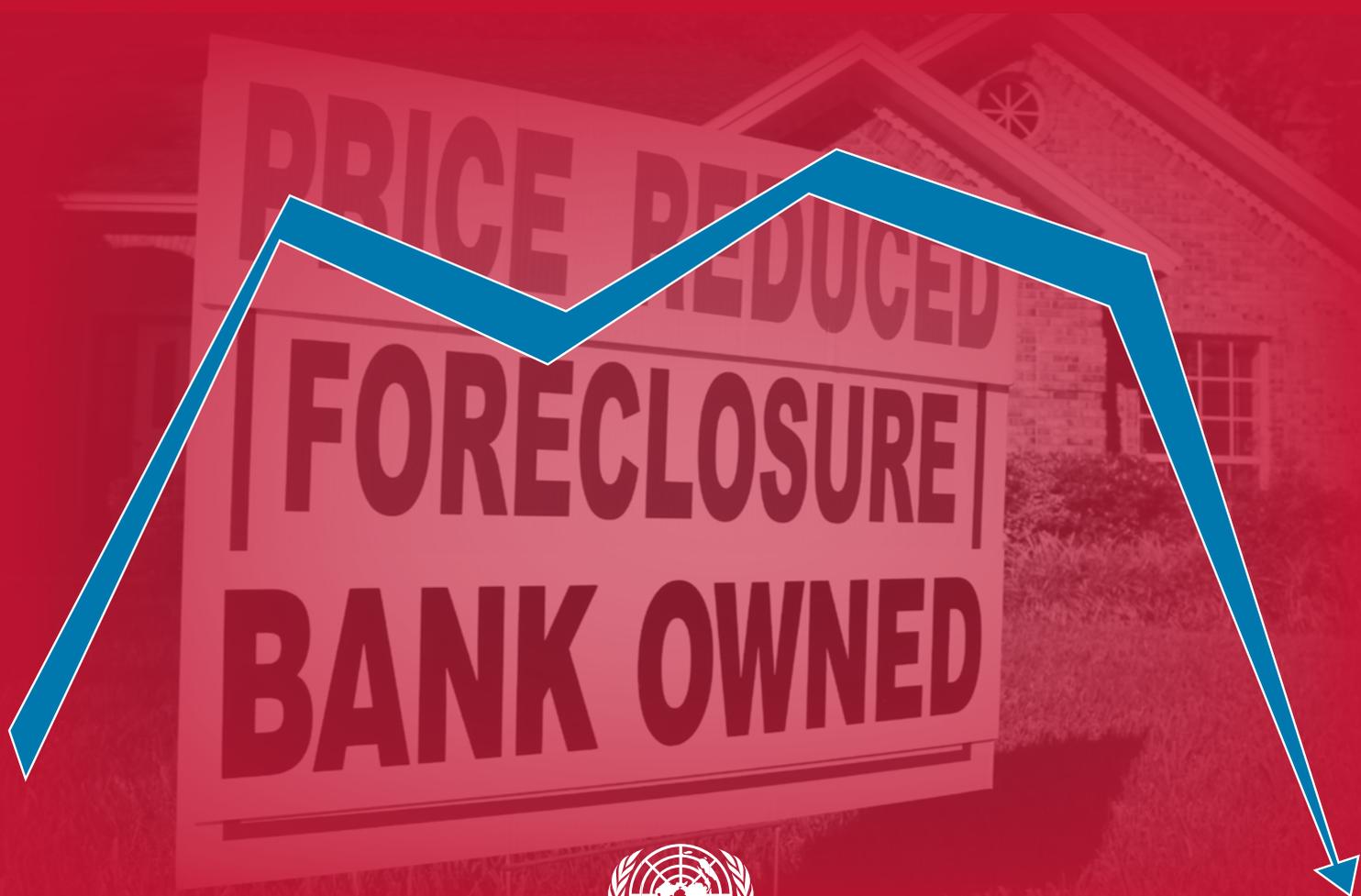


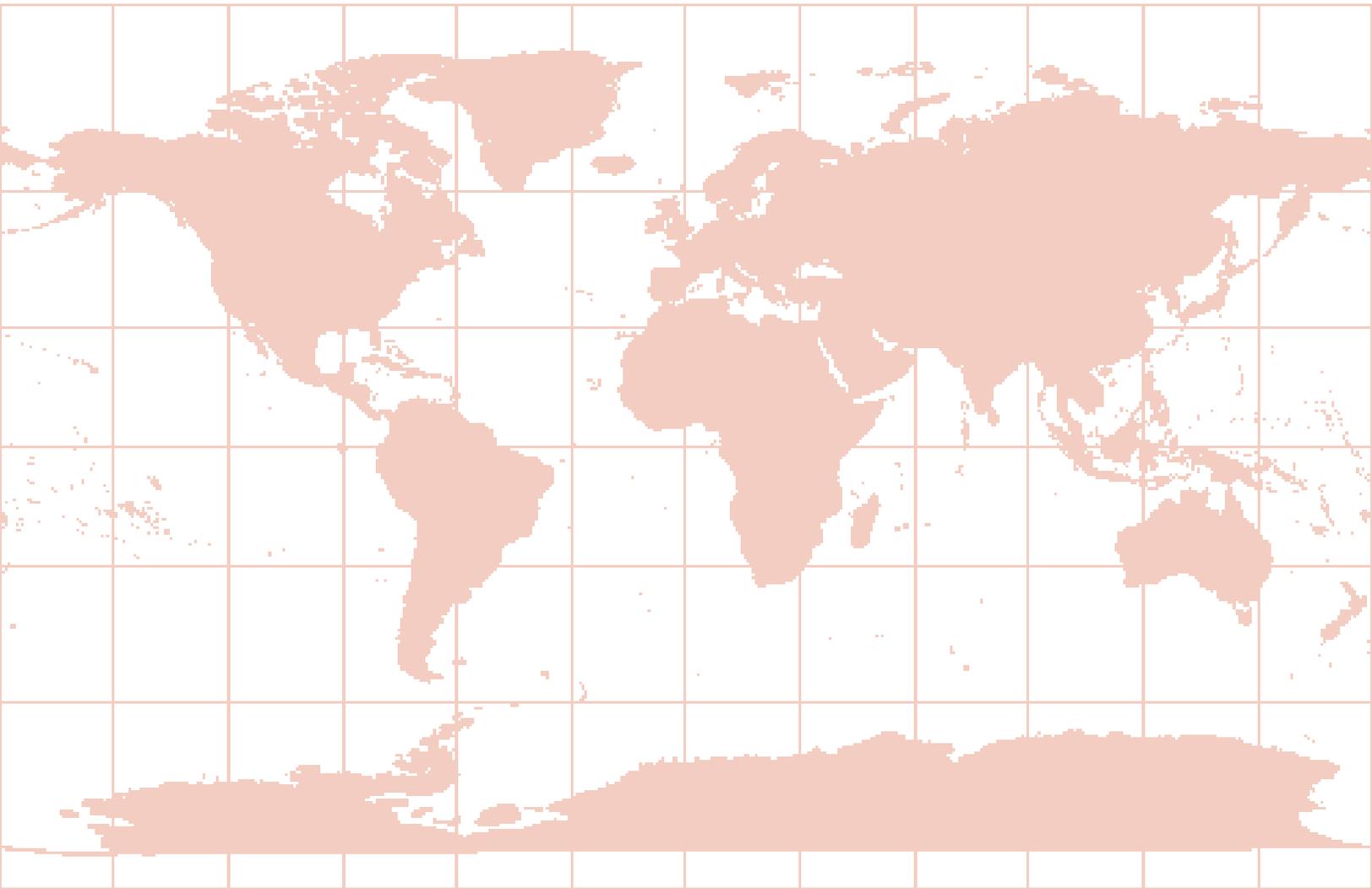


World Economic Situation and Prospects 2009



United Nations

World Economic Situation and Prospects 2009



United Nations
New York, 2009

Acknowledgements

The report is a joint product of the United Nations Department of Economic and Social Affairs (DESA), the United Nations Conference on Trade and Development (UNCTAD) and the five United Nations regional commissions (Economic Commission for Africa (ECA), Economic Commission for Europe (ECE), Economic Commission for Latin America and the Caribbean (ECLAC), Economic and Social Commission for Asia and the Pacific (ESCAP) and Economic and Social Commission for Western Asia (ESCWA)).

For the preparation of the global outlook, inputs were received from the national centres of Project LINK and from the participants at the annual LINK meeting held in New York on 23 and 24 October 2008. The cooperation and support received through Project LINK are gratefully acknowledged.

Rob Vos, Director of the Development Policy and Analysis Division (DPAD) of UN/DESA, was the lead author and manager of the report. Pingfan Hong led the team of DESA/DPAD, which comprised Grigor Agabekian, Clive Altshuler, Marva Corley, Keiji Inoue, Alex Izurieta, Matthias Kempf, Malinka Koparanova, Hung-Yi Li, Ingo Pitterle and Sergio Vieira. The Financing for Development Office at UN/DESA contributed through inputs from Manuel Montes, Tserenpuntsag Batbold, Sergei Gorbunov, Benu Schneider and Frank Schroeder. The team at UNCTAD included Heiner Flassbeck, Alfredo Calcagno, Olivier Combe, Pilar Fajarnes, Marco Fugazza, Masataka Fujita, Detlef Kotte, Alexandra Laurent, Anne Miroux, Victor Ognitvsev, Olle Ostensson, Astrid Sulstarova and Harmon Thomas. The team at ECA included Fabrizio Carmignani, Adam Elhiraika and Susanna Wolf; at ECE: Rumen Dobrinsky, José Palacin and Robert Shelburne; at ECLAC: Osvaldo Kacef, Jürgen Weller and Francisco Villareal; at ESCAP: Tiziana Bonapace, Alberto Isgut, Muhammad Malik and Shigeru Mochida; and at ESCWA: Shaun Ferguson, Ali Kadri, Nabil Safwat and Yasuhisa Yamamoto.

Helpful guidance was received from Jomo Kwame Sundaram, Assistant Secretary-General for Economic Development at UN/DESA. Comments and suggestions from Richard Kozul-Wright are also gratefully acknowledged.

For further information, please see <http://www.un.org/esa/policy> or contact:

DESA:

Mr. Sha Zukang, Under-Secretary-General, Department of Economic and Social Affairs, Room DC2-2320 United Nations, New York, NY 10017, USA; phone: +1-212-9635958, e-mail: sha@un.org.

UNCTAD:

Mr. Supachai Panitchpakdi, Secretary General, United Nations Conference on Trade and Development, Palais des Nations, Room E-9050, CH - 1211 Geneva 10, Switzerland; phone: +41-22-9175806; e-mail: sgo@unctad.org.

ECA:

Mr. Abdoulie Janneh, Executive Secretary, United Nations Economic Commission for Africa P.O. Box 3005, Addis Ababa, Ethiopia, phone: +251-11-544 3336; e-mail: ecainfo@uneca.org.

ECE:

Mr. Paolo Garonna (OiC) United Nations Economic Commission for Europe, Information Service Palais des Nations, CH - 1211 Geneva 10, Switzerland; phone: +41-22-9171234; e-mail: info.ece@unece.org.

ECLAC:

Ms. Alicia Bárcena, Executive Secretary, ECLAC, Av. Dag Hammarskjöld 3477, Vitacura, Santiago, Chile; phone +56-2-2102000; e-mail: secepal@cepal.org.

ESCAP:

Ms. Noeleen Heyzer, Executive Secretary of the Economic and Social Commission for Asia and the Pacific, The United Nations Building, Rajadamnern Nok Avenue, Bangkok 10200 Thailand; phone: +66-2-2881234, fax +66-2-2881000, e-mail: unescap@unescap.org.

ESCWA:

Mr. Bader Al-Dafa, Executive Secretary of the Economic and Social Commission for Western Asia, P.O. Box 11-8575, Riad el-Solh Square, Beirut, Lebanon; phone: +961-1-981301; e-mail: <http://www.escwa.un.org/main/contact.asp>.

Executive Summary

The global outlook

The world economy is entering into a recession

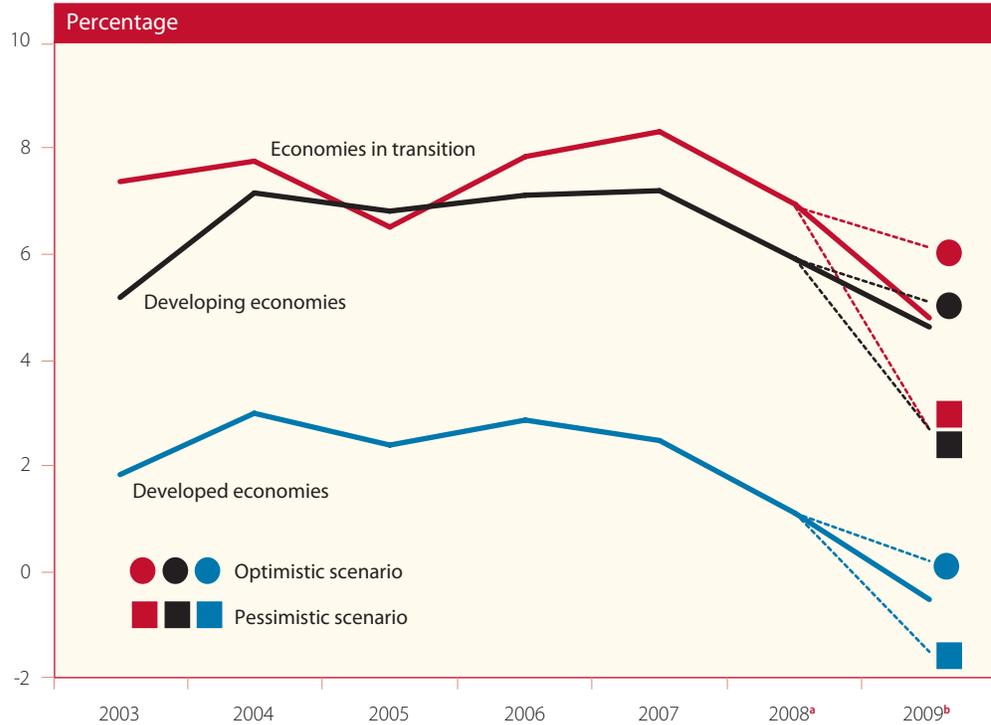
The world economy is mired in the worst financial crisis since the Great Depression. What first appeared as a sub-prime mortgage crack in the United States housing market during the summer of 2007 began widening during 2008 into deeper fissures across the global financial landscape and ended with the collapse of major banking institutions, precipitous falls on stock markets across the world and a credit freeze. These financial shockwaves have now triggered a full-fledged economic crisis, with most advanced countries already in recession and the outlook for emerging and other developing economies deteriorating rapidly, including those with a recent history of strong economic performance.

In the baseline scenario of the United Nations forecast, world gross product is expected to slow to a meagre 1.0 per cent in 2009, a sharp deceleration from the 2.5 per cent growth estimated for 2008 and well below the more robust growth of previous years. At the projected rate of global growth, world income per capita will fall in 2009. Output in developed countries is expected to decline by 0.5 per cent in 2009. Growth in the economies in transition is expected to slow to 4.8 per cent in 2009, down 6.9 per cent in 2008, while output growth in the developing countries would slow from 5.9 per cent in 2008 to 4.6 per cent in 2009.

The world economy could fall into recession in 2009



Synchronized global slowdown, led by a recession in developed countries



Source: UN/DESA.
 a Partly estimated.
 b Forecast.

Given the great uncertainty prevailing today, however, a more pessimistic scenario is entirely possible. If the global credit squeeze is prolonged and confidence in the financial sector is not restored quickly, the developed countries would enter into a deep recession in 2009, with their combined gross domestic product (GDP) falling by 1.5 per cent; economic growth in developing countries would slow to 2.7 per cent, dangerously low in terms of their ability to sustain poverty reduction efforts and maintain social and political stability. In this pessimistic scenario, the size of the global economy would actually decline in 2009—an occurrence not witnessed since the 1930s.

To stave off the risk of a deep and global recession, *World Economic Situation and Prospects (WESP) 2009* recommends the implementation of massive, internationally coordinated fiscal stimulus packages that are coherent and mutually reinforcing and aligned with sustainable development goals. These should be effected in addition to the liquidity and recapitalization measures already undertaken by countries in response to the economic crisis. Under a more optimistic scenario—factoring in an effective fiscal stimulus of between 1.5 and 2 per cent of GDP by the major economies, as well as further interest-rate cuts—*WESP* forecasts that, in 2009, the developed economies could post a 0.2 per cent rate of growth, and growth in the developing world would be slightly over 5 per cent.

Origins of the global financial crisis

The story of a crisis foretold

The intensification of the global financial turmoil in September-October 2008 revealed the systemic nature of the crisis and heightened fears of a complete global financial meltdown. Although the problems originated in the major developed countries, the mounting

financial fragility was closely tied to an unsustainable global growth pattern that had been emerging as far back as the early 2000s, a risk forewarned early on in previous issues of *WESP*. As part of this pattern, growth was driven to an important extent by strong consumer demand in the United States of America, stimulated by easy credit and underpinned by booming house prices as well as very high rates of investment demand and strong export growth in some developing countries, notably China. Growing United States deficits in this period were financed by increasing trade surpluses in China, Japan and other countries that had accumulated large foreign-exchange reserves and were willing to buy dollar-denominated assets.

At the same time, increasing financial deregulation, along with a flurry of new financial instruments and risk-management techniques (mortgage-backed securities, collateralized debt obligations, credit default swaps, and so forth), encouraged a massive accumulation of financial assets supported by growing levels of debt in the household, corporate and public sectors. In some countries, both developed and developing, domestic financial debt has risen four- or fivefold as a share of national income since the early 1980s. This rapid explosion in debt was made possible by the shift from a traditional “buy-and-hold” banking model to a “dynamic-originate-to-sell” trading model (or “securitization”). The leverage ratios of some institutions went up to as high as 30, well above the ceiling of 10 generally imposed on deposit banks. The deleveraging of this financial house of cards now under way has brought down established financial institutions and has led to the rapid evaporation of global liquidity, together threatening the normal operations of the real economy.

Until recently, all parties seemed to benefit from the boom, particularly the major financial players in the rich economies, while the risks were conveniently ignored, despite repeated warnings, such as those highlighted in *WESP*, that mounting household, public sector and financial sector indebtedness in the United States and elsewhere would not be sustainable over time. As strains in the United States mortgage market were transmitted to the wider financial sector, fears of a meltdown escalated and have now spread around the world.

*Policymakers worldwide have taken
unprecedented measures to deal with the crisis ...*

Policymakers initially responded in piecemeal fashion, failing to see the systemic risk or to consider the global ramifications of the turmoil in their entirety. The approach included massive liquidity injections into the financial system and the bailout of some major financial institutions, while accepting the failure of others. As the crisis intensified in September 2008, policymakers shifted to a more comprehensive and internationally improved coordinated form of crisis management. The measures taken have reshaped the previously deregulated financial landscape. Massive public funding has been made available to recapitalize banks, taking partial or full ownership of failed financial institutions and providing blanket government guarantees on bank deposits and other financial assets. Governments in both developed and developing countries have started to put together fiscal and monetary stimulus packages in attempts to prevent the global financial crisis from turning into a worldwide human disaster.

... but it will take a long time for the policies to take effect on the real economy

These policy measures are aimed at restoring confidence and unfreezing credit and money markets by recapitalizing banks with public funds, guaranteeing bank lending and insuring bank deposits. During the fourth quarter of 2008, interbank lending rates retreated somewhat following the start of the large-scale bailout. However, by December 2008, congestion and dysfunction remained in important segments of the credit markets. In any event, it will take time for most of these policy measures to take effect; the restoring of confidence among financial market agents and normalization of credit supplies will take months, if not years, if past crises can be taken as a guide. Furthermore, it typically takes some time before problems in financial markets are felt in the real economy. Consequently, it seems inevitable that the major economies will see significant economic contraction in the immediate outlook and that recovery may not materialize any time soon, even if the bailout and stimulus packages were to succeed. Moreover, the immediate fiscal costs of the emergency measures will be huge, and it is uncertain how much of these can eventually be recovered from market agents or through economic recovery. This poses an additional macroeconomic challenge.

Implications for world trade and finance

Commodity prices have become increasingly volatile ...

The crisis has already had a severe impact on global commodity markets with far-reaching implications for the prospects of the developing world at large. Commodity prices have been highly volatile during 2008. Most prices surged in the first half of 2008, continuing a trend that had begun in 2003. Trends in world market prices reversed sharply from mid-2008, however. Oil prices have plummeted by more than 60 per cent from their peak levels of July to November. The prices of other commodities, including basic grains, also declined significantly. In the outlook, most of these prices are expected to even out further along with the moderation in global demand.

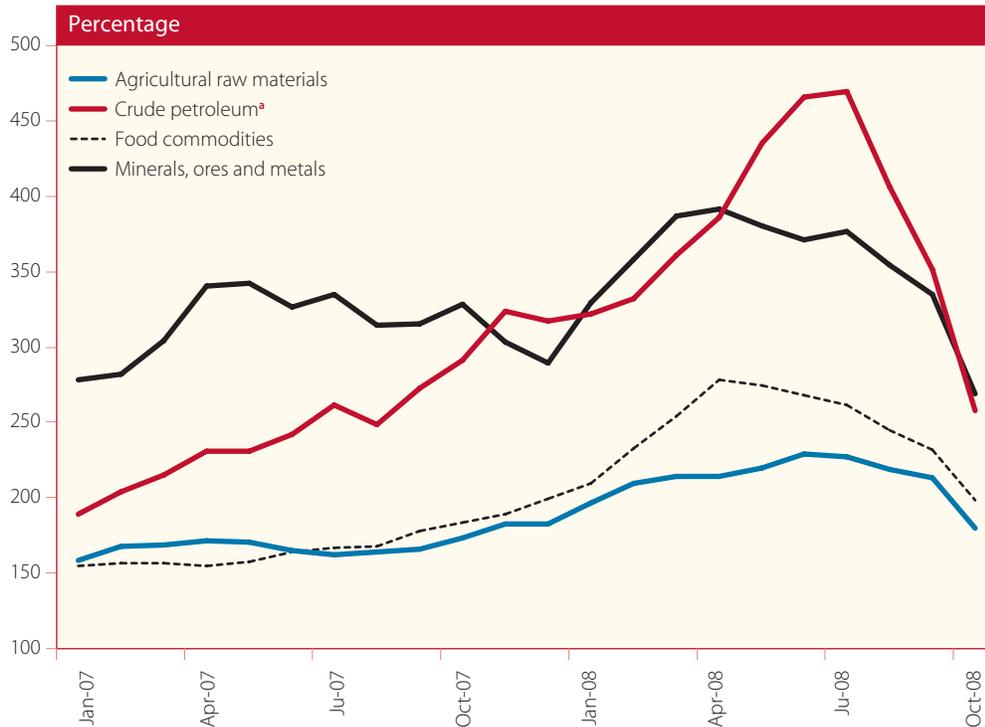
... and prospects for world trade are bleak

Growth of world *trade* decelerated to 4.3 per cent in early 2008, down from 6.4 per cent in 2007, owing mainly to a decline in imports by the United States. United States imports, which account for about 15 per cent of the world total, have registered a decline in every quarter since the fourth quarter of 2007 and dropped as steeply as 7 per cent in the second quarter of 2008. Growth in the volume of world trade had dropped to about 3 per cent by September 2008, to about one third of the rate of growth a year earlier. In the outlook, global trade is expected to weaken further in 2009.

The risk of a pullback of lending to developing countries has heightened

Owing to their limited exposure to the mortgage market derivatives that brought down major banks in the United States and Europe, financial systems in most developing countries initially seemed shielded from any direct impact from the international financial crisis. Growing risks have emerged through other channels, however, as investors have started to pull back resources from emerging market economies and other developing countries

The rise and fall of commodity prices in 2007 and 2008



Source: UNCTAD Commodity Price Statistics database.

^a Average of Brent/Dubai/Texas, equally weighted (dollars per barrel).

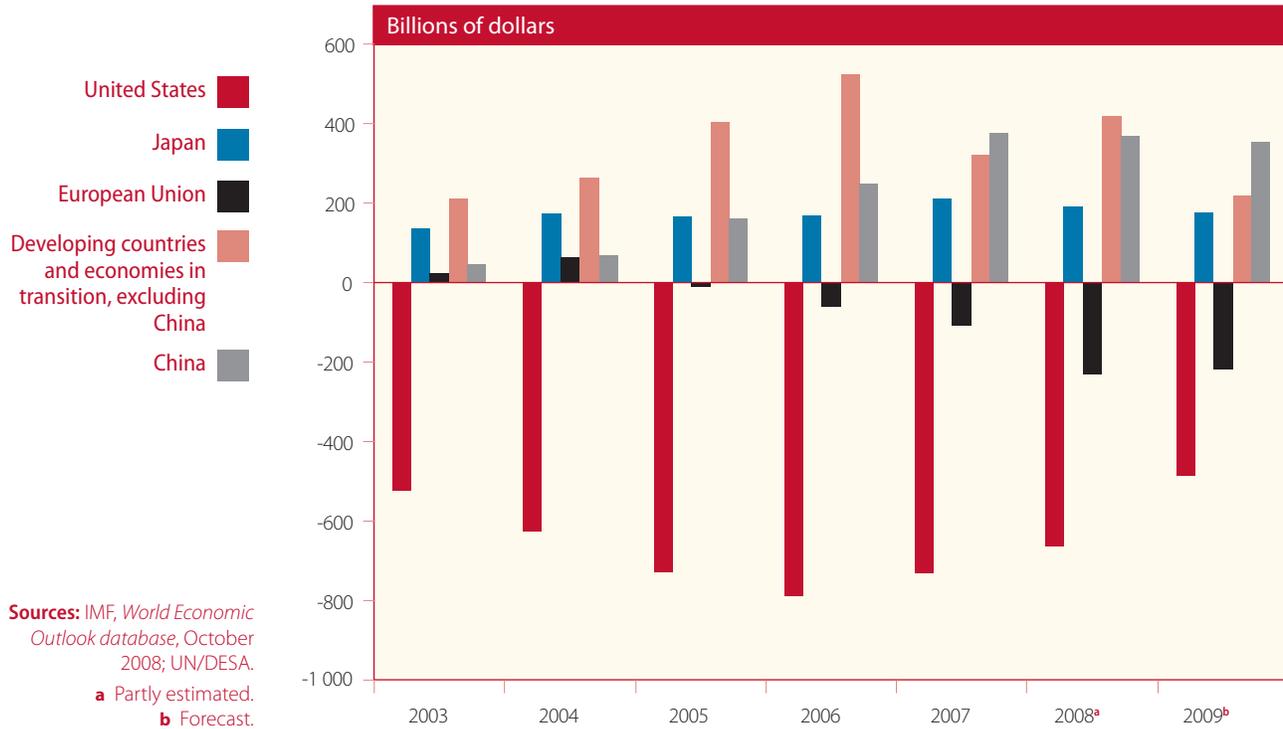
as part of the deleveraging process of financial institutions in the developed countries. External financing costs for emerging market economies surged along with the tightening of the global credit market, as measured by the spreads of the Emerging Markets Bond Index. Unlike in recent years when the spread varied significantly across regions and countries to indicate investor discrimination among country-specific risks, the latest surge has been uniform, suggesting that contagion and aversion to investing in emerging markets has taken hold among investors. Spreads are expected to remain high in 2009, as the strains in global credit markets linger and also as capital flows to emerging market economies are projected to drop further.

Exchange-rate volatility has increased and the risk of a hard landing of the dollar in 2009 remains

Volatility in *foreign-exchange markets* has also increased substantially with the deepening of the global financial crisis. The United States dollar depreciated substantially vis-à-vis other major currencies, particularly the euro, in the first half of 2008, but has since reversed direction even more sharply. For many currencies in developing countries, the earlier trend of appreciation vis-à-vis the dollar has either reversed or slowed. Currencies in a number of developing countries, particularly those that are commodity exporters, have depreciated against the dollar substantially since mid-2008. The heightened risk aversion among international investors has led to a “flight to safety”, as indicated by the lowering of the yield of the short-term United States Treasury bill to almost zero.

However, it is expected that the recent strength of the dollar will be temporary and the risk of a hard landing of the dollar in 2009 or beyond remains. Even though the global imbalances have narrowed somewhat in 2008 and are expected to narrow further in

The global imbalances have narrowed, but still pose a risk for further financial trouble



2009 with the recession in developed countries, the United States external deficit remains significant and its net international liability position continues to increase. The large current-account deficit and perceptions that the United States debt position is approaching unsustainable levels are important factors underlying the trend depreciation of the United States dollar since 2002. The flight to safety into the United States dollar in the wake of the global financial crisis is pushing the external indebtedness of the United States to new heights; this is likely to precipitate a renewed slide of the dollar once the process of deleveraging has ended. Policymakers should recognize the risk of a possible hard landing of the dollar as a potential source of renewed turmoil in financial markets in 2009.

Impact on developing countries

Developed economies are leading the global downturn, but the weakness has rapidly spread to developing countries and the economies in transition, causing a synchronized global downturn in the outlook for 2009.

Among the *economies in transition*, growth of the *Commonwealth of Independent States* (CIS) region is on course for a marked slowdown in 2009, dragged largely by the impact of a global recession and falling commodity prices on the largest economies, such as Kazakhstan, the Russian Federation and Ukraine. A slowdown in business investment, and, to a lesser degree, in household consumption will be felt throughout the region. In *South-eastern Europe*, a further moderation of economic growth is expected.

