9.9	4.3	11.1	-1.1	8.6
1996		6.8	-15.2	-4.2	-9.9	-12.1	-4.2	1.0	-3.6	-0.6	20.3
1997		-3.5	33.3	-0.9	-10.3	0.0	0.0	5.2	-7.5	8.2	-7.9
1998[e]		-10.9	-15.6	8.4	-11.3	-17.1	-11.9	-9.2	1.0	-11.8	-32.0
1997	I	-3.9	19.9	4.2	-9.3	-3.1	-2.3	0.0	-6.5	4.5	12.8
	II	-5.6	47.3	-3.7	-8.7	0.5	0.2	5.0	-5.7	6.2	-7.5
	III	-5.4	36.6	-6.8	-10.9	8.2	0.2	6.3	-8.5	9.5	-10.9
	IV	1.4	32.3	1.5	-13.0	-2.4	0.5	6.1	-7.6	8.8	-20.6
1998	I	-8.9	9.9	2.6	-14.6	-15.8	-8.5	-5.2	-2.0	-6.7	-35.7
	II	-9.8	-27.9	9.8	-11.6	-18.0	-13.6	-10.5	-1.0	-12.7	-30.0
	III	-14.3	-24.5	13.3	-7.4	-17.7	-13.8	-11.9	2.1	-15.5	-31.8

Sources: UNCTAD, *Monthly Commodity Price Bulletin*, United Nations, *Monthly Bulletin of Statistics* and *OPEC Statistical Bulletin.*

a For quarterly data, quarter shown is compared to same quarter of previous year.
b Index of developed countries manufactured export prices (1990 base year).
c Combined index of dollar commodity prices deflated by manufactured export price index.
d OPEC basket of 7 crude oils.
e Three quarters only.

Table: A.11. Selected developed and developing economies: real effective exchange rates[a], 1988-1998

(1990=100)

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998[b]
Developed economies											
Canada	101.8	105.0	100.0	97.6	91.4	89.0	88.7	92.3	91.5	92.7	91.3
France	98.8	95.9	100.0	97.9	101.7	103.1	102.6	103.1	103.2	98.6	99.3
Germany	99.8	96.7	100.0	97.9	100.7	100.9	99.8	104.8	100.4	94.9	96.4
Italy	90.1	93.1	100.0	101.0	98.4	85.0	83.3	81.1	91.4	91.2	93.3
Japan	120.3	112.2	100.0	104.8	106.6	121.6	126.5	127.5	108.8	103.4	100.0
United Kingdom	100.2	98.2	100.0	102.9	99.9	91.6	92.6	89.7	92.4	106.8	109.5
United States	97.9	101.8	100.0	101.2	101.1	103.3	100.5	95.7	100.2	106.3	114.5
Developing economies											
Argentina	103.3	88.0	100.0	115.4	113.4	115.0	111.4	108.9	112.8	120.4	123.6
Brazil	67.0	82.7	100.0	80.4	73.1	82.2	94.2	100.2	98.6	104.8	104.7
Chile	98.6	101.9	100.0	106.1	113.9	113.9	113.9	120.3	126.6	135.1	129.5
Mexico	112.3	107.6	100.0	106.2	107.8	116.6	112.2	78.9	89.8	102.8	103.0
Venezuela	135.5	117.9	100.0	99.8	100.7	104.0	109.3	139.1	119.1	139.4	156.2
Hong Kong, China	93.1	98.1	100.0	103.5	106.3	111.7	114.5	113.0	121.2	131.5	138.9
Indonesia	101.8	102.8	100.0	101.0	99.6	101.6	100.3	98.8	103.5	96.7	42.8
Malaysia	106.0	103.5	100.0	98.8	106.5	109.6	106.4	106.1	111.3	108.7	82.9
Philippines	99.6	106.1	100.0	97.0	105.7	97.4	104.4	103.5	114.7	109.0	89.2
Republic of Korea	96.3	107.7	100.0	96.9	88.4	85.8	84.1	85.6	88.5	83.8	65.4
Singapore	90.0	95.5	100.0	102.5	105.3	106.2	109.2	110.3	115.1	117.0	113.7
Taiwan Province of China	101.0	107.7	100.0	97.1	94.7	91.6	90.5	91.3	88.7	90.3	86.2
Thailand	97.4	100.3	100.0	102.4	98.7	100.2	99.5	97.7	105.6	97.6	86.4
Turkey	87.2	95.4	100.0	97.1	89.1	92.6	72.8	75.6	74.3	78.4	78.3

Source: Morgan Guaranty Trust Company, *World Financial Markets*.

a Measured against a broad currency basket of 22 OECD currencies and 23 developing-economy currencies (mostly Asian and Latin American). The real effective exchange rate, which adjusts the nominal index for relative price changes, gauges the effect on international price competitiveness of the country's manufactures due to currency changes and inflation differentials. A rise in the index implies a fall in competitiveness and vice versa. The relative price changes are based on indices most closely measuring the prices of domestically produced finished manufactured goods, excluding food and energy, at the first stage of manufacturing. The weights for currency indices are derived from 1990 bilateral trade patterns of the corresponding countries.

b Data for ten months only.