Summary

- The recent United Nations conference on the global financial and economic crisis proposed a comprehensive set of actions to mitigate the immediate impact of the crisis and to formulate adequate medium- and long-term responses.
- Unemployment is rising rapidly across the globe, posing a key risk for a sustained recovery of the world economy.
- The contraction in world trade is slowing but import demand in developed economies remains weak as policymakers focus on domestic issues.

Global issues


Heads of State and Government and High Representatives of the world’s nations met on 24-26 June 2009 for the United Nations Conference on the World Financial and Economic Crisis and Its Impact on Development. The debates at the General Assembly and the Round Tables highlighted that developed countries were at the epicentre of the crisis, but that developing countries were hit particularly hard through declining trade and commodity prices, capital flow reversals, exchange rate volatility, subsiding remittances, and other channels. Consequently, it was stressed, inter alia, that developed and large emerging countries need to do much more to enhance the space for developing countries, allowing them to engage in macroeconomic stimulus measures. For countries in the deepest financial distress, a temporary moratorium on external debt payments is needed. In addition, fundamental reforms of the international financial system and existing regulatory frameworks were considered paramount and a number of recommendations were issued accordingly. Furthermore, the Conference called for enhancing the coherence and coordination of policies and actions between the United Nations, international financial institutions and relevant regional organizations; further developing the United Nations development system’s comprehensive crisis response in support of national development strategies through a coordinated approach by United Nations funds and programmes, specialized agencies and the international financial institutions at the country level.

Rising unemployment poses significant risk for sustained recovery

While recent data on industrial production and world trade indicate that the global recession is slowing, labour market conditions around the globe continue to deteriorate rapidly. In the second quarter of 2009, unemployment rates increased significantly in all developed economies as well as in many developing countries and economies in transition as the private sector responded to the plunge in global demand by shedding jobs. In the United States, another 467,000 jobs were lost in June, pushing the unemployment rate up to 9.5 per cent, the highest level since 1983. Unemployment has also reached multi-year highs in Japan and the Euro area. Of greater concern, young people below the age of 25 are disproportionately affected by the job losses. In April 2009, the youth unemployment rate in the EU-27 area was 18.7 per cent, up from 14.7 per cent in April 2008. Labour markets are also deteriorating across the developing world as indicated by rapidly rising unemployment and underemployment rates in East Asia and Latin America. In addition to the social effects of unemployment, the deterioration of labour markets represents a key risk for a sustained economic recovery through its negative impact on consumption demand.

Global trade no longer in a free fall, but import demand in developed economies remains weak

The volume of world trade declined by 0.6 per cent in April 2009, as reported by the Central Planning Bureau of The Netherlands (see figure 1). April was the third month in a row registering only a small decline, which suggests that global trade is no longer in a free fall as it was the case between August 2008 and January 2009. The volume of world trade in April 2009 was 20 per cent below that during the same period last year. Trends are uncertain, however, and the possibility of further declines of world trade in the near future should not be discarded. So far, policymakers in most countries have focused on domestic stimuli favouring primarily non-traded activities (such as infrastructure) and spending categories with generally lower-than-average import propensities.

In developed economies, the volume of imports continued to decline at an average rate of 2 per cent per month from February to April. By contrast, the trade volume in developing Asia started to rise in February but the momentum has not been sustained. Besides, country-level data show that the rise of trade activity mainly reflects flows within the region, with China and its neighbours at the centre. Could this imply that...
Developed economies

**United States: financial regulatory reform and addressing greenhouse gas emissions**

According to the final estimate United States GDP contracted at an annualized rate of 5.5 per cent in the first quarter of 2009, which is 0.8 percentage points lower than the contraction observed in the last quarter of 2008. On the income side, corporate profits rose by 3.8 per cent after continuously falling for six quarters. Personal income has declined at an annualized rate of 2.3 per cent but temporary tax reductions have led to an increase in disposable personal income by 5 per cent. However, owing to a perceived higher level of uncertainty, households have increased savings rather than using the income increases for consumption purposes.