Among developing countries, growth in *Africa* is expected to decelerate in 2009, as the contagion effects of the global economic slowdown spread throughout the region, leading to weakened export demand, lower commodity prices and a decline in in-

vestment flows to the region. Growth in *East Asia* is expected to decline notably in 2009, as exports see significant deceleration. Some economies in the region will also experience sizeable financial losses as a result of their relatively high exposure to global financial markets. *South Asia* is experiencing an overall slowdown in economic growth from the industrial sector to the service sector. Growth in *Western Asia* is anticipated to slow down significantly in 2009 as export earnings from oil fall sharply, and investment spending across the region is expected to decline. Growth in *Latin America and the Caribbean* is also expected to slow markedly, dragged largely by the fall in commodity prices and global credit constraints.

Significant downturn in all developing regions in 2009

Annual percentage change									
	2003	2004	2005	2006	2007	2008 ^a	2009 ^b		
							Baseline scenario	Pessimistic scenario	Optimistic scenario
Economies in transition	7.4	7.7	6.5	7.8	8.3	6.9	4.8	2.7	6.1
Developing economies	5.2	7.1	6.8	7.1	7.2	5.9	4.6	2.7	5.1
Africa	4.9	5.9	5.7	5.7	6.0	5.1	4.1	0.1	4.7
East Asia	6.9	8.0	7.7	8.6	9.0	6.9	5.9	4.6	6.4
South Asia	6.9	6.7	9.5	6.9	7.9	7.0	6.4	4.0	6.6
Western Asia	4.9	8.2	6.8	5.9	4.7	4.9	2.7	1.6	3.3
Latin America and the Caribbean	1.8	5.9	4.6	5.5	5.5	4.3	2.3	-0.2	2.7

Source: UN/DESA.

^a Partly estimated.

^b Forecasts, based on Project LINK.

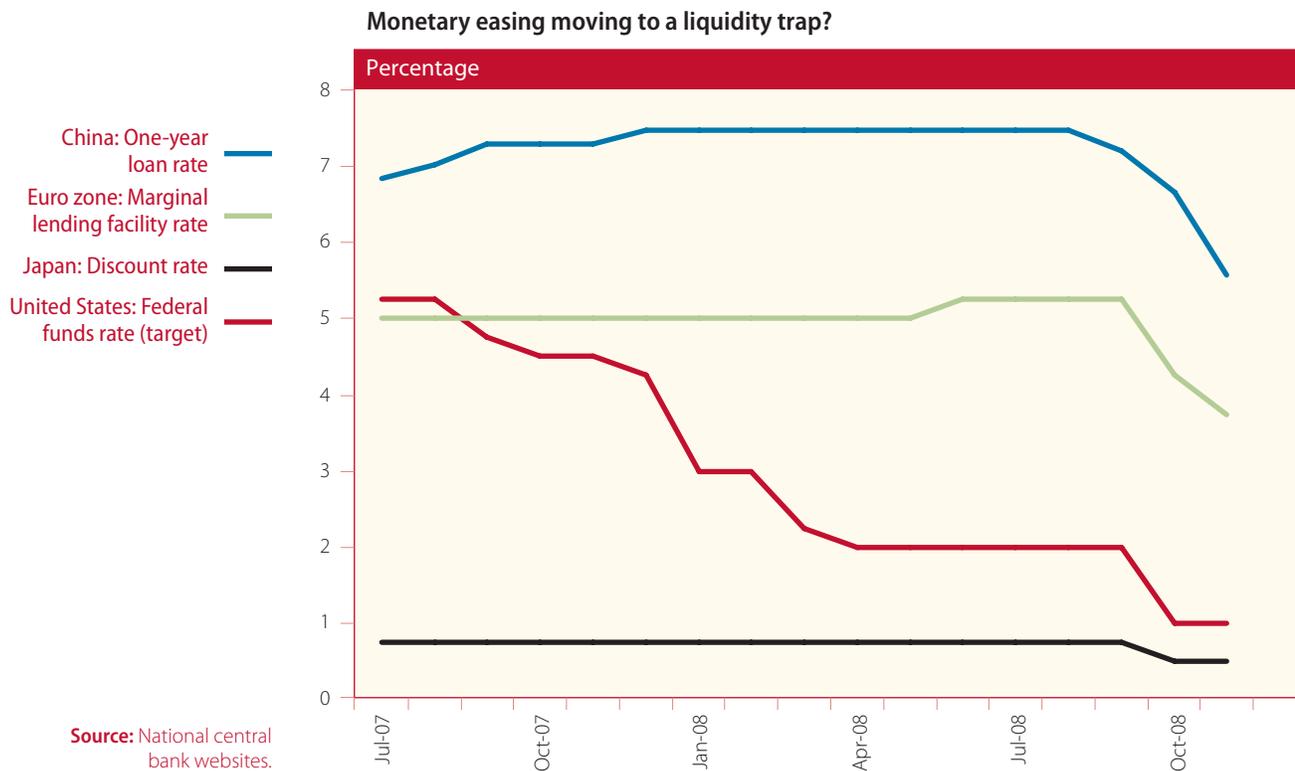
The crisis will present a setback for the fight against poverty

Coming on the heels of the food and energy security crises, the global financial crisis will most likely substantially set back progress towards poverty reduction and the Millennium Development Goals. The tightening of access to credit and weaker growth will cut into public revenues and limit the ability of developing country Governments to make the necessary investments to meet education, health and other human development goals. Unless adequate social safety nets are in place, the poor will no doubt be hit the hardest. An estimated 125 million people in developing countries were already driven into extreme poverty because of the surge in global food prices since 2006. Lessons from earlier major financial crises point to the importance of safeguarding (public) investment in infrastructure and social development so as to avoid major setbacks in human development and allow a recovery towards high-quality economic growth in the medium term.

Immediate policy challenges

Policymakers initially underestimated the crisis

Policymakers worldwide initially underestimated the depth and breadth of the current financial crisis. As a result, policy actions by and large fell behind the curve and, in the early stages, policy stances were grossly inadequate for handling the scale and nature of the crisis.



Only after the systemic risks for the global financial system became manifest in September 2008 did six major central banks decide to move in a more coordinated fashion by agreeing to cut their respective official target rates simultaneously and scale up direct liquidity injections into financial markets.

Further monetary easing is expected in the world economy in the outlook for 2009. However, with consumer and business confidence seriously depressed and banks reluctant to lend, further lowering of interest rates by central banks will do little to stimulate credit supplies to the non-financial sector or to encourage private spending. Indeed, it may end up merely expanding the money base within the banking system.

Massive fiscal stimulus is needed

Restoring confidence in financial markets in order to normalize credit flows remains of primary importance. However, as long as fears for a deep recession prevail, consumers and investors will likely remain severely risk averse. Hence, counter-cyclical macroeconomic policies are needed to complement the efforts to rescue the financial sector from widespread systemic failure.

With limited space for monetary stimulus, fiscal policy options will need to be examined as ways of reactivating the global economy. The severity of the financial crisis calls for policy actions that are commensurate with the scale of the problem and that should thus go well beyond any normal range of budgetary considerations. The United States adopted a fiscal stimulus package in early 2008, totalling some \$168 billion, or about 1.1 per cent of annual GDP, mainly in the form of a tax rebate for households. While some analysts believe the package had worked well to keep the economy buoyant for at least one quarter, others doubted the permanency of its effects. It is now clear that the size of the fiscal pack-

age was too small in comparison with the seriousness of the situation and failed to sustain the economy. At the end of 2008, a second, more substantial, fiscal stimulus package was under discussion in the United States. Similarly, European countries were easing monetary policies and preparing for significant fiscal expansion in 2009.

Counter-cyclical fiscal policies are also needed in developing countries

A large number of developing countries and the economies in transition have been reluctant to ease monetary policy over concerns of inflationary pressures and currency depreciation. Inflationary pressures should taper off during 2009, however, as world food and energy prices are now retreating and global demand is weakening. This should provide some space for monetary easing, as well as for fiscal stimulus, at least in those countries that still possess ample foreign-exchange reserves.

The scope for counter-cyclical policies will vary greatly across developing countries, mainly for two reasons. First, many countries have a history of pro-cyclical macroeconomic policy adjustment, partly driven by policy rules (such as inflation targeting). Providing greater monetary and fiscal stimuli in such cases will thus require a departure from existing policy practice and policy rules. Second, not all countries have equally sufficient foreign-exchange reserves and some are likely to suffer stronger balance-of-payments shocks.

There are countries with ample policy space for acting more aggressively to stave off a recession. The Chinese Government has already started to use its policy space, for instance, and has designed a large-scale plan of fiscal stimulus amounting to 15 per cent of its GDP to be spent during 2009 and 2010, which should contribute to reinvigorating global demand. The Republic of Korea has also announced a fiscal stimulus package equivalent to 1 per cent of its GDP.

For many of the middle- and low-income countries, the scope for providing such stimuli will be even more limited, as they may see their foreign-exchange reserves evaporate quickly, with either continued capital reversals taking place or strong reductions in the demand for their export products, or both. In order to enhance their scope for counter-cyclical responses in the short run, further enhancement of compensatory financing and additional and reliable foreign aid flows will be needed to cope with the drops in export earnings and reduced access to private capital flows caused by the global financial crisis.

As they fight fires today, policymakers worldwide must look to tomorrow

Looking to the long run, however, a broadening of the development policy framework is needed to conduct active investment and technology policies so as to diversify these countries' economies and reduce their dependence on a few commodity exports, thereby allowing them to meet key development goals, including reaching greater food security, addressing climate change and meeting the Millennium Development Goals. This will require massive resources for public investment in infrastructure, food production, education and health, and renewable energy sources. The crisis also presents various opportunities to align fiscal stimulus packages with long-term goals for sustainable development.

The fiscal stimulus needs to be coordinated internationally

To ensure sufficient stimulus at the global level, it will be desirable to coordinate fiscal stimulus packages internationally. In a strongly integrated world economy, fiscal stimulus implemented by only one country tends to be less effective because of high import leakage

effects. By coordinating fiscal stimulus internationally, the positive multiplier effects can be amplified through international economic linkages by 30 per cent or more, thereby providing greater stimulus to both the global economy and the economies of individual countries. As in the case of a coordinated monetary easing, internationally coordinated fiscal stimuli can also limit unnecessary fluctuation in cross-country interest rate differentials and in exchange rates among major currencies. Compared with coordinated interest rate policies, fiscal policy coordination tends to be more difficult to attain, both technically and politically, and hence may be difficult to achieve through ad hoc agreements, requiring instead a more institutionalized platform for coordination.

Without adequate coordination, global economic reactivation may be delayed, and it may take longer before market confidence is restored. This may prolong the credit crunch and keep borrowing costs high for developing country Governments and private firms, thereby undermining their efforts to counteract the crisis.

Internationally coordinated policy action among deficit and surplus countries is also critical for achieving a benign adjustment of the global imbalances and avoiding a disruptive hard landing of the dollar. Now that the financial crisis has already turned a disorderly adjustment into a synchronized global downturn, the need for international policy coordination and cooperation is more pressing than ever.

Reform of the international financial system

Even in the most optimistic scenario, however, it will take time before confidence is restored in financial markets and recovery can take place. As immediate solutions are being worked out, it is important to address the systemic causes that led to the present crisis.

Global economic governance mechanisms are inadequate

The depression of the 1930s had been aggravated by “beggar-thy-neighbour” policies, disintegration of the global economy and resurgent protectionism. Under the promise “never again”, it led to the design of the Bretton Woods institutions, including the creation of the International Monetary Fund (IMF) and the World Bank, to safeguard the stability of the global economy and promote growth and development. But over time, the ability of the IMF to safeguard the stability of the global economy has been hampered by limited resources, and it has been increasingly undermined by the vastly greater (and more volatile) resources of private actors with global reach. More exclusive and ad hoc country groups, such as the Group of Seven (G7) or the Group of Eight (G8), have become the platforms where international policy coordination has taken place in practice.

The apparent irrelevance of the Bretton Woods institutions in today’s crisis also stems from their skewed voting structures and governance, which do not adequately reflect the importance of developing countries in today’s world economy. The lack of a credible mechanism with broad representation for international policy coordination is an urgently felt lacuna which is limiting swift and effective responses to the present crisis.

Regulatory frameworks are deficient

The financial crisis has revealed major deficiencies in the regulatory and supervisory frameworks of financial markets. First, the new approach to the regulation of finance, including that under the New Basel Accord (Basel II) rules, places the burden of regulation on the

financial institutions themselves. Second, the more complex the trade in securities and other financial instruments has become, the greater the reliance on rating agencies who proved inadequate to the task at hand, in part because of conflicts of interest over their own sources of earnings, which are proportional to the trade volume of the instruments they rate. Consequently, risk assessments by rating agencies tend to be highly pro-cyclical as they react to the materialization of risks rather than to their build-up. Third, existing approaches to financial regulation tend to act pro-cyclically, hence exacerbating a credit crunch during a crisis. At times of boom, when asset prices and collateral values are rising, loan delinquency falls and results in inadequate provisioning and overexpansion of credit. When the downturn comes, loan delinquency rises rapidly and standard rules on provisions can lead to a credit crunch. Fourth, the spread of financial networks across the world, and the character of securitization itself, has made practically all financial operations hinge on the “confidence” that each institution in isolation is capable of backing up its operations. But as insolvencies emerge, such confidence is weakened and may quickly vanish, generating a generalized credit freeze. The risk models applied by regulatory agencies typically disregard such “contagion” effects and fail to account for the vulnerabilities of the financial system as a whole, at home and abroad.

The basic objectives of the reform of prudential regulation and supervision of financial sectors should thus be to introduce strong, internationally concerted counter-cyclical rules supported by counter-cyclical macroeconomic policies.

The risk of a hard landing of the dollar is intrinsic to the nature of the international reserve system

The risk of a hard landing of the United States dollar is intrinsic to the very nature of the global reserve system, which uses the national currency of the United States as the main reserve currency and instrument for international payments. Under this system, the only way for the rest of the world to accumulate dollar assets and reserves is for the United States to run an external deficit. However, as the net liability position of the United States continues to increase, investors will start anticipating a readjustment and confidence in the dollar will erode.

The world lacks an international lender of last resort

Over the past decade, many developing countries have accumulated vast amounts of foreign-currency reserves, providing some “self-insurance” against external shocks. However, both the carry cost of holding such reserves and the opportunity costs of not using them for long-term investment purposes are high. The tendency to accumulate a large amount of reserves in developing countries has its roots in more fundamental deficiencies of the international monetary and reserve system. Improved macroprudential capital-account regulation can help reduce the need for the cost of self-insurance via reserve accumulation. The need for self-insurance can be reduced further with more effective mechanisms for liquidity provisioning and reserve management at the international level, both regionally and multilaterally.

More generally, all IMF facilities should be significantly simplified and include more automatic and quicker disbursements proportionate to the scale of the external shock. Recent action has been undertaken in this direction with the reform of the IMF Exogenous Shocks Facility. But total resources remain limited and much more is needed to provide collective safeguards for large-scale crises.

The way forward

Given the existing systemic flaws, it seems paramount that deliberations on a new international financial architectures should address at least four core areas of reform:

- (a) The establishment of a credible and effective mechanism for international policy coordination. To guide a more inclusive process, the participation not only of major developing countries but also of more representative institutions of global governance is required; hence, a fundamental revision of the governance structure and functions of the IMF and the World Bank is needed.
- (b) Fundamental reforms of existing systems of financial regulation and supervision to prevent the re-emergence of excesses.
- (c) Reform of the present international reserve system, away from the almost exclusive reliance on the United States dollar and towards a multilaterally backed multi-currency system which, perhaps, over time could evolve into a single, world currency-backed system.
- (d) Reforms of liquidity provisioning and compensatory financing mechanisms backed through, among other things, better multilateral and regional pooling of national foreign-exchange reserves and avoiding the onerous policy conditionality attached to existing mechanisms.

The crisis is global; hence, global solutions are needed

World leaders have acknowledged these needs for reform. At the *Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus*, held in Doha, Qatar, from 29 November to 2 December 2008, Governments agreed to address systemic problems and fundamentally reform the global financial system.

At the Conference, donors also promised to honour all commitments to bridge existing deficiencies in official development assistance to developing countries and emphasized that the financial crisis should not stand in the way of achieving this.

The global financial crisis could motivate countries to recur to greater trade protection. At the Doha conference on financing for development, Governments pledged to resist such temptation, but also stressed the need to break the impasse in the negotiations to complete the *Doha Round* of multilateral trade negotiations and safeguard its development dimensions, in particular the principle of special and differential treatment.

It will not be easy to find consensus among all stakeholders on the precise shape of a new system of global economic governance, but the risk of endangering global peace and prosperity by failing to address the systemic problems underlying the present crisis are simply too high. This awareness should be the common ground for seeking common solutions.

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Explanatory Notes

The following symbols have been used in the tables throughout the report:

- .. **Two dots** indicate that data are not available or are not separately reported.
 - **A dash** indicates that the amount is nil or negligible.
 - **A hyphen (-)** indicates that the item is not applicable.
 - **A minus sign (-)** indicates deficit or decrease, except as indicated.
 - . **A full stop (.)** is used to indicate decimals.
 - / **A slash (/)** between years indicates a crop year or financial year, for example, 2007/08.
 - **Use of a hyphen (-)** between years, for example, 2007-2008, signifies the full period involved, including the beginning and end years.
- Reference to “dollars” (\$)** indicates United States dollars, unless otherwise stated.
- Reference to “billions”** indicates one thousand million.
- Reference to “tons”** indicates metric tons, unless otherwise stated.
- Annual rates** of growth or change, unless otherwise stated, refer to annual compound rates.
- Details and percentages in tables do not necessarily add to totals, because of rounding.
- Project LINK** is an international collaborative research group for econometric modelling, coordinated jointly by the Development Policy and Analysis Division of the United Nations Secretariat and the University of Toronto.

The following abbreviations have been used:

AAA	Accra Agenda for Action
ABCP	asset-backed commercial paper
AIG	American International Group, Inc.
Basel II	New Basel Capital Accord
bps	basis points
CAADP	Comprehensive Africa Agriculture Development Programme
CDS	credit default swap
CFA	Common Framework of Action (of the United Nations High-Level Task Force on the Global Food Security Crisis)
CIS	Commonwealth of Independent States
CPI	consumer price index
DAC	Development Assistance Committee (OECD)
ECA	Economic Commission for Africa
ECB	European Central Bank
ECE	Economic Commission for Europe
ECLAC	Economic Commission for Latin America and the Caribbean
ECU	European Currency Unit
EESA	Emergency Economic Stabilization Act
EMBI	Emerging Markets Bond Index
ESCAP	Economic and Social Commission for Asia and the Pacific
ESCSA	Economic and Social Commission for Western Asia
ESF	Exogenous Shock Facility
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	foreign direct investment
Fed	United States Federal Reserve

FHFA	Federal Housing Finance Agency
FSAP	Financial Sector Assessment Program
FSIs	Financial Soundness Indicators
FSF	Financial Stability Forum
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GDP	gross domestic product
GHG	greenhouse gas
GNI	gross national income
GSEs	government-sponsored enterprises
HIPCs	heavily indebted poor countries
ICT	information and communication technologies
IFIs	international financial institutions
IFPRI	International Food Policy Research Institute
IIF	Institute of International Finance
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (IMF)
IT	information technology
IWG	International Working Group of Sovereign Wealth Funds (IMF)
LDCs	least developed countries
LME	London Metal Exchange
M&As	mergers and acquisitions
mbd	millions of barrels per day
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
NAMA	non-agricultural market access
NEER	nominal effective exchange rate
NEPAD	New Partnership for Africa's Development
NGLs	natural gas liquids
NPV	net present value
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
pb	per barrel
PPP	purchasing power parity
PRGF	Poverty Reduction and Growth Facility
R&D	research and development
REER	real effective exchange rate
ROSCs	Reports on the Observance of Standards and Codes
SLF	Short-term Liquidity Facility
SSM	special safeguard mechanism
SWFs	sovereign wealth funds
TNCs	transnational corporations
TSR	Triennial Surveillance Review
UNCTAD	United Nations Conference on Trade and Development
UN/DESA	United Nations Department of Economic and Social Affairs
WGP	world gross product
WTO	World Trade Organization

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the United Nations Secretariat concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

The term “country” as used in the text of this report also refers, as appropriate, to territories or areas.

Data presented in this publication incorporate information available as of 30 November 2008.

For analytical purposes, the following country groupings and subgroupings have been used:^a

Developed economies (developed market economies):

Australia, Canada, European Union, Iceland, Japan, New Zealand, Norway, Switzerland, United States of America.

Major developed economies (the Group of Seven):

Canada, France, Germany, Italy, Japan, United Kingdom of Great Britain and Northern Ireland, United States of America.

European Union:

Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom of Great Britain and Northern Ireland.

EU-15:

Austria, Belgium, Denmark, Finland, France, Greece, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom of Great Britain and Northern Ireland.

New EU member States:

Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia.

Economies in transition:

South-eastern Europe:

Albania, Bosnia and Herzegovina, Croatia, Montenegro, Serbia, the former Yugoslav Republic of Macedonia.

Commonwealth of Independent States (CIS):

Armenia, Azerbaijan, Belarus, Georgia,^b Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

Net fuel exporters:

Azerbaijan, Kazakhstan, Russian Federation, Turkmenistan, Uzbekistan.

Net fuel importers:

All other CIS countries.

Developing economies:

Africa, Asia and the Pacific (excluding Australia, Japan, New Zealand and the member States of CIS in Asia), Latin America and the Caribbean.

Subgroupings of Africa:

North Africa:

Algeria, Egypt, Libyan Arab Jamahiriya, Morocco, Tunisia.

Sub-Saharan Africa, excluding Nigeria and South Africa (commonly contracted to “sub-Saharan Africa”):

All other African countries except Nigeria and South Africa.

Southern Africa:

Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe.

East Africa:

Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Rwanda, Seychelles, Somalia, Sudan, Uganda and United Republic of Tanzania.

West Africa:

Burkina Faso, Benin, Cape Verde, Côte d’Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo.

Central Africa:

Cameroon, Chad, Congo, Gabon, Equatorial Guinea, Central African Republic and Sao Tome and Principe.

Subgroupings of Asia and the Pacific:

Western Asia:

Bahrain, Iraq, Israel, Jordan, Kuwait, Lebanon, Occupied Palestinian Territory, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, Yemen.

East and South Asia:

All other developing economies in Asia and the Pacific (including China, unless stated otherwise). This group is further subdivided into:

South Asia:

Bangladesh, Bhutan, India, Iran (Islamic Republic of), Maldives, Nepal, Pakistan, Sri Lanka.

East Asia:

All other developing economies in Asia and the Pacific.

Subgroupings of Latin America and the Caribbean:

South America:

Argentina, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela (Bolivarian Republic of).

Mexico and Central America:

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Mexico.

Caribbean:

Barbados, Cuba, Dominican Republic, Guyana, Haiti, Jamaica, Trinidad and Tobago.

For particular analyses, developing countries have been subdivided into the following groups:

Oil-exporting countries:

Algeria, Angola, Bahrain, Bolivia, Brunei Darussalam, Cameroon, Colombia, Congo, Ecuador, Egypt, Gabon, Iran (Islamic Republic of), Iraq, Kuwait, Libyan Arab Jamahiriya, Mexico, Nigeria, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Trinidad and Tobago, United Arab Emirates, Venezuela (Bolivarian Republic of), Viet Nam.

Oil-importing countries:

All other developing countries.

Least developed countries:

Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People’s Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen, Zambia.

Landlocked developing countries:

Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, Lao’s People’s Democratic Republic, Lesotho, Malawi, Mali, Republic of Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, Swaziland, Tajikistan, the former Yugoslav Republic of Macedonia, Turkmenistan, Uganda, Uzbekistan, Zambia, Zimbabwe.

^a For definitions of country groupings and methodology, see *World Economic and Social Survey 2004* (United Nations publication, Sales No. E.04.II.C.1, annex, introductory text).

^b In September 2008, the Georgian Parliament carried a motion to leave the Commonwealth of Independent States; this decision is due to enter into force in mid-2009.

Small island developing States:

American Samoa, Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Cape Verde, Commonwealth of Northern Marianas, Comoros, Cook Islands, Cuba, Dominica, Dominican Republic, Fiji, French Polynesia, Grenada, Guam, Guinea-Bissau, Guyana, Haiti, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia (Federated States of), Montserrat, Nauru, Netherlands Antilles, New Caledonia, Niue, Palau, Papua New Guinea, Puerto Rico, Samoa, Sao Tome and Principe, Seychelles, Singapore, Solomon Islands, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu, U.S. Virgin Islands, Vanuatu.

Heavily Indebted Poor Countries (countries that have reached their Completion Points or Decision Points):

Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Chad, Democratic Republic of the Congo, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Uganda, United Republic of Tanzania, Zambia.

The designation of country groups in the text and the tables is intended solely for statistical or analytical convenience and does not necessarily express a judgement about the stage reached by a particular country or area in the development process.

Chapter I

Global outlook

The financial crisis and the prospects for the world economy

It was never meant to happen again, but the world economy is now mired in the most severe financial crisis since the Great Depression. In little over a year, the mid-2007 subprime mortgage debacle in the United States of America has developed into a global financial crisis and started to move the global economy into a recession. Aggressive monetary policy action in the United States and massive liquidity injections by the central banks of the major developed countries were unable to avert this crisis. Several major financial institutions in the United States and Europe have failed, and stock market and commodity prices have collapsed and become highly volatile. Interbank lending in most developed countries has come to a virtual standstill, and the spread between the interest rate on interbank loans and treasury bills has surged to the highest level in decades. Retail businesses and industrial firms, both large and small, are finding it increasingly difficult to obtain credit as banks have become reluctant to lend, even to long-time customers. In October 2008, the financial crisis escalated further with sharp falls on stock markets in both developed and emerging economies. Many countries experienced their worst ever weekly sell off in equity markets.

Since early October, policymakers in the developed countries have come up with a number of more credible and internationally concerted emergency plans. Compared with the earlier piecemeal approach, which had failed to prevent the crisis from spreading, the latest plans are more comprehensive and better coordinated. The measures have reshaped the previously deregulated financial landscape; massive public funding was made available to recapitalize banks, with the Government taking partial or full ownership of failed financial institutions and providing blanket guarantees on bank deposits and other financial assets in order to restore confidence in financial markets and stave off complete systemic failure. Governments in both developed and developing countries have started to put together fiscal and monetary stimulus packages in order to prevent the global financial crisis from turning into another Great Depression.

Will this work? It is hard to predict, but doing nothing would almost certainly have further aggravated the downside risks and more likely than not pushed the world economy into a deeper crisis. It should be appreciated, however, that it will take time for most of these policy measures to take effect; the restoring of confidence among financial market agents and normalization of credit supplies will take months, if not years, if past crises can be seen as a guide. Furthermore, it typically takes some time before problems in financial markets are felt in the real economy. Consequently, it seems inevitable that the major economies will see significant economic contraction in the immediate period ahead and that recovery may not materialize any time soon, even if the bailout and stimulus packages succeed. Moreover, the immediate fiscal costs of the emergency measures will be huge, and it is uncertain how much of these can eventually be recovered from market agents or through economic recovery. This poses an additional macroeconomic challenge.

The world economy is mired in the most severe financial crisis since the Great Depression

Early responses failed to prevent the crisis from spreading

New, better coordinated measures, if effective, will take time to show results

Developed countries have entered into recession and are dragging the world economy down

Most developed economies entered into recession during the second half of 2008, and the economic slowdown has spread to developing countries and the economies in transition. According to the United Nations baseline forecast, world gross product (WGP) is expected to slow to a meagre 1.0 per cent in 2009, a sharp deceleration from the 2.5 per cent growth estimated for 2008 and well below the more robust growth in previous years (table I.1). The baseline forecast assumes that it will take six to nine months for financial markets in developed countries to return to normalcy, assuming central banks in the United States, Europe and Japan provide further monetary stimulus from the end of 2008 and on into 2009 (see box I.1).

Uncertainties surrounding this forecast are high, as shown by the confidence interval around the baseline forecast (figure I.1). In a more pessimistic scenario, both the fire sale of financial assets and the credit crunch would last longer, while monetary stimulus would prove ineffective in the short run and fiscal stimulus would turn out to be too little, too late. This would then lead to worldwide recession in 2009, with global output falling by 0.4 per cent, and postpone recovery to, at best, the following year. In a more optimistic scenario, a large-scale fiscal stimulus coordinated among major economies would stave off the worst of the crisis, yet—for the reasons indicated—it would not prevent a significant slowdown of the global economy in 2009. Both of these scenarios are also shown in table I.1 and figure I.1 and discussed further below.

Table I.1
Growth of world output, 2003-2009

Annual percentage change									
	2003	2004	2005	2006	2007	2008 ^a	2009 ^b		
							Baseline scenario	Pessimistic scenario	Optimistic scenario
World output^c	2.7	4.0	3.5	4.0	3.8	2.5	1.0	-0.4	1.6
<i>of which:</i>									
Developed economies	1.8	3.0	2.4	2.9	2.5	1.2	-0.5	-1.5	0.2
United States	2.5	3.6	2.9	2.8	2.0	1.2	-1.0	-1.9	-0.5
Euro zone	0.8	2.1	1.7	2.8	2.6	1.1	-0.7	-1.5	0.3
Japan	1.4	2.7	1.9	2.4	2.1	0.4	-0.3	-0.6	0.5
Economies in transition	7.4	7.7	6.5	7.8	8.3	6.9	4.8	2.7	6.1
Developing economies	5.2	7.1	6.8	7.1	7.2	5.9	4.6	2.7	5.1
China	10.0	10.1	10.4	11.6	11.9	9.1	8.4	7.0	8.9
India	7.3	7.1	11.5	7.3	8.9	7.5	7.0	4.7	7.5
Brazil	1.1	5.7	3.2	3.8	5.4	5.1	2.9	0.5	3.0
Mexico	1.4	4.0	3.1	4.9	3.2	2.0	0.7	-1.2	1.5
<i>of which:</i>									
Least developed countries	5.2	7.2	7.9	7.7	7.8	6.4	5.1	2.0	6.1
Memorandum items:									
World trade	5.6	11.2	8.0	8.8	6.3	4.4	2.1	-3.1	3.1
World output growth with PPP-based weights	3.6	4.9	4.5	4.9	4.9	3.7	2.3	1.3	3.0

Source: UN/DESA.

