Monthly Briefing
World Economic Situation and Prospects

No. 17 **UN/DESA** 4 March 2010

Summary

- The strength of the global recovery, witnessed in the second half of 2009, has been moderating and the recovery has become more uneven
- Global financial markets experienced a notable turbulence in the first two months of 2010, in part as a result of increasing sovereign debt risks in Europe and elsewhere
- Inflation, which edged up in developed countries in late 2009, is down again facilitating continuation of low interest-rate policies

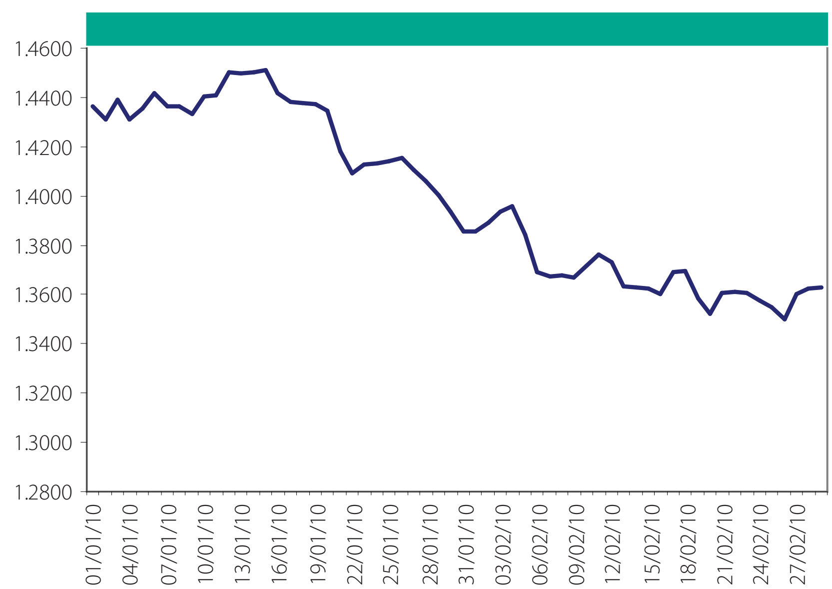
Global issues

The world economy continues its recovery from the recession, but recent indicators signal the pace of output recovery is slowing and becoming more uneven across countries.

The economic situation in the euro area has stopped improving, in sharp contrast to the stronger-than-expected recovery in the United States and Japan. In developing Asia, the output growth continues to be robust, while it is much more subdued in many economies of Africa and Latin America and still very fragile in most economies in transition. The world economy as a whole witnessed a strong rebound during the second half of 2009, but is now moderating, as the strengths of the early driving forces of inventory restocking and policy stimuli are tapering off.

Global financial markets experienced a notable turbulence in January-February, partly in response to the perceived increases in sovereign debt risks associated with widening government deficits and mounting debts in developed economies, particularly in a few European economies. Financial markets have also reacted to indications of an unwinding of expansionary monetary policy stances in several major economies. Equity markets worldwide fluctuated downward by about 10 per cent and the euro depreciated markedly against the dollar (see figure 1).

Figure 1: Exchange rate of the US dollar versus the euro



Source: OANDA Corporation.

Both core and headline inflation rates have moderated notably, especially in developed countries. The fall in inflation rates gives policymakers breathing space to keep interest rates low in order to stimulate the economy.

Jobs recovery remains weak overall, though trends in open unemployment diverge. Unemployment rates are still on the rise in most transition economies, but they seem to have stabilized in several developed countries and come down in a number of developing countries (see World Economic Vulnerability Monitor No. 4 — forthcoming).

Developed economies

United States and Canada: US fourth-quarter GDP revised upwards, mortgage rules tightened in Canada

The United States Bureau of Economic Analysis has revised its estimate for annualized fourth-quarter GDP growth upward from 5.7 to 5.9 per cent. The numbers for inventory change and private fixed investment were better than originally estimated. In contrast, the figures for private consumption, net exports, and state and local government expenditures were revised downward.

