There are increasing signs that the world economy is entering a recession.
- Slowing global demand underpinned a further decline in oil prices.
- Weakening economic conditions led to further accommodative policy actions.

Global issues

Deteriorating economic indicators in the United States, Europe and Japan as well as slowing economic activity in developing countries and the economies in transition increase the likelihood of a global recession. Much needed fiscal stimulus packages in major economies are under consideration, but not yet being implemented.

Oil prices continue to slide

Crude oil prices continued to fall on further evidence of rapidly slowing global oil demand. The price of Brent crude dropped from about $60 per barrel in early November to a low of $38 on 5 December, before recovering slightly. Global demand for crude oil is expected to contract in 2008 for the first time since 1983 and is forecast to remain weak throughout 2009. Rising levels of inventories provide a clear indication that supply currently continues to outstrip demand. OPEC announced on 17 December, 2008 an unprecedented production cut of 2.2 million barrels per day that comes on top of the reduction by 2 million barrels per day it had pledged in September. This helped to stabilize prices towards the end of December. Among non-OPEC countries, Azerbaijan and the Russian Federation indicated their willingness to reduce production.

Currency markets: financial market turmoil drives exchange rate volatility

Exchange rates moved dramatically during the month. The euro reversed direction against the dollar and surged from around 1.26 to above 1.45, but has fallen back to 1.39 in recent days. These fluctuations are an indication of continued uncertainty in financial markets. During December, risk perceptions moved against the US currency once again, as investors have grown increasingly concerned with the fiscal and monetary implications of the various bailout packages and further monetary easing in the United States. However, with economic activity also rapidly deteriorating in Europe, it is unclear whether this rebound of the euro will be sustainable.
The British Pound also depreciated sharply against the euro and experienced high volatility vis-à-vis the dollar, as the economic situation deteriorates rapidly in the UK.

Developed economies

United States: further monetary easing to unfreeze credit markets

The economic outlook for the United States has weakened further, as labour market conditions have deteriorated and consumer spending, business investment and industrial production have declined. Financial markets remain strained and credit conditions tight.

In response, the Fed has adopted further measures to unfreeze credit markets, particularly those for consumers. By the end of November 2008, the Fed had initiated a program to purchase up to $100 billion in government-sponsored-enterprises (GSE) direct obligations, and up to $500 billion in mortgage-backed securities (MBS). The Fed also created the Term Asset-Backed Securities Loan Facility (TALF) to lend up to $200 billion to support the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans and loans guaranteed by the Small Business Administration (SBA). On 16 December 2008, the Fed cut the federal funds rate to a range of 0 to 0.25 per cent, the lowest rate ever.

Western Europe and the EU: monetary policy easing accompanies weakening economic activity and falling inflation

Economic activity in Western Europe continues to decelerate sharply. The most recent industrial production figures showed declines across the region, with Ireland and Spain being the hardest hit economies. Indices of industrial confidence continued to dive, in many cases reaching lows not seen in decades.

Inflation has also dropped sharply, now standing just above the European Central Bank (ECB) target of “less than 2 per cent”. Given the continuing decline in energy and food prices, it is likely to fall further over the next year.

Monetary policy in Europe was eased dramatically, with the ECB cutting its main policy rate by 75 bps (basis points), the largest rate cut in the ECB’s 10-year history, bringing it to 2.5 per cent. Other central banks in Europe took similar measures. The Bank of England cut rates by 100 bps to 2 per cent (their lowest level since 1951); the Bank of Sweden cut rates by 175 bps to 2 per cent; the Swiss Nation Bank cut rates by 50 bps to a range of 0.0-1.0 per cent; and the Bank of Norway cut rates by 175 bps to 4.0 per cent.

On the fiscal policy side, fiscal stimulus measures proposed by the European Union are still awaiting approval.

The new EU member states still offer a mixed picture, but the outlook is getting bleaker

Some of the new EU member states such as Bulgaria, the Czech Republic and Slovakia continued to see solid growth in the third quarter, while output contracted in Estonia and Latvia in the same period. However, even for the strong performers, decelerating industrial production points to a weaker outlook for overall growth in 2009.

The IMF announced the outline of a stabilization package for the Latvian economy, consisting of $10.5 billion provided by the IMF, the World Bank, the EU, the EBRD and a number of individual countries, subject to approval by the IMF’s board and other lenders. Other countries in Eastern Europe suffer similar symptoms of external financial vulnerability and this should be of great concern as the global credit crunch and economic slowdown continue.

Japan: weaker external demand and the stronger yen put pressure on exports

In Japan, exports fell sharply in November due to weaker demand in all major regions as well as the continued rise in the value of the yen. On the policy side, the central bank cut interest rates from 0.3 per cent to 0.1 per cent and announced
increased purchases of government bonds in an effort to provide sufficient liquidity to financial markets. Meanwhile, the government announced a further emergency stimulus package in the amount of 23 trillion yen (about $250 billion). The main elements of the package include tax cuts as well as additional funding to stabilize the banking sector.

**The economies in transition**

*Economic activity is clearly weakening*

The countries of the Commonwealth of Independent States (CIS) experienced a sharper than expected fall in GDP growth in the third quarter, driven by sliding industrial output, declining business investments, deteriorating labour markets in some countries and weakening household spending. In addition, the resource-rich countries of the CIS registered a sharp fall in export revenues due to the persistent downward trend of prices for oil and metals as well as lower global demand for these commodities. Financial markets continue to see increased volatility and tightened credit conditions.

In the Russian Federation, GDP growth decelerated in the third quarter, with construction and manufacturing being most severely hit by the slowdown in global and domestic demand. In November, industrial output contracted for the first time since the Russian crisis in August 1998. In response, the government announced a new $10.7 billion programme to provide state guarantees for bank loans.