^a Partly estimated.

^b Forecasts, based in part on Project LINK.

^c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

Box I.1

Key assumptions for the baseline forecast and the pessimistic and optimistic scenarios

The baseline forecast

The baseline forecast assumes that it will take six to nine months for financial markets in developed countries to return to normalcy while central banks in the United States, Europe and Japan provide further monetary stimulus from the end of 2008 and on into 2009.

The Federal Reserve (Fed) is assumed to maintain its main policy interest rate, the federal funds rate, at its current level of 1 per cent throughout 2009. In addition, the Fed (as well as other major central banks) is expected to continue using direct injections of liquidity into the financial system through some special facilities, including the Term Securities Lending Facility, and the extension of non-recourse loans at the primary credit rate to depository institutions and bank holding companies to finance their purchases of high-quality asset-backed commercial paper (ABCP) from money market mutual funds.

The European Central Bank (ECB) is assumed to cut its main policy interest rate, the minimum bid rate,^a further during the fourth quarter of 2008 from its current level of 3.25 per cent to 2.75 per cent by the end of the year. In 2009, it is expected to cut an additional 50 basis points (bps), bringing its policy rate to 2.25 per cent and then to maintain this stance for the rest of the year.

The Bank of Japan is assumed to hold its policy rate, the target Uncollateralized Overnight Call Rate, at its current 0.3 per cent until the end of 2009.

The euro peaked against the United States dollar during the second quarter of 2008, at \$1.60, and has depreciated significantly since then. It is assumed to remain close to the current levels of around \$1.28 in the fourth quarter of 2008 and to depreciate further in 2009, reaching \$1.20 as interest-rate differentials against the United States narrow further.

The Japanese yen is expected to stay close to current levels of Y99 to the United States dollar for the fourth quarter of 2008 and then to appreciate and average Y91 in the fourth quarter of 2009.

Brent oil prices are expected to average \$64 per barrel in 2009, compared with an estimated average of \$101 per barrel in 2008.

A pessimistic scenario

Given the great uncertainties with regard to how deep this financial crisis could become and how effective the policy measures in place would be, risks for the world economy to perform even worse than in the already gloomy baseline outlook remain high. The key factor in a more pessimistic scenario of this kind would be a much sharper-than-anticipated decline in net lending to households and businesses in major developed countries, not unlike the experience of the United Kingdom of Great Britain and Northern Ireland, Japan and the Scandinavian countries during their respective financial crises in the early 1990s. The lack of confidence and trust in the financial sector would be prolonged, especially if, for instance, large "off balance-sheet" positions of financial institutions continued to disguise risks at much larger financial losses.

As a result, the fire sale in equity markets and drops in asset prices will also be prolonged, along with deteriorating indicators of the real economy, including falling business profits and rising unemployment. As financial institutions continue to deleverage and investors become even more risk averse, the pessimistic scenario assumes an extended vicious circle of asset price deflation and perceptions of rising financial risk. House prices in the United States, which have declined by about 20 per cent since the housing bubble burst, are assumed to fall by another 15-20 per cent during 2009. The wealth losses from a further sell-off in assets worldwide could completely dwarf the attempts at recapitalization of financial institutions and corporate businesses put in place by the Governments of major developed countries, and make the financial rescue look seemingly impossible. This will erode market confidence further. Developing economies would be hurt more through a deeper recession in the developed economies, a steeper fall in commodity prices and a sharper reversal of capital inflows. Aid budgets could come under greater pressure and affect low-income countries relying on official development assistance not only for their long-term development but also as a cushion against external shocks.

^a In order to supply further liquidity to the markets, the ECB has now changed its main refinancing operations from a variable rate to a fixed-rate tender, and is supplying unlimited liquidity at the stated fixed rate.

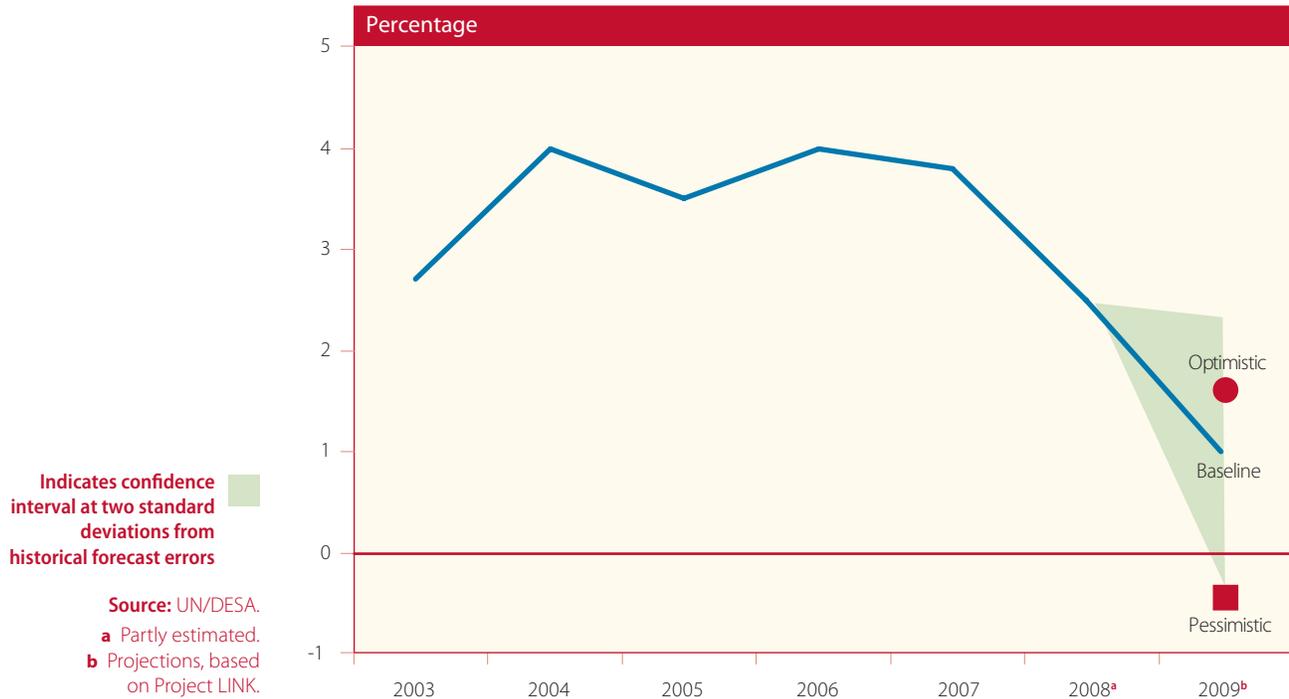
Box I.1 (cont'd)

In this scenario, fiscal and monetary stimulus is likely to be less effective. First, it could push the United States and parts of Europe into a "liquidity trap"—akin to that of Japan during the 1990s—where monetary easing would fail to stimulate private consumption and investment. Second, the deep risk aversion and lack of confidence force banks to use any liquidity injections to shore up their balance sheets without enhancing the credit supply to households and businesses. Third, fiscal stimulus also fails to restore confidence among market agents as they fear that Governments lack sufficient means to finance ever-larger bailouts of the financial system or that exorbitant increases in public debt will be a threat to economic stability in the future.

An optimistic scenario

In contrast, in a more optimistic scenario, it is assumed that financial market confidence is restored as quickly as assumed in the baseline. In addition, it is assumed that during the first half of 2009, fiscal stimulus packages of between 1.5 and 2 per cent of gross domestic product (GDP) are introduced in coordinated fashion. Also, compared with the baseline, greater monetary easing is assumed through further interest-rate cuts.

Figure I.1
World economic growth, 2003-2009



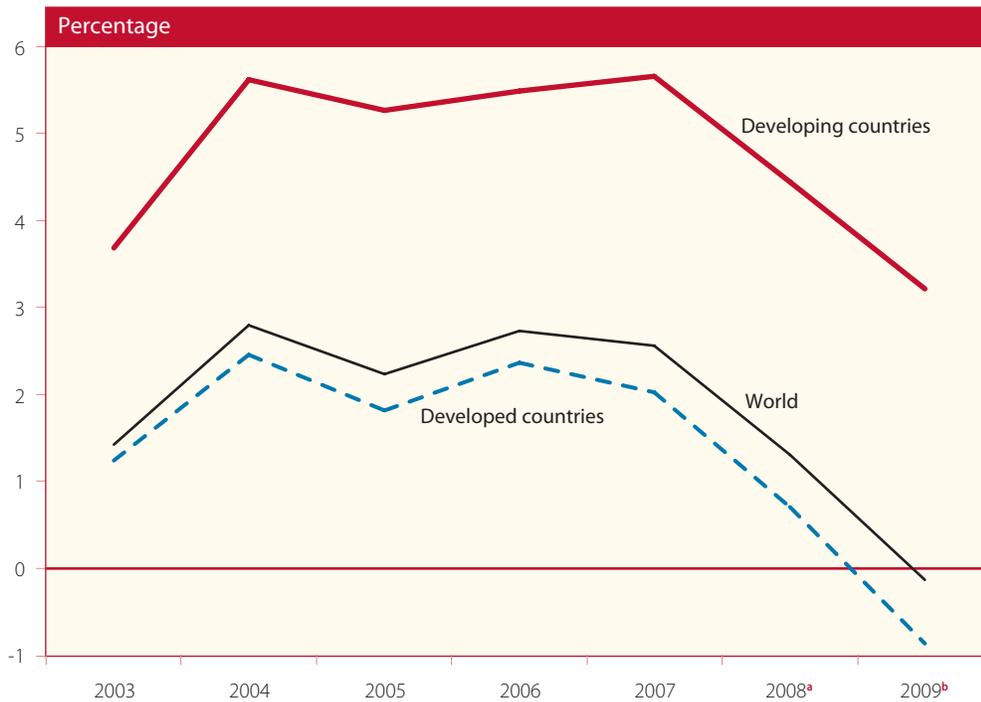
World income per capita will fall in 2009

In the baseline scenario, income per capita for the world as whole is expected to decline in 2009 (figure I.2). This will be the case not only in the developed economies but also in many developing countries, where per capita income growth will be negative or well below what is needed to address poverty reduction.¹

The vast majority of countries are experiencing a sharp reversal in the robust growth registered during the period 2002-2007. For example, among the 160 economies in

¹ As a rule of thumb, 3 per cent per capita income growth is sometimes seen as the minimum required growth rate for achieving significant reductions in poverty, even in the absence of income redistribution.

Figure I.2
Real per capita GDP growth in developed and developing countries, 2003-2009



Source: UN/DESA.

^a Partly estimated.

^b Projections, based on Project LINK.

the world for which data are available, the number of economies that had an annual growth in gross domestic product (GDP) per capita of 3 per cent or higher is estimated to have dropped from 106 in 2007 to 83 in 2008, and this is expected to decline further, to 52, in 2009 (see table I.2). Among the 107 developing countries, this number is estimated to have dropped from 70 in 2007 to 57 in 2008, and to decline significantly further in 2009 to 29. This trend suggests a significant setback in the progress made in poverty reduction in many developing countries over the past few years. The prospects for the least developed countries (LDCs), which generally did so well on average over the past several years, are also deteriorating rapidly (see box I.2). Meanwhile, divergences in economic performance among the low-income countries remain greater than among the mainly middle-income countries in Asia or Latin America (figure I.3), although with the synchronized global downturn, growth divergences have narrowed somewhat from preceding years.

The story of a crisis foretold

The crisis should have taken no one by surprise. That analysts and policymakers are now expressing bewilderment at the extent of the crisis suggests not only a gross underestimation of the fundamental causes underlying the crisis but also unfounded faith in the self-regulatory capacity of unfettered financial markets. Past issues of the *World Economic Situation and Prospects* have repeatedly pointed out that the apparent robust growth pattern that had emerged from the early 2000s came with high risks. Growth was driven to a significant extent by strong consumer demand in the United States, stimulated by easy credit and underpinned by booming house prices, and by very high rates of investment demand and strong export growth in some developing countries, notably China. Growing

Policymakers have grossly underestimated the global consequences of the financial crisis in the United States

Table I.2
Frequency of high and low growth of per capita output, 2006-2009

	Number of countries monitored	Decline in GDP per capita				Growth of GDP per capita exceeding 3 per cent			
		2006	2007	2008 ^a	2009 ^b	2006	2007	2008 ^a	2009 ^b
		Number of countries							
World	160	10	15	14	36	97	106	83	52
<i>of which:</i>									
Developed economies	35	0	0	7	21	18	18	7	6
Economies in transition	18	0	0	0	0	16	18	18	17
Developing countries	107	10	15	7	15	63	70	57	29
<i>of which:</i>									
Africa	51	9	14	6	9	25	29	24	16
East Asia	13	0	1	1	2	11	12	8	1
South Asia	6	0	0	0	0	5	5	5	4
Western Asia	13	1	0	0	1	8	7	7	2
Latin America	24	0	0	0	3	14	17	13	6
Memorandum items:									
Least developed countries	39	6	11	5	10	17	20	16	10
Sub-Saharan Africa ^c	44	9	14	6	9	20	23	19	13
Landlocked developing countries	25	2	5	2	3	12	15	15	13
Small island developing States	17	2	2	1	4	9	12	9	5
	<i>Share^d</i>	Percentage of world population							
Developed economies	15.8	0.0	0.0	1.7	13.7	2.5	2.5	1.5	1.4
Economies in transition	5.0	0.0	0.0	0.0	0.0	4.9	5.0	5.0	4.2
Developing countries	79.1	0.9	1.6	0.7	3.3	67.2	72.2	65.9	49.4
<i>of which:</i>									
Africa	13.5	0.9	1.6	0.7	1.0	7.0	10.2	8.4	6.4
East Asia	30.5	0.0	0.0	0.0	0.1	30.4	30.5	28.3	20.9
South Asia	23.7	0.0	0.0	0.0	0.0	25.7	26.1	26.5	24.1
Western Asia	2.8	0.1	0.0	0.0	0.3	1.8	2.0	0.6	0.4
Latin America	8.5	0.0	0.0	0.0	2.0	4.7	6.3	5.2	0.7
Memorandum items:									
Least developed countries	10.5	0.4	1.1	0.5	1.2	6.6	7.6	6.4	5.0
Sub-Saharan Africa ^c	8.4	0.9	1.6	0.7	1.0	4.5	5.5	4.6	3.1
Landlocked developing countries	4.9	0.3	0.8	0.3	0.5	2.7	2.9	2.9	2.7
Small island developing States	0.8	0.0	0.0	0.0	0.2	0.5	0.6	0.5	0.2

Source: UN/DESA, including population estimates and projections from *World Population Prospects: The 2006 Revision*.

- ^a Partly estimated.
- ^b Forecast, based in part on Project LINK.
- ^c Excluding Nigeria and South Africa.
- ^d Percentage of world population for 2000.

Box I.2

Prospects for least developed countries

Growth in the least developed country (LDC) group decelerated from 7.8 per cent in 2007 to 6.4 per cent in 2008, breaking a four-year trend of growth over 7 per cent. In 2009, growth is expected to slow further to 5.3 per cent. These figures, however, obscure a significant variation across countries. Cape Verde recently graduated from LDC status. Of the remaining 38 countries with data coverage, only five had growth over 7 per cent in 2008—the minimum rate of growth needed to achieve the Millennium Development Goals (MDGs). Growth was between 3 and 7 per cent in 25 countries, while the remaining 8 countries, most of which were mired in conflicts or political instability, had growth of less than 3 per cent (see table).

Table
Growth in least developed countries, 2008

<i>Less than 3 per cent</i>	<i>Between 3 and 7 per cent</i>		<i>Greater than 7 per cent</i>
Chad	Bangladesh	Mozambique	Angola
Comoros	Benin	Niger	Democratic Republic of the Congo
Eritrea	Burkina Faso	Nepal	Equatorial Guinea
Guinea	Burundi	Rwanda	Ethiopia
Somalia	Central African Republic	Sudan	Liberia
Togo	Djibouti	Sao Tome and Principe	
Myanmar	Gambia	Senegal	
Haiti	Guinea-Bissau	Sierra Leone	
	Lesotho	United Republic of Tanzania	
	Madagascar	Uganda	
	Malawi	Yemen	
	Mali	Zambia	
	Mauritania		

The majority of countries with growth above 7 per cent in 2008—for example, Angola, the Democratic Republic of the Congo and Equatorial Guinea—were oil- and mineral-exporting economies, thus underscoring the importance of the recent commodity boom for the export and growth performance of the group and also highlighting that their growth remains susceptible to volatility in the international commodity markets. Although the value of merchandise exports rose by 43 per cent in the LDCs between 2007 and 2008, quadrupling since 2003, this was largely due to the rising prices of oil and mineral exports. The LDCs remain marginalized in terms of their share in world trade, accounting for only 1 per cent of global exports.

In addition, about half of the LDCs, many of which are high-growth performers, experienced a de-industrialization of their economies in the past decade. This suggests the lack of structural transformation and economic dynamism necessary for reducing commodity dependence and bringing about long-term sustainable growth.

Most LDCs are net food importers and have therefore been strongly affected by the rise in commodity food prices, deteriorating terms of trade and widening current-account deficits. After experiencing a declining trend since 2001, inflation in the LDCs increased to 13.5 per cent in 2008, up from 9.5 per cent in 2007, triggered mainly by rising world market prices of food and fuel. In the oil-exporting countries, this was compounded by strong domestic demand growth. Of the 38 LDCs monitored, half had inflation rates over 10 per cent in 2008, up from 13 countries in 2007.

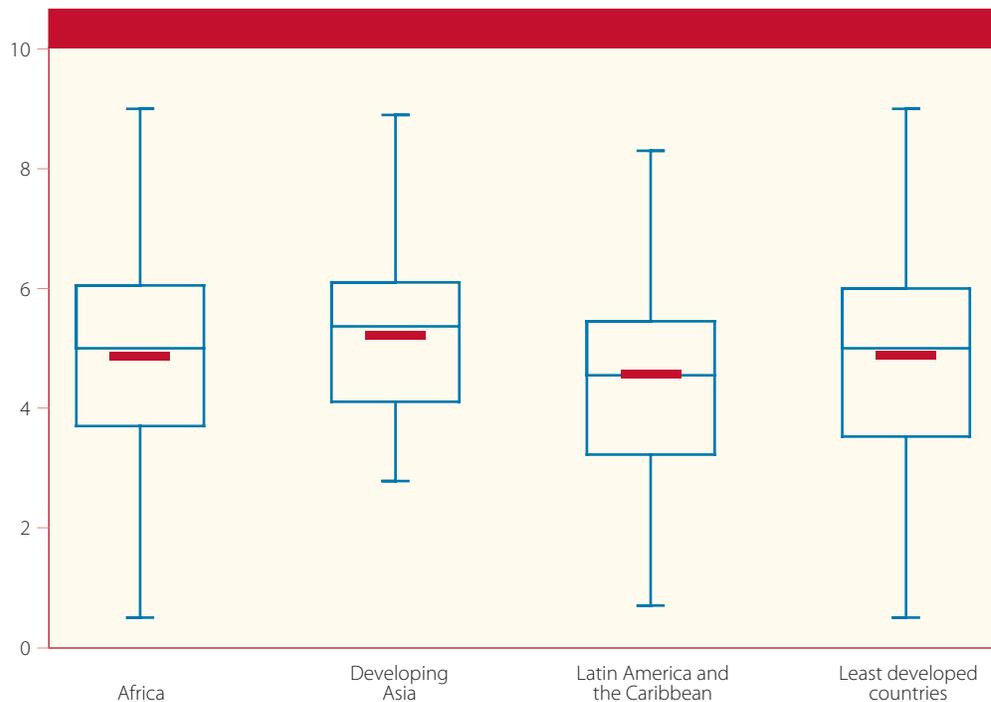
Food import bills of LDCs climbed by 37 per cent in 2008, from \$17.9 million in 2007 to \$24.6 million in 2008 and after having risen by 30 per cent in 2006, owing to surging prices of rice,

Box I.2 (cont'd)

wheat and vegetable oils. By the end of 2008, the annual food import basket in LDCs cost more than three times that of 2000, not because of the increased volume of food imports, but as the result of rising food prices. The moderation in commodity prices which began in 2008 is expected to improve the terms of trade of oil-importing and net food-importing LDCs in the near term, yet much of the damage has already been done, as the surge in food prices has led to double-digit levels of inflation, sparked food riots in at least eight LDCs (Burkina Faso, Guinea, Haiti, Mauritania, Mozambique, Senegal, Somalia and Yemen) and slowed progress towards the MDGs.

The global economic downturn will affect the LDCs through lower commodity prices, weaker investment and trade flows, and higher exchange-rate vulnerability. Aid flows, which are important for funding improved social service delivery, large-scale infrastructure projects and industrial development, may recede if traditional donors mired in the financial crisis renege on their aid commitments, thus further hampering progress towards achieving the MDGs.

Figure I.3
Divergence in economic performance across developing countries in 2008



Source: UN/DESA and Project LINK.

Note: For each region, the red bar within the box corresponds to the regional mean value of growth rates. The five blue horizontal bars, from bottom to top, correspond to the smallest observation, the first quartile, the median, the third quartile and the largest observation, respectively. The outliers are excluded from the determination of the smallest and the largest observations.

United States deficits in this period were financed by increasing trade surpluses in China, Japan and other countries accumulating large foreign-exchange reserves and willing to buy dollar-denominated assets. At the same time, increasing financial deregulation, along with a flurry of new financial instruments and risk-management techniques (mortgage-backed securities, collateralized debt obligations, credit default swaps, and so on), encouraged a massive accumulation of financial assets supported by growing levels of debt in the household, corporate and public sectors. In some countries, both developed and developing, domestic financial debt has risen four- or fivefold as a share of national income since the early 1980s. This rapid explosion in debt was made possible by the shift from a traditional “buy-and-hold” banking model to a dynamic “originate-to-sell” trading model (or

“securitization”). Leverage ratios of some institutions went up to as high as 30, well above the ceiling of 10 generally imposed on deposit banks. The deleveraging now under way has brought down established financial institutions and led to the rapid evaporation of global liquidity that together threaten the normal operations of the real economy.

All parties seemed to benefit from the boom, particularly the major financial players in the rich economies, while the risks were conveniently ignored, despite repeated warnings that mounting household, public sector and financial sector indebtedness in the United States and elsewhere would not be sustainable over time.² As strains in the United States mortgage market were transmitted to the wider financial sector, fears of a meltdown escalated and spread around the world.

Severe problems in United States mortgage markets and increasing volatility in interest-rate spreads in the markets for interbank and emerging market lending surfaced in August 2007 as early signs of emerging global financial turmoil. Despite massive liquidity injections and an increasingly loose monetary policy stance in the United States, Japan and parts of Europe, the turmoil continued into 2008. Major warning signs came with the collapse of Bear Stearns, the fifth-largest investment bank in the United States, which had to be rescued by joint action of the United States Federal Reserve (Fed) and JPMorgan Chase. In September 2008, the financial turmoil intensified once again, this time turning into a global financial tsunami characterized by a severe credit freeze, a precipitous sell-off in stock markets worldwide and the collapse or near collapse of major financial institutions in the United States and Europe. Several developed countries, including Iceland and Hungary, needed massive emergency loans from the International Monetary Fund (IMF) to cope with their financial problems.

The continued housing slump in the United States triggered the collapse of this financial house of cards. House prices continued to decline in 2008 at an annual rate of about 17 per cent. Mortgage delinquency rates surged, particularly for sub-prime loans. No less than 40 per cent of the sub-prime mortgage loans originated in 2006 were delinquent by the second half of 2008. As a result, the value of mortgage-related assets deteriorated significantly. By the third quarter of 2008, financial institutions worldwide had written down a total value of about \$700 billion worth of asset-backed securities, of which more than \$500 billion related to the commercial banking sector. Many more write-downs are forthcoming as the prices of these securities continue to drop, leading to an accelerated erosion of the capital base of financial institutions and severely constraining their ability to lend.

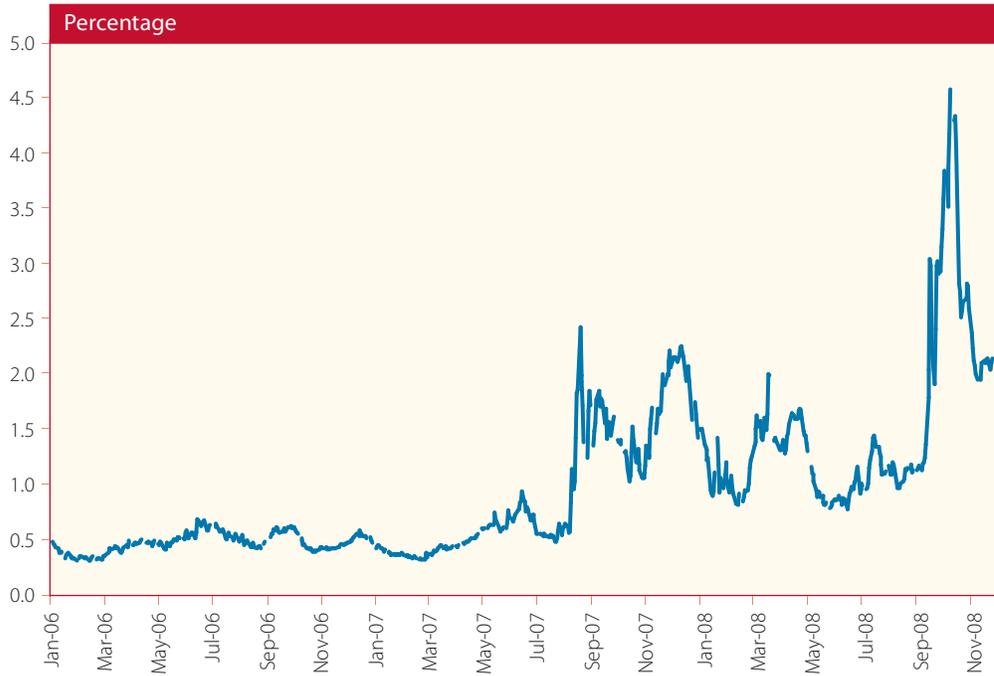
Moreover, the complex way in which those asset-backed securities were constructed made it difficult to assess their value. Having been cavalier about risk during the boom years, investors have become extremely risk averse along with the plummeting market confidence, resulting in further declines in asset prices and a further drying up of liquidity in a number of funding markets. Banks have become extremely reluctant to lend to each other, losing confidence in the creditworthiness of counterparties. The credit market stress was reflected in the surge of the spread between the interest rate on interbank lending and the interest rate on Treasury bills. In late September and early October, this spread reached its highest level in decades. It had soared to nearly 400 basis points, whereas under normal market conditions, the spread would be about 20 to 30 basis points (figure I.4).

² For example, as early as 2006, the *World Economic Situation and Prospects 2006* (United Nations publication, Sales No. E.07.II.C.2) warned of the “vulnerability of the global economy derived from the possible burst of the house price bubble in some countries” (p. 23) and cautioned that the related widening of the global imbalances posed a threat to the stability of the financial system.

The financial turmoil of August 2007 was an early sign of larger problems ahead

Deregulation and financial innovations led to excessive risk-taking by financial institutions

Figure I.4
Daily spread between three-month LIBOR and three-month
United States Treasury bill interest rate, January 2006–November 2008



Sources: British Bankers' Association and the United States Federal Reserve Bank.

The credit crunch has become widespread, and even some large, financially sound non-financial corporations were unable to roll over their commercial paper in the money market to fund working capital needs.

A fire sale in asset markets followed the collapse of major financial institutions in the United States and Europe

Prices of financial companies' stocks were under tremendous pressure even before September, but a further erosion of investor confidence, combined with a significant downgrading of the outlook for the real economic sector, triggered another round of asset sell-offs worldwide in late September and October. Equity markets remained highly volatile thereafter. In the first ten days of October alone, equity markets worldwide plummeted by about 20 per cent on average, losing roughly \$10 trillion worth of equity. Many markets, including those of the United States and some Asian countries, experienced the worst sell-off recorded in a single week. For the year, global equity markets have declined by about 40 per cent on average. In several emerging markets, the decline has been even steeper, with stock exchanges dropping by more than 60 per cent in China and the Russian Federation, for example.

A number of large financial institutions came under severe financial stress and were cut off from access to long-term capital and short-term funding markets. In the United States, these included the two government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, as well as Lehman Brothers, American International Group (AIG), Inc. and Washington Mutual. Fannie Mae and Freddie Mac hold about \$5 trillion worth of mortgage loans, about half of all the mortgage loans in the United States. They are also the issuers of multi-trillion-dollar bonds bought by many other financial institutions worldwide, including the central banks of many countries, as well as pension funds. The failure of these two companies would inevitably have caused unacceptably large dislocations in the global financial system. Therefore, the Federal Housing Finance Agency

(FHFA) put Fannie and Freddie under conservatorship of the United States Government, and the Treasury provided financial support.

