Global issues

**Inflation remains weak in developed economies**

Along with subdued economic recovery in developed economies and moderated growth in emerging economies, the average global consumer price inflation index fell to historical lows in 2013, indicating considerable slack in the global economy and the risk of deflation in some countries. Global consumer price inflation (excluding food and energy) decelerated from an annual rate of 2.2 per cent in the six months through March 2013 to a 1.8 per cent in the six months through September 2013, with many countries close to zero inflation, the lowest level on record (excluding 2009, the year of Great Recession).

The deceleration of inflation has been the steepest in developed economies (figure 1), as a result of weak demand, deleveraging of households, elevated unemployment, and output gaps. In the United States of America, core inflation has been slowing for the past 18 months, with the core PCE price index at only 1 per cent. In the Euro area, consumer prices have been decelerating since mid-year, with inflation rates reaching multi-year lows in a number of European economies. In contrast, inflation has resumed in Japan after several years of deflation, as intended by policy measures.

![Figure 1: Quarterly CPI Inflation in Developed, Emerging and Developing Countries (2006 Q1-2013 Q3)](source: IMF, International Financial Statistics Database.)

There are risks associated with very low inflation, as a sustained period of below-target inflation could become increasingly embedded in expectations. The example of Japan illustrates well the costs of a deflationary dynamic, as the last two decades were marked by a spiral of deflation and a shrinking economy. The situation in the Euro area is not yet severe, but deflationary concerns do exist. For instance, real stock prices in the Euro area are down 44 per cent from their 2007 peak, while real property prices are down 14 per cent. At the same time, there is a steep decline in credit supply to many sectors of the Euro area economy.

Central banks in developed economies have been taking concrete steps, as concerns over deflation rise. The Bank of Japan has made substantial efforts to undo this vicious cycle by expanding its balance sheet. At this early stage, it is still difficult to fully assess the impact of these policies, but they seem to have had relative success in promoting economic growth and in lifting inflation expectations from very depressed levels. In the Euro area, the European Central Bank (ECB) cut interest rates one more time in November to 0.25 per cent, a record low. The cut can be interpreted as an attempt to head off the risk of deflation. If deflation risks persist in the near future, the ECB may introduce other policy tools, as there isn’t much scope for further interest rate cuts. In the United States, the extremely accommodative monetary policy will continue for a considerably long period.

**Currencies in emerging economies resumed the downturn**

Currencies of many emerging economies have been volatile since mid-2013, after the United States Federal Reserve (Fed) announced the possible tapering of its purchase of long-term assets, or quantitative easing (QE). Amid financial turbulence, these currencies depreciated sharply. After an attempted rebound in September, these currencies resumed their downturn in November (figure 2).

The depreciation was more pronounced in countries with larger or increasing fiscal and current-account deficits, such as Brazil, India, Indonesia, South African and Turkey. For instance, be-
Developed economies

The United States: third quarter growth of gross domestic product was stronger than expected

The direct economic impact of the shutdown of the United States Government in October seems to have been limited. The second revision of the third quarter gross domestic product (GDP) shows that economic output expanded at an annualized rate of 3.6 per cent, a noticeable increase from the original estimate of 2.8 per cent. However, the build-up in inventory stock has been the main driver, contributing to almost half of the economic growth in the third quarter. In the labour market, the number of initial unemployment claims resumed the downward trend, after some disturbances in September caused by process delays in California. In the housing sector, the mortgage rate has stabilized in the past few weeks, but the current level is still about 100 basis points higher than one year ago. As a result, the issuance of permits and the construction starts for single-unit houses have stabilized, after increasing at a strong pace from 2011 to early 2013. Transactions in the housing market also seem to have stalled recently. The pending home sale index has declined for five months in a row through September. However, all indices for housing prices have continued to increase through August 2013, the latest available information.

