Global issues

Most major economies remain in deep recessions, but recovery hopes are growing

Recently released data on GDP growth in the first quarter of 2009 underscore the severity of the global economic crisis. In most regions of the world, the pace of the downturn accelerated sharply during the first three months of the year, most notably in Western Europe and the New EU members, Japan, and the Economies in Transition. Many large developing countries such as Mexico, South Africa, and Turkey have also fallen into deep recessions, largely owing to the collapse in demand for manufactured goods in developed economies. By contrast, some large Asian economies including China, India, and Indonesia reported relatively robust GDP growth in the first quarter, surpassing the expectations of most analysts. Economic activity in these countries continued to expand owing to large fiscal stimulus packages and resilience in domestic demand. While these better-than-expected performances during the first quarter of the year have raised hopes of an early recovery in parts of East and South Asia, other regions may need much longer to return to robust growth.

Industrial activity and international commodity prices recover slightly

Over the past two months, global industrial activity tended to stabilize and international commodity prices moved upwards as growth in some Asian countries exceeded expectations, the pace of the downturn in developed economies slowed and companies started to build up inventories again. The recent recovery in the prices of oil, metals, and other commodities—which partly reflects an overshooting on the down side earlier in the year—has also been supported by a renewed weakness of the dollar and a rising risk appetite of investors. Brent crude oil prices have shown a clear upward trend, rising from $46.4 per barrel in early April to $64.9 per barrel at the end of May (see figure 1). While the Organization of Petroleum Exporting Countries (OPEC) decided to leave supplies unchanged, it also voiced its expectation that crude prices reach $75 per barrel by the end of 2009.
The pace of decline in global trade is slowing

Recent data also indicate that the speed of decline in global trade volumes has decelerated. Meanwhile, the Baltic Dry Index, which provides an assessment of the price of shipping the major raw materials, has slowly risen from its bottom of 663 in December 2008 to above 3000 in May 2009, after reaching 11000 in May 2008. However, these improvements need to be taken cautiously because of their volatility and preliminary nature. Estimates of the world trade volume for the first quarter of this year show a sharp decline of 11.3 per cent with respect to the previous quarter.

Developed economies

United States: bond yields increase and dollar falls as concerns about US debt mount

According to revised data, GDP contracted by 5.7 per cent during the first quarter of 2009, slightly less than initially estimated. The US labour market is still deteriorating; unemployment reached 8.9 per cent in April and the growth of hourly earnings for production workers has declined to its lowest level since 2004. In April, the year-over-year headline inflation rate fell to -0.7 per cent, the lowest level since 1935. However, the core inflation rate is still close to two per cent. The housing market has not yet started to turn around. The April data for housing starts continued to show a downward trend, while the ongoing decline of housing prices has pushed the average price level in March 2009 to less than 70 per cent of its peak value. The residential mortgage delinquency rates increased to almost 8 per cent in the first quarter of 2009, compared to 1.6 per cent when housing prices were at their peak. Pressures on financial institutions may increase again if the delinquency rate continues to rise.

The dollar has depreciated significantly vis-à-vis major currencies, in particular the Euro, in May 2009 (see figure 2). While improving competitiveness of US exports, the more important implication will likely be increased uncertainty in international financial markets. Meanwhile, US government bond yields have risen sharply, increasing the costs for the Government to finance its deficit. The yield for the 10-year bond has returned to the level of November 2008, almost completely wiping out the decline in interest rates generated by monetary policy operations. If this trend continues, mortgage rates will increase as well, possibly delaying a recovery of the housing sector. Both developments have been prompted by worries about a possible downgrade of the rating for US sovereign debt and the potential impact of quantitative easing on future inflation.