AIG is one of the largest insurance companies in the world. It has more than one trillion dollars in assets and operates in more than 100 countries. AIG plays a central role in a number of markets by insuring risks for many other companies. For example, it holds a swap portfolio valued at about \$500 billion for the insurance of the debts of many other major financial institutions. Given the size and composition of its obligations, a failure of AIG would also severely threaten global financial stability. To salvage AIG, the United States Treasury provided an emergency credit line of \$85 billion in exchange for about 80 per cent equity ownership in AIG, after which further support was given, raising the bailout to \$150 billion in November of 2008.

Two more large financial institutions failed: Lehman Brothers and Washington Mutual had to file for bankruptcy, the former being the largest firm to do so in United States history, while the latter is the largest bank ever to fail.

September 2008 marked a sea change in the international financial landscape, including the end of independent investment banking in the United States and an end to previous faith in the virtues of unfettered financial markets. Investment banks either went bankrupt, merged with other commercial banks, or converted themselves into commercial banks. Between September 2007 and October 2008, 16 banks in the United States filed for bankruptcy, and more than 100 out of some 7,000 banks are on the Fed's watch list. While this proportion is still small compared with the Great Depression, when about 700 out of a total of 9,000 banks failed, its ramifications in an integrated financial world are every bit as big. In November, the United States Government also had to come to the rescue of Citigroup, backing about \$306 billion in loans and securities and investing \$20 billion directly in the financial institution considered "too big to fail".

The credit crisis quickly spread to Europe, with a number of large European financial institutions teetering on the edge of collapse, such as the Dutch-Belgian bank Fortis, the French-Belgian Dexia, the British mortgage lender Bradford & Bingley, Germany's Hypo Real Estate, as well as the Dutch bank and insurance company ING and the Dutch insurance giant Aegon. In Iceland, three major banks collapsed, dragging the country to the brink of bankruptcy as the total external liabilities of the three banks accounted for five times Iceland's annual GDP. The contagion effects of the crisis also spread rapidly to emerging economies. Hungary was among the first of the emerging market countries to suffer. Both Iceland and Hungary had to recur to the IMF (and other sources) to alleviate the immediate financial market stress, becoming the first two European countries to do so in over 30 years. Ukraine also ran into acute liquidity problems, as its access to international capital markets was curtailed sharply, its currency was sold off and the credit-rating agencies downgraded the country's debt. Ukraine also had to recur to the IMF for a \$16.4 billion loan. Belarus and Serbia also filed requests for substantial emergency support from the IMF. Pakistan also entered into acute balance-of-payments' problems and filed for IMF support, as its foreign reserve level dropped to less than a few weeks worth of imports.

The intensification of the global financial crisis from late September-October 2008 onwards heightened the risk of a complete collapse of the global financial system. In response, policymakers worldwide, particularly those in major developed countries, drastically scaled up their policy measures in October. Most importantly, they made two strategic changes in the way they deal with the crisis. First, as noted above, the initial piecemeal approach was abandoned and replaced with a more comprehensive one. Second, unilateral national approaches have given way to more international cooperation and coordination.

The international financial landscape changed dramatically after September 2008

The crisis quickly spread around the globe

Fears of systemic failure have led to massive financial sector rescue plans

Totalling about \$4 trillion, these policy measures aimed at unfreezing credit and money markets by recapitalizing banks with public funds, guaranteeing bank lending and insuring bank deposits. Interbank lending rates retreated somewhat following the start of the large-scale bailout. However, congestion and dysfunction remain in important segments of the credit markets. Meanwhile, great uncertainty remains in credit derivatives, with \$400 trillion to \$500 trillion in notional value of derivatives outstanding.

Given the stark erosion of confidence and massive destruction of financial capital over the past year, it will take months, if not years, before beleaguered banks significantly revive lending and fraught investors see confidence restored. It will take even longer for these policy measures to show their effects in terms of a regaining of strength in the real economy. Meanwhile, the crisis has already had a severe impact on global commodity markets and has led to reversals in private capital flows to emerging markets, with far-reaching implications for the prospects of the developing world at large.

The deteriorating international economic environment for developing countries

The myth of a “decoupling” of developing country growth led to an underestimation of the global repercussions

There had been complacency about the impact of the global financial crisis on developing countries and the economies in transition. In fact, the broader international economic environment for developing countries and the economies in transition has deteriorated sharply, and since October 2008 the financial stresses have shifted rapidly towards these economies. The cost of external borrowing has risen considerably and capital inflows are reversing. Both currency and commodity markets have become extremely volatile, with the exchange rate depreciating at an alarming pace in several countries and prices of primary commodities tumbling. Export growth in these economies is decelerating and the current-account balances of many countries have shifted back into a rising deficit. These economies are facing even bigger challenges in the outlook for 2009.

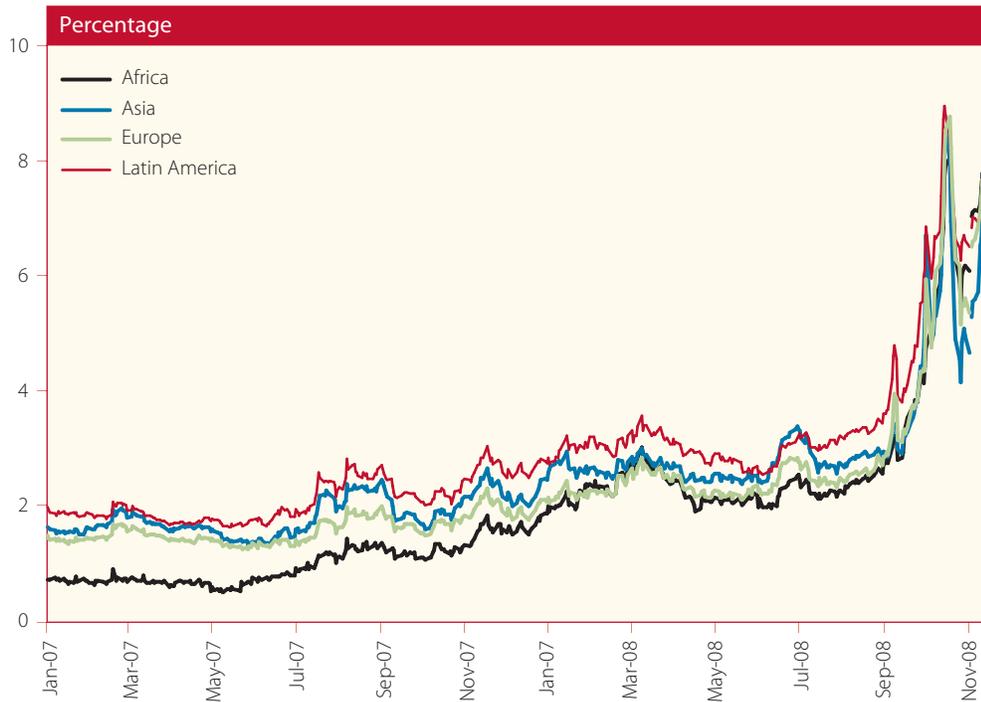
Tightening and more costly external financing

Spreads on emerging market bonds have more than doubled

In the second half of 2007, *external financing costs* for emerging market economies started to edge up from record lows, but remained within normal range until September 2008. Costs surged thereafter with the tightening global credit market. Spreads, as measured through the Emerging Markets Bond Index (EMBI), soared from 250 to about 550 basis points within the space of a few weeks during the second half of September (figure I.5). Unlike in recent years where the spread varied significantly across regions and countries as an indication that investors were discriminating among country-specific risks, the latest surge has been uniform, suggesting that contagion and generalized aversion to investing in emerging markets has taken hold among investors. Spreads are expected to remain high in 2009, as the strains in global credit markets linger, but some renewed differentiation in the spreads across regions and countries may re-emerge once it becomes clearer which individual countries are better able to cope with the crisis.

Private capital inflows to emerging market economies were relatively robust in the first half of 2008, after peaking in 2007, but have dropped sharply since the third quarter of 2008. Declines in bank lending and portfolio equity inflows explain most of the drop. The volume of bank loans to emerging markets declined by about 40 per cent from 2007 levels as a consequence of the freeze in interbank lending worldwide. The decline further reflects an adjustment in the surge in lending seen in 2007, when the volume

Figure I.5
Daily yield spreads on emerging market bonds, January 2007–November 2008



Source: JPMorgan Chase.

of lending doubled the flows to the Russian Federation and the Republic of Korea, for instance. Portfolio equity inflows fell on average by about 30 per cent from the previous year, also coinciding with the wave of sell-offs in emerging equity markets. In some emerging markets, equity prices dropped by as much as 60 per cent. By contrast, foreign direct investment (FDI) inflows to these countries remained relatively stable; a decline of about 10 per cent is estimated for 2008 from the record highs of 2007.

In the outlook for 2009, capital inflows to emerging market economies are projected to drop further. A continued deleveraging in the large financial institutions of developed countries and the eroded confidence of international investors are likely to limit portfolio inflows to emerging market economies, while the pro-cyclical nature of FDI flows will also imply a slowdown in FDI along with weakening growth prospects for emerging market economies. On the other hand, as emerging market economies are not at the epicentre of this financial crisis and as growth in many of them remains stronger in relation to that of developed economies, capital flows to these countries may gradually regain impetus as global financial markets start to stabilize.

The *outflow of capital* from emerging to developed market economies continued to be larger than the inflow. On balance, emerging market economies continue to be net lenders to the rest of the world, financing the external deficits of the United States and other developed economies. Sovereign wealth funds (SWFs) of emerging market economies continued to grow and totalled about \$4 trillion at the end of 2008. During the early stage of the global financial crisis, many SWFs injected sizeable amounts of money into the beleaguered financial institutions of developed countries, but became more prudent after registering considerable losses.

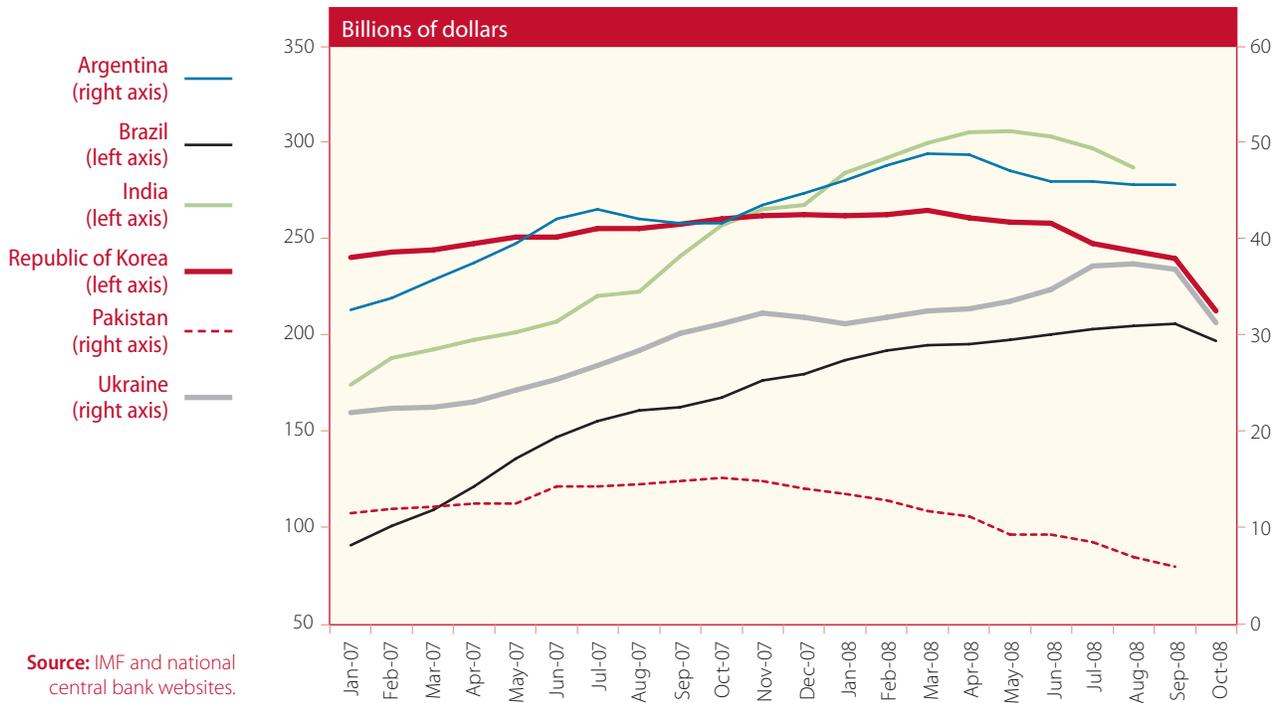
Most of the net transfer of financial resources from developing to developed countries is achieved through the accumulation of international reserves. The total value of the *official foreign-exchange reserves* of developing countries reached about \$3.1 trillion in 2007, and that amount rose further in the first half of 2008. China's foreign-exchange

Private capital flows to developing countries will weaken in 2009

Foreign reserves of developing countries increased further in 2008, but may dwindle in 2009

reserves, for example, rose from \$1.5 trillion at the end of 2007 to about \$1.9 trillion in the third quarter of 2008. Nevertheless, a significant deceleration in the pace of reserve accumulation has been reported for many developing countries amid the intensification of the global financial crisis (figure I.6). In the outlook, the foreign reserves of developing countries are expected to stagnate, or even decline in some countries, as more of these countries are expected to experience either weakening current or capital accounts, or both.

Figure I.6
Foreign reserves of selected countries, January 2007–October 2008



Source: IMF and national central bank websites.

Increased exchange-rate volatility and the risk of a dollar collapse

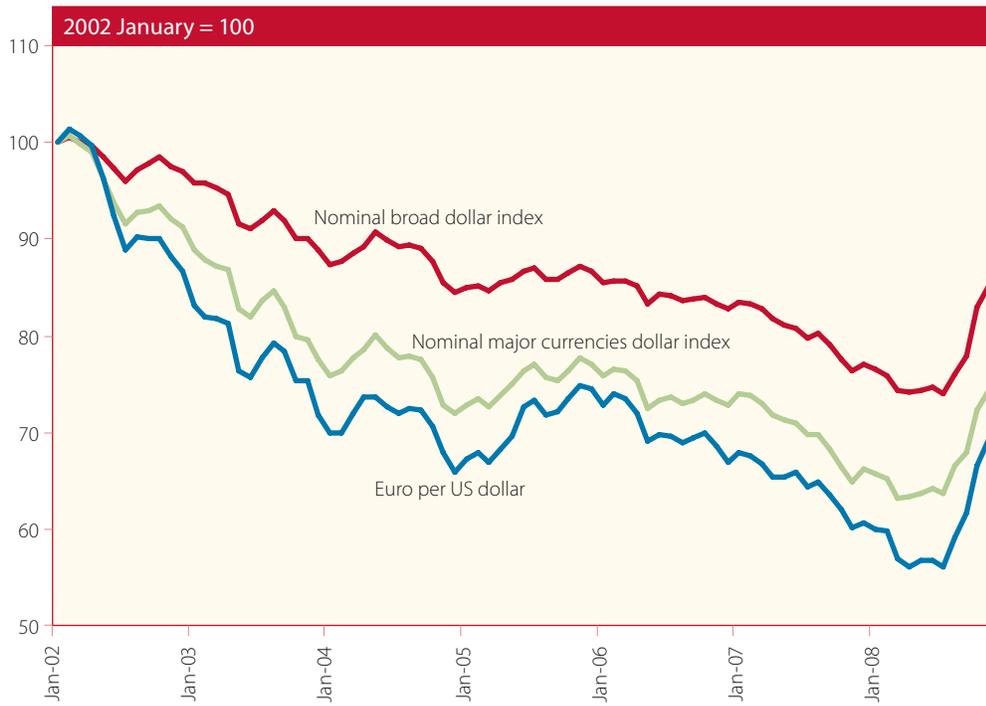
The dollar has appreciated during the crisis ...

Volatility in *foreign-exchange markets* has also increased substantially with the deepening of the global financial crisis (figure I.7). The United States dollar depreciated substantially vis-à-vis other major currencies, particularly the euro, in the first half of 2008, but has since reversed direction even more sharply. Many currencies in developing countries have also either reversed their earlier trend of appreciation vis-à-vis the dollar or slowed their appreciation. Currencies in a number of developing countries, particularly those that are commodity exporters, have depreciated against the dollar substantially since mid-2008. The heightened risk aversion of international investors has led to a “flight to safety”, as indicated by the lowering of the yield of the short-term United States Treasury bill to almost zero.

... but persisting global imbalances could precipitate a hard landing in 2009

However, it is expected that the recent strength of the dollar will be temporary and the risk of a hard landing of the dollar in 2009 or beyond remains, as stressed in previous issues of the *World Economic Situation and Prospects*. As the global financial crisis intensifies, the world economy is experiencing an abrupt adjustment of the global imbalances. The current-account imbalances across the globe narrowed somewhat in 2008 and are expected to narrow further in 2009 (figure I.8). The deficit of the United States is

Figure I.7
Exchange-rate indices for the United States, 2002-2008^a

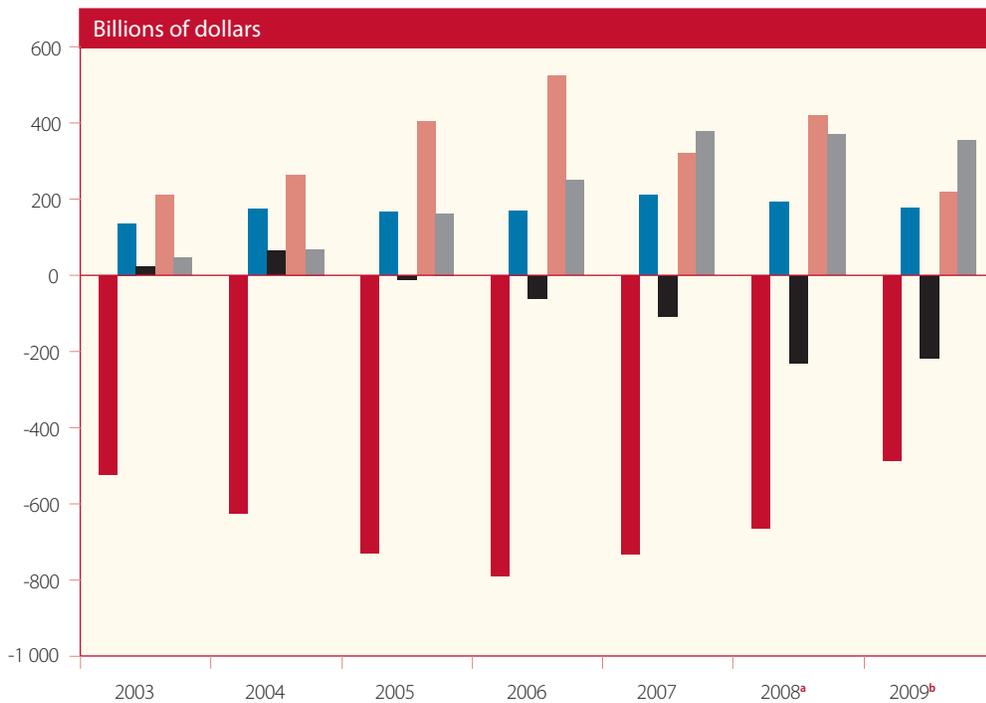


Source: United States Federal Reserve Board. Rebased by UN/DESA.

Note: The major currencies index contains currencies of most developed countries; the broad index incorporates currencies of emerging economies into the other index. A decline in the index represents a depreciation of the dollar.

^a Until November 2008.

Figure I.8
Current-account balances, 2003-2009



Sources: IMF, *World Economic Outlook database*, October 2008; UN/DESA.

^a Partly estimated.

^b Forecast.

estimated to be about \$690 billion in 2008, down only slightly from the \$732 billion gap of 2007. Developed economies as a whole still registered a deficit of more than \$600 billion in 2008. Most developing regions continued running savings' surpluses.

The narrowing of the United States current-account deficit during 2008 occurred in the wake of the financial crisis, which led to a downward adjustment in private sector spending through weakening household consumption and business investment. In the third quarter of 2008, household consumption expenditure dropped at an annualized rate of more than 2 per cent, the largest decline in 28 years, as the large wealth losses forced households to rebuild savings. This was only partially offset by rising government spending, which increased notably following the emergency measures adopted in response to the crisis. Declining import demand on the heels of further retrenchment in domestic consumption and investment will probably also dominate external adjustment in 2009.

Despite its narrowing current-account deficit, the net international liability position of the United States has continued to increase. Over the past few years, the increase in net external indebtedness has been smaller than the annual current-account deficit, however, as a consequence of the dollar depreciation, which has facilitated an appreciation of the value of United States-owned assets abroad and a depreciation in the value of United States liabilities owed to the rest of the world. Being the issuer of the international reserve currency, the United States might thus try to "inflate" its way out of its external indebtedness. However, the favourable revaluation effects are not nearly large enough to outweigh the adverse trend associated with sustaining large current-account deficits. As equity markets worldwide plummeted during 2008, the value of both the United States-owned assets abroad and the foreign-owned assets of the United States has dropped significantly. The official estimate of the valuation adjustment for 2008 will be available in mid-2009, but a rough estimate suggests a further increase in the net debt position of the United States to about \$2.7 trillion by the end of 2008, up from \$2.5 trillion in 2007.

The large current-account deficit and perceptions that the United States debt position is approaching unsustainable levels are important factors underlying the trend depreciation of the United States dollar since 2002. During 2008, the dollar became highly volatile, driven by a number of factors related to the global financial crisis.

In the first half of 2008, when investors seemed to believe that the financial problems were mainly confined to the United States, dollar depreciation accelerated, with the dollar dropping from \$1.45 to the euro at the beginning of the year to \$1.60 to the euro by mid-2008. Since then, however, the dollar has appreciated significantly vis-à-vis most other major currencies (except the Japanese yen) and moved to about \$1.25 to the euro in the last quarter of 2008.

This sharp rebound of the dollar was mainly driven by the effects of a flight to safety as the global financial crisis intensified in September-October and spread to Europe and the rest of world. Many European financial institutions were suddenly found to be on the verge of collapse, the growth prospects for emerging economies were downgraded significantly, the prices of oil and other primary commodities tumbled, and many financial institutions, including hedge funds and mutual funds, either started to deleverage or were forced to redeem. All these factors, plus a heightened risk aversion in general, caused a massive move of financial assets worldwide into United States Treasury bills, driving their

The rebound of the dollar was driven by a flight to safety

yields to almost zero and pushing the dollar sharply higher.³ At the same time, however, the situation is pushing the external indebtedness of the United States to new heights, possibly precipitating a renewed slide of the dollar once the process of deleveraging has ended.

Consequently, the disorderly adjustment of the global imbalances and a hard landing of the dollar remain major downside risks to the global economy, as an accelerated fall of the dollar could cause renewed turmoil in financial markets. Investors might renew their flight to safety, though this time away from dollar-denominated assets, thereby forcing the United States economy into a hard landing and pulling the global economy into a deeper recession.

Weakening world trade and commodity prices

Prices of oil and non-oil primary commodities have also shown strong fluctuations during 2008, largely driven by financial factors, as well as shifts in the balance between supply and demand. The prices of most commodities rose sharply in the first half of 2008, continuing a multi-year upward trend that began in 2003. Food prices, especially the price of rice, surged the most in early 2008, leading to a food crisis in some 40 developing countries. Oil prices also soared by about 50 per cent in the first half of the year. While some commodity-specific factors on either the supply or demand side could explain part of the surge in these prices, a common factor had been the relocation of funds by investors from other financial assets towards commodity markets, along with the declining value of other financial assets.

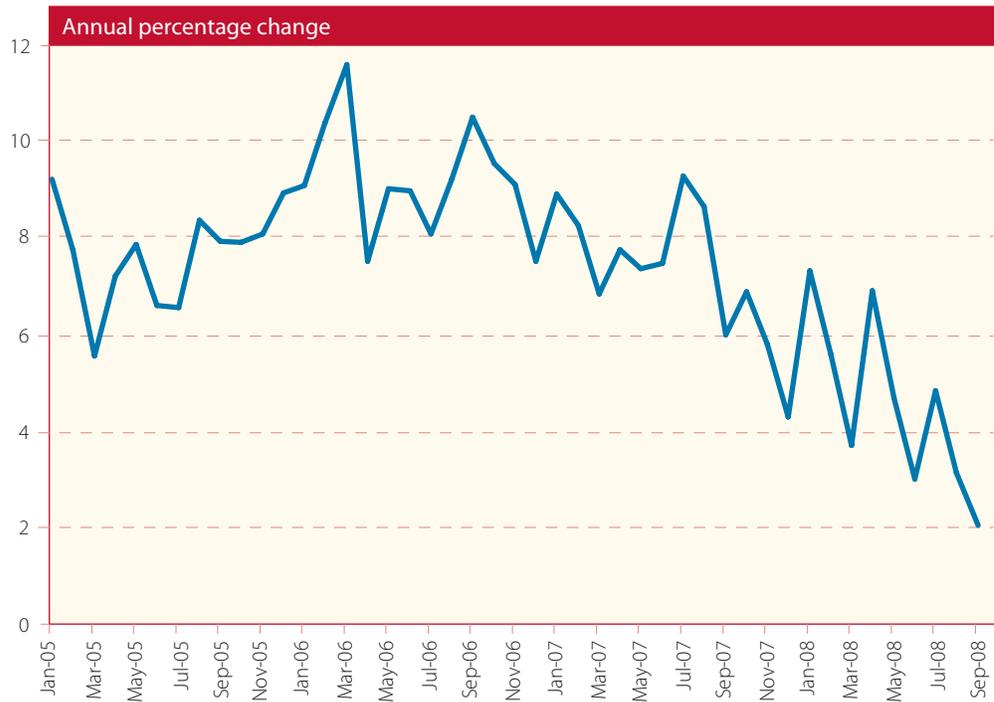
These trends reversed sharply in mid-2008, however (see chapter II for details). Oil prices plummeted by more than 60 per cent from their peak levels of July to November. The prices of other commodities, including basic grains, have also declined significantly. In the outlook, most of these prices are expected to even out further along with the moderation in the global demand, but a cut in the supply of oil, as already indicated by the Organization of the Petroleum Exporting Countries (OPEC), may keep oil prices from falling.

Growth of world *trade* decelerated to 4.4 per cent in early 2008, down from 6.3 per cent in 2007, mainly owing to a decline in imports of the United States. United States imports, which account for about 15 per cent of the world total, have registered a decline in each quarter since the fourth quarter of 2007 and dropped as steeply as 7 per cent in the second quarter of 2008. Growth in the volume of world trade dropped to about 2 per cent by September 2008 to about one third of the rate of growth in the previous year (figure I.9). In the outlook, import demand in most economies is expected to diminish further, leading to a further weakening of growth in global trade in 2009 (see chapter II for more details).

Commodity prices have starkly declined from mid-2008

³ The strengthening of the Japanese yen vis-à-vis the dollar, as well as other major currencies during the second half of 2008, can be explained mainly by two factors: the exposure of Japanese financial institutions was very limited, and the “carry trade” in foreign-exchange markets reversed. Over the past few years, traders in foreign-exchange markets had borrowed yen at very low interest rates to invest in government bonds denominated in other currencies paying much higher interest rates. Since mid-2008, however, as interest rates in other countries were also decreasing, the traders reduced “carry-trade” positions and repaid the loans in yen they had borrowed earlier, thus pushing up the exchange rate of the yen. Moreover, as the yen appreciated, the margin of returns on the “carry trade” were squeezed, forcing more traders to liquidate their positions and further pushing up the yen in an unstable spiral.

Figure I.9
Growth of world trade volume, January 2005-September 2008



Source: UN/DESA, based on data from the CPB Netherlands Bureau for Economic Policy Analysis online database, available from <http://www.cpb.nl/eng/research/sector2/data/trademonitor.html> (accessed on 21 November 2008).

A synchronized global downturn

Developed economies are leading the global downturn, the majority of them already experiencing a recession in the second half of 2008. Meanwhile, through international trade and finance channels, the weakness has spread rapidly to developing countries and the economies in transition, causing a synchronized global downturn in the outlook for 2009. Such a globally synchronized slowdown may be the first of its kind in the post-war era.

The crisis is likely to undo employment gains of recent years

The employment situation is expected to deteriorate in most regions during 2009 and much of the employment gains could be lost because of the global economic slowdown. Employment began to change course in many economies in the second half of 2008, with unemployment rising rapidly in some (the United States, for instance) as lower consumption, production and trade started to have an adverse impact on the demand for labour. The employment situation worldwide is expected to deteriorate more significantly in 2009.

Inflationary pressures are giving way to fears of deflation worldwide

Global inflation is expected to decelerate significantly in the outlook for 2009, with the risk for deflation increasing in some economies. Surging commodity prices, particularly those for oil and food, boosted global inflation in 2008, leaving consumer price inflation at its highest level in a decade. Inflation was markedly higher in developing economies and economies in transition than in the developed economies. In the second half of 2008, however, inflationary pressures dissipated rapidly following the steep fall in world commodity prices (despite the lag in the pass-through effect from international to domestic prices) and weakening demand worldwide. The projected economic downturn is expected to weaken inflationary pressures further in 2009, and the concern of policymakers should focus on staving off sharp downfalls in economic growth (figure I.10).

Figure I.10
 Inflation versus growth in selected developed and developing countries, 2008^a and 2009^b



Developed economies

The United States economy is expected to decline in 2009

Among *developed economies*, the economy of the *United States* is expected to decline by 1 per cent in the baseline scenario for 2009. The most severe credit crunch since the Great Depression has turned a housing sector-led slowdown into a full-scale retrenchment of households and businesses, affecting the economy at large. Even though effective implementation of the Emergency Economic Stabilization Act (EESA), together with other measures, may eventually stabilize financial markets, it came too late to prevent a recession in the real economy. The unemployment rate is expected to rise above 7 per cent as job losses in almost all sectors of the economy increase sharply. Inflation, by contrast, is expected to abate notably. Should all the policy measures fail to unclog the credit markets soon, the United States most probably will suffer a much deeper and longer recession.