Japan: employment recovery strengthened

The economic recovery in Japan has slowed down recently. The preliminary estimate of GDP for the third quarter of 2013 shows an annualized growth of 1.9 per cent, much slower than the 4.0 per cent observed in the first half of 2013. Despite this deceleration, caused mainly by the rapid slowdown of private consumption and export growth, the economic recovery remains sustained. Both the export volume index and the industry production index have maintained an upward trend. Nevertheless, the simultaneous growth in import volume has kept trade deficit expanding. Although GDP growth decelerated, the employment level increased noticeably, both in September and October, surpassing the level observed before the natural disasters of March 2011. In October, the labour participation ratio increased, keeping the unemployment rate at 4.0 per cent, the same level as September.

Western Europe: economic growth decelerates in the third quarter

Western Europe continued to grow in the third quarter of 2013, but at a reduced pace compared to the second quarter. The euro area grew by 0.1 per cent quarter on quarter, after growing 0.3 per cent in the second quarter. However, this deceleration was exaggerated by the fact that growth was particularly strong in the second quarter, rebounding from a relatively subdued first quarter affected by bad winter weather. In the large economies, performance was mixed. Growth in France declined by 0.1 per cent after increasing by 0.5 per cent in the second quarter. Germany also decelerated, growing by 0.3 per cent, down from 0.7 per cent in the second quarter. But Spain exited recession, growing by 0.1 per cent and ending nine consecutive quarters of decline. Italy continued to contract, but at a greatly reduced pace, declining by 0.1 per cent. The...
United Kingdom of Great Britain and Northern Ireland continued its more robust performance, growing by 0.8 per cent after 0.7 per cent in the second quarter. Looking ahead, indicators of confidence have rebounded significantly from previous lows, but remain below their long-term averages in most cases, consistent with steady and low growth over the coming quarters.

**The new EU members: economic recovery is sustained**

The trend towards economic recovery is gaining momentum in the region, although economic performance in the third quarter diverged among the new European Union (EU) members. On an annual basis, GDP grew by 1.7 per cent in both Hungary and Poland, where economic sentiment strengthened and reached a thirty-month high in November. In Poland, industrial output has been expanding, increasing by 4.4 per cent year on year in October. By contrast, in Croatia, the Czech Republic and Slovenia, GDP declined in the third quarter, although economic confidence strengthened in the Czech Republic in November. Inflation in most of the region remained subdued, held back by lower food prices and still sluggish domestic demand, dropping in October to 0.9 per cent in the Czech Republic and in Hungary, and to 0.4 per cent in Lithuania. External borrowing conditions in the last months were favourable, allowing Croatia, Hungary and Slovenia to issue bonds that raised $1.75 billion, $2 billion, and €1.5 billion, respectively, in November. The Governments in the region are preparing their draft budget proposals for 2014, which reflect some divergence from the tight fiscal austerity path of the previous years. Nevertheless, monetary policy still remains the main economic policy tool to support the economy. Benefiting from the ongoing disinflation, the Hungarian National Bank and the National Bank of Romania reduced their policy rates in November to new record lows of 3.2 and 4.0 per cent, respectively. The Czech National Bank started direct interventions into the foreign-exchange market aiming to avoid deflation and to weaken the currency in order to bolster export competitiveness.

**Economies in transition**

**CIS and Georgia: currencies weaken in Belarus and the Russian Federation**

In October, weak economic activity persisted in Belarus, the Russian Federation and Ukraine. In the Russian Federation industrial production contracted in October by 0.1 per cent on an annual basis, while investment declined by 1.9 per cent, held back in particular by the tight monetary policy. This was only partially offset by the strong growth in agriculture of 26.3 per cent. The Russian rouble depreciated in November, as the central bank widened the corridor of currency trading, while capital outflows continued. In Ukraine, GDP growth is estimated to have declined by 1.5 per cent year on year in the third quarter. Industrial output also shrank in October by 4.9 per cent year on year. Seeking to diversify its energy sources, the country concluded a production-sharing agreement in November with the energy company Chevron, worth about $10 billion. In Belarus, the currency depreciated in November by around 7 per cent against the dollar since the middle of the year, as

the country’s foreign-exchange reserves shrank. In Kazakhstan, industrial output growth slowed down, affected by the suspension of operations at the large Kashagan oil and gas field, due to a gas leak. Annual inflation in the Russian Federation unexpectedly accelerated to 6.3 per cent in October, preventing any near-term monetary easing. Despite weak economic growth in the Russian Federation, the economies of Central Asia continued to receive a steady inflow of remittances.

