Global issues: growth loses momentum at an alarming pace in some parts of the world

There are increasing signs of a widespread deceleration in the global recovery. These are particularly alarming in the United States and Japan. The pace of economic activity in China has also been cooling notably, although it has been partly engineered by policy measures. Although Germany and a few other European economies have registered a better-than-anticipated growth rate in the past quarter, and the recovering momentum seems to have been maintained so far in other emerging economies such as India and Latin America, many forecasting institutions have recently downgraded their prospects for the world economy, marking up the risk of a “double-dip” recession. As global growth prospects are becoming grimmer, investors are fleeing to “safe haven” assets, bringing down yields of German, Japanese and United States government bonds as observed in figure 1. Even without a double-dip recession, the world economy will be in for a protracted period of subdued growth, accompanied by elevated unemployment, which equally would be detrimental. The hangover from the impact from the global financial crisis, particularly the prolonged adjustment in the balance sheets of financial institutions and households, and the fading of Government stimulus measures are the two major factors dragging the global recovery. Policymakers worldwide would have to revisit stimulus measures in order to resurrect the global recovery.

Heavy rains since the end of July have caused the worst flooding in Pakistan’s history. Water covers about 20 per cent of the territory and the total number of displaced people is estimated at 15 to 20 million. The most acute challenges are to get food, medicine and shelter to the victims, and to halt the spread of water-borne and vector-borne diseases such as cholera and malaria. The flooding has inflicted immense damage to the economy, which had just started to recover from the balance-of-payments crisis suffered in late 2008 and which depends on loans from the IMF totalling $11.3 billion. The flooding has destroyed large parts of the infrastructure in the affected areas, including roads, bridges, irrigation systems and power plants, as well as cotton, rice, corn and wheat crops, driving up food prices and exacerbating electricity shortages. Preliminary government estimates indicate that growth in the current fiscal year will decline to 2.6 per cent\(^1\) (from 4.1 per cent in the fiscal year 2009/10), almost 2 percentage points lower than previously expected. According to Pakistan’s Foreign Minister, total commitments and pledges by international donors have reached $815 million. In addition, the World Bank has committed $900 million in support of the recovery, while the Asian Development Bank has pledged $2 billion for reconstruction over the next two years.

A heat wave, along with related droughts and wildfires, hit the Russian Federation this summer. This caused a spectacular rally in global wheat prices that accelerated in early August after the Russian Government banned wheat exports. Prices briefly reached a 23-month record high after increasing by more than 70 per cent since early June. However, since 5 August, with fears of a new food

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\(^1\) Growth rates in this Note refer to year-on-year estimates, unless otherwise specified.
crisis dissipating, prices have been declining again. Indeed, even with the Russian shortfall, the 2010 wheat crop is still forecast to be one of the largest in world history. Moreover, in contrast with the 30-year low in 2007-2008, global wheat stocks will continue to be higher than average in 2010.

**Developed economies**

**United States: second quarter GDP revised downwards**

According to the latest figures, the United States economy grew at an annualized 1.6 per cent in the second quarter of 2010 over the first quarter, compared with the 2.4 per cent previously announced and reported in the Monthly Briefing of August. The revision was mainly due to slower inventory restocking and higher imports. However, private consumption and fixed investment have been revised upwards. Other high-frequency indicators also highlighted the slowdown of the recovery. The housing sector cooled significantly following the expiration of the homebuyer tax credit programme in June, and the building and sales of houses are currently at their lowest levels ever. New orders for core capital goods also registered a month-on-month decline of 8 per cent in July. However, the manufacturing industry has maintained its recovery trend over the past few quarters. Nevertheless, total employment has increased by only 0.5 per cent since the beginning of the year.

**Western Europe and the EU: the recovery continues, albeit more unevenly**

Western Europe showed further signs of recovery in the second quarter, as quarter-on-quarter GDP growth accelerated to 1.0 per cent in the Euro area, after a 0.2 per cent increase in the first quarter. This was the strongest growth since the onset of the recession. Germany led the way with a growth of 2.2 per cent, which, if annualized, amounts to more than 9 per cent. The United Kingdom registered 1.1 per cent, while France and Italy grew by 0.6 and 0.4 per cent, respectively. Germany and other export-oriented economies benefited from strong demand in emerging economies, particularly for capital goods, as well as from the sharp depreciation of the euro. But the quarter also saw further signs of divergences within the region, with Spain and Portugal growing by only 0.2 per cent, while Greece remained mired in recession, contacting by a further 1.5 per cent. These countries were all victims of massive fiscal consolidation programmes made necessary by the sovereign debt crisis that erupted in June, and were not well positioned to take advantage of strong export demand due to deeper structural problems. Recent high-frequency data, such as industrial production and purchasing manager indices, point to continued expansion, but at a diminished pace and with continuing large divergences in performance.