Some high-frequency data for the first quarter of 2010 signal a possible slowdown in the pace of the recovery. Initial jobless claims were on a downward trend since mid-2009, but this trend now seems to have stalled. Sales of new and existing homes have dropped, likely because of the diminished effect of the tax credit for homebuyers.

The Canadian economy expanded at an annualized rate of 5 per cent over the fourth quarter of 2009, the growth was mainly being driven by domestic final demand**.** Average house prices in Canada increased by almost 20 per cent in 2009. In order to prevent the emergence of a new housing bubble, the Government announced in February that it will require banks to impose higher standards for mortgage lending.

Western Europe and the EU: fragile recovery, continuing fiscal crisis in Greece

In Western Europe the recovery has moderated and remains fragile at the beginning of 2010. GDP figures for the fourth quarter of 2009 showed that the euro-area economy grew by a mere 0.1 per cent, a slowdown from the 0.4 per cent posted in the third quarter. Economic recovery continued in France and the United Kingdom finally exited recession, but the German economy registered zero growth in the quarter, Spain's remained in recession, while Italy's slipped back into negative territory.

Industrial production clearly lost momentum in the final quarter of 2009. Confidence surveys are also showing some deceleration. The European Commission's business climate index stalled in February, after 10 months of uninterrupted improvement. The main cause was declining consumer and retail trade confidence, while industry and services confidence improved. This points to likely weakness in consumer spending and stems from high unemployment which in January remained at 9.9 per cent. The rate of capacity utilization stood at only 72 per cent in the first quarter of 2010. Excess capacity will continue to blow significant headwinds to any turnaround in investment spending.

The fiscal crisis in Greece continues to simmer. The EU has stated that Greece will not be abandoned, but has been unwilling to reveal any concrete proposal for support so as to keep pressure on the Greek Government to follow through on its pledge of reducing its deficit from 12.7 per cent to 8.7 per cent during 2010. In an additional effort to achieve this, Greece announced early March a freeze of pensions and wage cuts for public employees.

The new EU member States: no turnaround yet for small open economies

Preliminary figures point to disappointing economic performance in most of Central Europe during the fourth quarter of 2009. The economy of the Czech Republic contracted by 0.6 per cent on a quarterly basis, reversing the earlier trend. In Hungary, GDP dropped by 0.4 per cent over the third quarter of 2009. Quarterly output growth in Slovakia was positive at 2.2 per cent, but much weaker than anticipated. In a stark contrast, Poland was the only country in the entire EU to register any economic growth at all, with annual GDP expanding by 1.7 per cent in 2009, and the Government expects the economy to return to a high-growth trajectory in 2010-2011.

Among the Baltic States, Estonia technically is no longer in a recession after posting fourth-quarter GDP growth of 2.6 per cent (quarter on quarter). The recovery fully relied on external demand.

There are increasing concerns about the sustainability of the mounting public debt of many of the new EU member states. The austerity measures taken in response are having a dampening effect on their economies, such that recovering export demand is left as the only source for growth in 2010. However, with continued economic weakness in the EU-15 countries, the new EU member states could face a further relapse into recession.

Developed Asia and Pacific: export-led recovery

Japan's economy grew at an unexpected strong pace of 4.6 per cent in the fourth quarter of 2009. Net exports continued to be the major driver, but consumer spending also rebounded notably along with a small drop in the unemployment rate. Nominal GDP stagnated, however, as deflation entrenched further. In response, the Bank of Japan continued to expand its measures of quantitative monetary easing. High-frequency data indicate that GDP growth could have moderated in the first quarter of 2010, however, as the impact of the fiscal stimulus is fading.

The economy of Australia emerged from the global downturn in better shape than other developed economies, benefiting from rapid growth in its major export markets which are in Asia. The Reserve Bank of Australia has gradually raised interest rates since the end of last year and the Government has also announced that the wholesale-funding guarantee for banks will be withdrawn at the end of March.

The situation in New Zealand, in contrast, unexpectedly has turned bleaker with worsening indicators for the housing market, employment growth, and retail sales. The strong rise in house prices at the end of 2009 has tapered off and house sales have slumped to an 18-year low. Also, the recovery in labour demand has been very slow.

