Global issues:

European sovereign debt crisis is spreading to larger economies

The euro area’s sovereign debt crisis continues, despite the agreement reached on November 28th which put together a bailout package worth 85 billion euro ($111 billion) for Ireland (see below section on Western Europe and the EU). European Union officials also agreed on a mechanism to smooth bond restructurings after 2013, but investors are speculating that European nations will not be able to cut deficits fast enough before that target date, especially as economic growth prospects remain gloomy. By early December, the European strategy had not yet helped to fully calm down markets, as borrowing costs for governments of countries with perceived debt distress continued to escalate and even started to affect countries like Italy and Belgium (figure 1). The premium on Portuguese and Spanish 10-year bonds over the rate for German bunds increased to euro-era highs during November. The risk premium on Portuguese bonds increased by 78 basis points to 447 and Spain saw the borrowing costs go up by 114 basis points to 291. Under such financial pressure, the two countries, but Portugal in particular, may be in need of external assistance in the near future. Investors have also expressed concerns that the European Union’s bailout fund may be insufficient to save Spain, whose economy is twice the size of Ireland, Greece and Portugal combined.

Stock markets have fallen with the increased financial volatility

Worldwide, equity markets declined notably in November as investors have become more pessimistic in the face of the continued sovereign debt crisis in Europe, interest rate increases in some emerging economies, the increased exchange rate volatility and news about weakening economic performance indicators in developed countries. Equity prices in many stock markets dropped by between 5 and 10 per cent. Nonetheless, the contagion effect of Europe’s sovereign debt woes on global equity markets appears to have been less severe than during the financial turbulence of May and June of this year, when Greece’s debt crisis erupted.

Exchange rates continued to gyrate

The exchange rates of major currencies continued to be highly volatile. Amidst strong fluctuations, it was the euro that depreciated against the yen and the dollar during most of the first half of the year, but from July it was the United States dollar which saw its value drop significantly. The euro rebounded and the yen reached a 15-year high against the dollar. During November, however, the second wave of the sovereign debt crisis in Europe sent the euro back into a tailspin. The roller-coaster ride of the major reserve currencies is harming the recovery and generating additional uncertainty in financial and commodity markets.
Mixed signals in global economic activity at the beginning of the fourth quarter

During the third quarter, industrial production had slowed down markedly (see Monthly Briefing No. 25), confirming expectations of a decelerating global recovery for the second half of the 2010. However, some recent short-terms indicators suggest that the deceleration in global economic activity observed since July 2010 might be stabilizing. Growth of global manufacturing production in October was the fastest since June. Month-on-month rates of manufacturing production growth accelerated in the United States, as well as in the euro zone, the United Kingdom, India, Turkey, Poland and Denmark. Within the euro area, Germany, France, Italy and Austria all showed strong performances in October. The end of the industrial production deceleration has been helped by a pickup in final sales, revealing that consumer confidence is improving. After slowing down between May and July, global retail sales volumes increased by 4.6 per cent in September. In the United States, retail sales also increased in October, while the consumer confidence index increased to 54.1 in November, up from 49.9 in October. While still weak by usual standards during upward cycles, the improvement in consumer confidence could be a positive sign. Further, export growth in Asia seems to have slightly picked up and business surveys in Germany hint at increased economic activity in November with the IFO survey hitting an all-time high.

These positive signals come amidst still high, uncertainty and other news showing further increasing unemployment rates in the United States and Japan and greater fiscal austerity in several European countries.

Developed economies

United States of America and Canada: Upward revision of GDP
growth in the United States, contrasts with slower growth in Canada

The United States Bureau of Economic Analysis revised its estimate of GDP growth for the third quarter to 2.5 per cent (quarter-to-quarter annualized rate), up from the original estimation of 2.0 per cent. The revision owes to higher than previously estimated levels of investment in equipment and software and net exports. Private and government consumption were also higher than initially estimated, while levels of investment in business construction and inventories were revised downward. The housing market remained weak after the expiration of homebuyer tax credit programme in June. Private data sources indicate that the number of homes in different stages of foreclosure remains extremely high and housing prices started to soften. Data based on payrolls signalled a small increase in employment in the United States during November. This was contradicted by household survey data which showed a loss of civilian employment of 173,000 in the same month. The survey data also point out that the total civilian labour force increased by 103,000 and that consequently the unemployment rate increased again to 9.8 per cent, the highest level in 7 months.

During the third quarter, the Canadian economy is estimated to have expanded at the annualized rate of 1.0 per cent from the previous quarter; a significant slowdown from the 2.3 per cent growth in the second quarter. The deceleration was caused by a substantial decline in exports to the United States.

Western Europe and the EU: a tale of two recoveries

According to first estimates for GDP in the third quarter, growth decelerated for most countries in the region—in the euro area GDP grew by 0.4 per cent on average, after having posted a growth rate of 1.0 per cent in the second quarter. Performance varies strongly across countries, however. Germany’s economy expanded by 0.7 per cent; a significant slowdown from the robust performance in the second quarter. GDP growth in Portugal picked up somewhat, but remained very weak. The Greek economy continued in recession while Spain saw zero GDP growth. After weeks of resisting assistance from the EU, in dealing with its insolvent banking system, Ireland finally requested and was granted emergency finance totalling €85 billion. The bailout was provided through a mix of funds from EU and International Monetary Fund (IMF). The support is conditional on Ireland adopting further austerity measures as part of a four-year programme of fiscal adjustment and structural reforms. The rescue operation thus far has not helped put financial markets at ease (see above section on global issues).