Western Europe and the EU: pace of the economic contraction is slowing

In Western Europe, GDP growth figures for the first quarter of 2009 showed the sharpest drop in activity thus far in the recession. In the Euro area, GDP fell by 2.5 per cent (quarter over quarter) after the already sharp decline of 1.6 per cent in the fourth quarter of 2008. Germany registered the largest drop among the major European economies, with output declining by 3.8 per cent. In France, GDP declined by 1.2 per cent, in Italy by 2.4 per cent and in the United Kingdom by 1.9 per cent. The pace of decline of leading indicators has clearly slowed in the course of 2009 and now a number of them are turning up albeit remaining near historical lows. In May, the Economic Sentiment Indicator (ESI) for the Euro area rose for the second month in a row after falling continuously since May 2007. At the country level, the German IFO business climate index has been rising slowly throughout the year, pushed by the component that measures future expectations, signalling more optimism about the economy. In France, the INSEE business climate indicator rose in May for the first time since the onset of the crisis; similar upturns can be seen in recent surveys from Italy and the United Kingdom. These perceptions may well be consistent with continuing contractions but at a more modest pace, and indicate that most economic actors expect an end to the downturn later in the year.

The New EU member States: first quarter figures confirm the severity of the crisis

Estimates of GDP growth for the first quarter of 2009 confirm the severity of the downturn in the Baltic States. In Latvia, the economy shrunk by 18 per cent year-on-year, in Estonia by 15.6 per cent and in Lithuania by 12.6 per cent. The recession in the Baltic States is widespread, affecting the manufacturing, construction, retail, and banking sectors. Elsewhere, GDP fell by 3.5 per cent in Bulgaria, by 3.2 per cent in the Czech Republic, by 6.4 per cent in Hungary and in Romania and by 5.2 per cent in Slovakia. All of these countries are affected by weak import demand in the EU-15 and by the decline in bank lending. Poland is the only exception to this pattern with GDP growing by 0.8 per cent in the first quarter as the economy is more strongly driven by domestic demand. The speed of economic decline in the region, however, slowed in May 2009. Facing lower-than-anticipated tax receipts and custom revenues, most Governments had to revise their budgets and chose to reduce planned expenditures when facing the dilemma of maintaining credibility versus stimulating their

Figure 2: Dollar-Yen and Dollar-Euro Exchange Rate

- 1

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Danish Government has pledged $3 billion in aid for more jobs for African youth and increased private sector investments. In addition, sub-Saharan Africa is expected to receive around $10 billion from the IMF in Special Drawing Rights, while the country into its first recession since 1992. Seasonally adjusted real GDP decreased by 6.4 per cent in the first quarter of 2009, after a revised 14.4 per cent contraction in the fourth quarter of 2008. While a sharp decline in export demand was driving the contraction at the end of 2008, weakening domestic demand was a major drag in the first quarter of 2009, with business capital spending shrinking by 35 per cent and labour income continuing to fall. Some recent indicators, including industrial production in April, suggest, however, that the economy no longer is in a nose dive and that the downturn may hit bottom in the second quarter.

**Japan: indicators point to an end of the nose-dive performance in the first quarter**

Official data released in May showed that Japan’s GDP plunged at an annual rate of 15.2 per cent in the first quarter of 2009, after a revised 14.4 per cent contraction in the fourth quarter of 2008. While a sharp decline in export demand was driving the contraction at the end of 2008, weakening domestic demand was a major drag in the first quarter of 2009, with business capital spending shrinking by 35 per cent and labour income continuing to fall. Some recent indicators, including industrial production in April, suggest, however, that the economy no longer is in a nose dive and that the downturn may hit bottom in the second quarter.

**Canada: fiscal stimuli provide some support for ailing economy**

Also in Canada, recent indicators of economic activity suggest a continuing, though slowing, downturn. On the downside, however, some lead indicators, such as residential construction and trade activity, have continued to fall. Meanwhile, indices of production, unemployment and household demand are levelling off owing mainly to fiscal stimuli. If credit conditions stabilize and the fall of world trade reaches bottom before the summer ends, a slow recovery may start to take hold towards the end of 2009.