Economies in transition

CIS: fragile outlook, but strengthened economic ties

The economic situation in the four largest CIS economies improved somewhat in the last quarter of 2009, but only Belarus recorded positive output growth (of 0.2 per cent) for the year as a whole. Inflation decelerated despite sharp depreciation of national currencies against the dollar and the euro. The Kazakh tenge formed the exception as, higher oil prices and greater FDI inflows put upward pressure on the currency, prompting the authorities to widen its trading band in February 2009. The measure may stem some of the mounting inflationary pressures in Kazakhstan that emerged at the end of 2009.

The outlook for the CIS remains fragile. In February, the Kazakh Government took control of two of the country's largest lenders, BTA Bank and Alliance Bank. Ukraine's capacity to finance future gas imports remains highly uncertain. Greater economic integration could give for better economic news in the outlook: the Russian Federation, Kazakhstan and Belarus established a customs union which came into effect on January 1, 2010.

South-Eastern Europe: Croatia to boost private businesses to lift economy

In Croatia, GDP fell by 5.9 per cent in 2009. The Government is seeking to stimulate the economy, but has little room for fiscal expansion. Consumer demand is expected to be weak in 2010 as unemployment is still on the rise, credit supplies remain tight and tax rates have been increased. To remedy the situation, the Government, in cooperation with the Central Bank, is looking at measures to boost lending to the private sector. In order to increase lending capacity of banks, the Central Bank cut mandatory reserve requirements from 14 to 11 per cent and the Government intends to establish a credit guarantee facility for private companies.

The IMF postponed release of the second tranche under its standby agreement with Bosnia and Herzegovina, worth about $141 million, over disagreements on payment of social benefits. After the passing of a new law in February which tightens criteria for benefit eligibility, the country has cleared the way for receiving the IMF funds.

Developing economies

Africa: economic recovery continues, but is expected to remain subdued

Recent economic data point at continued recovery in Africa. Mineral-exporting countries like Botswana and Namibia rebounded after external demand for diamonds and other minerals rebounded in late 2009. The economies of Mauritius and Seychelles, which heavily rely on tourism, saw an increase in the number of visitors of, respectively, 4 and 12 per cent in January 2010 compared with a year ago. Oil-exporting countries, such as Angola and Nigeria, benefited from higher oil prices which stabilized around 80 dollars per barrel over the last four months.

Ghana experienced strong output recovery. Lower inflation (which fell from 18.0 to 14.8 per cent between October 2009 and January 2010) led the Central Bank to reduce its policy rate by 200 basis points to 16 per cent.

Economic recovery in South Africa picked up further on the back of a robust expansion of government services and strong growth of manufacturing and mining production. GDP of the continent's largest economy increased by 3.2 per cent in the fourth quarter of 2009 (quarter on quarter). Year on year, however, GDP was still 1.4 per cent lower. Consumer spending is expected to remain sluggish with the unemployment rate still standing at 24.3 per cent. As a result, the economy will continue to perform below potential for some time to come.

East Asia: economic outlook for 2010 continues to brighten

East Asia's economic outlook continued to brighten as GDP growth in the fourth quarter of 2009 strengthened. Industrial production and exports are rebounding while labour market conditions in most countries are also improving. The region's recovery is not only faster than expected but also remarkably broad-based. It is driven by sustained growth in household spending and ongoing fiscal stimulus measures, as well as by a strong rebound in exports which in turn has fueled private investment growth. In the Republic of Korea, Taiwan Province of China and Thailand – three economies that had suffered massive contractions in late 2008 – seasonally adjusted quarterly output levels returned to pre-crisis peaks on the back of strong growth in the second half of 2009. The positive outlook for 2010 is underpinned by rapidly expanding industrial output. Year-on-year industrial production indices were up by 34 per cent in the Republic of Korea in December 2009 and by 39.4 per cent in Singapore in January 2010. While the rate of unemployment continued to decline in Hong Kong Special Administrative Region of China, Singapore and Taiwan Province of China, it soared in January 2010 to a ten-year high of 4.8 per cent in the Republic of Korea. This is mainly owing to the fact that the (seasonally-adjusted) participation rate moved up after having fallen markedly in 2009.