**The new EU member States: Estonia’s economy returns to growth**

The recovery continues in the new EU member States. Estonia’s economy showed a return to growth in the second quarter, with GDP expanding by 2 per cent on a seasonally adjusted quarterly basis, on the back of strong performance in exports of manufactured goods and electricity. Latvia also grew by 0.1 per cent quarter on quarter, even though its second quarter GDP was 3 per cent lower than the same period last year. Employment in Latvia has increased by 2.1 per cent on a quarterly basis. However, the active population is now shrinking, as the country experiences large outward migration.

In early August, the joint mission of the IMF, the European Commission and the World Bank completed its review of Romania’s multilateral funding programme. They concluded that the programme was on track and that the target deficit of 6.8 per cent of GDP for 2010 was achievable, clearing the way for a release of $1.2 billion from the IMF and €1.2 billion from the EU. Moreover, Romania’s authorities also aim to raise €1 billion in the international bond market. However, the economic recovery may be delayed by the continuing weakness in domestic demand and harsh austerity measures, as well as by summer floods, which also caused damage in Hungary and Slovakia.

**Developed Asia and the Pacific: a sharp deceleration in Japan**

The latest data show a stall in the economic recovery of Japan. GDP registered a mere annualized and seasonally adjusted growth rate of 0.4 per cent in the second quarter, compared with 4.4 per cent in the previous quarter. A 12.9 per cent drop in public investment was the key factor behind the slide, but private consumption also weakened notably. By contrast, net exports continued to grow, but at a slower pace. In the outlook, net exports are expected to soften further, given a general weakening in global demand and the appreciation of yen. Facing the growing downside risks, the Government is anticipating new measures to stimulate demand, although the scale is likely to be small.

The economy of Australia continued to grow at a solid pace, as indicated by a robust growth in employment. Since mid-2009, the economy has added some 330,000 jobs, and the unemployment rate has dropped by 0.5 percentage points. Real wages have
increased notably, particularly in the mining sector. The buoyant mining sector has helped boost domestic investment and has been a key factor in saving the economy from falling into a recession during the global financial crisis.

**Economies in transition**

**CIS: varied performance in the large economies**

The larger economies of the CIS continued to show signs of further recovery in the second quarter of 2010. Output growth in the first half of 2010 was estimated at 4.2 per cent in the Russian Federation. It reached 6 per cent in Ukraine and 8 per cent in Kazakhstan. There are, however, some signs of slowing industrial sector activity. In Ukraine, for instance, output of steel was one fifth lower in June than in March. While industrial output also weakened in the Russian Federation in June, it still registered a 10 per cent increase in the first semester. In Ukraine, an anaemic retail sector is dampening performance of the economy at large. In the Russian Federation, by contrast, retail sales have strengthened and they are particularly buoyant in Kazakhstan, increasing by more than 17 per cent in June. Nonetheless, inflationary pressures remain low in these economies. In June, inflation slowed to below 7 per cent in Kazakhstan and Ukraine and to below 6 per cent in the Russian Federation.

In August, the IMF approved a $15.1 billion loan for Ukraine to help strengthen the financial system and public finances. Meanwhile, a newly introduced oil-export duty came into effect in Kazakhstan in August. Levying it at $20 per metric ton of oil ($2.73 per barrel), the Kazakh authorities hope to raise more than $400 million by the end of 2010, and more than $1 billion in 2011.

**South-Eastern Europe: satisfactory export performance in Albania**

Albania’s exports increased by 85 per cent in the second quarter. Despite the Greek economic crisis, Albania’s exports to that country increased by 30 per cent. However, remittances from Greece, where a large number of Albanian migrants work, have declined and are expected to remain subdued in the medium run. Although domestic demand in the region remains weak, some progress in infrastructure projects were reported in Albania and the former Yugoslav Republic of Macedonia.

Overall, inflation in the region remains low, except in Serbia, where consumer prices were affected by weaker agricultural performance and a depreciating currency. This led the National Bank of Serbia to raise interest rates in early August to achieve the country’s annual inflation target.

**Developing economies**

**Africa: loss of momentum in South Africa’s economy amid workers’ unrest**

Growth in South Africa slowed to an annualized and seasonally adjusted rate of 3.2 per cent during the second quarter, down from 4.6 per cent in the first quarter. Growth of manufacturing output decelerated to 6.9 per cent from 8.4 per cent. Mining output shrank by 20.8 per cent during the quarter after growing by 15.4 per cent before, owing to stoppages resulting from both routine maintenance and labour strikes. The wave of strikes also hit other sectors, both public and private, of the continent’s biggest economy and offset earlier optimism about the growth in South Africa as reported in the previous WESP—Monthly Briefing. At the end of August, the movement was still spreading and threatened to paralyse several parts of the public sector. Meanwhile, inflation slowed to 3.7 per cent in July, making room for another interest rate cut in September (see figure 2).