**Economies in transition**

**CIS: outlooks remain bleak as domestic and external conditions deteriorate further**

Among the economies in transition, the contraction of economic activity in the Commonwealth of Independent States (CIS) continues. Mounting evidence of deeper-than-expected slumps in the largest economies—the Russian Federation, Kazakhstan and Ukraine—suggests a further deterioration in the outlook for the neighbouring countries through declines in trade, capital flows and remittances. In the Russian Federation, after a year-on-year contraction of about 9.5 per cent in the first quarter of 2009, economic activity continues to be on a sharp downturn trend. Preliminary estimates of GDP growth show a further decline of about 10.5 per cent (year-on-year) in April 2009. This sharp downturn is largely owing to continued declines in investment demand, but also to a contraction in private consumption as household incomes are declining and unemployment is increasing. Among the smaller economies of the CIS, GDP contracted most in Armenia, declining by an annualised rate of 6.1 per cent in the first quarter of 2009 on the back of an economy-wide slowdown. As inflationary pressures subsided in the region, monetary authorities in many countries took measures to ease liquidity. In May, the Central Banks of the Russian Federation, Kazakhstan and Tajikistan cut key policy rates significantly in order to revive sluggish lending.

**South-Eastern Europe: more countries reach loan agreements with the IMF**

The economies of South-Eastern Europe remain depressed, but the speed of the economic contraction slowed during the past two months, partly owing to fiscal and monetary stimulus measures. However, it is premature to declare a turnaround. Financing difficulties forced several Governments to revise their budgets, complicating the implementation of earlier plans to increase public spending to mitigate the downturn. Bosnia and Herzegovina agreed with the IMF on a $1.5 billion three-year stand-by loan, which is accompanied by a strict conditionality of keeping public spending in check. Serbia reached an agreement with the IMF on a larger than originally negotiated stand-by loan amounting to €2.9 billion. Meanwhile, monetary conditions are being relaxed where possible. In Serbia, the Central Bank continued its policy of monetary loosening, while in Bosnia and Herzegovina the Central Bank reduced mandatory reserve requirements.

**Developing economies**

**Africa: as economic conditions continue to worsen, the international community pledges more funds**

The economic situation continues to deteriorate in Africa. In South Africa, the decline of the manufacturing and mining sectors plunged the country into its first recession since 1992. Seasonally adjusted real GDP decreased by 6.4 per cent in the first quarter of 2009, after having fallen by 1.8 per cent in the fourth quarter of 2008. Meanwhile, unemployment in South Africa rose to 23.5 per cent and is expected to increase further. Nigeria is also facing difficulties after government and state revenues were 30 per cent below budget expectations in the first quarter of 2009, mostly owing to lower oil prices. This situation might further worsen if the recent military expedition in the Niger Delta leads to a further decline in oil output, which is already running at only half its potential. Meanwhile, donors responded positively to requests for additional development assistance for African countries. In May 2009, the largest bilateral and multilateral donors agreed to provide at least an additional $15 billion over the next two to three years to promote trade, strengthen the financial sector, and increase lending for infrastructure, agribusiness and small and medium enterprises as the region is severely affected by the global economic slowdown. In addition, sub-Saharan Africa is expected to receive around $10 billion from the IMF in Special Drawing Rights, while the Danish Government has pledged $3 billion in aid for more jobs for African youth and increased private sector investments.
East Asia: resilience in China and Indonesia contrasts with deep recessions in other parts

While the export-oriented economies of East Asia are mired in deep recessions, China and Indonesia show remarkable resilience thanks to increased government spending and robust private consumption. In the first quarter of 2009, growth was stronger than expected in both countries, with GDP expanding by 6.1 per cent year-on-year in China and 4.4 per cent in Indonesia despite large declines in exports. However, several short-run economic indicators including industrial production and power generation suggest that China’s recovery remains fragile. Meanwhile, other economies in the region continued to experience massive contractions of GDP in the first quarter of 2009 as the collapse in external demand triggered sharp declines in investment. Real GDP declined by 4.3 per cent year-on-year in the Republic of Korea, 6.2 per cent in Malaysia, 7.1 per cent in Thailand and 11.5 per cent in Singapore. The downturn has also been sharper than expected in the Philippines, where the economy is now on the brink of a recession. On a slightly positive note, recent data show that the pace of the decline in trade and industrial production has started to slow. This has raised hopes that the more export-oriented economies in the region could return to growth in the fourth quarter of the year.