**South-Eastern Europe: Serbia brings inflation down**

Export-led recovery continues in Bosnia and Herzegovina and Serbia. In October, industrial production in Serbia expanded by 5.2 per cent year on year (although contracting on a monthly basis) and strengthened in Bosnia and Herzegovina. The disinflationary trend also continued in the region. Annual inflation in Serbia (which stood at 11.4 per cent in April) decelerated to just 2.2 per cent in October. The disinflation was driven by several factors, including high interest rates, declining food prices, against the backdrop of weak aggregate demand. Consequently, the National Bank of Serbia reduced its key policy rate in November, by 50 basis points to 5 per cent. Inflation also subsided in the former Yugoslav Republic of Macedonia, declining to 1.3 per cent in October, mostly thanks to lower food prices. In November, the Serbian Government raised $1 billion for budget financing, through five-year bonds, benefiting from abundant liquidity in international markets.

**Developing economies**

**Africa: growth slowed down in South Africa, while accelerating in Nigeria**

South Africa’s growth decreased to 1.8 per cent in the third quarter, from 2.3 per cent in the previous quarter, as manufacturing contracted owing to strikes in the automotive sector. By contrast, in Nigeria, growth increased to 6.8 per cent in the third quarter, from 6.2 per cent in the previous quarter, underpinned by solid performances of both the oil and non-oil sectors. At the same time, inflation in Nigeria continued to decrease in October, reaching 7.8 per cent after 8.0 per cent in the previous month, owing to falling food prices. By contrast, in Malawi, inflation increased to 22.2 per cent in October from 21.7 per cent in the previous month, driven by food shortages and higher food prices.

 Strikes and unrest in Libya continue to depress oil exports, which were down to an estimated 200,000 barrels per day, less than 20 per cent of the amount exported this summer and even farther below post-revolutionary peaks. Libya’s Government ordered a 67 per cent increase in wages for oil sector workers in an effort to end some of the strikes, but this has had limited effects. Libya had already lost over $6 billion in oil sales by mid-November and will be unable to pay public salaries if the protests continue much longer, according to the Prime Minister. The instability is likely to continue as the eastern region of Cyrenaica has declared its autonomy with its own Government. This region has announced plans to begin shipping oil from its own newly created oil company, although it is unclear how far these plans have actually progressed.
East Asia: macroeconomic impact of typhoon on Philippines likely to be limited

The Philippines were hit by a massive typhoon in early November, which caused widespread destruction. According to official estimates, more than 5,600 persons were killed, 4,000,000 persons were displaced and almost 600,000 houses were completely destroyed. Despite this devastation, the wider macroeconomic impact is expected to be relatively limited and the country’s generally favourable growth outlook remains intact. The affected areas are not major manufacturing and export centres and account only for about 13 per cent of national GDP. Given the damage to agricultural output, full-year growth in 2013 is estimated to be close to 7.0 per cent, about 0.5 percentage points lower than previously expected. In 2014, growth is likely to receive a boost from reconstruction activities.