The Ukrainian economy continues to decline precipitously, with GDP contracting by 14.4 per cent in November, reflecting a sharp slide in industrial output and a significant drop in exports as global demand and prices for steel went into a steep decline. Meanwhile, the country has received the first $4.5 billion of a $16.5 billion IMF loan package.

The IMF has approved a loan of $100 million for Kyrgyzstan to support policy makers in dealing with deteriorating economic conditions. These are due to a number of factors, including upward pressure on food prices, a shortfall in hydro power, mounting problems in the banking system as a spillover effect of Kazakhstan's banking crisis, and an earthquake in the country.

In most parts of South-Eastern Europe, output growth declined in response to weak external and domestic demand. In order to maintain macroeconomic stability, Serbia has reached an agreement with the IMF on a $518 million stand-by loan. Meanwhile, Montenegro submitted an application for EU membership, which will be reviewed by the European Commission.

**Developing economies**

*Africa: weaker growth and falling exchange rates*

In Africa, some of the larger economies saw weaker than expected growth in the third quarter. In Kenya, for example, economic activity slowed due to the decline in the tourism sector and a slowdown in agricultural output as unfavourable weather conditions and rising costs of inputs have weighed heavily on crop production. Remittances from Kenyan workers overseas have become a leading source of foreign exchange, increasing by 10.6 per cent in the first 10 months of 2008 compared with the same period last year.

Growth also declined in South Africa in the third quarter, as exports weakened and higher interest rates undermined consumer spending. However, falling inflation has provided room for monetary easing and interest rates were recently cut by 50 bps to 11.5 per cent.

Currencies of many countries have been sliding in value along with falling commodity prices and increased capital flight, particularly in the case of fuel exporters. Nigeria has so far exhausted $5 billion of its $60 billion of foreign exchange reserves to intervene in the market and stabilize the naira, which has fallen by more than 15 per cent since the middle of November. In Egypt, where the pound has fallen 5 per cent against the dollar between August and December, the central bank has hinted that it may do little to prevent further depreciation. Yet, as one of the world’s largest importers of staple foods, and with inflation hovering around 20 per cent year-over-year in November, there is a high cost to a weaker pound, particularly for the poor who would suffer the most in the short-term from higher food and associated prices.
East and South Asia: worsening economic conditions have prompted decisive policy actions

For most East Asian countries, growth has been declining. For Hong Kong Special Administration Region (SAR) of China, Malaysia, Philippines, Singapore and Taiwan Province of China, growth rates for the third quarter have been more than two percentage points lower than the figures for the same quarter in 2007. The declines are most significant in Hong Kong SAR, Singapore and Taiwan Province of China; for the latter two, the growth rates for the third quarter of 2008 are negative. A major reason for this slowdown is slower export growth caused by the deepening recession in developed countries, which are a major destination of exports from this region.

In response to the crisis, many monetary authorities such as those in Hong Kong SAR, China, Republic of Korea, Indonesia and Viet Nam have taken forceful actions to help stabilize the financial system and the real sector. But the policy reaction to the crisis has extended beyond national boundaries. At a meeting in December, the leaders from China, Japan and the Republic of Korea vowed to boost regional trade and investment. They also emphasized the importance of supporting domestic demand.

South Asia has seen an equal deterioration in economic conditions. In India, the global economic crisis has led to increasing pressure on exports as well as tighter credit conditions, which negatively affect domestic demand. Economic growth has been slowing and falling corporate profits have led to increasing layoffs of workers. The resulting deterioration in the labour market picture represents an additional drag on available incomes and domestic consumption, which is the main pillar of the economy. To address the crisis, the government has announced additional fiscal support measures, while monetary policy has been loosened further. Besides the global economic crisis, business confidence has also suffered in the wake of the terror attacks in Mumbai. In Pakistan, tighter economic policies emanating from the conditions implied by the IMF’s emergency financing package will increase the downward pressure on domestic demand. This comes in addition to the worsening outlook for exports, especially in the textile sector.

Western Asia: increasing signs of a more pronounced slowdown

Several central banks in Western Asia, including those in Israel, Saudi Arabia and Turkey, cut interest rates further as evidence mounts that the economies in the region are slowing rapidly. In Israel, GDP growth dropped in the third quarter, underpinned by a fall in exports and lower investment. In Turkey, real GDP almost stagnated in the third quarter, while consumer and producer confidence indexes plunged to historic lows, sparking fears that the country may slip into recession. The Turkish Government continued talks with the IMF over a new programme to secure its external financing needs and to support confidence, but a deal has not been reached yet. Across GCC countries, real estate markets are weakening as prices have started to decline and property sales fell sharply in recent months. The overheated housing market in Dubai is expected to be most severely hit by weaker demand and financing constraints.

Latin America: policy makers are waiting for a clearer macroeconomic picture to emerge

Domestic demand and economic growth started to cool down in the fourth quarter in Argentina and Chile. Brazil still had a strong economic performance in the third quarter of 2008, despite falling export earnings. As financial troubles have mounted, including a cut-off from trade credits in October, Brazil’s economic performance is expected to be much weaker in the fourth quarter of 2008. To stimulate the economy, political pressure for immediate cuts in interest rates and fiscal stimulus has increased. As inflation has slowed more than expected in several countries, including Argentina, Colombia and Chile, there is greater space for countercyclical responses. However, the majority of central banks are still waiting for a clearer macroeconomic picture to emerge and kept their benchmark interest rates unchanged in December. Monetary easing was also postponed in Mexico and Brazil as a result of mounting fears regarding the inflationary consequences of the depreciation of their national currencies against the dollar. In Venezuela, petroleum exports have dropped by 72.7 per cent from July to December, dramatically reducing expected fiscal revenues for 2009 and complicating any effort to stimulate the economy.