The new EU member States: stronger performance in the third quarter

Among the new EU member States, Poland posted strong growth in the third quarter—GDP expanded by 4.2 per cent, the best result in two years. Domestic demand provided necessary momentum, with total private and public consumption adding 2.9 percentage
points to overall GDP growth, and inventory restocking another 1.2 points. Helped by stronger exports, the Czech Republic, Estonia, Latvia and Slovakia also registered solid growth of 3.0 per cent, 4.7 per cent, 2.7 per cent and 3.7 per cent, respectively in the third quarter. In Lithuania, third-quarter growth was revised upwards to 1.1 per cent.

The recovery among the new EU countries is not yet on a strong footing as domestic demand is still weak. The UEFA European Football Championship of 2012 (organized jointly by Poland and Ukraine) is expected to boost infrastructure spending and capital investment during 2011 and 2012 in Poland. In Estonia, which prepares to adopt the euro in January, higher food and energy prices have pushed up the consumer price index by 4.7 per cent in October year-on-year. This may exert upward pressure on wages which could affect export competitiveness. In November, the European Commission provisionally agreed to release the final tranche of 1.2 billion euro of assistance to Romania, but provided there is no slippage in the implementation of the country’s fiscal consolidation strategy.

**Developed Asia and Pacific: Japan’s exports continue to fall**

Recent data show that Japanese exports fell in volume for a third consecutive month in October. The decline concerned all trading partners, but exports to the United States and Europe fell strongest, respectively, by 22.8 per cent and 16.7 per cent. EU imports from Japan had already dropped by 20.4 per cent in the previous month. Meanwhile, Japan’s import demand also declined. If this trend continues and given the dependence of the Japanese economy on exports, there is a high probability that GDP will decline in the fourth quarter of 2010.

Australia’s GDP grew by 0.2 per cent in the third quarter of 2010, well below the 1.1 per cent output growth recorded in the previous quarter. Aggregate demand was kept up by still expanding household consumption and business investment, but net exports fell by 2.4 per cent. Output in agriculture, forestry and fishing expanded strongly, but non-farm output contracted by 0.2 per cent.

**Economies in transition**

**CIS: Poor agriculture dampens growth in the CIS**

Real growth weakened in the Commonwealth of Independent States (CIS) in the third quarter of 2010. In the Russian Federation, GDP growth declined to 2.7 per cent (compared to 5.2 per cent in the second quarter), while it softened in Kazakhstan to 6 per cent from 8.6 per cent in the second quarter. Poor performance of the agriculture sector caused by adverse weather conditions exacerbated the general economic slowdown. In Kazakhstan, industry and services showed robust growth but agricultural output contracted by 12.4 per cent in the period January-October due to a bad grain harvest. Similarly, in Ukraine, poor grain and potato harvests (down by, respectively, 12.1 per cent and 6.2 per cent in January-October, year-on-year) partially offset the growth impulses coming from industrial sectors where output was up by 10.7 per cent. While growth in Belarus strengthened somewhat in the third quarter, reaching 4.1 per cent by the end of September, it remained flat in October. Moreover, agriculture in Belarus also performed weakly, with grain harvests a fifth lower in the period January-November, contrasting to a 14.7 per cent expansion in industrial output in the period January-October. Overall, higher food prices continued to contribute to inflationary pressures in the region in October (see Monthly Briefing No. 25).

**South-Eastern Europe: the economic recovery is gaining momentum**

Data for the second quarter in Albania shows an acceleration of GDP growth to 3.3 per cent, driven by export-led industrial growth, which more than offset the continued decline in construction activity. In Croatia, the income surcharge tax introduced in 2009 was fully phased out in November, which should support the recovery of private consumption. Most of the South-east European countries maintain accommodative monetary conditions. In November, the Croatian National Bank hinted at the possibility of further reducing mandatory reserve requirements in order to release more liquidity available to the business sector. Serbia forms an exception as the National Bank of Serbia increased its policy rate by 100 basis points in November, citing strong inflationary pressures and a faster-than-expected recovery in aggregate demand. Also in November, the European Commission granted Montenegro candidate status to become member of the EU.

