World Economic Situation and Prospects

Monthly Briefing

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Summary

- Global manufacturing production has improved
- Economic recovery is strengthening in developed economies, although slowly
- Public fiscal stimulus programmes have been a determinant factor in economic growth in many developing countries

Global issues

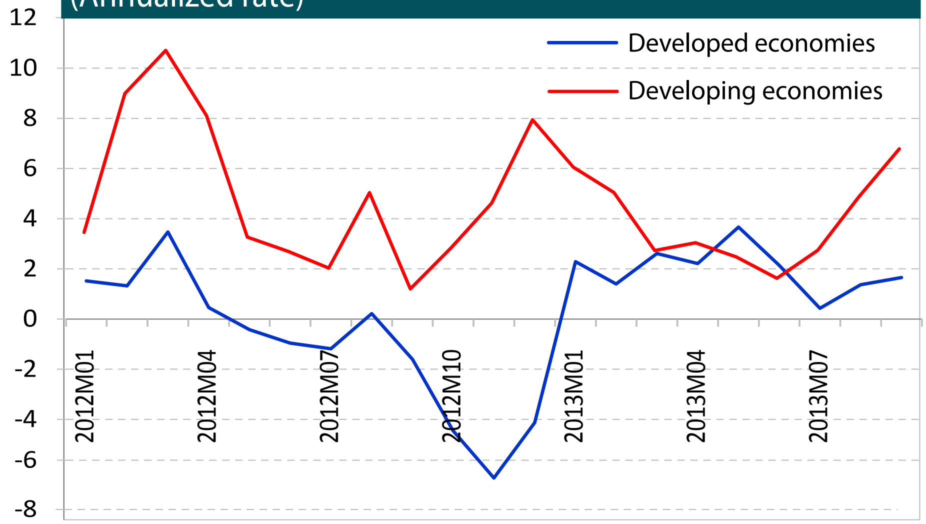
Positive industrial data indicate stronger economic performance at the global level

Global industrial production accelerated by an annualized rate of 4 per cent in the third quarter of 2013, in line with an ongoing positive trend in industrial production and trade (figure 1). This is the fastest pace in about two and a half years, excluding the exceptional circumstances that followed the flooding in Thailand and Japan's nuclear disaster in 2011. Industrial production picked up in many countries, but the strongest acceleration in output has been experienced in emerging economies, where industrial production growth reached almost 8 per cent between June and August of this year. The improvement has been more modest in developed economies. The United States economy registered only a 2 per cent increase over this period—although some analysts talk about a manufacturing renaissance—while industrial production in the Euro area has been more volatile. In August, however, European industrial production has registered a significant improvement of 1 per cent month on month, suggesting that the sector is returning to growth. It is worth noting, however, that the August rebound in industrial production was led by automotive production, particularly in Germany, rather than being broadly based across industries. This positive trend may gain more traction in the fourth quarter, as presaged by leading indicators in the October purchasing managers' indices in many countries.

Several factors seem to explain the relatively positive performance of industrial production in emerging economies. In Central Europe, for instance, stronger demand for imports from the euro area may have been the determining factor. But in some East Asian economies, such as China and the Republic of Korea, industrial production growth resulted mainly from stronger construction and facilities investment, which was supported by fiscal stimulus measures.

Figure 1: 3-month change of industrial production

(Annualized rate)



Source: UN/DESA, based on data from CPB Netherlands Bureau for Economic Policy Analysis

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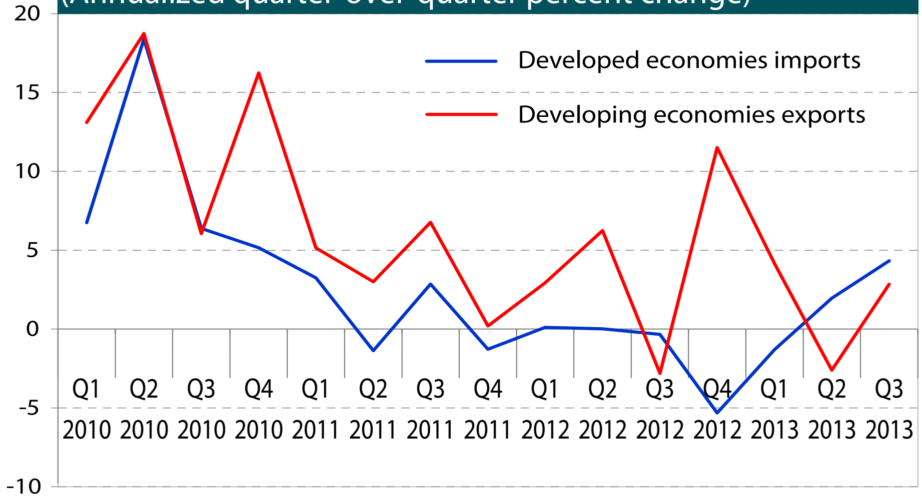
Imports from developed economies are picking up

Recent data on trade highlights increasing demand for imports from developed economies (figure 2). Real imports in developed economies picked up in the second quarter of 2013, registering the fastest increase in the past three years. The improvement in the trade sector had some spillover effects on several emerging European economies. In Central Europe for instance, industrial production and exports accelerated strongly in the Czech Republic and Poland, benefiting from their strong ties with the euro area.