Japan is in recession and its economy will stagnate in 2009

Japan's economy is in a recession and is expected, at best, to stagnate in 2009. While the direct losses from the global financial crisis have been contained so far, the indirect effects are becoming increasingly significant, including those brought on by weakening external demand as well as the appreciation of the yen.

Major European countries are in recession

Since September 2008, the global credit crunch has transformed a sharp slowdown in *Western Europe* into a full-fledged recession, and the major European economies have technically entered into recession. Having lost all growth momentum, GDP is expected to contract further in the first half of 2009, with little likelihood of recovery in the second half, leaving a negative growth rate for the year as a whole. After a long period of improving labour market conditions, unemployment rates began to drift upwards from mid-2008 and are expected to move up further by nearly a full percentage point on average for the region as a whole in 2009. With activity slowing, and commodity prices falling well below their peaks of mid-2008, inflation is expected to decelerate significantly from the highs experienced during 2008. Risks continue to be slanted towards the downside, particularly as regards the effectiveness of current and anticipated policies in stabilizing financial markets.

Following several years of buoyant economic expansion throughout the entire region, the *new EU member States* exhibited divergent growth patterns in 2008. Domestic demand is weakening in response to higher credit costs and accelerated inflation, and export growth is also likely to decline. Growth is expected to weaken and inflation to moderate in 2009. While the new EU members are not directly exposed to the sub-prime loans of the United States, the region's banking system is subject to the shocks generated by the troubles among financial institutions in the EU-15. The high stock of short-term private debt in foreign currencies has already created a serious liquidity squeeze in Hungary. The risks for the region include a protracted slowdown in the EU-15, as well as a sharp reversal of capital flows.

In *other developed economies*, growth in both Australia and New Zealand are slowing as consumer demand has weakened owing to tighter credit conditions, higher inflation and falling asset prices. The Canadian economy will suffer from the economic slowdown in the United States, especially in sectors such as the automotive industry.

Economies in transition

Economies in transition will suffer a marked slow down

Among *the economies in transition*, growth of the members of the *Commonwealth of Independent States* (CIS) is heading for a marked slowdown in 2009, largely dragged by the impact of the global recession and falling commodity prices on the largest economies, such

as Kazakhstan, the Russian Federation and Ukraine. A slowdown in business investment, and, to a lesser degree, in household consumption will be felt throughout the region. The smaller CIS economies will likely be affected by declining worker remittances and FDI inflows. The adverse effects of a domestic credit squeeze and increased costs of external financing will be significant on the real economy of the region, despite some recently adopted offsetting policy measures. The unemployment rate will increase in some countries, while inflation is set to moderate, although it could remain at elevated levels. Among the downside risks, a worse-than-expected growth in the Russian Federation would have recessionary effects on other members.

In *South-eastern Europe*, growth in 2008 continued to be largely driven by domestic demand, underpinned by rising real wages and the lasting credit boom, as well as by strong FDI inflows. With the global financial crisis, these growth factors have started to lose momentum. In view of the weak demand in their main export markets, it is also unlikely that the region would be able to switch to a more export-oriented pattern of economic growth in the short run. Therefore, a further moderation of economic growth is expected in 2009.

Developing countries

Developing countries will be hurt by the crisis through international trade and finance channels. The drop in commodity prices will hurt primary exporters in particular, but lower demand in the developed countries will affect export growth throughout the developing world. Some emerging market economies, such as Brazil, are already facing severe curtailments in access to trade credit, while the threat of a sudden reversal in private capital flows has heightened. The vast amounts of foreign reserves accumulated by developing countries still provide a buffer and allow some space for counter-cyclical measures, but these reserves could well dwindle rapidly as the global crisis deepens further. A growing number of developing countries have already witnessed a significant deceleration in economic growth. This, no doubt, is diminishing the prospects of achieving the Millennium Development Goals (MDGs).

Growth in *Africa* is expected to decelerate to 4.1 per cent in 2009 from 5.1 per cent in 2008, as the contagion effects of the global economic slowdown spread throughout the region, while inflationary pressures continue to dampen consumer demand. Africa would be impacted through weakened export demand, lower commodity prices and a decline in investment flows to the region. Consequently, employment growth in Africa is anticipated to weaken, pushing unemployment rates higher and forcing more workers into the already large informal economy. Inflation is expected to subside from 2008 levels. Risks for greater growth retardation exist if donor countries do not live up to their aid commitments, threatening not only the achievement of the MDGs, but also undermining past progress.

Growth in *East Asia* is expected to decline notably in 2009, as exports will decelerate significantly. Some economies in the region will also experience sizeable financial losses as a result of their relatively high exposure to global financial markets. An outflow of capital from this region will further intensify the difficulties experienced by the local financial institutions. Inflation in the region is expected to moderate, and the employment situation will start to deteriorate. Further monetary easing is expected in the region, and most countries have enough policy space to adopt more expansionary fiscal policy necessary for stimulating domestic demand. Some countries, such as China and the Republic of Korea, have already taken action in that direction.

The crisis will hit growth prospects of developing countries hard

Growth in Africa will suffer from lower commodity prices and weakening export demand

Growth in East Asia is affected by the weakening of global demand and the global credit crunch

Capital outflows and waning investor confidence dim growth prospects in South Asia

South Asia is experiencing an overall slowdown in economic growth from the industrial sector to the service sector as a result of the negative impact of higher costs and the global financial turmoil. Inflation is forecast to moderate in view of the retreat in energy and food prices, resulting in lower pressure on government budgets related to price subsidies. During 2008, external balances suffered from higher import prices for fuel oil, food and other commodities, although continued solid remittances exerted a certain stabilizing effect in this regard. The financial sector in the region has had only very limited direct exposure to the global financial crisis, but the tightening in liquidity emerged as a major indirect impact. In parallel to this, waning investor confidence has led to capital outflows and shrinking foreign-exchange reserves. A number of downside risks include a more prolonged slowdown in global growth, unsustainable fiscal balances and current accounts, natural disasters and political instability. Pakistan is a case in point where all of these factors have already come to a head.

Lower oil prices and the global slowdown affect growth prospects in Western Asia

Growth in *Western Asia* is anticipated to slow down significantly in 2009, to the lowest rate in seven years. The region will register a sharp decline in export revenues as average annual oil prices are expected to drop. Lower oil revenues and deteriorating credit conditions in the countries of the Gulf Cooperation Council (GCC) are likely to trigger a delay of large investment projects throughout the region. Facing large current-account deficits, the economies of Jordan, Lebanon and, in particular, Turkey appear to be the most vulnerable to a drop in FDI inflows and tighter financing conditions. By contrast, strong fiscal and external positions will allow authorities in GCC countries to maintain an expansionary fiscal policy stance in order to weather the economic downturn. While labour markets have already started to deteriorate in a number of countries, most pronouncedly in Turkey, the high inflation rates throughout the region are expected to decline moderately.

Latin American and Caribbean economies will slow markedly in 2009

Economic growth in *Latin America and the Caribbean* is expected to slow markedly in 2009. The key drag is the fall in commodity prices. In addition, domestic credit is expected to tighten in many economies. Inflationary pressures, which surged during 2008 owing to the increasing costs of energy, transportation and food, should decelerate in 2009, but Governments of the region may not be able to ease monetary policy in the face of currency depreciation. Stimulus will have to come through counter-cyclical fiscal policies, for which most countries have some room to manoeuvre given improvements in external and fiscal positions in preceding years. However, the region remains very vulnerable to an intensification of the global credit crunch, particularly a sharper reversal of capital inflows and a further decline of external demand.

Macroeconomic policies to stimulate the global economy

Policy responses have fallen well behind the curve

In general, policymakers worldwide have underestimated the depth and breadth of this financial crisis. As a result, policy actions by and large fell behind the curve, and early on policy stances were grossly inadequate for handling the scale and the nature of the crisis. In Europe and the United States, policies initially focused almost exclusively on providing additional liquidity to financial markets and were myopic to the greater underlying risk of insolvency of large financial institutions. Later, in September 2008, when policy measures moved towards the bailout and recapitalization of those important financial institutions seen to pose systemic risks, the economies of most developed countries had already

entered into recession. Policymakers in emerging economies were in turn complacent about the resilience of their economies, believing they would be sufficiently insulated from the financial sector woes of the United States and Europe. Until the fourth quarter of 2008, containing inflation was their main concern in setting macroeconomic policy, and they were caught by surprise when the crisis rapidly spread to hit their economies also in October 2008.

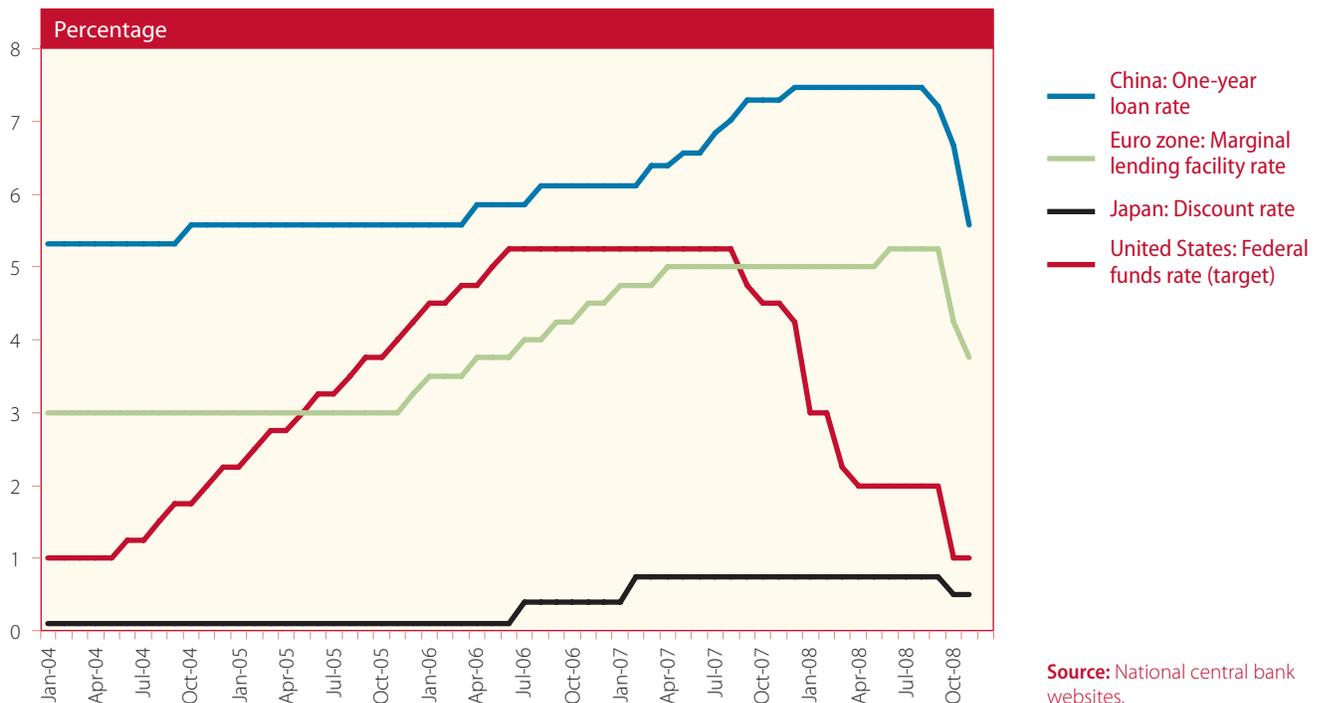
In the first half of 2008, *monetary policy* in the United States was aggressively expansive in attempts to stave off a recession, while central banks in Europe maintained a tightening stance over inflationary concerns. Only after the risk of a systemic failure in global financial markets became manifest, did six major central banks—the Fed, the ECB, the Bank of England, the Bank of Canada, the Swiss National Bank and the Sveriges Riksbank—decide to move in a more coordinated fashion and agree to cut their respective official target rates simultaneously by 50 basis points (bps). At the same time, the Fed and other major central banks also scaled up their unorthodox measures to inject liquidity more directly into financial markets, particularly credit markets. Since then, more central banks have followed suit, some of them reducing interest rates drastically (figure I.11). Further monetary easing is expected in the world economy in the outlook for 2009.

During October 2008, some retreat in the spread between the interbank lending rate and the return on Treasury bills was observed in the United States. Yet, tighter-than-normal credit conditions continued to strain markets into the fourth quarter. The macroeconomic situation now resembles the liquidity trap in which Japan found itself during the 1990s and into the 2000s, rendering monetary policy ineffective as nominal interest rates near zero. With consumer and business confidence seriously depressed and banks reluctant to lend, further lowering of interest rates by central banks would do little to stimulate credit supplies to the non-financial sector or encourage private spending.

Monetary policies became aggressively expansive ...

... but a liquidity trap is now looming

Figure I.11
Policy interest rates of major economies, January 2004–November 2008



Source: National central bank websites.

Rather, it would end up expanding base money within the banking system. With limited space for monetary stimulus, fiscal policy options will need to be examined as ways to reactivate the global economy.

Fiscal stabilizers in developed countries are too weak

Many developed economies have a certain built-in counter-cyclical budgetary stance by virtue of so-called “automatic stabilizers”. For instance, during a recession, tax revenue tends to fall while unemployment benefits and welfare transfers increase, leading to a more expansionary fiscal stance. These automatic stabilizers may well be too weak to counteract the recessionary effects of the large-scale financial crisis that is currently raging. Additional discretionary fiscal measures will be needed. The United States adopted a fiscal stimulus package in early 2008, totalling some \$168 billion, or about 1.1 per cent of annual GDP, mainly in the form of a tax rebate for households. While some analysts believed the package had worked well to keep the economy buoyant for at least one quarter, others doubted its effects would be more permanent. It is now clear that the size of the fiscal package was too small in comparison with the seriousness of the situation, and it failed to sustain its effects. A second fiscal stimulus package is under discussion in the United States, as well as in some European economies.

Strong additional fiscal stimulus is needed

Governments are hesitant to move quickly on such stimulus packages, fearing possible negative repercussions in the medium run from a further widening of fiscal deficits, which are already ballooning as a result of the emergency fiscal measures to recapitalize the financial institutions and the workings of automatic stabilizers. These are not normal times, however. The severity of the financial crisis calls for policy actions that are commensurate with the scale of the problem and should thus go well beyond any normal range of budgetary considerations.

A large number of developing countries and the economies in transition have not been easing monetary policy so far over concerns of inflationary pressures and currency depreciation. Most Latin American economies and many economies in transition, as well as several Asian developing countries, have either further increased policy interest rates or kept them constant in late 2008. Inflation has remained high in these countries in part because of the lags in the pass-through effect of the rise in energy and food prices during the first half of 2008. Inflation also remained a concern during the third and fourth quarters of 2008 following the strong depreciation of the countries’ currencies on the heels of a strengthening dollar, as discussed above. Inflationary pressures should taper off during 2009, however, as world food and energy prices are retreating and global demand is weakening. This should provide some space for monetary easing, as well as for fiscal stimulus, at least in those countries still possessing ample foreign-exchange reserves. Most developing countries and the economies in transition have weak automatic stabilizers; hence, much of the stimulus would depend on discretionary fiscal measures.

Counter-cyclical fiscal policy is also needed in developing countries

The scope for a counter-cyclical stance will vary greatly across developing countries. First, many countries have a history of pro-cyclical macroeconomic policy adjustment, partly driven by policy rules (such as inflation targeting). Providing greater monetary and fiscal stimuli will thus require a departure from existing policy practice and policy rules in such cases. Second, not all countries possess equally sufficient foreign-exchange reserves, and some are likely to suffer stronger balance-of-payments shocks. Some countries still have ample policy space for acting more aggressively to stave off crisis. China has already begun to use its policy space and has designed a large-scale plan of fiscal stimulus which could potentially contribute to reinvigorating global demand. The fiscal stimulus package of \$586 billion (or 15 per cent of China’s GDP), to be implemented during 2009 and 2010, is aimed at strengthening domestic demand through investment in

public infrastructure and social transfers, and would rebalance an economy that is facing a likely increase in excess capacity of manufacturing export production in the wake of a declining external demand.⁴ The Republic of Korea has also announced a fiscal stimulus package equivalent to 1 per cent of its GDP.

For many middle- and low-income countries, the scope for conducting such policies will be even more limited as they may see their foreign-exchange reserves evaporate quickly, to the extent that they are hurt by either sharp capital reversals or strong reductions in the demand for their exports, or both. In order to enhance their scope for counter-cyclical responses in the short run, further enhancement of compensatory financing and additional and reliable foreign aid flows will be needed to cope with the drops in export earnings and reduced access to private capital flows as a result of the global financial crisis.

Over the longer run, however, a broadening of the development policy framework is needed to conduct active investment and technology policies so as to diversify these countries' economies and reduce their dependence on a few commodity exports and thereby help them to meet key development goals, including reaching greater food security, addressing climate change and meeting the MDGs. This will require massive resources for public investments in infrastructure, food production, education and health, and renewable energy sources. Box I.3 exemplifies this challenge as it relates to the investment requirements for dealing with the global food crisis. In the case of energy and climate change, it should be expected that with the global downturn, demand for oil (and energy in general) will fall in the short run, likely leading to a drop in greenhouse gas (GHG) emissions (see appendix table A.22). Since this would simply be the result of a cyclical downturn, however, it should not provide a deterrent to making the necessary long-term investments to reduce the energy intensity of production worldwide and shift radically away from the use of fossil fuels towards sustainable energy sources. The crisis presents a unique opportunity to align fiscal stimulus packages with long-term goals in favour of sustainable development.

Furthermore, to ensure sufficient stimulus at the global level, it will be desirable to coordinate the fiscal stimulus packages internationally. In a strongly integrated world economy, fiscal stimulus in one country tends to be less effective because of high import leakage effects. By coordinating fiscal stimulus internationally, the positive multiplier effects can be amplified through international economic linkages, thereby providing greater stimuli to both the global economy and the economies of individual countries.⁵ As in the case of coordinated monetary easing, internationally coordinated fiscal stimuli can also limit unnecessary fluctuation in cross-country interest-rate differentials and in exchange rates among major currencies. Compared with coordinated interest-rate policies, fiscal policy coordination tends to be more difficult to achieve, both technically and politically, and hence may be difficult to settle through ad hoc agreements, requiring instead a more institutionalized platform (see below). As a consequence, the baseline forecast does not foresee the emergence of fully coordinated fiscal stimuli any time soon. Should this come about more quickly, however, as in the more optimistic scenario (see box I.1), the

Fiscal stimulus in response to the crisis should be aligned with long-term development goals

Internationally coordinated fiscal stimulus will be more effective

⁴ Policy directions of that nature were also suggested for China in *World Economic Situation and Prospects 2007* (United Nations publication, Sales No. E.07.II.C.2) and *World Economic Situation and Prospects 2008* (United Nations publication, Sales No. E.08.II.C.2). For a more detailed discussion of fiscal stimulus in China to redress the global imbalances, see Pingfan Hong, Rob Vos and Keping Yao, "How China could contribute to a benign global rebalancing", *China and the World Economy*, vol. 16, No. 5, September-October 2008, pp. 35-50.

⁵ For an example of the output effects of coordinated fiscal policies, see *National Institute Economic Review*, vol. 206, No. 1, October 2008, which suggests that coordinated policies could increase the multiplier effects of fiscal stimulus by at least 30 per cent.

Box I.3

Don't forget the food crisis

In spite of falling international commodity prices, the food crisis still exists and high price levels will remain, at least in the short term. In addition, the global financial crisis threatens to worsen the situation. The present food crisis, which started in early 2008, was triggered by rapidly rising international prices of grains, propelled by a series of short-term factors forming a “perfect storm”; more importantly, however, many underlying longer-term factors had been brewing in the market for some time, making the crisis inevitable (see chapter II).

According to the Food and Agriculture Organization of the United Nations (FAO), there are currently still 36 countries in critical situations owing to exceptional supply shortfalls, general lack of access or severe localized food insecurity of displaced populations requiring immediate food assistance.^a Most of these countries have not seen their situation improve, and in some cases the situation has worsened because of persistent high prices, as food prices have been sticky on the downside and the dollar appreciation has offset some of the price effects of falling commodity prices. Adverse weather conditions, political strife and worsening economic conditions in the face of a global economic slowdown are also prevalent. Between 109 million and 126 million people may have fallen below the \$1 per day poverty line since 2006 owing to the increase in food prices, with the vulnerable populations located in South Asia and sub-Saharan Africa.^b All else being equal, the incidence of extreme poverty in sub-Saharan Africa may have risen by almost 8 percentage points, implying that the recent food price increases have more than offset the poverty reduction achieved between 1990 and 2004.

On the macroeconomic side, about 50 low- and middle-income countries are experiencing a weakening of their balance of payments and are expected to remain vulnerable through 2009.

Inflationary pressures, which had been present prior to the food price surge because of higher oil and non-food commodity prices, as well as rising domestic demand in the oil-exporting economies, were exacerbated by the rising food prices. The surge in world market prices for grains had immediate pass-through effects on domestic food prices. Given the large weight of food in the consumer price index (CPI) in most developing economies, this sent headline inflation soaring. The International Monetary Fund (IMF) has noted that annual food price inflation for 120 low-income and emerging market economies had risen by 12 per cent at the end of March 2008, up from 10 per cent three months earlier.^c

Net food importers were the most affected by the rising prices, causing deterioration in their terms-of-trade and current-account balances. Africa saw its net food imports increase to 1.6 per cent of gross domestic product (GDP) in 2007. Countries in sub-Saharan Africa (excluding South Africa) imported 1.9 per cent of GDP worth of net food imports. Latin America and the Caribbean as a whole had net food exports owing to South American exporters, but food imports of Central America and Mexico accounted for 0.6 per cent of GDP, while the Caribbean imported 3.7 per cent of its GDP in food. Relatively, Western Asia's net food imports were the highest in the Asian region.

Prices of grains started to decrease starkly from mid-year 2008. The emerging financial crisis has been one factor in this regard, as speculators started to retreat from commodity markets to salvage asset positions in the financial system. The related dollar appreciation (see main text) and the falling price of oil have compounded the drop in international grain prices. Shifts in the supply and demand for grains have also pushed prices downwards. These could continue to decline now that the production of cereals has recovered, caused in part by better weather conditions and also since the global demand for grains is weakening with the worldwide economic slowdown. The sharp decrease in the price of oil may weaken incentives to further increase biofuel production, which had been an important factor in pushing up the demand for grains in recent years. However, the average price levels of rice, corn and wheat, the three most-consumed grains, will still be substantially higher in 2008 compared to 2007, but are expected to decline in 2009. The observed high price volatility, however, may be detrimental to long-term investment in the production of grains and could sustain conditions of food insecurity for some time to come, unless counteractive measures are taken.

a Food and Agriculture Organization of the United Nations, *Crop Prospects and Food Situation*, No. 4, October 2008.

b Based on UN/DESA estimates.

c International Monetary Fund, “Food and Fuel Prices—Recent Developments, Macroeconomic Impact, and Policy Responses,” report prepared by the Fiscal Affairs, Policy Development and Review and Research Departments, 30 June 2008.

Box I.3 (cont'd)

The massive underinvestment suffered by the agricultural sector over the past two decades must be compensated for. In order to return to the levels of three decades ago, government spending in agriculture would need to double or triple in most developing countries. The United Nations, through its High-Level Task Force on the Global Food Security Crisis, has proposed a Common Framework of Action (CFA)^d as a comprehensive strategy for tackling the crisis. The CFA estimates that an additional \$25 billion to \$40 billion will have to be invested every year, financed through domestic resource mobilization and official development assistance, for food and nutrition security, social protection, agricultural development and a better functioning of food markets. According to CFA estimates, approximately one third of the resources would be needed for immediate food assistance and short-term budgetary and balance-of-payments support, and the rest for investments in rural infrastructure, education, clean water and agricultural research. The largest sums need to be invested in South Asia, followed by Latin America, although on a per capita basis, Africa will require the greatest investment push.

The present commitments by the international community still fall short of bridging the gap identified in the CFA. In order to regain lost ground in reducing rural poverty, initial support and reform programmes should be targeted at small producers of food, especially those in sub-Saharan Africa, since they are the most vulnerable and least-productive group. It has been estimated, for instance, that if all Asian countries could manage to lift agricultural productivity to the present yield levels of Thailand, one third of the region's mostly rural poor—or about 220 million people—could be lifted out of poverty.^e

In view of the present global financial crisis, it is more important than ever to strengthen the development finance architecture, not only to limit the negative effects of such crises and to enable countries to respond effectively, but also to ensure that the internationally agreed development goals can be met without diverting either external or domestic resources away from ensuring food security. The key challenge is to secure adequate resources for the necessary long-term investments in agriculture and rural development through better coordinated support from the international community which can be sustained over an extended period of time.

^d See <http://www.un.org/issues/food/taskforce/Documentation/CFA%20Web.pdf>.

^e United Nations Economic and Social Commission for Asia and the Pacific, Economic and Social Survey of Asia and the Pacific 2008: Sustaining Growth and Sharing Prosperity (United Nations publication, Sales No. E.08.II.F.7).

recessionary effects of the financial crisis could be contained to a considerable degree during 2009 (see table I.1 and figure I.1).

Internationally coordinated policy action among both the deficit and the surplus countries is also critical for achieving a benign adjustment of the global imbalances and avoiding a disruptive hard landing of the dollar (see above). Now that the financial crisis has already triggered a disorderly adjustment in a synchronized global downturn, the need for international policy coordination and cooperation is more pressing than ever.

The need for reform of the international financial system

Systemic failures

Even in the most optimistic scenario, it will take time before confidence is restored in financial markets and recovery can take place. As immediate solutions are being worked out, it remains important to understand the systemic causes of the present crisis, which—in a nutshell—relate to weaknesses in global economic governance, excessive financial deregulation, the problem of global (current- and capital-account) imbalances and related systemic shortcomings in the international reserve system and the lack of an international lender of last resort. Understanding these deeper causes makes it clear that much more

fundamental change is needed to reform the international financial system in order to provide better safeguards for preventing a recurrence of the present crisis and to create a framework for global economic governance in line with twenty-first century realities.

The need for systemic reforms is now widely recognized

World leaders have acknowledged this need for reform. Proposals for reforming the economic governance architecture should be addressed, through, among other things, the appropriate organs of the United Nations system, including the Bretton Woods institutions. The reform discussion on new rules for governing the global economy needs to be embedded in the wider United Nations system so as to ensure that a more inclusive and open exchange of ideas, in line with democratic governance principles, informs the debate and that any reforms adopted are owned by the full membership of the international community. The same kind of visionary multilateral spirit that informed the discussion in Bretton Woods in 1944 and San Francisco in 1945 is needed today, one which recognizes that peace, stability and prosperity are indivisible and that delivering these goals requires fundamental reforms of the international financial architecture.

Lack of credible mechanisms for international policy coordination

“Beggars-thy-neighbour” policies in the 1930s aggravated the depression of the 1930s

The immediate priority in today’s context is to prevent the global financial crisis from turning into a 1930s-style Great Depression. As discussed in the previous section, and as recognized by most parties, this requires internationally concerted policy actions. The first of these major systemic failures is the lack of an institutionalized and credible mechanism for such policy coordination. The depression of the 1930s had been aggravated by “beggars-thy-neighbour” policies, disintegration of the global economy and resurgent protectionism. More than a decade later, under the promise “never again”, it led to the design of the Bretton Woods system, including the creation of the IMF and the World Bank as institutions to safeguard the stability of the global economy and to promote growth, employment and development. But over time, the ability of the IMF to safeguard the stability of the global economy has been hampered by, among other things, limited resources and increasingly undermined by the vastly greater (and more volatile) resources of private actors with global reach. More exclusive and ad hoc country groups, such as the Group of Seven (G7) and the Group of Eight (G8), have become the platforms where international policy coordination has taken place in practice.

The lack of a credible mechanism for policy coordination is limiting adequate responses to the crisis

As a consequence, the IMF has, by and large, been sidelined in handling the present crisis. The apparent irrelevance of the Bretton Woods institutions in today’s crisis also stems from their skewed voting structures and governance, which are more reflective of the distribution of economic power in the world that prevailed in 1944 than of the present day, where developing countries carry much larger weight. Also, developing countries as a group are net creditors to the rest of the world, and their savings will quite likely provide, directly or indirectly, a major source of funding to cover the costs of the multi-trillion-dollar bailouts of financial institutions in the United States and Europe. Quite apart from this, they clearly have an abiding interest in taking an active part in any concerted solution. The lack of a credible mechanism with broad representation for international policy coordination reflects an urgently felt lacuna which is limiting swift and effective responses to the present crisis.

Inadequate financial regulation

Second, this crisis is systemic in nature both because it has affected all financial institutions and markets simultaneously and because it has spread to the real economy. To a significant degree, this has been a result of the dismantling of firewalls within and across financial sectors over the past two decades. This was part of a relentless drive to promote efficient and innovative financial markets which were expected to better manage risk (“securitization”); instead—as it has turned out—the deregulation added to global financial fragility. Particularly critical has been the pace and reach of new financial instruments which were encouraged despite the glaring absence of international surveillance and regulations.