**Developing economies**

**Africa: South Africa’s recovery is slowing down**

South Africa’s GDP growth in the third quarter slowed down to an annualized 2.6 per cent (quarter-on-quarter), from 2.8 per cent in the second quarter of 2010. The subdued performance is mainly explained by a contraction of 5 per cent in the manufacturing sector, owing to labour strikes and the appreciation of the South African rand. In addition, construction activity weakened further and growth in domestic trade, accommodation, transport and communications moderated. These factors largely offset the positive impact of strong rebounds in mining and agricultural output, as well as growth of financial services and real estate businesses. In Ghana, the first offshore oil extraction is expected to start in mid-December, normalizing the production at 120,000 barrels per day in the first phase, eventually increasing up to 250,000 barrels per day after three years. The parliament has yet to decide on the use of oil
revenues, amid disagreement over the Government’s proposal to use portions of the revenue as collateral for foreign loans. Morocco’s unemployment rate fell to 9 per cent in the third quarter from 9.8 per cent a year earlier. A total of 125,000 additional jobs in services and building activities more than offset 70,000 jobs destroyed in the manufacturing industry. Moreover, the labour-intensive farming sector—which accounts for about one fifth of Morocco’s gross domestic product and employs more than the half its work-force—created 40,000 jobs in the third quarter.

**East Asia: Slower growth in the third quarter**

The recovery in East Asia has slowed in recent months as the effects of monetary and fiscal stimulus measures waned and demand from developed countries weakened. While the pace of expansion decelerated significantly in the third quarter of 2010, year-on-year growth still reached 5.3 per cent in Malaysia, 5.8 per cent in Indonesia, 6.5 per cent in the Philippines and 6.7 per cent in Thailand. However, in the latter two countries seasonally adjusted GDP contracted compared to the second quarter. The slowdown reflects slower growth of investment and exports, partly owing to the appreciation of national currencies. In addition, some Governments have started to cut back on public spending to consolidate fiscal balances. Government consumption declined by 10.2 per cent year-on-year in Malaysia and by 6.1 per cent in the Philippines. Meanwhile, consumer price inflation in China jumped to 4.4 per cent because of soaring food prices. In response, the authorities have stepped up measures to contain inflation. The Central Bank further increased capital reserve requirement for banks, while the Government aims at increasing grain supply and at limiting speculation.

**South Asia: India’s economy maintains its strong growth momentum**

India’s economy continued to expand at a brisk pace in the third quarter of 2010. GDP increased by 8.9 per cent, following growth of 8.7 per cent in the first half of the year. Private and government consumption each expanded by about 9.2 per cent, notably faster than in the first half of the year, whereas growth of gross fixed capital formation slowed from 18 to 11 per cent. At the sector level, the expansion was mainly driven by strong growth in manufacturing output and services (in particular trade, hotels, transport and communication). Agricultural output rose by 4.4 per cent thanks to good monsoon rains. Meanwhile, the Reserve Bank of India raised its main policy rates for the sixth time in 2010, lifting the repo rate and the reverse repo rate to 6.25 per cent and 5.25 per cent, respectively. In Bangladesh, an increase of the minimum wage in the garment sector took effect in November. Garment workers must be paid at least 3,000 taka ($43) per month, 80 per cent more than before. However, the increase falls short of the demands of unions and labour rights groups, which had pressed for a minimum wage of 5,000 taka ($71).

**Western Asia: indications of a consolidation in growth**

In Turkey, inflation receded to 8.6 per cent in October from 9.2 per cent in the previous month as virtually all components except food showed weaker price increases. At the same time, while industrial production increased by 10.4 per cent in September year-on-year, it actually contracted moderately by 0.4 per cent from the previous month. In the United Arab Emirates, inflation picked up to 1.2 per cent in September compared to 0.9 per cent in the previous month, driven in particular by higher food prices. GDP growth in Israel fell to 3.8 per cent in the third quarter from 4.5 per cent in the previous quarter, with only government spending providing a stronger growth impetus.

**Latin America and the Caribbean: inflation is on the rise in biggest economies**

In Mexico, GDP growth figure for the third quarter shows a deceleration of to 0.73 per cent (quarter on quarter), from 2.3 per cent in the second quarter. The economic slowdown is mainly explained by lower investment demand and declining manufacturing output. In Venezuela, the economy contracted by 0.4 per cent in the third quarter of 2010. Despite being the seventh consecutive quarter of economic contraction, the economy is improving owing to stronger internal demand and may soon come out of its recession. In Peru, GDP grew by 9.7 per cent during the third quarter of 2010, driven by strong domestic demand. Inflationary pressures are mounting in Brazil and Mexico. In Brazil, inflation reached 5.5 per cent, which is above the year-end target of 4.5 per cent for 2010, in a context where the unemployment rate declined further to 6.1 per cent in October and real wages increased. In Mexico, consumer price inflation reached 4.02 per cent in October, above central bank’s target of 3 per cent, mainly owing to higher agricultural commodity prices. In Uruguay, exports continued to increase, by 21.8 per cent during the first 10 months of 2010, benefiting from strong demand in Brazil. Brazil is now Uruguay’s major trading partner.

**Least developed countries: devaluation of the Sudanese pound**

The Central Bank of Sudan surprisingly raised the margin for commercial banks to buy foreign currency to 17.6 per cent above their official rates in November in an attempt to curb the black market and to bring more liquidity into the economy. Over the last months, the Sudanese pound has become under pressure over speculations of a new outburst of domestic conflict, fuelled by the possible referendum on independence for the oil-producing South to be held in January 2011. The Central Bank hopes to be able to roll back the devaluation once the uncertainty about the referendum has subsided.