On 17 June 2009, the President of the United States introduced a financial regulatory reform plan, aiming at four objectives: (i) promoting robust supervision and regulation of financial firms; (ii) establishing comprehensive regulation of financial markets; (iii) protecting consumers and investors from financial abuse; and (iv) providing the United States Government with the required tools to manage financial crises. In general, the proposed plan addresses certain weak points in the regulation of the financial industry, but not all observers agree that the reforms go far enough to prevent future excesses and financial crises. On 26 June, the United States House of Representatives passed a bill that aims at reducing the emission of greenhouse gases. The economic approach implemented in the bill is the “cap and trade” scheme, which sets a limit to the total production of greenhouse gases, while allowing the trading of pollution permits. As both plans are still undergoing the domestic political procedures, the final details are far from clear.

**Western Europe and the EU: unemployment rises further as a recovery is not in sight**

In June, the European Commission’s Economic Sentiment Index improved for the third month in a row, but still remains below the trough registered during the major recession of 1992. The index improved for a majority of the countries that are included in the composite indicator and such positive signs were also apparent in the latest country-specific Purchasing Manager Indices. At the same time, however, the most recent data on capacity utilization show that, at the Euro area level, utilization remains at its lowest level since 1990. There was no sign of any upturn in industrial production, which continues to decline. The rate of decline has slowed significantly, however, compared with the sharp fall witnessed at the end of 2008. Unemployment rates continue to be on the rise in Europe. In the Euro area, joblessness increased to 9.2 per cent in April as compared to 7.3 per cent one year ago. In Spain, it has now reached 18.1 per cent. Inflation rates continue to fall across the region and have turned negative in several countries, signalling deflationary tendencies. Average inflation in the Euro area stood at 0.0 per cent in May, but this was heavily influenced by the 11.6 per cent year-on-year decline in energy prices. This statistical effect will continue to provide a downward bias for headline inflation over the next few months. Core inflation, which nets out energy and food prices, has drifted down throughout the year, but remains much higher, averaging 1.4 per cent in May.

**The New EU member States: sharp increases in fiscal deficits as Governments fight the crisis**

In several countries of the region industrial production has increased in April and May on a month-on-month basis, retail sales are stabilizing and the consumer sentiment is improving. However, it is still early to speak about “green shoots” signalling imminent recovery. In Latvia, large external financing needs prompted fears of a currency devaluation and the sale of government bonds worth $100 million did not attract bidders. The Government has reiterated its commitment to exchange-rate stability and prefers the real exchange rate to adjust by declining wages and prices. If one of the Baltic States were to forfeit its fixed exchange rate, this would exert serious pressure on its neighbours and perhaps also on the countries of South-eastern Europe that are committed to currency boards, with potentially serious implications for the private sector due to its high level of foreign indebtedness. The IMF and the EU have agreed to accept larger budget deficits than originally planned in those new EU countries that receive financial assistance subject to fiscal austerity measures. Hungary would now be allowed to run a fiscal deficit of 3.9 per cent of GDP and the ceiling for Latvia was set at 7 per cent of GDP.

**Japan: mixed picture of further weakening and some rebound**

After the Japanese economy contracted sharply during the previous two quarters, data for the second quarter of 2009 point to a moderated pace of deterioration, with a few indicators even rebounding. Both private consumption and business investment have continued to weaken, reflecting a further worsening in the employment situation and deteriorating corporate profits, but exports and industrial production have begun to turn upward, although the rebound may mainly be attributable to the inventory adjustment worldwide. Meanwhile, public investment has been growing along with the implementation of various stimulus measures. The picture presented by financial market indicators has also turned from
grim to mixed. Short-term interest rates remain close to zero due to continued monetary easing of the Central Bank. Spreads on corporate bonds have been narrowing, funding costs have declined further, and stock prices have rebounded. However, many firms have continued to see their financial positions weaken while lending conditions tightened.

**Australia and New Zealand: Australian economy circumvents recession owing to policy stimuli**

The economy of Australia unexpectedly circumvented a recession in the first quarter of 2009, largely owing to significant policy stimuli, but it remains uncertain if private sector activity will continue its mild recovery as fiscal stimulus spending declines. The economy of New Zealand continues to contract as both household consumption and business investment have fallen further.