It is generally the case that international regulation lags behind domestic regulation because of the inherent difficulties in designing standardized “rules of the game” across a large number of countries. But the problem has been amplified for four main reasons:

- a) The new approach to the regulation of finance, including under the New Basel Capital Accord (Basel II) rules, places the burden of regulation on the financial institutions themselves. This has generalized the problem of moral hazard, caused by a belief that as long as financial institutions are expanding their international operations they would be deemed too big to fail by (national) central banks, and has encouraged the proliferation of irresponsible behaviour across a range of financial institutions. The hypertrophying of Iceland’s financial system to ten times the size of its national GDP is an extreme example of this trend.
- b) The more complex the trade in securities and other financial instruments, the greater the reliance on rating agencies who proved inadequate for the task at hand, in part because of conflicts of interest over their own sources of earnings, which are proportional to the trade volume of the instruments they rate. In consequence, risk assessments by rating agencies tend to be highly pro-cyclical as they react to the materialization of risks rather than to their build-up. The lack of supervision and regulation of the quality of rating agencies, as much as of the operations of most non-bank financial institutions and of the transactions through offshore financial centres, has further encouraged reckless risk-taking.
- c) Existing approaches to financial regulation tend to act pro-cyclically, hence exacerbating a credit crunch during a crisis. This also applies to the international standards set by Basel I and Basel II rules and is most clearly the case for loan-loss provisions based on current rates of loan delinquency. At times of boom, when asset prices and collateral values are rising, loan delinquency falls and results in inadequate provisioning and overexpansion of credit. When the downturn comes, loan delinquency rises rapidly and standard rules on provisions can lead to a credit crunch. Similar difficulties also apply to capital charges. Banks typically lose equity when an economy is hit by a massive exit of capital, hikes in interest rates and declines in the currency. Enforcing capital charges under such conditions would only serve to deepen the credit crunch and a recession. This was the case in Asia during the 1997-1998 financial crisis, as a result of extensive efforts to strengthen regulatory regimes as part of the IMF packages of financial support.

Deregulation has induced greater global financial fragility

Four key areas of deficiencies in the international financial regulatory framework need to be addressed

- d) The spread of financial networks across the world, and the character of securitization itself, has made practically all financial operations hinge on the “confidence” that each institution in isolation is capable of backing up its operations. But as insolvencies emerge, such confidence is weakened and may quickly vanish, generating a credit freeze that spreads to the business sector, which in turn makes that sector increasingly vulnerable. The risk models applied by regulatory agencies typically disregard such “contagion” effects and, consequently, may fail to foresee the systemic risks posed by the failure of one or the other financial institution. The growing interaction among markets implies, in fact, that correlation of market swings has increased, limiting the room for effective risk diversification.

Improved financial regulation needs to be complemented with counter-cyclical macroeconomic policies

The regulatory deficit has made all these problems more severe. The basic implication for prudential regulation, which has been largely ignored in the past, is simple: since the basic problem of financial markets lies in strong cyclical swings, the basic objective of prudential regulation and supervision should be to introduce strong counter-cyclical rules to complement and fortify counter-cyclical macroeconomic policies.

The dollar as the reserve currency

The use of the dollar as the global reserve currency is an intrinsic source of instability

The third systemic failure is the world’s reliance on one single national currency—the United States dollar—as the major reserve currency. The Bretton Woods system originally gave the dollar this central role as part of a system of fixed exchange rates. The new system was put to a major test in the late 1960s when the United States was running large budget and current-account deficits, caused to a significant extent by the escalating costs of the Vietnam War and an increasingly overvalued dollar. The deficits were financed by the large current-account surpluses leading to high dollar reserve accumulation in Germany and most of the rest of Europe, and Japan. The ensuing monetary growth led to a rise in inflation and a rise in commodity prices worldwide, making the holding of low-yielding dollar assets less attractive and making the “dollar standard” of fixed exchange rates untenable. In 1971, the growing imbalances led to the collapse of the Bretton Woods “dollar standard” regime and a shift to flexible exchange rates for major currencies, followed by almost a decade of stagflation and a weakening dollar.

The dollar remained as the de facto world reserve currency and, as indicated, a similar pattern has been building up over the past decade: the United States has run up rising budget and external deficits stimulated by far-reaching financial deregulation, and these deficits were conveniently covered through loose monetary policy and mounting reserve accumulation in surplus countries, this time not just in Europe and Japan, but most importantly also in China and other parts of developing Asia as well as in major oil-exporting countries, many of which have in practice managed exchange-rate regimes with their currencies pegged to the dollar.⁶ Strong export-led economic growth, especially in Asia, has fed renewed commodity price inflation and loose monetary policy in the United States and has elsewhere cheapened the cost of borrowing, leading to accelerated credit growth and feeding an asset price bubble worldwide. The risks of this global growth pat-

⁶ This is officially the case in China and with most of the oil exporters in the Middle East. Many Asian countries formally moved to a flexible exchange-rate regime after the 1997-1998 financial crisis. In practice, however, in attempts to avoid a strong appreciation of those currencies that had collapsed during the crisis as part of export-led growth strategies, most countries have managed their currencies.

tern were conveniently ignored. Moving forward, the same problems will persist if not adequately addressed. Also, as argued above, the risk of a hard landing of the dollar will remain high even after confidence in financial markets has been restored, as the problem of the global imbalances will not automatically disappear as a result.

Inadequate liquidity provisioning

The tendency of accumulating vast amounts of foreign currency reserves in developing countries has its roots in more fundamental deficiencies of the international monetary and reserve system. Improved prudential capital-account regulation can help reduce the need for and the cost of self-insurance via reserve accumulation. The need for self-insurance can be further reduced with more effective mechanisms for liquidity provisioning and reserve management at the international level, both regionally and multilaterally (see below).

Current mechanisms are limited in coverage, too narrowly defined, or subject to unduly strict conditionality.⁷ The establishment in 1997 of the Supplemental Reserve Facility provided some collective insurance to countries hit by capital-account crises, but the Facility did not provide enough protection in the case of a typical sudden reversal in capital flows; when it was first used in the Republic of Korea, it did not prevent an economic implosion there, possibly because it was accompanied by pro-cyclical policy conditionality. The Contingent Credit Line (established in 1999) remained unused and expired in 2003, and little has been done to revitalize the Compensatory Financing Facility (established in 1963), which provided liquidity to developing countries to manage terms-of-trade shocks.

In October, the IMF proposed establishing a Reserve Augmentation Line as part of the Supplemental Reserve Facility to provide emergency liquidity to members who have strong macroeconomic policies, a sustainable debt situation and proven credibility in policy implementation, but who are still faced with shocks through the capital account. To overcome the potential stigma associated with the Facility, there is a need to enhance the reliability of access to financial resources and reinforce positive signalling to markets. A significant number of emerging market members should qualify based on the information available from past IMF Article IV consultation reports. Allowing automatic front-loaded drawing of up to 500 per cent of quota for eligible members, based on simple and transparent guidelines, would send a clear signal to private markets that the line is an insurance facility. If such a mechanism could emulate the lender-of-last-resort functions of central banks, it could reduce the demand for high reserve build-up in developing countries. This in turn could create more policy space in developing countries by offloading pressures towards exchange-rate appreciation.

More generally, all IMF facilities should be significantly simplified and include more automatic and quicker disbursements proportionate to the scale of the external shocks, without onerous policy conditionality attached to them. Recent action has been undertaken in this direction with the reform of the IMF Exogenous Shocks Facility. But total resources remain limited and more is needed to provide collective safeguards for large-scale crises.

Existing mechanisms for liquidity provisioning are inadequate

⁷ See, for example, Stephany Griffith-Jones and José Antonio Ocampo, "Compensatory financing for shocks: what changes are needed?", background paper prepared for the tenth session of the Committee and Development Policy, March 2008, available from http://www0.gsb.columbia.edu/ipd/pub/CompensatoryFinancing_24apr_sgj_topost.pdf; and *World Economic and Social Survey 2008: Overcoming Economic Insecurity* (United Nations publication, Sales No. E.08.II.C.1), chapter II.

The way forward

In today's world of increased economic and political interdependence, achieving a broad-based, rapid and sustained growth in incomes and employment involves even more complex policy challenges than in the past. Certainly, the external environment of developing countries has undergone a number of fundamental changes that are unlikely to be reversed in the foreseeable future. The multilateral arrangements designed at Bretton Woods in 1944 did not include a global regime for capital movements, given that capital mobility was expected to be limited. However, no such regime has emerged even after the breakdown of these arrangements, and despite the surge in private capital flows. In the aftermath of the Asian crisis, various codes and standards were established through international institutions, not just with respect to the financial sector, but also with regard to auditing and accounting, data collection and so on. While these could have benefits over the longer term, they will not necessarily contribute to financial stability, and in many cases they will involve substantial costs.

Another major outstanding challenge for the international financial institutions is to help developing countries mitigate the damaging effects of volatile capital flows and commodity prices and provide counter-cyclical financing mechanisms to compensate for the inherently pro-cyclical movement of private capital flows. A number of options are available to dampen the pro-cyclicality of capital flows through better macroprudential regulation and the provisioning of counter-cyclical multilateral financing, and thereby help create a better environment for sustainable growth and poverty reduction.

The failure to create a truly inclusive system of global economic governance—for adequate counter-cyclical policies in the short term and appropriate regulatory reform in the medium term—has frustrated a coordinated, comprehensive and inclusive international response to the current crisis. These flaws were also recognized during the financial crises in emerging markets in the 1990s, but relevant proposals for reform did not lead to much change in actual practice.⁸ The failure of the international community to draw lessons from the financial crises of the 1990s is now proving to be highly costly.

There is no legitimate forum, other than the United Nations itself, in which the interests of all countries can be articulated, considered and reconsidered to ensure more inclusive and equitable—and thus credible and effective—global economic governance. A decade after the collapse of the inter-war international financial system, the 1944 Bretton Woods Conference, which created the IMF and the World Bank, formed part of the new post-war system of inclusive multilateralism, led by the United Nations.

This is not the place to provide a blueprint but given the existing systemic flaws, it seems paramount that deliberations on a new international financial architecture should address at least four core areas of reform:

- a) The establishment of a credible and effective mechanism for international policy coordination.⁹ To guide a more inclusive process, adequate participation and representation of developing countries in the process of policy coordina-

⁸ For one of many elaborate reform proposals, see, for instance, José de Gregorio, Barry Eichengreen, Takatoshi Ito and Charles Wyplosz, *An Independent and Accountable IMF*, Geneva Report on the World Economy No. 1 (Geneva: International Center for Monetary and Banking Studies, and London: Centre for Economic Policy Research, September 1999).

⁹ This could be carried out along the lines suggested in *World Economic Situation and Prospects 2007* (United Nations publication, Sales No. E.07.II.C.2), pp. 24-34.

An inclusive, multilateral system of global economic governance is needed

Systemic reforms need to focus on four core areas

- tion and in the institutions of global governance is required, implying the need for a fundamental revision of the governance structure and functions of the IMF and the World Bank;
- b) Fundamental reforms of existing systems of financial regulation and supervision leading to a new internationally coordinated framework that can avoid the excesses of the past;
 - c) Reform of the present international reserve system, away from the almost exclusive reliance on the United States dollar and towards a multilaterally backed multi-currency system which, perhaps, over time could evolve into a single, world currency-backed system;
 - d) Reforms of liquidity provisioning and compensatory financing mechanisms—backed through, among other things, better multilateral and regional pooling of national foreign-exchange reserves—which avoid the onerous policy conditionality attached to existing mechanisms.

Such reforms will not easily find consensus among all stakeholders, but the risk of endangering global peace and prosperity by failing to address the systemic problems underlying the present crisis are simply too high. This awareness should be the common ground for seeking common solutions.

Chapter II

International trade

Trade flows

Merchandise trade: growth deceleration and potential revenue falls

World trade has started to decelerate sharply, weakening its role as a major engine of global economic growth in recent years. Growth in the volume of trade is estimated to have slowed to 4.4 per cent in 2008, nearly half of the average annual growth of 8.6 per cent during the period 2004-2007. This trend is expected to continue in 2009, with the volume of world exports anticipated to slow further to about 2 per cent on the heels of the global economic recession. In a more pessimistic scenario of a deeper and prolonged financial crisis, however, the recession will be more profound, causing world trade activity actually to decline by 3 per cent (see the pessimistic scenario outlined in chapter I), something which has not happened since the Second World War. During 2008, the signs of significantly weakening world trade were already visible in the Baltic Dry Index, a leading indicator of global trade activity measuring the demand for shipping capacity to transport commodities versus the supply of dry bulk carriers. In the six months between May and November 2008, the Index experienced an unprecedented continuous decline of 85 per cent. Because dry bulk primarily consists of materials that function as raw-material inputs into the production of intermediate or finished goods, such as concrete, electricity, steel and food, the Index can also be seen as an efficient indicator of future economic growth and production and is hence not signalling a promising outlook.

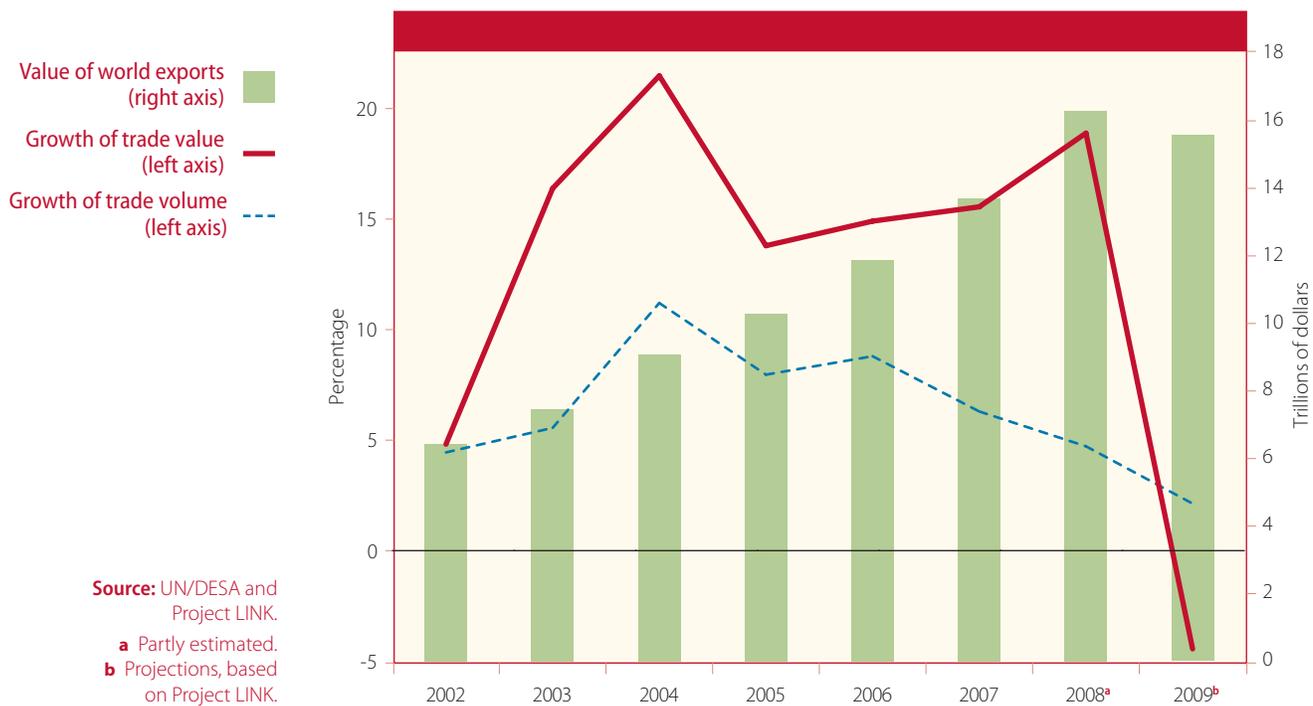
Meanwhile, the value of trade flows has increased significantly over 2008, but unlike a similar rise in 2004 which took place because of robust volume growth, this increase is largely due to extraordinary rises in the prices of oil and most commodities during the first half of the year. As noted in figure II.1, the declining trend of volume and the dramatic gyrations of the prices of most commodities in the second half of 2008 will lead to a fall in the value of global trade in the baseline estimate for 2009.

The costs of falling trade and commodity prices tend to be distributed unevenly across countries. In 2008, the clear winners were those who benefited from the sharp rise in oil and commodity prices. At an aggregate level, oil producers in North Africa, the Commonwealth of Independent States (CIS) and Western Asia doubled their rate of nominal export revenue growth in 2008, to 53 per cent, 48 per cent and 38 per cent, respectively. In addition, countries in sub-Saharan Africa (excluding Nigeria and South Africa) and the least developed countries (LDCs) as a group achieved remarkable rates of growth of export revenue following the primary commodity boom, averaging about 42 per cent in 2008. Latin America, which has a somewhat more diversified trade structure, saw the doubling of its rate of export revenue growth being offset by a more rapidly increasing import bill. Manufactured goods' exporters in East and South Asia were affected by the rise in commodity prices. In 2008, their import bills increased at almost twice the pace of 2007. In Europe, although import growth was less dramatic, it outpaced export growth (see tables II.1 and II.2).

World trade volume is growing at only half the pace of recent years

The value of trade has increased mainly on account of dramatic price increases

Figure II.1
Growth of global trade, 2002-2009



Collapsing commodity prices have led to severe trade shocks in many parts of the world

The global imbalances have narrowed as a result of the recession in the developed countries

Fortunes reversed following the dramatic fall in the prices of oil and primary commodities in the second half of 2008, a trend which is likely to continue in 2009 as the global economy enters into recession. Countries in North Africa, the CIS and Western Asia that had gained from high commodity prices are expected to experience falling export revenues at rates ranging from between 4 and 19 per cent in 2009. Most alarming are the losses in export earnings in sub-Saharan African countries and among the LDCs, which are expected to fall by about 22 per cent on average on account of declining commodity prices. At the same time, these economies will see modest increases in their import bills in 2009, to the extent that their trade deficits are expected to widen.

The turnaround in the prospects for world trade will have an impact on the global imbalances. As emphasized in previous issues of the *World Economic Situation and Prospects*, the United States of America has, for the past decade, played a critical role as the world consumer of last resort. With the recession and the drop in consumer confidence in the United States, this is now changing and the trade deficit of the world's major economy has narrowed, mainly because of weakening domestic demand. As the United States accounts for about 12 per cent of other developed country exports on average, trade surpluses in Europe and Japan will be trimmed, and export growth in China and other developing countries will also be directly and indirectly affected by the recession in the United States. Income growth in the United States started to slow in 2007 (showing a negative growth rate in the fourth quarter) which, together with the cumulative dollar depreciation over recent years, resulted in shrinking import demand. Except for a small positive rate of growth in imports in the second quarter of 2007, weakening demand in the United States has been a main cause in the deceleration of global trade in 2007-2008. Consequently, export volume growth in developed Asia and Oceania fell from 7.6 per cent in 2006 to an average of 2.7 per cent during 2007-2008. Similarly, in Europe, export

Table II.1
Value growth of exports and imports, 2002-2009

Annual percentage change									
	Flow	2002	2003	2004	2005	2006	2007	2008 ^a	2009 ^b
World	Exports	4.8	16.4	21.5	13.8	14.9	15.6	18.9	-4.4
Developed economies	Exports	3.6	15.1	18.5	8.3	11.9	14.4	13.9	-7.3
	Imports	3.0	16.0	19.3	11.8	13.2	13.6	14.7	-10.4
North America	Exports	-4.2	5.0	15.1	10.8	11.3	9.7	12.8	2.0
	Imports	1.5	7.9	16.4	13.9	10.5	5.9	11.4	-7.1
Asia and Oceania	Exports	3.1	13.1	20.2	7.0	9.3	11.2	15.4	4.3
	Imports	-0.3	15.6	19.8	15.9	11.2	11.0	24.7	-1.6
Europe	Exports	6.7	19.0	19.3	7.7	12.5	16.3	13.9	-11.7
	Imports	4.3	20.4	20.6	10.2	14.8	17.5	14.7	-12.9
Economies in transition									
South-eastern Europe	Exports	6.5	20.6	30.8	24.4	17.5	27.4	26.1	0.8
	Imports	20.2	19.1	21.9	17.4	15.2	30.7	24.5	3.5
Commonwealth of Independent States	Exports	6.3	26.8	36.7	36.9	28.1	25.0	47.9	-4.2
	Imports	10.3	27.1	30.0	28.0	32.4	40.4	38.2	13.4
Developing countries	Exports	7.2	18.2	26.1	21.9	18.4	16.3	23.2	-0.5
	Imports	5.0	16.4	27.9	17.4	16.9	17.5	25.3	5.7
Africa	Exports	3.4	23.4	29.3	37.1	18.6	20.1	38.3	-7.1
	Imports	3.4	20.3	26.3	22.5	19.5	25.5	29.1	6.6
North Africa	Exports	0.1	29.6	23.5	37.2	33.1	19.4	52.7	-5.4
	Imports	11.4	6.8	22.4	24.6	20.8	33.7	50.8	15.2
Sub-Saharan Africa (excluding Nigeria and South Africa)	Exports	15.1	14.9	28.0	36.8	20.7	21.2	42.1	-22.5
	Imports	4.6	19.6	26.7	19.3	12.0	18.7	18.2	2.8
East and South Asia	Exports	9.9	19.4	25.6	18.1	18.3	16.4	18.2	6.0
	Imports	8.7	19.5	28.1	16.9	16.5	14.4	24.8	8.1
East Asia	Exports	9.7	19.4	25.5	17.2	18.3	16.3	18.0	6.5
	Imports	8.8	19.2	27.4	15.5	15.8	14.8	24.1	7.5
South Asia	Exports	12.2	18.9	26.3	29.2	17.9	17.6	20.2	0.0
	Imports	7.5	22.6	35.3	30.6	22.3	10.8	31.0	13.6
Western Asia	Exports	5.0	22.5	31.0	33.1	19.1	17.3	37.7	-18.7
	Imports	7.2	17.4	36.5	15.2	14.7	28.1	23.2	-0.1
Latin America and the Caribbean	Exports	1.0	8.5	23.0	20.8	18.2	12.5	21.3	-2.5
	Imports	-7.0	3.4	22.0	18.7	19.4	19.0	26.8	0.2
Memorandum item: Least developed countries	Exports	9.5	16.0	35.8	35.6	23.2	25.6	42.8	-22.6
	Imports	3.5	18.8	25.5	14.7	14.9	18.2	22.3	6.4

Source: UN/DESA and Project LINK.

^a Partly estimated.

^b Forecasts, based in part on Project LINK.

volume growth slowed from 8.2 per cent in 2006 to 3.8 per cent per year on average in 2007-2008. This, in turn, suggests that the typically robust intraregional European trade is also experiencing negative feedbacks from export revenue to income, and from there to imports from other countries in the region. In the outlook, export growth of developed Asia and Oceania is likely to be negative and that of Europe to be flat, at best.

Table II.2
Volume change of exports and imports, 2002-2009

Annual percentage change									
	Flow	2002	2003	2004	2005	2006	2007	2008 ^a	2009 ^b
World	Exports	4.4	5.6	11.2	8.0	8.8	6.3	4.4	2.1
Developed economies	Exports	2.2	2.5	8.9	5.6	7.5	4.5	3.1	0.0
	Imports	2.5	4.6	9.5	6.5	7.0	3.9	1.1	-1.1
North America	Exports	-2.4	0.5	9.0	6.3	5.5	4.8	4.6	1.3
	Imports	3.2	4.7	10.8	6.8	5.0	1.4	-4.1	-4.1
Asia and Oceania	Exports	6.6	8.1	12.1	5.5	7.6	6.8	-1.4	-4.0
	Imports	3.1	7.1	8.2	5.7	5.5	3.7	5.8	-5.5
Europe	Exports	3.1	2.1	8.2	5.4	8.2	3.9	3.6	0.4
	Imports	2.0	4.1	9.0	6.5	8.3	5.2	3.2	1.2
Economies in transition									
South-eastern Europe	Exports	5.2	7.5	17.6	18.1	8.9	13.7	9.2	6.6
	Imports	17.0	3.6	9.6	12.2	9.8	17.0	12.1	8.0
Commonwealth of Independent States	Exports	8.0	13.6	15.4	-0.2	6.4	8.6	4.7	4.4
	Imports	10.7	19.1	21.2	8.2	20.1	26.3	18.3	16.7
Developing countries	Exports	8.6	10.8	15.0	12.5	10.9	8.8	6.2	4.8
	Imports	7.4	10.3	16.3	11.7	12.0	9.8	9.8	6.3
Africa	Exports	4.7	10.0	9.0	17.9	0.2	10.1	10.6	3.6
	Imports	5.0	10.5	10.7	17.5	11.6	17.6	15.2	10.5
North Africa	Exports	1.2	16.0	1.1	12.0	16.5	10.4	14.3	6.6
	Imports	11.8	5.7	8.7	18.1	16.0	24.9	24.3	17.9
Sub-Saharan Africa (excluding Nigeria and South Africa)	Exports	11.0	2.7	10.5	13.8	4.7	8.1	6.1	4.9
	Imports	3.9	6.7	14.5	13.9	5.9	9.8	6.7	7.6
East and South Asia	Exports	12.0	13.0	17.8	14.0	13.6	10.5	7.4	5.2
	Imports	11.4	11.9	18.0	12.0	12.1	8.3	9.4	6.0
East Asia	Exports	12.0	13.5	18.5	14.2	13.8	10.7	7.4	5.3
	Imports	11.8	11.9	17.6	11.0	11.8	8.8	8.7	4.4
South Asia	Exports	11.8	6.0	9.2	11.5	10.7	7.8	7.1	3.9
	Imports	7.5	11.2	22.1	22.4	15.7	2.9	16.6	21.3
Western Asia	Exports	4.5	8.9	8.0	6.0	5.6	6.2	5.8	3.9
	Imports	7.3	7.7	23.5	8.8	9.8	15.6	9.8	8.5
Latin America and the Caribbean	Exports	1.7	4.4	11.3	8.9	7.3	1.9	-2.0	4.1
	Imports	-4.1	6.2	7.5	10.4	13.0	9.1	8.6	3.6
Memorandum item: Least developed countries	Exports	9.7	2.5	14.1	10.7	7.7	12.5	5.8	8.1
	Imports	3.1	7.3	13.9	8.9	9.1	9.7	9.9	10.5

Source: UN/DESA and Project LINK.

^a Partly estimated.

^b Forecasts, based in part on Project LINK.

Weaker global trade will severely affect developing countries

While the widening of the global imbalances during the past decade has been posing an increasing threat to global financial stability, the present trend of a recessionary unwinding could affect development prospects in the medium run. As noted in chapter I, the outlook of a global recession and falling commodity prices will have an adverse impact on growth and domestic resource mobilization in most developing countries. Net food and energy importers already suffered serious setbacks in early 2008 owing to the extraor-

dinary surges in prices of oil and food. The reversal in commodity prices in the second half of 2008 may be of little comfort to these countries, as the global recession will significantly weaken demand for their exports. Financing ensuing trade deficits will be increasingly difficult and costly in the context of great uncertainty in financial markets. In contrast, countries that had benefited from the commodity boom but did not invest in diversifying their economy in a timely fashion will be doubly hit as they will see both the prices and the volume of their exports decline.

Regional trends in trade

As mentioned above, import demand in the United States has been weakening since 2007 and has fallen further in every quarter of 2008. Demand for imports of automobiles and car parts has been particularly affected. High oil prices and the slowdown in activity led to a drop in the volume of imports of fossil fuels. Export growth, in contrast, has strengthened over the past two years, driven by increased global demand for cheaper United States-made goods (in particular industrial inputs, computer-related commodities and consumer goods) after a prolonged period of dollar depreciation. Weakening demand worldwide and the rebound of the United States dollar (see chapter I) have reversed this trend, and United States exports have been falling since August 2008.

Trade growth in Western Europe has been affected by the United States slowdown. Growth of the total European export volume slowed from 3.9 to 3.6 per cent in the course of 2008. Export performance in the United Kingdom of Great Britain and Northern Ireland deviated from this trend, showing a recovery from the contraction in trade observed in 2007. European exports are expected to grow by a meagre 0.4 per cent in 2009, reflecting the global slowdown as well as the appreciation of the euro and the pound sterling against other major currencies from mid-2008. The weakening of global demand dominates prospects for import demand in Europe, which slowed from 5.2 per cent in 2007 to 3.2 per cent in 2008 and is expected to slow further, to 1.2 per cent in 2009.

The softening of import demand in the United States and elsewhere is also slowing export growth in developed Asia (Japan and Australia in particular). Falling oil prices are reversing the trend in preceding years of a rising import bill in Japan and have helped preserve the country's trade surplus, despite the poorer export performance. Australia managed to reduce its trade deficit, thanks to sharp increases in the negotiated price for its iron ore and coal exports, underpinning an increase in the country's total export revenues by more than 20 per cent in 2008. Canada's external sector is suffering from the weak United States economy, especially in the automobile industry, and, from mid-2008, also from the drop in oil prices and the appreciation of the Canadian dollar.

Among the new European Union (EU) member States, Estonia and Latvia have seen their imports decline in real terms as a consequence of the bursting housing and credit bubbles and their impact on private consumption and investment. In other new EU member countries, most notably Bulgaria and Romania, strong private consumption, continued foreign direct investment (FDI) inflows and continuing strong domestic investment have been driving import growth at a pace of about 12 per cent. Export performance of the new EU members has not been immediately hurt by the sluggishness in demand from major trading partners, possibly because many export contracts were component-based. The export contracts, on average, stretch over three quarters of the year, causing export growth to respond to slower foreign demand with a similar time lag. A significant deceleration of exports is therefore likely to be felt during the first half of 2009. During 2008, though, exports by the new EU members continued to expand at an annualized rate of 11 per cent in real terms.