South Asia: India keeps fiscal stimulus measures in place as growth decelerates

India's economic growth slowed markedly from 7.9 per cent (year on year) in the third quarter of 2009 to 6.0 per cent in the fourth quarter as agricultural output declined by 2.8 per cent owing to insufficient monsoon rains. The manufacturing sector, however, continued to recover with year-on-year growth accelerating to 14.3 per cent. For the year as a whole, industrial output increased by 6.5 per cent despite the difficult global economic environment. In its budget for the forthcoming fiscal year 2010/11, the Government of India announced to keep the fiscal stimulus measures in place. The high level of public spending is expected to lift growth to the pre-crisis rate of about 9 per cent. The Government also aims at making development more inclusive, inter alia, through further investment in rural infrastructure. At the same time, it vowed to gradually reduce the fiscal deficit from its current level of about 7 per cent to 4.1 per cent of GDP in 2012/13. The Government of Pakistan revealed ambitious fiscal targets, including a reduction of the deficit from currently 4.2 per cent to 2.3 per cent of GDP in 2012/13 and an increase in the tax to GDP ratio from 9 per cent to 12 per cent.

Western Asia: strong increase of industrial output in Turkey

The economy of Israel expanded by 0.5 per cent (year on year) in the fourth quarter of 2009 on the back of strong export growth. Compared with the previous quarter, growth reached 4.4 per cent at an annualized rate, the third consecutive increase. While consumer prices dropped by 0.7 per cent month on month in January due in part to reduced taxes, the annual inflation rate was 3.8 per cent, virtually unchanged from the previous two months.

In Turkey, industrial output increased by 25.2 per cent (year on year) in December. Stronger exports by, among others, the automotive sector were a major driving force. The annual rate of inflation accelerated to 8.2 per cent in January, up from 6.5 per cent in the previous month as a result of higher taxes and fuel costs as well as base effects.

The Central Bank of Kuwait reduced the discount rate by 50 basis points to 2.5 per cent in an effort to support economic activity in the non-oil sector and against the backdrop of lower inflationary pressure.

Latin America: recovery still subdued

Mexico recorded a 2.3 per cent decline in GDP in the last quarter of 2009 (year on year). The Mexican economy declined by 6.5 per cent for the year as whole, the worst recession in decades. Peru, in contrast, registered positive economic growth of 1.1 per cent in 2009, though much below that of previous years. Official data indicate that also Argentina posted a very modest, but still positive output growth (0.5 per cent) in the first 11 months of 2009. Data for January 2010 suggest that economic recovery in Chile is still weak as industrial and mining production decreased by, respectively, 1.1 and 1.7 per cent (year on year) and unemployment increased by 1 percentage point from the previous month, reaching 9.1 per cent. The positive news in January was that Chile's copper exports had increased by 117 per cent in January (year on year), while copper prices were up by 130 per cent. On February 27, the country was hit by a devastating earthquake costing the lives of hundreds and causing enormous economic damages. It is not yet clear to what extent the earthquake has affected mining production, but no doubt the disaster will imply an enormous set back to Chile's economic recovery efforts.

Least developed countries: drug trafficking threatens West Africa

Paris Club creditors have agreed to restructure almost half of the $6.9 billion debt owed to them by the Democratic Republic of the Congo. Of the $3 billion covered by the agreement, $1.3 billion will be cancelled and almost $1.7 billion rescheduled. Moreover, debt service payments have been deferred until after July 2012.

Drug trafficking continues to severely affect some coastal West African least developed countries, including The Gambia, Guinea, Guinea-Bissau, Liberia, Senegal and Sierra Leone. The United Nations estimates that $1 billion worth of cocaine had passed through West Africa in 2008, a figure comparable to or higher than the GDP of some nations in the region. Drug trafficking is fuelling money laundering, crime and corruption in a region much in need of greater stability and productive investment.■