Figure 2: Imports from developed economies and exports for developing countries

(Annualized quarter-over-quarter percent change)



Source: UN/DESA, based on data from CPB Netherlands Bureau for Economic Policy Analysis

The question, however, is whether import demand from developed economies and industrial output can be sustained. There are some positive signs that the economic activity may be back on track in developed economies. The United States economic recovery continues on with some momentum, helped by consumer spending and private investment. The euro area emerged from recession in the second quarter of 2013, after six consecutive quarters of contraction. And Japan's economy is performing better as a result of government spending, while business confidence is also at its highest level of the past six years. Thus, world trade is expected to grow at a faster pace in the next few quarters, but in the long term it may not be as dynamic as in previous decades.

The global economic outlook remains uncertain, however

Despite these positive indicators that point to stronger global economic performance, there are still considerable uncertainties about the economic recovery in developed economies, as discussed during the recent United Nations Department of Economic and Social Affairs Expert Group Meeting (Project LINK), held in New York from 21 to 23 October 2013. The United States has just averted a default crisis, but negotiations over the government budget and the debt ceiling will take place again in 2014. At the same time, the main challenge is still job creation, which has recently slowed down in the United States and remains exceptionally weak in Europe. Owing to a number of policy measures, the systemic risks in the euro area have abated and, more recently, GDP for the region as a whole was growing. However, considerable banking and fiscal risks remain, and the real economy in the euro area, particularly in those member countries under debt distress, remains fragile. Many emerging economies are vulnerable to external shocks and face bottlenecks in their domestic economy. Japan's economic recovery, supported by stimulus programmes, may peter out when the increase in the consumption tax rate, which is scheduled for the next two years, phases in. Overall, managing a smooth tapering of the quantitative easing programmes will be the key challenge for the monetary authorities in major developed countries, as the risks associated with this transition will pose a threat not only for developed economies, but also for the rest of the world.

Developed economies

The United States: budget issues are not yet fully solved

With Congress failing to agree on the federal budget, the Government of the United States was partially shut down for 16 days in October. About 400,000 federal employees were furloughed during that period, and a number of public services were disrupted. The last minute agreement enabled the Government to re-open and to raise the debt ceiling, but it did not provide a long-term solution. The agreement only enables the federal Government to operate until 15 January 2014 and to issue more debt until 7 February 2014. In the real economy, the recovery of the housing sector seems to have slowed down, considering that the pending home sales index declined continuously in the past four months. The softening in the housing sector is partly attributed to the spike in mortgage interest rates by about 100 basis points in May-June, after the United States Federal Reserve announced the possibility of tapering the quantitative easing.

Developed Asia: New consumption tax hike, while labour market recovery remains weak

On 1 October 2013, the Government of Japan decided to raise the consumption tax rate from the current level of 5 per cent to 8 per cent, starting in April 2014. The Government will also introduce an economic stimulus package of 5 trillion yen to compensate for the negative impact of the higher tax rate. Economic activity continued to expand in the past few months. Both industrial production and international trade volume have maintained an upward trend since the beginning of this year. However, import growth has been faster than export growth, aggravating the deficit in the balance of merchandise trade. Recovery in the labour market has been slower than other segments. In the first few months of 2013, job creation remained feeble, although it started to accelerate in September. The seasonally adjusted employment level is now almost back to the level observed before the March 2011 disasters. However, the wage rate remained flat and kept the core inflation rate close to zero.

Western Europe: economic activity continues to strengthen

The recovery in Western Europe is continuing, but remains fragile. At the sectoral level, industrial and retail trade confidence are now above their long-term averages, consumer confidence is close to its long-term average, while confidence in the construction and service sectors remains well below average. Capacity utilization ticked up to 78.4 per cent at the beginning of the fourth quarter, but remains below its long-term average. The Markit Eurozone PMI Composite Output Index dipped in October, driven by a slight decline in services activity, but bolstered by an increase in industrial activity. The index remains above the level that demarks expansion from contraction. Short-term hard data improved in August; industrial production and retail trade both rose again in August, while construction picked up for the fifth consecutive month. Inflation continues to decelerate, with the headline HICP rising by only 1.1 per cent in September, after a 1.3 per cent increase in August. The gap between core and headline inflation has nearly closed, as the impact of past high energy prices has dissipated. However, these low rates of inflation are well below the European Central Bank's target of 2 per cent, indicating that activity remains weak. Unemployment data were revised in September, showing that unemployment increased to 12.2 per cent in August and September.