**Economies in transition**

**CIS: deep recession in the Russian Federation affects neighbouring countries**

Recent data show that the economic downturn in the CIS continued to deepen in the first half of 2009. This largely reflects the ongoing contraction of the Russian economy where real GDP fell by 11 per cent in May year-on-year. The significantly weaker-than-expected economic performance on the back of a double-digit decline of investment and weak household consumption is causing further downward revisions of the output projections for 2009 and 2010. Despite some signs of stabilization on the financial side, such as a strengthening of the rouble and a recovery of the equity markets, banks have been unwilling to boost credit activity. This, in turn, has been an obstacle in transferring the monetary easing into the real sector. Growth in the neighbouring countries has been adversely affected by the sharper-than-anticipated slump in the largest economy through reduced trade and investment flows and falling remittances. Among these economies, the Republic of Moldova and Armenia have suffered the most, while Azerbaijan and Turkmenistan managed to record weak growth. As inflationary pressure eased and exchange rates stabilized in many CIS, the Central Banks continued to cut interest rates in order to stimulate their economies: in the Russian Federation, the key refinancing rate was lowered for a third time since the end of April and in Ukraine the rate was cut for the first time since 2008.

**South-Eastern Europe: conditions of IMF packages imply public spending cuts**

According to new data, first quarter GDP declined by 6.7 per cent year-on-year in Croatia and by 0.9 per cent in the former Yugoslav Republic of Macedonia. The tourism industry, which is particularly important for the Croatian economy, is performing poorly. To implement anti-crisis measures the countries need external funding, but the agreement reached by Bosnia and Herzegovina with the IMF on a $1.5 billion stand-by loan has been criticized within the country for predominantly focusing on macroeconomic stability and not on economic stimulus. In Serbia, in accordance with the conditions of the international assistance package, the Government has introduced measures to reduce budgetary expenses, such as salary cuts and pension freezes, which will however depress aggregate demand. The Central Bank in Serbia continued its policy of monetary loosening by reducing interest rates.

**Developing economies**

**Africa: Northern African countries are more resilient than most sub-Saharan countries**

In South Africa, new economic indicators provide a mixed picture. On the negative side, manufacturing production for April 2009 decreased by 21.6 per cent year-on-year, while retail sales during the period February to April 2009 fell by 5.4 per cent year-on-year, steeper than the 0.5 per cent decline during the period November to January. However, some indicators suggest that the worst of the decline might be over. The purchasing managers index rose for the second month in a row in June, while seasonally adjusted electricity consumption for the three months ended May 2009 increased by 2.9 per cent compared with the previous three months. *Unemployment is still rising in most sub-Saharan countries*, while inflation rates are declining more or less sharply after peaking last year. Several Central Banks, including the ones of Botswana, Egypt and Namibia, have announced new interest rate cuts to cope with the economic downturn. Northern African economies have been more resilient than sub-Saharan countries, owing to more robust domestic spending. In most Northern African countries, year-on-year GDP growth in the first quarter of 2009 stood at around 3 per cent, significantly lower than in previous years but well above growth in sub-Saharan Africa.

**East Asia: labour markets continue to deteriorate despite tentative signs of a recovery**

While many East Asian countries appear to be on their way to a moderate economic recovery, the labour market situation across the region has deteriorated sharply in the first half of 2009, with rates of unemployment and underemployment rising significantly. In China, the ongoing weakness in exports, imports and foreign direct investment continues to contrast sharply with the strength in domestic demand as indicated, for instance, by robust growth in retail sales. In Singapore - one of the East Asian economies most severely affected by the crisis - manufacturing output rose for a second consecutive month. Meanwhile, both official data and anecdotal evidence suggest that labour markets in the region continue to deteriorate. In Taiwan Province of China, the unemployment rate reached 5.8 per cent in May 2009, the highest level since the Government began compiling figures in 1978. In the Philippines, official records registered a decline in the rate of open unemployment from 7.7 per cent in January to 7.5 per cent in April, mainly owing to the creation of a large number of jobs in the public sector. However, the rate of underemployment increased from 18.2 per cent in January to 18.9 per cent in April. The pressures on the Philippine labour market are further aggravated by returning migrant workers who lost their jobs overseas. High unemployment and underemployment may prompt consumers across the region to curtail spending, posing a risk for sustained recovery.
**South Asia: workers’ remittances are holding up amidst worsening external conditions**

