Monthly Briefing
World Economic Situation and Prospects

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Summary

- Global recovery continues, with an increasing number of countries reporting rises in output. The recovery, however, is uneven across regions and economic and financial fragilities remain
- Global trade is gaining momentum and prospects for commodity exporters have improved
- Continued and better coordinated policy support is still needed to avoid a double-dip recession

Global issues

An increasing number of economies return to growth

The world economy is on the mend, with quarterly GDP growth rates in an increasing number of countries moving into positive territory again and international trade and industrial production indices showing continued upward trends. While the latest debt debacle in Dubai seems to have been contained, it provides a vivid reminder that financial sectors are still exposed to high risks.

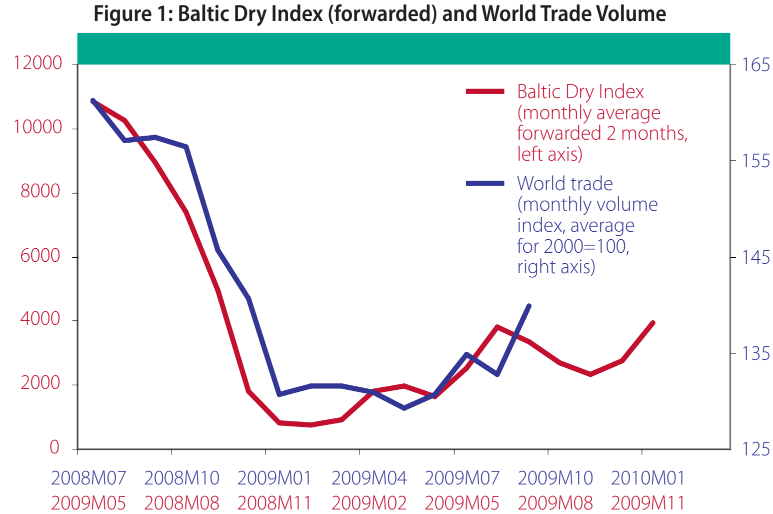
The recovery, led by the Asian countries, remains uneven across the regions, and conditions for sustained growth remain fragile. Credit conditions are still tight in major developed economies, while high unemployment rates and the large output gap in most countries continue to pose challenges for policymakers worldwide. As private sector demand remains sluggish, they will need to sustain fiscal stimulus despite already strongly widening fiscal deficits and mounting public indebtedness. As analyzed in the forthcoming *World Economic Situation and Prospects 2010*, they will need to do so until the global recovery becomes more solid and need to do so in an internationally coordinated fashion in order to avoid a double-dip recession.[1]

Global trade is building momentum

World trade continues to expand at a moderate pace. In the first quarter of 2009, the value of global trade had dropped to 40 per cent below its peak level in July 2008. It has rebounded since, but by October 2009 its value was still 25 per cent below its peak of a year ago. Trade volumes, which had declined by less, also showed a moderate rebound, but remain about 14 per cent below the last year's peak.

Based on the observed regularities between the lagged 'Baltic Dry Index' (BDI) and the volume of trade activity, trade expansion is expected to continue in the following months, albeit with some volatility (see figure 1). In 2010, the volume of international trade is expected to increase by about 5.5 per cent, only partially offsetting its decline in 2009.

Figure 1: Baltic Dry Index (forwarded) and World Trade Volume



Source: Monthly averages of the Baltic Dry Index are computed by UN-DESA/DPAD based on daily data provided by the Baltic Exchange Information Services Ltd. http://www.balticexchange.com/. Volumes of world trade are provided by CPB Netherlands Bureau for Economic Policy Analysis. http://www.cpb.nl/eng/org/

1 See United Nations (2010) *World Economic Situation and Prospects 2010*, forthcoming in January. A pre-release of the global outlook is available at http://www.un.org/esa/policy/wess/wesp2010files/wesp2010pr.pdf

Note to the Secretary-General prepared by the Global Economic Monitoring Unit
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Developed economies

United States and Canada: recovery remains tentative in the US

The recently released data for the United States confirm the mildness of the recovery. According to the ISM manufacturing index the recovery in the sector continued in November, but at a slower pace than in previous months. The unemployment rate unexpectedly declined in November to 10.0 per cent, from 10.2 per cent a month earlier. Although the number of initial jobless claims has been declining from its peak in early 2009, the number is still much higher than before the start of the crisis, which suggests that the unemployment rate will likely stay up for some time. The slowing nominal wage growth, combined with increased productivity, has contributed to the annualized 2.5 per cent decline of unit labour cost for non-farm businesses in the third quarter. For workers, though, the lower nominal wage growth implies they will see little to no improvement in their real incomes.