The new EU members: monetary policy to remain accommodative

Available indicators suggest that both business and consumer confidence continued to strengthen further during October in the countries of Central Europe. In Poland, domestic demand continued to recover and consumer spending surged in the third quarter. In September, the volume of retail sales increased by 3.9 per cent year on year, while industrial activity expanded by 6.2 per cent year on year. Among the Baltic States, however, growth in Lithuania subsided in the third quarter, to 2.2 percent year on year from the 3.8 percent increase attained a quarter earlier. Governments in the region are preparing the draft budget proposals for 2014. As a new member of the European Union, since July, Croatia now has to comply with the requirements of the Stability and Growth Pact; the Government has therefore presented a three-year fiscal-adjustment plan consisting of spending cuts and revenue boosting measures. Thanks to high levels of international liquidity and subdued inflation, monetary easing is likely to continue in the region. The National Bank of Romania cut its policy rate to 4.25 per cent in late September, while the Hungarian National Bank reduced its policy rate to 3.4 per cent in late October—both being record-low levels.

Economies in transition

CIS and Georgia: weak investment remains a drag on the Russian economy

The Russian economy expanded by a mere 1 per cent year on year in September as investment declined, including in the construction sector, while the retail sector contracted and unfavourable weather affected agricultural output. GDP growth is estimated at 1.2 per cent year on year for the third quarter. For the year as whole, the economy is unlikely to expand more than 1.5 per cent. Annual inflation in the Russian Federation continued to subside in September, declining to 6.1 per cent, but remains an impediment for a monetary relaxation. In Ukraine, devaluation expectations increased due to the depletion of foreign exchange reserves. The National Bank of Ukraine had spent about $580 million in September to support the currency and also widened currency control measures in October. In Azerbaijan, GDP grew by 5.4 per cent in the first three quarters, mainly driven by the non-oil sector. By contrast, Georgia's economy has slowed down significantly, held back by weak construction and investment, as well as stagnating credit. GDP expanded only by 1.6 per cent year on year during the period January-August.

The economies of Central Asia continued to register strong growth, supported by commodity exports and public spending. In Kyrgyzstan, GDP expanded by 9.2 per cent year on year in the first three quarters of the year, thanks both to the return of normal production levels in the gold mine sector, and to improvements in the retail and agricultural sectors. In Uzbekistan, GDP increased by 8.1 per cent, during the same period

South-Eastern Europe: policy rate cut in Serbia

The second quarter GDP growth in Serbia, initially estimated at 0.7 per cent, was revised down to 0.2 per cent year on year in October. Available figures for the third quarter suggest a pick-up in industrial output, which expanded by 5.6 in August year on year. In the former Yugoslav Republic of Macedonia, by contrast, industrial output shrank by 1.2 per cent year on year in August. This drop is attributable to the decrease in food production and basic metals. In Albania, the economy virtually stagnated in the second quarter, expanding by a mere 1.1 per cent year on year, despite a strong rebound in the construction sector. In September, inflation remained low in Albania, at 1.7 per cent, below the lower bound of the official target, and decelerated to 4.9 per cent in Serbia, returning to the official target tolerance band. In response, the National Bank of Serbia cut its benchmark policy rate in mid-October by 50 basis points to 10.5 per cent.

Developing economies

Africa: growth is up in Botswana and Uganda

In the second quarter of 2013, GDP growth in Botswana accelerated to an estimated 7.4 per cent growth rate year on year, from 3.3 per cent year on year in the first quarter. The growth was driven by resurgence in the mining sector, particularly in diamond production.

Uganda also posted an improvement in growth for the second quarter, rising to 2.2 per cent quarter on quarter from 1.5 per cent in the previous quarter. This is expected to bring growth for the 2012/2013 fiscal year up to 5.8 per cent, above the previous estimate of 5.1 per cent. Exports have been growing strongly, benefiting from growth in the neighbouring trading partners.