South Asia: robust growth in India fuels hopes of an early recovery

While growth in India remains much lower than in previous years, the slowdown may have bottomed and a recovery could set in earlier than previously expected. Driven by a strong increase in government expenditure GDP expanded by 5.8 per cent year-on-year in the first three months of 2009, matching the revised rate of growth in the last quarter of 2008. Most notably, gross fixed capital formation continued to increase despite lower manufacturing output and weakening exports. The service sector, which accounts for almost 60 per cent of GDP, grew by 8.6 per cent in the quarter. The victory of the ruling Congress Party in the recent elections held in India is expected to contribute to political and economic stability. The new Government is likely to introduce another round of economic reforms to improve the business environment and attract more foreign direct investment. In Sri Lanka, the end of the 26-year-long civil war is expected to stimulate economic growth in 2010 as improved security conditions should strengthen domestic demand and boost tourism. In Pakistan, which received the second tranche of the IMF loan in April (worth $848 million), the Central Bank reduced its key policy rate by 100 basis points to 14 per cent on an improved inflation outlook.

Western Asia: economic activity continues to trend downwards

The negative trend in the region regarding economic activity remains unchanged. In Turkey, for example, industrial output contracted by 20.9 per cent in March 2009, only slightly less than the decrease by 23.8 per cent in February. The decline mirrored weaker global demand across the product spectrum of the Turkish export sector, with automotive and textile goods especially hard hit. In Iraq, the recent spike in violence has put new clouds over any economic recovery in the short term. The country is already reeling from the sharp fall in oil prices as oil exports account for almost all its fiscal revenue. In addition, the global financial crisis has made it even more difficult to generate any private investment inflows. Looking ahead, the country faces an increasingly precarious budget shortfall that may require much more pronounced foreign assistance in 2010.

Latin America: pressures on fiscal balances mount amid shrinking trade activity

In Latin America and the Caribbean, commodity production and trade shrunk considerably in the first quarter of 2009. In Chile, exports plummeted by 41 per cent, mainly owing to lower copper export earnings, which fell by 57 per cent. Oil export revenues declined sharply in Brazil, Colombia, Ecuador, Mexico, and Venezuela (Bolivarian Republic of) owing to much lower prices as well as reduced output, particularly in the case of Venezuela (Bolivarian Republic of) as member of OPEC. Mexico has registered a sharp year-on-year GDP contraction of 8.2 per cent in the first quarter of 2009. Meanwhile, trade deficits have decreased in several oil-importing countries, for example Costa Rica, as imports fell even more sharply than exports owing to shrinking domestic demand. Weak trade and economic activity has reduced fiscal revenues, resulting in higher budget deficits and challenging counter-cyclical fiscal spending. The Ministry of Finance in Mexico considers revising its balanced budget rule to allow for a deficit this year, while also cutting back on spending and raising taxes given its expectation of a prolonged economic downturn. In Brazil, the primary budget surplus target for 2009 was lowered from 3.8 per cent to 2.5 per cent, while in Argentina the primary fiscal surplus was down by 54 per cent in the first four months of 2009 compared to the same period in 2008.

Least Developed Countries: more funds are required to cushion the impact of the crisis

As economic conditions deteriorate, the Least Developed Countries (LDCs) are in need of more external support. Among East African countries, Mozambique has received aid pledges of $804.5 million to support the 2010 state budget and development projects, after its mining sector has been severely hit by the global financial crisis. In West Africa, the Paris Club has reached an agreement with Côte d’Ivoire to restructure its external public debt, prompting an immediate cancellation of $845 million. The IMF approved arrangements under the Fund’s Exogenous Shocks Facility worth $336 million for Tanzania and $209 million for Kenya to cushion the impact of the crisis. Meanwhile, the World Bank and Kenya signed agreements for four projects in the sectors of transport, energy, social protection and environment totalling $413 million. Remittances to Kenya—a key source of foreign exchange for East Africa’s largest economy—were 15 per cent lower in the first four months of 2009 than a year ago.

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