In Thailand, the recent escalation of anti-government protests is likely to undermine investor confidence and local demand. In view of deteriorating short-run growth prospects, the Bank of Thailand cut its main policy rate by a quarter of a percentage point to 2.25 per cent in November. In the third quarter of 2013, Thailand’s GDP grew by only 2.7 per cent year on year, as household consumption and private and public investment contracted. In Indonesia, economic growth further weakened in the third quarter, with GDP expanding by 5.6 per cent, the slowest pace in four years. While exports continue to be hampered by lower commodity prices, domestic demand has been adversely affected by rises in the administered prices of fuel and energy and tighter monetary policy. Indonesia’s central bank has lifted its benchmark policy rate from 5.5 per cent in May to 7.5 per cent in November.

South Asia: growth in India picked up in the third quarter

Economic growth in India picked up in the third quarter of 2013, with GDP expanding by 4.8 per cent year on year. Although growth remained below 5 per cent for the fourth consecutive quarter, the economy has likely bottomed out and is expected to gain momentum. Despite massive portfolio capital outflows in July and August, fixed capital formation recovered mildly in the third quarter. At the same time, export growth accelerated sharply, supported by a weaker rupee and improved conditions in key markets, including China, the United States and Europe. At the sectoral level, a good monsoon helped agricultural output expand by 4.6 per cent, but growth in manufacturing remained sluggish. Pakistan’s central bank raised its main policy rate for the second time in two months, increasing the discount rate by 50 basis points to 10 per cent. The authorities aim to bring down inflationary pressures, which have intensified amid hikes in administered fuel and electricity prices and a marked depreciation of the rupee. As part of the interim agreement on its nuclear program, the Islamic Republic of Iran will receive some relief from the sanctions that have crippled the domestic economy over the past two years. However, most of the sanctions will remain in place, limiting positive short-term effects on the economy, but offering the hope that they could be completely removed soon.

Western Asia: mixed economic conditions across the region

Economic growth has been robust in some commodity exporters, despite relatively lower oil prices. A case in point is Oman, where oil and gas production have picked up in September, while private sector lending grew by 9.4 per cent year on year during the same month. The GDP growth forecast remains close to 5 per cent. As in other oil exporters, public spending also increased this year to support the economy, as oil prices fell. However, the fiscal balance is expected to remain in positive territory in 2013. In Jordan, economic growth remains hampered by regional instability, due in particular to the Syrian crisis and developments in Egypt that have hit economic confidence, tourism and gas flows from Egypt. The need for fiscal consolidation has also been a drag. Nevertheless, the pace of GDP growth is recovering, reaching 3.1 per cent year on year in the second quarter, up from 2.6 per cent in the first quarter. Several factors have contributed to a better performance in the second quarter, including higher government spending. In Turkey, economic growth has slowed down in the third quarter, partly owing to more difficult financial conditions and higher inflation pressures, which have hampered domestic demand.

Latin America and the Caribbean: Brazilian economy slowed down in the third quarter

In Brazil, economic activity slowed down to 1.8 per cent year on year in the third quarter, but contracted by 0.5 per cent quarter on quarter. The agricultural sector and total investment registered significant contractions. The main concern in Brazil is, however, the widening of the current-account deficit, which reached 3.67 per cent of GDP at the end of October. Among main metal exporters, Chile has registered steady GDP growth during the third quarter, 1.3 per cent quarter on quarter. Despite lower metal prices, exports were the main driving force of economic growth, while domestic demand was subdued. By contrast, in Peru, GDP growth slowed down to 4.2 per cent year on year in the third quarter, from 5.3 per cent in the first half of 2013 year on year.

The two economies with high inflation pressures continue to face serious challenges. In Argentina, the national currency depreciated further against the U.S. dollar. On 18 November, the official government exchange rate fell 20 per cent in value since the beginning of the year. Strict currency controls have led to higher inflation rates, which have led to higher demand for U.S. dollars in the black market, where the parallel exchange rate is much higher than the official one. In Venezuela, in the first 10 months of 2013 food prices rose an accumulated 57.8 per cent, the most for the period in 16 years (since 1998). In October alone, food price inflation was 72.1 per cent year-on-year, as over a fifth of basic goods are considered scarce, according to the Central Bank of Venezuela’s scarcity index.