In South Asia, domestic demand has shown some resilience during the economic crisis, but external conditions continue to be very challenging as demand from developed countries remains subdued. In India, Pakistan, and Sri Lanka export earnings during the first five months of 2009 were sharply lower than a year ago and there are no signs yet of a recovery. In dollar terms, India’s exports declined by 29.2 per cent year-on-year in May, while Sri Lanka’s exports dropped by 28.2 per cent year-on-year in April. However, as imports have fallen even more rapidly, partly owing to the decline in oil and commodity prices, trade deficits have contracted in recent months. In Sri Lanka, the cumulative trade deficit during the first four months of 2009 was 61.5 per cent lower than in the corresponding period of 2008. This has helped the Central Bank of Sri Lanka to build up its international reserves to a more comfortable level and to remove restrictions on foreign exchange transactions that were introduced in October 2008. Unlike trade flows, workers’ remittances to South Asian countries have so far held up reasonably well since the onset of the crisis, in sharp contrast with remittance flows to Latin America and the Caribbean (see figure 2). In Sri Lanka, average monthly remittance inflows during the first four months of 2009 were only slightly below the level reached in 2008, whereas remittances sent to Bangladesh and Pakistan continue to show a rising trend.

**Western Asia: economic activity weakens further**

The economic situation in Western Asia continues to deteriorate, with only some signs of a deceleration in the slowdown. In Turkey, GDP declined by 13.8 per cent year-on-year in the first quarter of 2009 as only the increase in public spending prevented an even more pronounced contraction. This trend has continued, with industrial production falling by 18.5 per cent year-over-year in April mainly owing to the weakness in the automotive and textile sectors. The decline represents only a slight improvement from the 20.9 per cent drop in the previous month. Against this background, unemployment increased to 15.8 per cent in the period February to April from 11.0 per cent a year ago. Contracting economic activity also underpinned a decrease in Turkey’s year-on-year inflation rate to 5.2 per cent in May. In Israel, the economy shrank at an annualized rate of 3.9 per cent in the first quarter, following a decline by 1.6 per cent in the fourth quarter of last year. While all GDP components contracted, the fall in exports by 37.0 per cent year-on-year was especially pronounced, albeit still smaller than the 46.0 per cent decline in the previous quarter. In view of falling inflation, Saudi Arabia’s Central Bank lowered its main policy rate by 25 basis points to 0.25 per cent, but banks have remained reluctant to use any increased liquidity for additional lending.

**Latin America: economic contraction deepens despite massive government efforts**

In Latin America and the Caribbean, economic indicators continue to reveal further deep contractions, with no signs of a recovery in the short run and further downward revisions of the growth forecasts for 2009 in several countries. In the first four months of the year, manufactured exports fell by more than 20 per cent in countries such as Chile and the Plurinational State of Bolivia. In Mexico, industrial production dropped by 13.2 per cent year-on-year in April, the biggest fall in the last 14 years. In addition to lower exports, domestic demand in Mexico is also declining, in part owing to higher levels of unemployment and lower remittance inflows. In May, the unemployment rate reached 5.3 per cent, the highest level since the peak of the tequila crisis, while remittance inflows during the first five months of 2009 were 11.2 per cent lower than during the same period in 2008 (see figure 2). More people are expected to slip back into poverty unless the economy recovers rapidly. Several Governments in the region are taking extraordinary measures to reactivate their economies. Interest rate cuts were particularly pronounced in Brazil and Chile. In Chile, interest rates were reduced to a historical low of 0.75 per cent in June 2009. In parallel, fiscal space is narrowing rapidly as public revenues are decreasing. While still registering a surplus, Argentina is also rapidly running out of fiscal space as its budget surplus declined by 85 per cent in May 2009 as compared with May 2008. In Nicaragua, the deterioration of fiscal balances prompted the Government to reduce current expenditures, notably in the areas of health and education, with potentially negative long-term effects on human development.

**Least Developed Countries: several countries increase fiscal spending to fight the crisis**

While some least developed countries (LDCs) were able to adopt new stimulus measures to cope with the economic downturn, others are facing increasing difficulties. In recent months, three East-African LDCs—Rwanda, United Republic of Tanzania and Uganda—raised their government expenditures by between 15 per cent and 31 per cent, with much of the increase being allocated for public investment in infrastructure, roads and energy projects. In the Democratic Republic of the Congo, where inflation stood at 74 per cent by the end of May, down from a peak of 121 per cent earlier this year, the situation has remained tense after its foreign reserves declined to the equivalent of one and a half weeks of imports. In Haiti, the World Bank approved a new four-year $121 million loan programme that focuses on economic growth and job creation as well as on reducing the impact of natural disasters. In addition, Haiti obtained $1.2 billion in debt relief, nearly two-thirds of Haiti’s outstanding debt, following reforms undertaken in compliance with the conditions of the Heavily Indebted Poor Country (HIPC) initiative.