Egypt has taken a number of steps to boost the economy. The cabinet approved a package of additional investment spending worth $4.3 billion for the 2013/2014 fiscal year. The Government considers that this will not impact its efforts to bring down the fiscal deficit to 10 per cent of GDP, although there have been underestimations in past deficit projections. In addition, there are plans to boost minimum monthly wages for public sector workers by about 70 per cent. Price controls on fruits and vegetables were also recently imposed in an effort to rein in rising food price inflation. Year-on-year food price inflation was up to 14 per cent in August, and this is expected to rise in the coming months

East Asia: growth in China and the Republic of Korea strengthens

The economic outlook for most East Asian economies has remained fairly stable in recent months. In China and the Republic of Korea, GDP growth strengthened slightly in the third quarter of 2013, mainly owing to a pick-up in investment and household consumption. China's economy grew by 7.8 per cent year on year, up from 7.5 per cent in the previous quarter. Investment activity was supported by fiscal stimulus measures, including a tax break for small businesses and accelerated spending on railway construction. Import growth accelerated markedly, helped by the recovery in domestic demand and the gradual appreciation of the renminbi. Since external demand remained weak, net exports exerted a drag on China's economic growth in the third quarter. In the Republic of Korea, GDP growth accelerated to 3.3 per cent year on year, the fastest pace since the last quarter of 2011. Construction activity was one of the main drivers of growth, expanding by 8 per cent from the previous year. This partly reflects the impact of a supplementary budget introduced in April, which has also helped improve consumer sentiment. While consumption and investment demand gained strength, the external sector continued to be sluggish. Exports grew at only 2.9 per cent year on year, down from 5.7 per cent in the second quarter.

South Asia: trade balances improve amid recovery in external demand

South Asia's economies saw a recovery in external demand and an improvement in trade balances in recent months. Export growth was supported by weaker national currencies, especially in India and Pakistan, and a pick up in activity in some of the region's main trading partners. In the third quarter of 2013, India's merchandise exports grew by 29 per cent year on year in rupee terms and by 12 per cent in dollar terms. In September, the country's trade deficit dropped to its lowest level since early 2011. Despite an appreciation of the taka against the dollar, Bangladesh's export revenues also increased rapidly in the third quarter, as a result of strong demand for ready-made garments in Europe and the United States. By contrast, workers' remittance flows to Bangladesh fell in the past few months. This can be mainly attributed to a drop in inflows from Saudi Arabia, which has introduced restrictions for overseas workers to qualify for employment.

The Reserve Bank of India (RBI) raised its repurchase rate by 25 basis points to 7.75 per cent in October. By increasing the benchmark interest rate for the second time in less than two months, the new RBI governor reiterated its commitment to bring down the country's stubbornly high inflation rate. At the same time, the RBI continued to unwind the short-term liquidity tightening measures that were introduced in July to defend the rupee

Western Asia: government spending stimulates economic growth in oil exporting countries

In oil exporting countries, such as Kuwait and the United Arab Emirates, economic output has been expanding owing to the non-oil sector, on the back of substantial government spending on infrastructure and the energy sector. In the United Arab Emirates, for instance, the PMI reached a 29 month high of 56.6 per cent in September, confirming a positive trend in the non-oil sector. In Kuwait, private sector bank lending also posted an eleven-month high of 4.7 per cent growth in August, reflecting confidence in the domestic economic conditions. By contrast, in Lebanon, instead, economic conditions have been affected by the overall instability in the region. Tourism, for instance, dropped by 10 per cent year on year, during the period June to August 2013, leading to a decline in the services surplus and a wider trade deficit. Over the same period, public finances worsened, as public revenues fell by 2.8 per cent. In Turkey, the Government has been able to reduce its budget deficit to 1.3 per cent of GDP at the end of August 2013, owing to stronger revenue collection.

Latin America and the Caribbean: fiscal tightening in the Caribbean compromises economic growth

In Jamaica, recent data points to a current account deficit close to 13 per cent of GDP and a sovereign debt equivalent to 146 per cent of GDP in 2013, resulting in high debt servicing costs and less available fiscal space to spend in more productive areas. This unsustainable condition led to an agreement on a four-year US$ 944 million extended fund facility programme with the IMF. The first US$ 30.6 million was disbursed in late September on an assessment of the Government's considerable efforts to raise its revenues. Public revenues increased by 9.1 per cent year on year in the first five months of 2013, which is considered a positive step towards overcoming its deficits. However, fiscal tightening, in addition to weak external demand, has been weighing on economic growth and unemployment. Youth unemployment reached 32 per cent in the first half of 2013. Thus, the main concern for policymakers has been sustaining economic activity, instead of relying on austerity measures alone to bring the country to solvency. This main point was expressed by several Governments in the region at the High-Level Caribbean Forum "Building Growth into the Caribbean Sustainability Agenda", which took place in late September in Nassau. The Forum gathered representatives from all major international financial institutions to discuss concrete measures to renew economic growth, while seeking fiscal sustainability. In response to this challenge, representatives from International Financial Institutions (IFIs) stressed the importance of private sector led activity, further economic integration, and structural reforms to stimulate economic growth in the region..