The United States Bureau of Economic Analysis revised its estimate of annualized GDP growth for the third quarter downward from 3.5 to 2.8 per cent, due to the lower estimations for private consumption, investment in non-residential structure and net exports.

The Canadian economy showed positive growth again in the third quarter after three quarters of continuous decline. The recovery is feeble, however, as GDP expanded by only 0.1 per cent as compared with the second quarter. Net exports still showed a sharp decline (by 33 per cent), but this was offset by growth of both public and private consumption and investment demand.

Western Europe and the EU: technically out of recession

Flash estimates[2] for the third quarter GDP indicate that after five consecutive quarters of decline, the euro area grew by 0.4 per cent quarter-on-quarter. Thus, technically, the euro zone exited the recession. Of the major European economies only the United Kingdom and Spain are still in recession. Even so, GDP of the euro area remains 4.1 per cent below its level of a year earlier. Industrial production continued to increase in September by 0.3 per cent month over month, marking 5 months in a row of improvement. Nonetheless, manufacturing production is still 12.9 per cent below its level of a year ago. Looking ahead, business climate surveys show continued signs of improved confidence, although related indicators remain below their historical averages (starting from 1990) and show some divergence amongst countries. In the European Commission's economic sentiment indicator, the November figure showed a decline for Spain and the United Kingdom, but rises in France and Germany. Industrial new orders increased for the sixth consecutive month and in November were 16.5 per cent below their level of a year ago, as opposed to more than 35 per cent below in April.

Fears of deflation subsided as headline inflation in the Euro area turned positive after four months of decline, but this was due mostly to the reversal of statistical effects stemming from the movement of oil prices over the last year.

The new EU member States: improving external conditions, little fiscal stimulus

The external environment for the new EU members remains challenging, but there are indications of a mild recovery in export demand. In some economies, including the Czech Republic, Hungary, Poland and Romania, the depreciation of their currencies earlier this year is further boosting export growth. In the third quarter of 2009 the year-on-year decline in GDP in Central Europe ranged from 4.1 per cent in the Czech Republic to 8.3 per cent in Slovenia, and in the Baltic States output dropped by 15 to 18 per cent, but the more recent quarterly dynamics has been positive and showing rebounding trends in some cases. The Polish economy, in contrast to the other countries, has continued to grow, expanding by a surprising 1.7 per cent in the third quarter year-on-year.

Inflation in the region is subdued even in the countries with flexible currencies, and the increases in indirect taxes were often absorbed by producers. In the Baltic States, deflation is a real and present danger, which may delay the recovery by increasing the real value of household and business debt.

The budgets for 2010, already passed by the Parliaments in Hungary and Latvia, contain austerity measures, leaving little to no space for fiscal stimulus next year.

Developed Asia and Pacific: export growth and declining unemployment in Japan

The unemployment rate in Japan fell further to 5.1 per cent in October, down from the peak of 5.7 per cent in July 2009. Employment improved mainly as a result of the continued recovery in external demand. However, facing a persistent deflationary pressure in the domestic economy and a heightened risk associated with a rapid appreciation of yen vis-à-vis the dollar, the Central Bank of Japan decided at the beginning of December to further ease monetary conditions by injecting an additional 10 trillion yen (or $115 billion) into the economy through a new liquidity mechanism. A new fiscal stimulus package was also announced.

2 Flash estimates use incomplete observed data in conjunction with historical trends to forecast macroeconomic indicators for the euro area.

The Reserve Bank of Australia (RBA), in contrast, raised the policy interest rate by 25 basis points on 1 December, 2009, the third increase since October 2009. The economic downturn in Australia has been relatively mild to begin with and the RBA believes the ongoing expansion of private demand is strengthening and that labour market conditions are better. Therefore, the RBA decided to gradually unwind the monetary stimulus put in place earlier.