After reaching a record high last year, grain harvests in North Africa are expected to decline owing to dry weather. In Morocco and Algeria, the two largest cereal producers in North Africa, a decline of about 25 per cent of output is expected. In Tunisia, however, a drop of more than 50 per cent is now forecast. So far, none of these long-standing net importers of cereals has presented a strategy to cope with the international price increase owing to the drought in the Russian Federation.

**East Asia: slowdown expected in the second half of the year**

Having expanded vigorously in the first semester, the East Asian economies are likely to experience slower growth over the coming quarters. Like other countries in the region, Indonesia, Malaysia and Thailand reported very
strong GDP data for the second quarter, with growth of 6.2 per cent, 8.9 per cent and 9.1 per cent, respectively. However, high-frequency indicators such as industrial production and trade have recently started to weaken, especially in the strongly export-oriented economies of the region. In Singapore, non-oil exports decreased by 3.9 per cent in July on a month-on-month, seasonally adjusted basis, and manufacturing output, excluding the volatile biomedical manufacturing sector, fell by 1.8 per cent in June. In Malaysia and Taiwan Province of China, industrial production stagnated in the past few months, and in China it increased by only 13.4 per cent in July, down from 20 per cent at the beginning of the year. Inflationary pressures have remained low in most countries. However, inflation in July rose to 6.2 per cent in Indonesia and 3.3 per cent in China, where food price inflation accelerated sharply. Against the background of slowing growth and mild inflationary pressures, central banks in East Asia not likely will tighten monetary policy in the immediate outlook.

**South Asia: monetary policy stances diverge**

Inflation has fallen in most South Asian economies recently, but remains at elevated levels. In India, wholesale price inflation declined to a six-month low of 10 per cent in June, primarily owing to slower food price increases. The Reserve Bank of India had accelerated its monetary tightening in late July by raising the key policy rate by 50 basis points, to 4.5 per cent, following three previous hikes of 25 basis points. Just before the flooding began, the State Bank of Pakistan had also raised the policy rate by 50 basis points, to 13 per cent, expecting inflation to remain a significant risk to macroeconomic stability. The Central Bank of Sri Lanka, by contrast, lowered interest rates in July and August by a total of 75 basis points after inflation declined from 6.9 per cent in February to 4.3 per cent in July.

**Western Asia: signs of a more challenging economic environment**

In Turkey, industrial output was up by 10.1 per cent in June compared with the exceptionally weak level of comparison in the previous year. Compared with May 2010, however, industrial production was down by 2.1 per cent, as an indication of a slowing recovery. Consumer price inflation fell to 7.6 per cent in July from 8.4 per cent in the previous month. By contrast, figures for Israel point to a continued solid expansion, with the annualized economic growth rate for the second quarter reaching 4.7 per cent, up from 3.6 per cent in the first quarter. Slower growth in government spending was more than offset by strong increases in private consumption, investment and exports. The Bank of Israel, meanwhile, increased its main policy interest rate by 25 basis points, to 1.75 per cent. Among the Gulf States, Moody’s cut the government debt rating of Bahrain by one notch, from A2 to A3, with a stable outlook. Reasons for the downgrade included reduced room for fiscal manoeuvre, with the oil price needed to achieve a balanced budget now seen at around $80 per barrel, as well as concerns regarding the country’s banking sector.

**Latin America: data confirms a firm rebound during second quarter in South America**

Peru registered an impressive monthly growth of 11.9 per cent in June, bringing overall growth for the first half of the year to 8.2 per cent. This was partly driven by an 11 per cent increase in domestic demand. Private investment and consumption demand were particularly strong. The most dynamic sectors were construction and manufacturing, which increased 19 and 12 per cent, respectively. Chile followed a similar pattern, with a GDP growth of 6.5 per cent in the second quarter after the negative impact of the earthquake during the first quarter of the year. In Brazil, as the economic expansion continues, the open unemployment rate in the big cities fell again in July, to 6.9 per cent. Surprisingly, consumer prices did not increase, despite recent fears of an overheating of the economy. The performance of the Bolivarian Republic of Venezuela continues to contrast with the regional trend, its economy shrinking by 1.9 per cent in the second quarter of 2010.

**Least developed countries: food situation improves in several East African LDCs after the 2009 drought, but remains extremely worrisome in Niger and the Sudan**

The prospects for cereal crops in several East African least developed countries, including Ethiopia, Uganda and the United Republic of Tanzania, are expected to be favourable for 2010 according to the FAO. The livestock sector is also recovering from the negative impacts of the 2009 drought that affected several countries in the region. While prices have been declining from record levels in local markets, they still remain far above the pre-food crisis levels of 2007. More worrisome, the Southern Sudan faces a severe food crisis as more than four million people risk severe food shortages owing to recent floods.

The IMF recently approved a $370 million loan to Yemen aimed at helping the country to stabilize its economy, which has come under increasing pressure from the difficult security situation and the fall in the value of the country’s currency.