Both imports and exports of the United States are declining

The rest of the developed world sees its income directly affected by sluggish United States trade growth

Export growth in new EU member States was strong in 2008, but it will be affected by the global slowdown with a time lag

Increases in production capacity of automotive plants in the Czech Republic and Slovakia in operation this year have helped to sustain a rapid growth of exports in 2008 despite declining sales of transport equipment in the EU, but prospects for 2009 will be less glowing.

The trade boom in South-eastern Europe may not last

In the economies of South-eastern Europe, buoyant private consumption, continuing FDI and, in some cases, heavy infrastructure spending resulted in strong import growth of about 8 per cent in 2008, amplified in nominal terms by higher food and energy prices. Exports of the region kept growing at a pace of about 9 per cent in 2008. It is expected, however, that the slower growth in the EU-15 may hold back further export expansion in the subregion.

Trade prospects in the CIS remain closely linked to oil and commodity prices

Growth of export revenues of the countries of the CIS was strong in 2008 and outpaced import value growth. The surge in oil and gas prices in the first half of 2008 helped boost trade surpluses in Azerbaijan, Kazakhstan and the Russian Federation, despite the rise in import demand based on growth in domestic consumption and investment. Growth in the volume of exports from the Russian Federation remained weak, and could decline significantly in the outlook. Imports of the Russian Federation increased by more than 20 per cent in 2008, but owing to the strong rise in hydrocarbon prices in the first six months of 2008, the economy was nonetheless able to increase its trade surplus. In some other parts of the CIS, however, import growth outpaced export growth in value terms, and trade deficits widened, especially in the smaller economies such as Armenia, Kyrgyzstan, the Republic of Moldova and Tajikistan. Ukraine suffered most from the rising costs of imported food, oil and gas. Its trade deficit surged during 2008 as import demand was further fuelled by strong domestic demand.

Trends in trade differ strongly between the oil and the non-oil exporters in Western Asia. In 2008, despite strong import growth, trade surpluses in the major oil-exporting countries of the Gulf Cooperation Council (GCC) and Iraq increased substantially from their already high levels of 2007. Saudi Arabia's trade surplus reached an estimated 65 per cent of gross domestic product (GDP) and that of Kuwait was no less than 72 per cent of GDP. In non-oil economies of the region such as Jordan, Lebanon and Turkey, in contrast, rising import costs outpaced increased export revenues, resulting in a further widening of trade and current-account deficits.

The fall in exports in Western Asia may cause worsening trade prospects in Europe

Until recently, import demand from oil exporters in Western Asia and from the fast-growing economies of East Asia had provided a buffer in Western Europe to the fallout in demand from the United States. This cushion is now deflating. East Asian economies are increasingly feeling the impact of the slowdown of developed economies in terms of a substantial deceleration in the demand for their exports. Export volume growth for the region as a whole is estimated to have weakened from an annual average of 13.7 per cent during 2001-2007 to about 8 per cent in 2008, and is likely to experience much weaker growth in the outlook for 2009. Nonetheless, China's trade balance has continued to widen in dollar terms during 2008, despite the appreciation of the renminbi that has taken place over the past three years. The Republic of Korea, the second largest exporter in the region, managed to sustain high rates of export growth until the third quarter of 2008. The economy's trade balance moved into deficit in 2008, however, as a consequence of strongly increasing import costs for energy and materials. Singapore and Taiwan Province of China suffered from considerably lower demand for information technology (IT) products, consistent with the weak demand in industrial countries.

Developing countries remain highly vulnerable to trade shocks

The developing countries most vulnerable to a global economic downturn and volatile commodity prices are primarily found in Africa and Latin America. The good performance of commodity exporters in Africa, owing to the rise in commodity prices in the first part of the year, is expected to give way to a much less favourable outcome, as

the demand and prices of their exports will decline further. A similar reversal of trends will also affect those African countries heavily reliant on agricultural exports and tourism. Oil exporters in the region will see significantly lower current-account surpluses in 2008 compared with previous years. Oil importers, in contrast, are expected to experience widening current-account deficits over 2008. South Africa is an exception to this trend, as its current-account deficit narrowed substantially in 2008 following the country's recovery from the electricity crisis that had stalled mining exports the year before. The outlook for 2009 will be much bleaker for both groups of economies, however, as export revenues are expected to collapse.

Meanwhile, the aggregate current-account balance of Latin America and the Caribbean is estimated to move into a small deficit in 2008, after registering a surplus of about 0.5 per cent of aggregate GDP in 2007. The declining trend is caused by a combination of the economic slowdown in the industrialized world, the drastic drop in commodity prices in the second half of 2008, which affected primary commodity exporters, and the erosion of competitiveness caused by strong currency appreciation in the region over the past few years (even though this trend has reversed in the second part of 2008). Going forward, the gains in competitive edge from the recent currency depreciation are likely to be more than offset by lower demand for exports because of the global slowdown and continued tight trade-credit constraints. Limited access to trade credit has already affected exports and production in Brazil. The recession in the United States will be felt most immediately in Mexico and Central America, which rely on United States markets for the lion's share of their exports. Countries in South America rely on a more diverse group of trading partners and will feel the consequences once demand for their exports slows in Europe and in Asia's emerging market economies.

Trade in services: growth to slow with global downturn

World trade in services has expanded dramatically in recent decades. In 2007, it reached a total value of \$3.1 trillion, more than triple the size of 1990. This trend has been consistent with the worldwide trend of an increasing share of services in total output. During 1990-2007, the share increased from 65 to 72 per cent in developed countries and from 45 to 52 per cent in developing countries. Services today account for over 70 per cent of employment in developed countries and about 35 per cent in developing countries. In recent years, however, the fastest growth has taken place in merchandise trade, and it seems that this was a factor in the sustained growth of trade in services. Since the growth of merchandise trade has been particularly robust in the developing world, the share of services in total trade has decreased (see table II.3).

Business services, including information and communication technologies (ICT), as well as financial and insurance services, are on the rise, and in 2007 made up about one third of the services trade of developing countries. However, a prolonged financial crisis is likely to affect the trade and production of such services. Trade in financial services will be affected directly, but the effects will probably spill over into merchandise trade through tightening access to trade credit. Experts at a high-level World Trade Organization (WTO) meeting have suggested that the shortage of liquidity for financing trade credit worldwide amounts to \$25 billion as of November 2008.¹ This, on top of the contraction of demand, will constrain export opportunities, especially in developing countries.

Trade in financial and transportation services, which has become increasingly important in developing countries, is likely to weaken as the financial crisis unfolds

¹ See "Experts discuss problems of trade finance", World Trade Organization, WTO: 2008 News Items, 12 November 2008, available from http://www.wto.org/english/news_e/news08_e/trade_finance_12nov08_e.htm (accessed on 15 November 2008).

Table II.3
Exports of services: share in total trade in goods and services, 2003-2007

Percentage					
	2003	2004	2005	2006	2007
World	20.1	19.9	19.5	18.9	19.4
Developed economies	22.5	22.7	22.7	22.2	22.8
Economies in transition	15.9	14.9	13.8	13.3	14.5
Developing economies	15.0	14.7	14.1	13.7	14.0
Africa	20.3	19.0	16.9	16.4	17.5
Latin America and the Caribbean	14.3	13.4	13.2	12.4	12.5
Asia	14.5	14.5	14.0	13.7	13.9
Oceania	35.4	34.2	33.7	30.4	28.5
Memorandum items:					
Least developed countries	15.9	14.7	12.4	12.5	11.6
Landlocked developing countries	17.3	15.9	14.6	13.0	13.4
Small island developing States	45.4	44.3	39.7	34.7	38.2

Source: UNCTAD GlobStat.

Most of the services trade of developing countries takes place in a limited number of countries, and its concentration has increased further over the past decade. Some 25 countries accounted for 86 per cent of total developing country services trade in 2007. Five of these alone accounted for 50 per cent of the total volume, up from 43 per cent in 2000 (table II.4). In less than two decades, China and India have become the largest developing country exporters of services, leaving behind other Asian countries that had dominated the services trade in the 1990s.

For developing countries in general, trade in services is particularly important in the areas of movement of natural persons supplying services (Mode 4 of the General Agreement on Trade in Services (GATS)) and outsourcing (included in Mode 1), but is also important in commercial presence (Mode 3), and is mostly carried out through FDI. Worldwide, the services sector accounts for the largest share of global FDI stocks and flows, while the share of manufacturing has continued to decline.² The services sector accounted for 62 per cent of estimated world inward FDI stock in 2006, up from 49 per cent in 1990. The share in the world total of FDI inflows to the services sectors in developing countries climbed from 35 per cent in 1990 to more than 50 per cent in 2007.

While trade, financial services and business activities continue to account for the lion's share of FDI in the sector, other services, including infrastructure, have begun to attract FDI since the 1990s. For example, the value of cross-border mergers and acquisitions (M&As) worldwide in electricity, gas and water rose from \$63 billion (about 6 per cent of total sales) in 2006 to \$130 billion (nearly 8 per cent of the total) in 2007.

In Africa, Western Asia, East and South Asia, and Latin America and the Caribbean, FDI inflows grew to nearly record levels in 2007, the finance sector being the largest FDI recipient, while activity in infrastructure services such as electricity, telecommunications and water was on the rise. In view of the current turmoil in financial markets, and considering the mixed results of privatized public services in the developing

FDI is a major vehicle for the expansion of trade in services in developing countries

FDI flows may weaken as the economic slowdown takes hold in developing countries

² See United Nations Conference on Trade and Development, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge* (United Nations publication, Sales No. E.08.II.D.23).

Table II.4
Exports of services among developing economies, 1990, 2000 and 2007

Values in billions of dollars, share in per cent									
	1990			2000			2007		
	Value of exports	Share	Rank	Value of exports	Share	Rank	Value of exports	Share	Rank
Developing economies	150.2	100.0		348.1	100.0		848.1	100.0	
China, excluding Hong Kong SAR ^a , Macao SAR ^a and Taiwan Province of China	5.9	4.0	9	30.4	9.0	3	117.2	14.0	1
India	4.6	3.0	10	16.7	5.0	7	84.8	10.0	2
Hong Kong SAR ^a	18.1	12.0	1	40.4	12.0	1	82.7	10.0	3
Singapore	12.8	9.0	2	28.2	8.0	4	69.7	8.0	4
Korea, Republic of	9.6	6.0	3	30.5	9.0	2	63.2	7.0	5
Taiwan Province of China	7.0	5.0	6	20.0	6.0	5	30.6	4.0	6
Thailand	6.4	4.0	7	13.9	4.0	9	30.0	4.0	7
Turkey	8.0	5.0	5	19.5	6.0	6	28.7	3.0	8
Malaysia	3.9	3.0	11	13.9	4.0	8	27.6	3.0	9
Brazil	3.8	3.0	12	9.5	3.0	12	23.8	3.0	10
Egypt	6.0	4.0	8	9.8	3.0	11	20.0	2.0	11
Mexico	8.1	5.0	4	13.8	4.0	10	17.3	2.0	12
South Africa	3.4	2.0	13	5.0	1.0	14	13.5	2.0	13
Morocco	2.0	1.0	18	3.0	1.0	22	13.4	2.0	14
Macao SAR ^a	1.5	1.0	23	3.6	1.0	18	12.3	1.0	15
Indonesia	2.5	2.0	16	5.2	1.0	13	12.1	1.0	16
Lebanon	0.1	1.0	76	1.2	1.0	40	11.4	1.0	17
United Arab Emirates	1.1	2.0	32	2.2	1.0	25	10.7	1.0	18
Argentina	2.4	0.0	17	4.9	0.0	15	9.8	1.0	19
Iran, Islamic Republic of	0.4	1.0	48	1.4	1.0	37	9.3	1.0	20
Chile	1.8	1.0	19	4.1	1.0	17	8.8	1.0	21
Kuwait	1.3	2.0	26	1.8	1.0	32	8.6	1.0	22
Philippines	3.2	2.0	14	3.4	1.0	19	8.4	1.0	23
Saudi Arabia	3.0	0.0	15	4.8	1.0	16	7.7	1.0	24
Cuba	0.5	0.0	42	3.1	1.0	21	6.6	1.0	25

Source: UNCTAD GlobStat.

^a Special Administrative Region of China.

world, these trends seem worrisome. Governments have often found themselves absorbing the costs of failures or shifting strategies of transnational corporations (TNCs) in basic services. Bailouts of large foreign financial corporations may give rise to an even heavier burden. Some countries in Latin America and the Caribbean adopted a number of policy measures related to FDI that range from reducing incentives to restricting or prohibiting such investment. As several factors have been influencing recent trends, the precise impact of the financial crisis on FDI flows is difficult to measure.³

Offshore services represent only a relatively small component of the world's outsourcing market. Offshore service activities mainly comprise IT services and IT-

³ See United Nations Conference on Trade and Development, *World Investment Prospects Survey 2008-2010* (New York and Geneva: United Nations, September 2008).

enabled business services, as well as pharmaceutical and research and development (R&D) services. Developing countries have captured a sizeable and growing share of this market. The potential impact of the current financial and economic crisis on this incipient market remains uncertain, since offshore activity may either increase in pursuit of cost-saving strategies or fall as global demand recedes.

World primary commodities and prices

Non-oil commodities: dramatic price swings

Commodity price fluctuations in 2008 were caused by new factors

During 2008, the upward trend in commodity prices, which had put its stamp on commodity markets since the early 2000s, reached its peak and was followed by a dramatic fall. Long- and short-term factors had combined in an unprecedented manner to create a broad rise in commodity prices with characteristics unlike those of previous commodity price booms, such as the one in the early 1950s or those following the two oil-price shocks of the 1970s. These earlier booms resulted from supply bottlenecks and were broken by a rise in global inflation followed by monetary tightening. The most recent boom was different, however. Rather than experiencing a shock, supply was rising consistently in response to price increases, but apparently not as fast as the rise of demand fuelled by speculation in the futures markets. The expectations and exchange-rate volatility which triggered speculation, driving stocks down, also contributed to the surge in prices. Hence, rather than balancing supply and demand, rising prices fed speculation and further price increases. The tide was turned by a change of sentiment among financial investors in commodity markets.

Growing supply in some commodity markets is facing fading demand

From June 2008, commodity prices have generally been decreasing, as shown by the United Nations Conference on Trade and Development (UNCTAD) commodity price index, which lost 11.5 per cent in dollar terms between June and September 2008. This trend holds for all commodity groups, though specific commodities or commodity groups have been more affected than others (see table II.5). The change in trends can be partially explained by high price incentives and favourable weather conditions that are contributing to increased planting and harvesting of cereals, which may hit a new record in 2008. World production of wheat, maize and rice is expected to exceed demand and contribute to a partial replenishment of stocks. In addition, the recent appreciation of the United States dollar may also explain part of the price decline in nominal terms. While the replenishment of stocks and lower prices is a welcome turn of events for consumers, the sharp rise in price volatility during 2008 has hurt both consumers and producers.

Table II.5
Commodity price indices in nominal terms, 2008

Base year 2000 = 100			
	Jan-08	Jun-08	Sep-08
All non-oil commodities	239.4	289.8	256.4
Food	200.0	262.6	232.3
Tropical beverages	167.1	192.8	186.7
Vegetable oilseeds and oils	318.8	370.5	266.9
Agricultural raw materials	196.6	228.6	212.7
Minerals, ores and metals	329.1	371.3	334.7

Source: UNCTAD Commodity Price Statistics.

Between 1997 and 2002, commodity prices followed a downward trend in both nominal and real dollar terms. The commodity price boom, which resulted in record prices in nominal dollar terms for several commodities, also allowed real prices to recover for some commodity groups. Nonetheless, most commodity prices, corrected for dollar inflation, remained well below previous peaks (see figure II.2 and table II.6).

Exceptional conditions caused the rise and fall of prices in world markets for basic grains, food and minerals. One of the unique features of the 2008 boom was the long and steady growth in commodity market trading, during which unused capacity was put into operation. Capacity utilization peaked in the production of most commodities belonging to the categories of basic grains, food and minerals, as new investments to increase sup-

Despite sharp rises, real prices of most commodities have remained below previous peaks

Figure II.2
Monthly averages of free-market price indices of non-oil commodities,
January 1997-September 2008

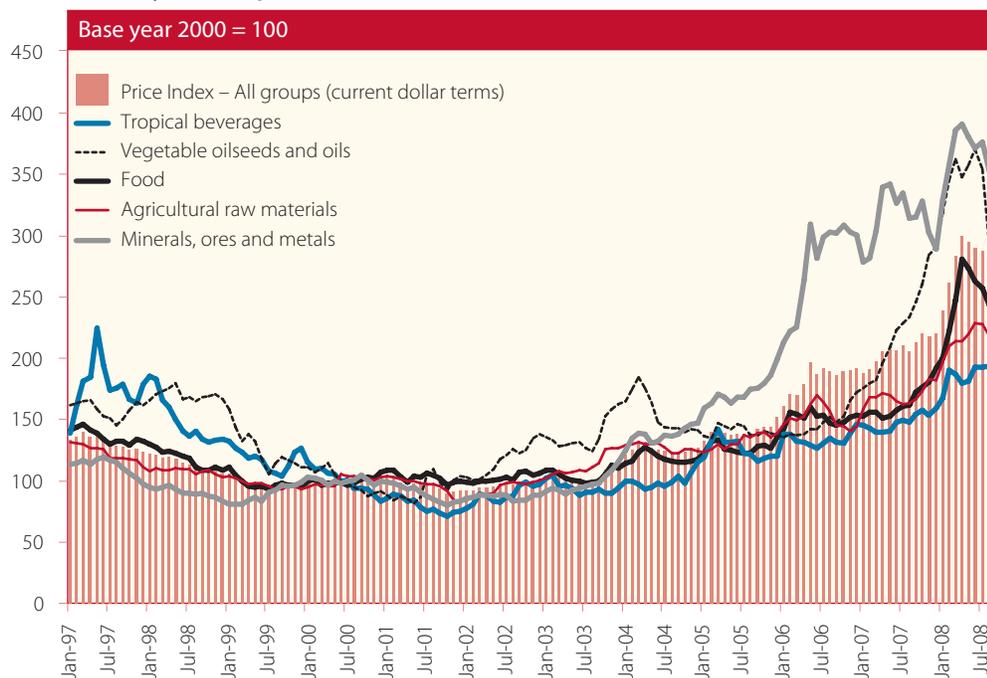


Table II. 6
Commodity price indices in real dollar terms, 1974-2008

Base year 2000 = 100					
	1st half 1974	1st half 1997	1st half 2008	1997-2008 change (percentage)	1974-2008 change (percentage)
All non-oil commodities	317.8	121.9	197.3	61.9	-37.9
Food	386.7	126.2	175.8	39.2	-54.5
Tropical beverages ^a	617.7	161.9	129.8	-19.8	-79.0
Vegetable oilseeds and oils	433.9	144.3	248.6	72.3	-42.7
Agricultural raw materials	203.1	115.0	151.3	31.5	-25.5
Minerals, ores and metals	239.7	103.8	262.0	152.5	9.3

Source: UNCTAD, Commodity Price Statistics and Infocomm.

^a The highest prices for tropical beverages were recorded in 1977, which for this group of commodities is used as the year of reference instead of 1974.

ply fell short of what was needed to match the increase in demand, and inventories became depleted. At that point, the financial crisis had arrived, rendering the question of how long the demand momentum could be maintained irrelevant. For other commodities such as agricultural raw materials, the supply response had been sufficiently large early on.

Exchange-rate fluctuations and speculative activity, among other factors, have increased commodity price volatility

It is also likely that the depreciation of the dollar since 2002 fuelled expectations of further price increases as investors tried to preserve international purchasing power by raising prices in dollar terms. Although difficult to ascertain with precision, the influence of speculation by financial investors has been considerable. Speculation in the actual, physical exchange of commodities certainly influenced prices as speculators bought and stored commodities, betting on price increases. Such positions have temporarily reduced the supply of goods and have no doubt affected price movements directly. The impact of speculation in futures markets (that is to say, where speculators do not physically trade any commodities) on price trends is much more difficult to determine, however. Futures trades are bets on buying or selling goods entitlements which are continuously rolled over. It is therefore not clear whether such trading does more to commodity prices other than increase their volatility. It could, however, be argued that increased global liquidity and financial innovation has also led to increased speculation in commodity markets. Conversely, the financial crisis contributed to the slide in commodity prices from mid-2008 as financial investors withdrew from commodity markets and, in addition, the United States dollar appreciated as part of the process of the deleveraging of financial institutions in the major economies (see chapter I).

As explained in Box II.1, the turmoil experienced in stock markets owing to the global financial crisis initially shifted speculative investments towards markets for basic grains, for example. But as the financial vulnerability of large investors surfaced later in the year, the need for liquidity to refinance bad debts and recapitalize ailing financial institutions seems to have abruptly stopped financial investments in commodity and futures markets. The credit crunch is also expected to have a negative impact on international commodity trade by raising import financing costs. This will reduce import demand and contribute to further declines in commodity prices. As economic actors expect a further downturn of the global economy, this may already have been translated into lower futures market prices.⁴

Trends in commodity stocks provided an early signal of price gyrations

Trends in commodity stocks have signalled impending shortages. Production conditions of many commodities were characterized by excess capacity in the 1990s. The resulting excess supply suppressed prices and provided little incentive to new investment. As demand gradually rose, spare capacity declined. Similarly, inventories, which in many cases had been built up to very high levels, started falling. Eventually, supply responded, but in many cases only after prices had reached unprecedented levels. Figure II.3 shows the surplus of supply over demand for lead and zinc, which in many ways are typical of the minerals and metals industry. A surplus of both metals in the early years of the twenty-first century turned into a widening deficit around 2004, and the industry did not return to surplus until 2008. Figure II.4 shows London Metal Exchange (LME) stocks for the same two metals.

⁴ See, for example, United Nations Conference on Trade and Development, *Trade and Development Report 2008: Commodity prices, capital flows and the financing of investment* (United Nations publications, Sales No. E.08.II.D.21), chapter 2, p. 24; Institute for Agriculture and Trade Policy, "Commodities market speculation: The risk to food security and agriculture", IATP Report, November 2008; W. Meyers and S. Meyer, "Causes and implications of a food price surge", background paper for the present report, available from http://www.un.org/esa/policy/publications/wesp_background_papers.htm; and Organization for Economic Cooperation and Development, Trade and Agriculture Directorate, Committee for Agriculture, "The relative impact on world commodity prices of temporal and longer term structural changes in agricultural markets: A note on the role of investment capital in the US agricultural futures markets and the possible effect on cash prices", Document No. TAD/CA/APM/CFS/MD(2008)6, 28 February 2008.

Box II.1

The making of the food crisis

In the years leading up to the food crisis of early 2008, demand for basic grains (rice, wheat, barley, maize and soybeans) exceeded production. As a result, stocks fell to 40 per cent of their levels in 1998/99, and the stocks-to-use ratio reached record lows for total grains and multi-year lows for maize and vegetable oils. Given such tight conditions, the market could not absorb the events that occurred on the demand and supply side, culminating in a “perfect storm”, and leading to soaring prices and rampant food shortages in many developing economies.

There are differences in how prices evolved among food commodities, as well as in the triggers that sparked the price surges. Some grain prices began an upsurge as early as the end of 2006; nevertheless, by September of 2007, all international grains prices had doubled from their 2003 price levels (see figure A below). The apparent common factor that affected all price dynamics was the comovement of the depreciation of the United States dollar and the rise in crude oil prices.

The United States dollar began to depreciate more steeply in 2006, and crude oil prices rose simultaneously. This not only increased production and transport costs for commodities but also stimulated an increase in biofuel production, increasing the demand for, and the price of, maize and vegetable oils. It has also been argued that biofuel production has increased the demand for agricultural inputs, energy and labour, thereby having the impact of increasing food prices in general. Increasing maize prices induced crop substitution towards more profitable maize production and led to the substitution on the demand side for feed and food, thereby increasing prices of other crops. Subsequently, higher crude prices raised the production costs of all crops, livestock and dairy, and these effects permeated throughout the agricultural sector raising the farm-to-retail margins and increasing the cost of food.

Shortfalls in grain production also emerged because of bad harvests, most notably in Australia and Europe. While these events would normally not have been such large market movers, in this case the effect on prices was dramatic given the record-low level of cereal stocks and the continuing strong global demand.

Figure A
Patterns of price developments among food commodities, 2003-July 2008



Source: W. Meyers and S. Meyer, “Causes and implications of a food price surge”, background paper for the present report, available from http://www.un.org/esa/policy/publications/wesp_background_papers.htm.

Box II.1 (cont'd)

The reaction to rising international food prices at the domestic level only served to exacerbate an already tenuous situation. Numerous exporting countries either banned, taxed or otherwise limited exports of grains and oilseeds, while importing countries reduced import tariffs, subsidized consumers or increased imports as precautionary measures. The most dramatic impact was on the price of rice, but wheat was also affected. Rice exports were banned in Cambodia, Egypt, India (except basmati), Indonesia and Viet Nam, and China introduced a 5 per cent export tax. Since the international market for rice is very thin (amassing no more than between 6 and 7.5 per cent of rice consumption), the trade restrictions generated market panic resulting in private hoarding and the delay of emergency food deliveries.

Increased consumption, most notably in China and India, is frequently seen as another factor in the price surges. While part of a longer-term trend, counterfactual evidence suggests that increased food demand in these emerging markets only played a role coming as it did on top of already emerging supply shortages. In general, growth in the demand for corn for food and feed has not been above trend over the past 10 years. It was the steep rise in the demand for maize for ethanol production in the United States (which, in turn, was driven by subsidies and the surge in fossil fuel prices) which—along with emerging supply shortages in China—contributed to the surge in the world price of corn in late 2006. This spilled over into other markets. The price of soybeans increased steeply following the shift of 5.5 million hectares of arable land from soybean to maize production in the United States in response to the rising maize prices. This further led to a decline in world oilseed production. As demand for oilseeds remained strong, especially in China, prices of other oilseeds surged as well.

Increased activity in futures markets by financial investors also had an impact on short-term price movements, as explained in the main text. This increased price volatility pushed up commodity prices in futures contracts well beyond what they would otherwise have been during the boom. Similarly, the withdrawal of financial investors at the emergence of the financial crisis exacerbated their decline. While clearly affecting price volatility, it is less evident whether speculation in futures markets is also having any lasting effect on seasonal average prices or long-term conditions affecting demand and supply.^a

Next to this storm of short-term factors pushing up food prices were longstanding policy failures that weakened the agricultural sector in many developing countries, making it harder for them to cope with market shocks and avoid a major-scale crisis. Thanks to the Green Revolution and development policies that spanned from the sixties through the eighties, world food prices decreased persistently from the late 1980s until 2002, providing self-sufficiency to many developing countries and helping to reduce poverty. However, the policy shift towards more confidence in price signals to stimulate production and less attention to government support for infrastructure investment and research and development for agricultural technology, together with lower official development assistance (ODA), has been most detrimental to agricultural productivity growth. In particular, sub-Saharan Africa has suffered the most from the present food crisis because of poorer social and physical infrastructure, making it harder to assimilate new technologies triggered by the Green Revolution. In 2003, African Governments committed themselves to raising their share of spending on agriculture to 10 per cent by 2008 in support of the Comprehensive Africa Agriculture Development Programme (the Maputo Declaration goal). In reality, however, such spending has dropped dramatically in recent decades and the target is far from being met (see figure B).

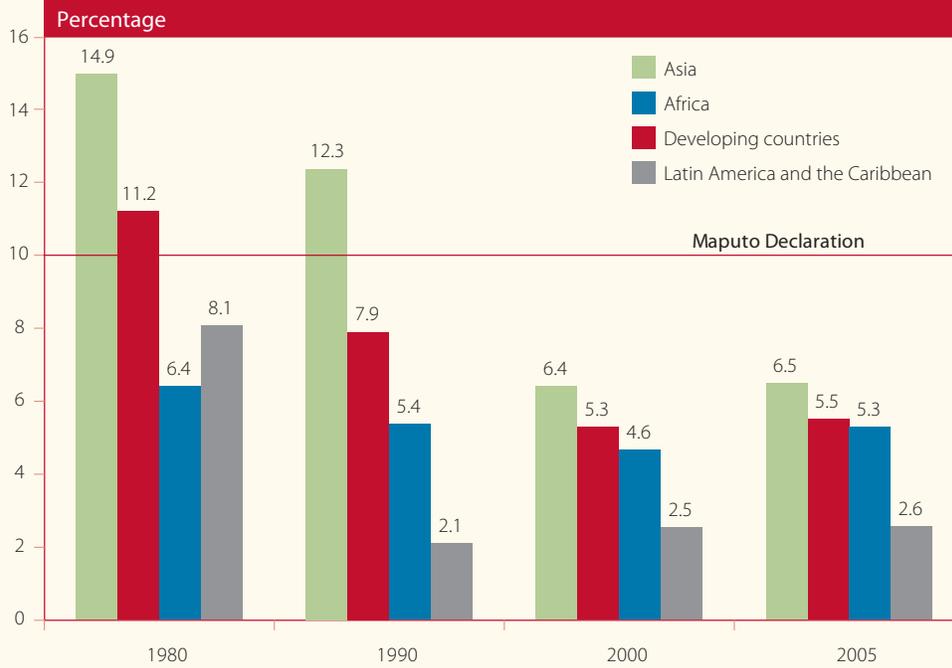
Donors have also neglected agriculture. The share of total ODA for agriculture declined from 13 per cent in the early 1980s to 2.9 per cent in 2005-2006. In addition, ODA allocated to other productive activities and economic infrastructure, which can have positive externalities for agriculture, also suffered from a significant drop in international support during the same period.

The downside of weakening investment and agricultural support measures in developing countries is that productivity growth for major food crops has stalled, and there has been no significant increase in the use of cultivated land. Thus, production has fallen woefully short of growth in food demand. Unless the problem of underinvestment in agriculture is addressed, beyond the short-term swings, food prices may remain on a longer-term upward trend.