Economies in transition

Commonwealth of Independent States: stabilization driven by the external sector

The speed of economic decline in the CIS decelerated in the third quarter of 2009. Output contraction slowed in the Russian Federation to 9.8 per cent year-on-year in the third quarter from 14.3 per cent in the second quarter. In Kazakhstan, output contracted by 2.2 per cent, while in Ukraine industrial production was 28.4 per cent lower than a quarter earlier. Most of the impetus stems, however, from the external sector. Kazakhstan registered a current account surplus again in the third quarter of 2009, for the first time since the third quarter of 2008. The third quarter current account surplus of the Russian Federation matched that of the sum of the first two quarters of 2009.

Domestic demand remains weak despite declining unemployment, thereby contributing to lower rates of inflation. In an attempt to boost demand, interest rates in the Russian Federation were cut in November for the ninth time since April. Meanwhile, in Ukraine concerns about a draft law on raising the minimum wage have contributed to a delay of the fourth tranche of IMF lending worth $3.7 billion, scheduled for mid-November.

South-Eastern Europe: the Albanian economy remained robust in the second quarter

The economy of Albania continued its strong growth, expanding in the second quarter by 5.8 per cent year-on-year. However, since the Government decided to freeze all public investment from August, growth is estimated to have slowed in the remainder of 2009. In other countries, output remains at about 4 per cent below its 2008 levels, although in Serbia GDP in the third quarter declined by only 2.7 per cent year-on-year and there are indications of a broad-based stabilization in the economy. After intensive negotiations, Serbia has reached a deal with the IMF on obtaining the next tranche of its Stand-by loan. The disbursement of the IMF's funds to Bosnia and Herzegovina, on the other hand, may be withheld over the disagreements on social spending.

Developing economies

Africa: third quarter data show some signs of recovery, but unemployment continues to increase in the biggest African economy

Recent GDP data point towards a meagre improvement of the economic situation in the two of the largest African economies in the third quarter of 2009. In South Africa, seasonally adjusted real GDP increased by an annualized rate of 0.9 per cent, supported by an increase of manufacturing production of 2.6 per cent. Egypt's GDP increased by 4.9 per cent on the back of strong recovery of the construction and telecoms sectors which showed growth rates of over 13 per cent. The labour markets provide a more mixed picture. While the unemployment rate in South Africa increased from 23.6 per cent to 24.5 per cent between the second and the third quarter, it slightly decreased from 9.4 per cent to 9.3 per cent in Egypt. As growth remains below potential, the Egyptian Government recently unveiled a third stimulus package of 1.83 billion dollars, mainly intended for infrastructure.

Although African oil-exporters are now benefiting from higher oil prices, the negative shock at the beginning of the year had lasting effects. In Cameroon, crude oil production dropped by 13.8 per cent in the first ten months of 2009 while average oil price for the considered period declined by about 45 per cent compared with the peaks of the same period a year ago. As a result, fiscal revenues declined by about 50 per cent year-on-year, slowing the Government's infrastructure projects aiming to diversify the traditionally oil-driven economy.

East Asia: recovery remains on track, but debate on exchange rate policies intensifies

The recovery in East Asia remains on track as evidenced by robust GDP growth in the third quarter and declining unemployment rates in several countries. On a quarter-on-quarter basis, the economy of the Republic of Korea grew by 2.9 per cent, the highest rate in seven years. Growth was almost exclusively driven by a build-up in inventories, however, and hence is not yet signalling robust recovery. In Indonesia, GDP expanded by 4.2 per cent year-on-year on the back of strong growth in private consumption. Unemployment has declined in several economies since August, including the Republic of Korea, Hong Kong Special Administrative Region of China and Taiwan Province of China. In the latter two economies, however, current rates remain well above pre-crisis levels. As the first central bank in the region, the State Bank of Viet Nam has raised interest rates – from 7 per cent to 8 per cent – in an attempt to rein in credit growth and combat inflation, which is forecast at 6.7 per cent in 2009. At the same time, the

Vietnamese central bank responded to the strong downward pressure on the exchange rate by devaluing the national currency by about 5 per cent against the United States dollar. This move comes at a time when exchange-rate policies and options for greater regional and global coordination are important subjects of discussion.

South Asia: India's economy grows stronger-than-expected

Year-on-year, economic activity in India expanded by 7.9 per cent in the third quarter of 2009, up from 6 per cent in the first half of the year and significantly above business-sector expectations. Growth was partly driven by strong government consumption expenditures, which were 27 per cent higher than a year ago. Private consumption and investment increased at a faster pace than in recent quarters, growing by 5.6 per cent and 7.3 per cent, respectively. The recovery is underpinned by strong growth in industrial output (9.1 per cent in the third quarter year-on-year) and a gradually improving trade environment. In light of the economic recovery and significant inflationary pressures, the Central Bank of India took initial steps to unwind its very loose monetary policy, including higher provision requirements for bank loans to property companies. However, since the monetary authorities consider the recovery to be fragile, interest rates were left unchanged. Meanwhile, the central banks of Pakistan and Sri Lanka lowered their benchmark policy rates by 50 basis points to 12.5 per cent and 7.5 per cent, respectively, in an effort to strengthen economic growth.

Western Asia: fears of a default in the UAE

Dubai, which is part of the United Arab Emirates (UAE), indicated its intention to restructure Dubai World, the investment firm for the emirate, including a standstill on all debt payments. Fears about a default and the possible exposure of major international banks subsequently gripped financial markets worldwide. In a continuation of previous trends, Turkey saw a further decline in trade activity in the third quarter, albeit at a slower rate than in the previous quarter. Merchandise exports contracted by 30.3 per cent year-on-year, while imports fell by 34.7 per cent. The picture was similar for industrial production, which contracted by 8.0 per cent in the third quarter after an even sharper decline by 15.4 per cent in the previous quarter. At the same time, inflation in Turkey stood at 5.1 per cent year-on-year in October, a slight decline from the rate of 5.3 per cent recorded in the previous two months. Monetary policy makers in Turkey continued their series of interest rates cuts, reducing the overnight borrowing rate by 25 basis points to 6.5 per cent. Meanwhile, in the trade policy arena, Turkey and Jordan agreed to wrap up negotiations of a free trade agreement by the end of the year.

Latin America: diverging performance, ambitious spending plans

In Latin America and the Caribbean there is a large divergence in the recovery among the large economies of the region. Brazil registered 4.1 per cent growth in industrial production in the third quarter of 2009, compared with the second quarter. Car sales in September increased by almost 20 per cent month-on-month and 14.9 percent year-on-year, confirming the resilience of the domestic consumer market. Mexico and Venezuela, in contrast, continued to register significant economic contractions, by 6.2 per cent and 4.5 respectively, year-on-year in the third quarter.

In the economies where the recovery is lagging, fiscal revenues are dwindling, while the Governments are announcing higher spending in 2010. In attempts to mitigate the rise in fiscal deficits, several Governments, in particular those of Mexico and the vulnerable economies of Central America, are considering tax reforms so as to broaden the tax base. However, the political and private sector support for these tax reforms appears to be weak, which has led to increased fears of fiscal deficits moving to unsustainable levels in 2010. Such fears pushed international credit-rating agencies, in turn, to downgrade the country's credit rating last month. In Cuba, in turn, the Government was forced to cut spending in October, as its financial situation remains particularly precarious.

Least Developed Countries: minerals and oil exporters face brighter prospects

The prospects for many least developed countries that are mineral or oil exporters have improved as demand and prices for these commodities have rebounded. In Angola, for instance, the newly approved government budget for 2010 envisages an increase in expenditure by 50 per cent, based on a rather conservative oil price assumption of $58 per barrel in 2010.

Remittances to Uganda recovered by 37 per cent in the fiscal year 2008-09 from a year earlier, but are still about 40 per cent below their record level of 2006-07. Bangladesh's main export sectors, especially garments, which had shown considerable resilience during the first half of 2009, suffered a severe contraction in the third quarter. Sharp price cuts initially worked to keep exports going, but these could not be sustained with continued weak global demand for garments. In dollar terms, exports declined by 11.9 per cent year-on-year in the third quarter, but the value of imports fell even more steeply (by 19.2 per cent) on the back of falling commodity prices. Along with the strong increase in remittances (up by 15.9 per cent), the import decline contributed to a sharp increase in the current account surplus.■

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