^a See, for example, Commodity Futures Trading Commission, Written testimony of Jeffrey Harris, Chief Economist before the Senate Committee on Homeland Security and Governmental Affairs, United States Senate, 20 May 2008, available from <http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/eajeffharristestimony052008.pdf> (accessed on 10 November 2008); Scott H. Irwin, Philip Garcia, Darrel L. Good and Eugene L. Kunda, "Recent convergence performance of CBOT corn, soybean and wheat futures contracts", *Choices*, vol. 23, No.2, 2nd quarter 2008, pp. 16-21, available from http://www.choicesmagazine.org/magazine/pdf/issue_4.pdf (accessed on 11 November 2008).

Box II.1 (cont'd)

Figure B
Public agricultural expenditures in developing countries, 1980-2005



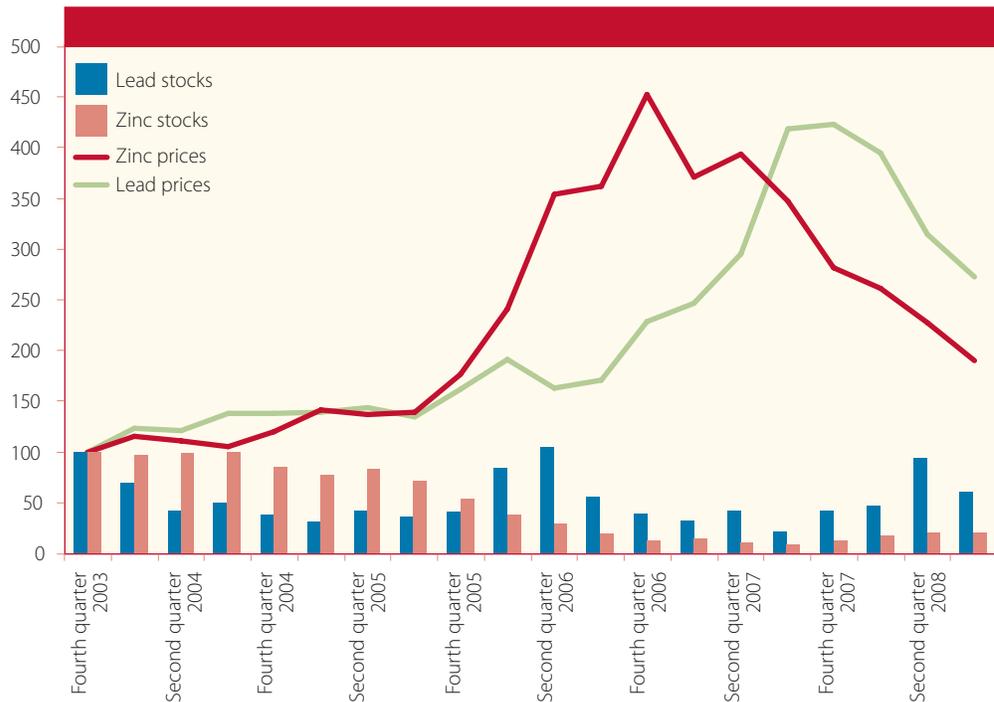
Source: Based on data from Shenggen Fan and Anuja Saurkar, "Tracking agricultural spending for agricultural growth and poverty reduction in Africa", *Regional Strategic Analysis and Knowledge Support System*, Issue Brief No. 5, available from <http://www.resakss.org/publications/Expenditure%20trends%20brief.pdf>.

Figure II.3
Surplus or deficit of global production over usage for lead and zinc, 1996-2007



Source: International Lead and Zinc Study Group, available from www.ilzsg.org/static/statistic.aspx?from=1 (accessed on 15 November 2008).

Figure II.4
Inventories and prices of lead and zinc,^a fourth quarter of 2003–second quarter of 2008



Source: London Metal Exchange.

^a Average quarterly cash prices (percentage of fourth quarter 2003 prices) and end of quarter inventories of lead and zinc (per cent of end 2003 inventories).

Since LME inventories are stocks of last resort, a severe decline in these stocks is possibly the best indicator of an acute physical shortage. Other metals have followed similar paths, commonly with a price peak around the time when inventories were at their lowest, followed by declines in prices as production caught up and inventories started to accumulate.

Developments regarding agricultural products have been roughly similar, although, after speculative forces, the explanation of price fluctuations lies in large part in supply-side factors. Among these are weather conditions—in the short term—and policy neglect, lack of long-term infrastructure and capacity investment, and insufficient technological innovation, in the longer term. An apparently relevant factor affecting both the demand and supply of agricultural products was the continuous rise of the dollar price of oil, which raised costs of production and transportation, on the one hand, and influenced substitution for biofuels on the other. It is not coincidental that some countries have resorted to export controls or bans to ensure adequate food supplies for their own populations, and this may have exacerbated price pressures. Such export restrictions were a response to the ongoing surge in prices rather than the initial cause.

According to data from the International Grains Council,⁵ after two years of production deficits and a year of relative balance between supply and demand in 2007/08, global *grains* stocks should remain unchanged in 2008/09, at 281 million tons, owing mainly to good harvests. At the same time, world trade in grains is expected to fall as the global economy slows. It is likely, therefore, that the decline in prices observed in the second half of 2008 will continue in the near future.

The decline in the prices of most grains, beverages and vegetable oils will continue as the global economy slows

⁵ International Grains Council, *Grain Market Report*, GMR No. 383, 30 October 2008; and, GMR No. 380, 31 July 2008.

The *tropical beverage* price index, which had increased steadily until mid-2008, declined thereafter (figure II. 2). In real terms, present price levels will remain well below the pre-crisis level in the immediate outlook. This will have severe implications for coffee growers, for example, prompting calls for the putting in place of compensatory mechanisms in Colombia and Brazil, which will perhaps be followed elsewhere.

The *vegetable oils* and *oilseeds* price index rose by almost 174 per cent between January 2006 and June 2008, partly owing to the indirect effect of increased production of biofuels which competed for agricultural inputs and capital utilization. However, prices fell by 30 per cent between June and September 2008, along with falling prices of fossil fuels and most basic grains.

Developments in agricultural raw material prices were dominated by price increases for *cotton*. With a price average of \$75.8 per pound over the first six months of 2008, the Cotlook 'A' index increased by 30 per cent compared with its level in January 2006. Nominal prices surged to levels not recorded since 1997. Between June and September 2008, however, cotton prices fell by 4.5 per cent, following the trend in other commodity prices, albeit less dramatically. World production contracted by 5 per cent in 2008 compared with the preceding year, in particular on account of a sharp decline (of 25 per cent) in production in the United States. Global demand for cotton increased by 1 per cent, leading to a tightening of the market. The price of *natural rubber* rose by 73 per cent from January 2006 to June 2008, mainly influenced by rising petroleum prices which drive the price of *synthetic rubber*. Declining *oil* prices pushed down the prices of natural and synthetic rubber by 10 per cent between June and September.

The prices of most *minerals, ores* and *metals* increased during the commodity price boom, although they peaked at different times. The prospect of a worldwide recession depressed prices in the second half of 2008 as projections for demand fell well short of current capacity. This does not take into account the capacity that is scheduled to enter operation in response to recent high prices. The outlook for next year for most minerals is that supply will exceed demand, allowing a build-up of inventories from present low levels and contributing to a fall in prices. The situation with regard to *gold* may perhaps be different. Prices in 2008 remained at historically very high levels, about \$800 per ounce, owing in part to its use as a safe storage of wealth in times of economic and currency turmoil. A decline in the course of the second semester of 2008 may be mainly explained by a contraction in consumption demand, especially in the jewellery market, where demand fell by 24 per cent year over year in the second quarter of 2008. In addition, China became the largest gold-producing country in 2007 with a total production of 276 tons, outstripping South Africa's 272 tons. The extent to which the decline in the price of gold was also triggered by "margin calls" is uncertain, however, and thus it remains unclear whether, in the near future, gold will regain its privileged character of wealth storage as the financial crisis deepens.

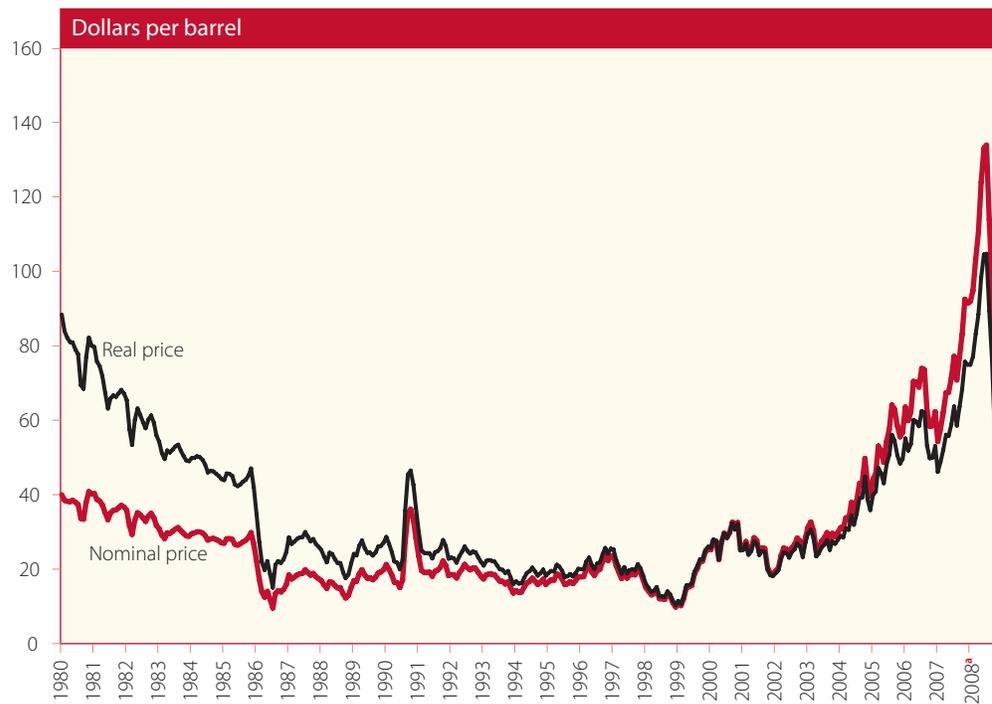
Cheaper derivatives of petroleum will win over natural fibres

Prices of most metals peaked between 2007 and mid-2008

Crude oil: the turnaround that was to be expected in a global slowdown

Oil prices were on a roller coaster ride throughout 2008 until the global commodity boom came to an abrupt end in the summer. The price of Brent crude, which stood at about \$100 per barrel (pb) in early January, rose to an all-time high of \$145 pb in July before dropping sharply to \$60 pb in November (see figure II.5). As was the case with other commodities, the surge in oil prices during the first half of 2008 reflected both a tight balance between supply and demand and increased speculation and herding behaviour.

Figure II.5
Nominal and real Brent crude oil prices, 1980-2008



Source: UN/DESA, based on IMF International Financial Statistics CD-ROM, November 2008.

Note: United States consumer price index was used as the deflator for the nominal price of Brent oil.

a Partly estimated.

Demand conditions explain to a great extent the fluctuations in the price of oil price

Fundamental conditions included fast-growing oil demand in transition and developing countries, weak supply from oil-producing countries that are not members of the Organization of the Petroleum Exporting Countries (OPEC), and geopolitical concerns. The upward price movement was reinforced by speculative activities, mostly in future markets, as investors built positions in anticipation of further price increases. In addition, speculative buyers used oil and other commodities as a hedge against inflation and a weakening United States dollar, pushing prices further in a self-propelling upward spiral.

This process went into reverse around the middle of July 2008 when concerns about slowing demand from developed countries coincided with rising supply in a larger number of oil-producing countries (more than offsetting declines in some others) and the depreciation of the dollar ended abruptly, for the reasons explained in chapter I. As the financial crisis in the United States deepened in September 2008 and increasingly spread across the globe, the oil-price decline accelerated, while daily prices became increasingly volatile. In October, international crude oil prices registered their biggest monthly drop ever as expectations mounted that a severe global economic downturn would sharply reduce demand for oil in 2009. Prices continued to slide even when OPEC decided to lower production considerably in late October and announced further cuts in subsequent months. Despite the steep decline in the second half of 2008, the price of Brent crude averaged \$101 pb for the year as a whole, almost 40 per cent above the average annual price of \$72.5 pb in 2007.

World demand for oil stagnated in 2008, caused by offsetting trends: falling demand in developed countries and rising demand in developing countries

The high average price of oil and the significant slowdown in global economic growth kept world oil demand flat in 2008, averaging 86.1 million barrels per day (mbd). Robust growth in demand by developing and transition economies offset a substantial contraction in the developed countries, particularly in the United States, where yearly oil demand saw its biggest fall since 1982.

Oil demand in the developed countries fell by approximately 3 per cent in 2008 as consumers faced sharply higher energy bills in the first half of the year and a severe economic downturn in the second. The United States, which currently accounts for 22 per cent of total world demand, registered the largest decline among developed economies, with demand for crude oil dropping by about 5 per cent as gasoline prices rose, increasing by 35 per cent between January and July. Oil demand in Europe continued its downward trend in 2008, mostly owing to shrinking demand for transportation fuels in the large economies of the EU. Demand for gasoline dropped sharply during the summer months in Germany, France, Italy, Spain and the United Kingdom, as very high retail prices and slowing economic growth reinforced the structural decline. Oil demand in the Pacific region decreased in 2008 for the third consecutive year as a result of weak gasoline and diesel demand in Japan.

However, in developing and transition economies, oil demand continued to expand significantly in 2008, growing on average by 3.8 per cent. All regions registered increasing demand owing to continuing robust, albeit slowing, economic growth. As in previous years, demand for transportation fuels rose sharply in China, India and Western Asia. Total oil demand increased by about 6 per cent in China and Western Asia, by almost 5 per cent in India, and by approximately 4.5 per cent in Latin America and the Caribbean. Soaring international fuel prices had only a limited effect on demand as price controls and subsidies in many developing countries continued to shield consumers partially from the cost increases. However, a number of South and East Asian countries, including China, Indonesia, Malaysia and Taiwan Province of China, cut fuel subsidies during 2008 to reduce the burden on the fiscal budget.

Global oil supply averaged 86.4 mbd in 2008, representing an increase of 0.9 per cent over average supply in 2007. This increase was entirely due to higher production by OPEC member countries during the first three quarters of the year (and despite more recent supply reductions). Non-OPEC supply, by contrast, remained virtually unchanged in 2008 as declining output in Mexico and Europe was compensated by higher production (which included liquid gas and biofuels as well as crude oil) in Brazil, China and the United States.⁶ Overall, weakness in non-OPEC supply could have been a key factor behind the surge in prices during the first half of 2008. Given rapidly growing demand in developing countries and constrained non-OPEC production, OPEC increasingly gained control over marginal supply. This sparked fears among market participants that future supply shortfalls would lead to further price hikes. However, as the financial crisis hit developed economies, these fears gave way to more short-term concerns of faltering demand.

After increasing quotas in the last quarter of 2007, OPEC left them unchanged during the period in which oil prices surged between January and July 2008, despite mounting pressure from major oil-importing countries to increase them. New members, Angola and Ecuador, which joined OPEC in 2006 and 2007, respectively, had formal quotas assigned to them from January 2008 onwards, whereas Iraq continued to be exempted from the quota system.⁷ Actual production—including all three of these countries—fluctuated somewhat during the first part of the year, primarily as a result of production outages in Iraq and Nigeria. From May onwards, as oil prices spiralled upwards, the largest producer in OPEC, Saudi Arabia, raised its output steadily. In July 2008, Saudi Arabian production increased by 0.6 mbd since April to 9.7 mbd, its highest level since 1981, and

Increases of supply by OPEC countries in 2008 compensated shortfalls by non-OPEC oil exporters

⁶ In assessing the supply and demand for oil to illustrate price fluctuations, the convention of the International Energy Association is to include both natural gas liquids and biofuels.

⁷ Ecuador had previously been an OPEC member, having become an oil exporter in the early 1970s, but it left the cartel in 1985 and rejoined in 2007.

about 8 per cent above its quota. As a result, total OPEC production reached a high of 37.7 mbd in July, when oil prices peaked. As the global economic outlook increasingly deteriorated and oil prices fell rapidly, OPEC members decided in September 2008 to return to the agreed quotas, mainly putting pressure on Saudi Arabia to lower output. However, prices continued to decline sharply in October, forcing OPEC to reduce quotas and cut production by a total of 1.5 mbd as of November 2007.

The upward price spiral has ended with the financial crisis and may be on a further downward path with the global slowdown

The oil market outlook for 2009 essentially depends on how deep and long the economic slowdown in major oil-consuming countries will be. The developed economies in particular, which account for the lion's share of global demand for energy, will be facing recession. Net oil-importers among emerging economies will experience a marked slowdown. In the baseline scenario, total oil demand in developed economies is expected to decline by about 3 per cent in 2009, similar to the rate in 2008. Since Japan, the United States and all large European economies have entered into recession, oil demand will remain subdued even though consumers face significantly lower prices for retail gasoline, diesel and heating oil. Meanwhile, oil demand growth in developing and transition countries is anticipated to slow down to about 3 per cent owing to decelerating economic growth in all regions.

Price falls and defensive supply cuts will act as disincentives to long-term investments

With global demand slowing and oil prices continuing to fall despite lower production, OPEC is likely to reduce supply further in 2009. Average OPEC output in 2009, including natural gas liquids (NGLs), is forecast at 36.1 mbd, almost 3 per cent below the average in 2008. This compares to expectations of slightly increased production in non-OPEC countries, where several new project start-ups are expected to bring total average output to 50.2 mbd. Based on experience in previous years, downward risks to production remain in a number of OPEC and non-OPEC countries. Actual output may fall short of target levels owing to accidents, technical problems, political unrest, security challenges or weather-related outages. It is plausible that increasingly low international oil prices may come close to or below marginal costs of production for many new projects, thus placing supply in jeopardy in the medium term. Output from existing fields is declining at a rapid pace; hence, global oil supply will depend fundamentally on exploration and production from new fields. This will require massive investments by private and public oil companies over the coming years and is likely to lead to upward pressure on prices in the medium- and long-run.

Given these expected shifts in demand and supply, during 2009 the price of oil is expected to fall back to levels seen in 2006. In the baseline scenario, oil demand is anticipated to decline slightly to 85.8 mbd and the average price of Brent crude is forecast at \$64 pb on average for the year 2009. If a more pessimistic global growth scenario plays out, prices could fall well below that level. On the other hand, if the world economy bounces back in the second half of 2009, oil prices will likely start rising again. Much uncertainty surrounds these prospects and, consequently, the price of oil is expected to remain highly volatile in the outlook.

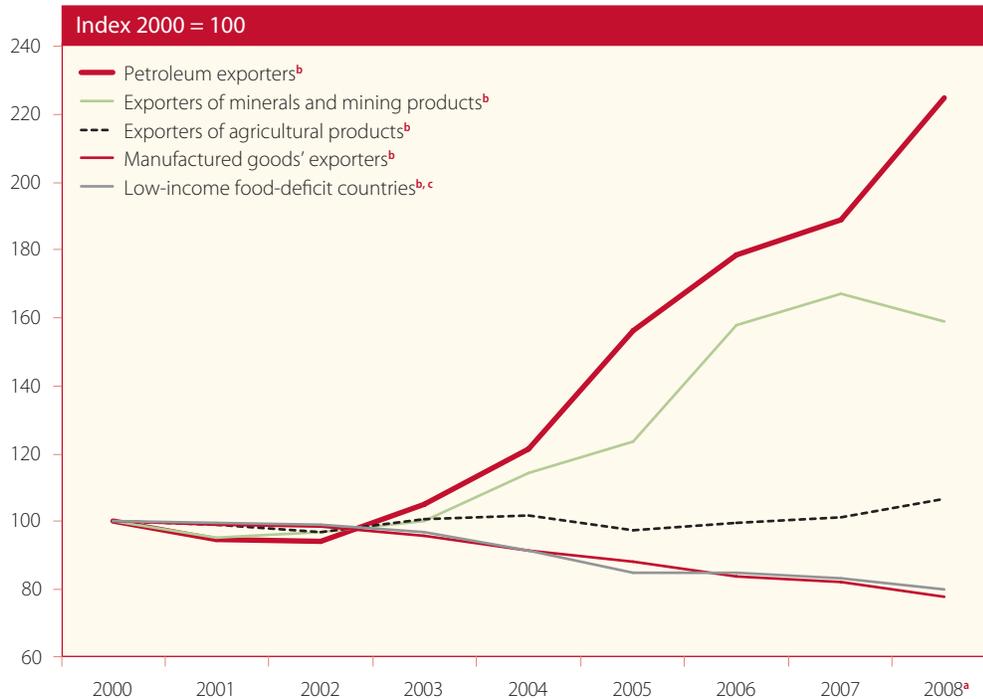
Terms of trade for developing countries and economies in transition

Main energy and primary exporters benefited from net terms-of-trade gains in 2008

As discussed above, during 2008, most commodity prices experienced sharp changes, with abrupt rises in the first part of the year followed by falls in the second half. By the end of 2008, world market prices of most primary products had dropped below levels posted at the beginning of the year. In the case of oil and most mining and food products, however, average prices for 2008 remained above those of 2007. Because of the importance of these

commodities in their trade, many primary exporters experienced, on balance, terms-of-trade gains in 2008, with significant gains for net oil exporters in particular (figure II.6).

Figure II.6
Terms of trade by trade structure, 2000-2008



Source: UNCTAD, *Trade and Development Report 2008* and UNCTAD Commodity Price Statistics.

^a Partly estimated.

^b Selection of developing and transition economies (see UNCTAD, *Trade and Development Report 2008*, chapter 2, section 2).

^c Excluding fuel, minerals and mining exporters.

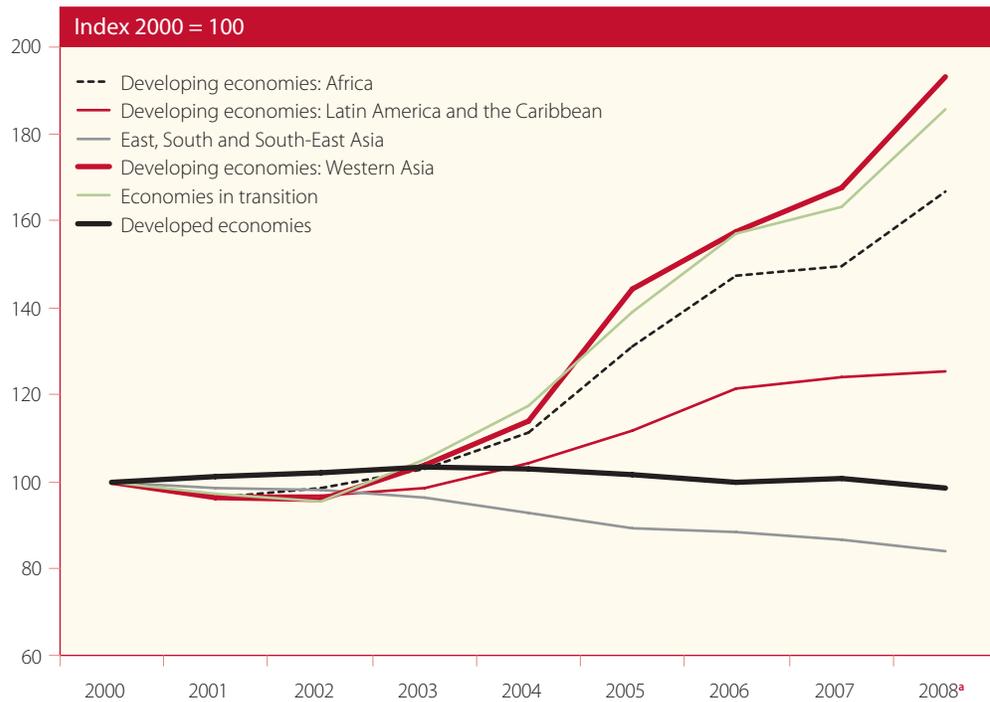
Regions with a large weight of oil in total exports recorded sizeable gains in their terms of trade in 2008, as was the case in Western Asia, the economies in transition and Africa (figure II.7). Exporters of agricultural products also saw their terms of trade improve as the skyrocketing food prices in the first half of the year were not fully offset by the subsequent fall. Most exporters of mineral and mining products, in contrast, saw their terms of trade decline somewhat on average for the year as a consequence of the sharp reversal in the prices of metals and minerals and because many of these economies are also net importers of oil and food.

Developing countries relying on exports of manufactures, particularly those in East and South Asia, registered a further deterioration in their terms of trade, as they were affected by higher prices of oil, food and some industrial raw materials of which they are net importers. The low-income countries that are net importers of food and do not export oil or mining products also experienced a significant deterioration in their terms of trade in 2008. The terms of trade of the developed countries, in contrast, are not greatly affected by the sharp swings in commodity prices and have undergone only very small changes in recent years. This is mainly due to the fact that the bulk of both their imports and exports comprise manufactured goods.

Most of these trends in the terms of trade are likely to be reversed in 2009, as the sharp correction in commodity prices resulting from the global financial crisis and the economic slowdown become fully reflected in annual data. Price declines for oil and minerals and metals should lead to a reduction in the terms of trade of developing countries which export these products, while food- and fuel-importing countries should find some relief from the softening in agricultural and energy prices.

Exporters of manufactures in East and South Asia faced further deteriorating terms of trade

Figure II.7
Terms of trade by region, 2000-2008



Source: UNCTAD, *Trade and Development Report 2008* and UNCTAD Commodity Price Statistics.

a Partly estimated.

Volatile terms of trade are damaging to long-term growth and development

Improved compensatory financing mechanisms are needed to support countries coping with large terms-of-trade shocks

Terms of trade can be very volatile in countries where the structure of exports differs considerably from that of imports. Fluctuations are especially strong in countries with high export concentration in a few primary products as this causes large swings in their external balances, income growth and employment. Commodity price volatility tends to affect investment and production planning of both sellers and buyers adversely and complicates the macroeconomic management of economies that are highly vulnerable to such instability. Renewed efforts at the domestic and international levels to mitigate the pass-through effects of world market volatility onto the domestic economy can therefore contribute to long-term growth and development, especially in low-income countries.

In the past, attempts have been made to support producers in coping with global price fluctuations through price stabilization funds. In the present-day context, securing new international price stabilization mechanisms has low political feasibility. Stricter regulatory measures that help prevent excessive speculation on commodity markets could be a more feasible step in the short run for stemming price volatility. As discussed in chapter I, improvements in available compensatory financing mechanisms are also needed to help low-income countries cope with commodity price shocks, provided such mechanisms allow for swift disbursements and are free of the sometimes onerous policy conditionality attached to existing mechanisms. Such mechanisms could also contribute to the creation of more space for national Governments to implement counter-cyclical macroeconomic policies. Countries should consider further strengthening institutional arrangements, such as stabilization funds, in order to smooth domestic development spending from export gains over time.⁸

⁸ For a more detailed discussion of the problem of instability in commodity markets, see United Nations Conference on Trade and Development, *Trade and Development Report 2008*, op.cit., chapter 2.

Trade policy developments: dealing with multilateral negotiations in the midst of financial and food crises

After nine days of intense negotiations at the ministerial level, the Doha Round broke down once again at the end of July. Some measure of convergence had been achieved with respect to both the agricultural and the non-agricultural market access (NAMA) components of the negotiations, but the remaining differences proved unbridgeable. In the crucial area of agriculture, of a “to-do list” of 20 issues, 18 had seen some narrowing of positions. On one issue, the special safeguard mechanism (SSM)—which would allow developing countries to raise tariffs on agricultural products temporarily in order to deal with import surges and price falls—there was a clear divergence between developed countries (led by the United States) and others (led by India) on the so-called “trigger” (the size of the import surge needed to trigger the tariff increase). Developing countries expected a low trigger (above the base import volume) in order to safeguard their domestic producers, while developed countries wanted the trigger to be as high as possible to avoid abuse of the safeguard.

The difficulty in dealing with the special safeguard scheme was, however, not the sole reason negotiations collapsed;⁹ rather, the breakdown appears to have reflected more deep-seated policy concerns among developing countries about the direction the Doha Round had taken, as well as fresh worries related to the state of the world economy.

The structural weaknesses, evident in the stop-and-start history of the Doha Round since its inception in 2001, refer to persistent concerns among developing countries related to their not being allowed to define the Round’s development content, as originally envisaged in the Doha Ministerial Declaration and subsequently agreed ministerial texts. This revived memories of the Uruguay Round negotiations which, despite the promises at the time, finally came to be viewed as a lopsided bargain. Such unease surfaced relatively early on in the process, particularly in academic and civil society circles, leading to political controversy over the treatment of such issues as cotton subsidies as well as over the perceived neglect of a series of development-related issues which were either left outstanding at the end of the Uruguay Round or became apparent during its implementation.¹⁰ More recently, in July 2007, the Secretary-General of UNCTAD proposed five key objectives

The failure to complete the Doha Round reflects deep-seated differences in policy concerns between developing and developed countries

Key concerns are to preserve the intended development content of the Doha Round

⁹ This was the conclusion of Ambassador Crawford Falconer, Chairman of the Agricultural Committee of the WTO, in his assessment of the breakdown of the WTO Trade Negotiating Committee. In particular, he noted that in any subsequent effort to revisit the SSM, “we must recognize that it was not, for any of the participants involved (and those participants include Members that were not in the G7, it should be added), a purely technical breakdown. It was a political divide. In fact there was progress made on it politically, and technically, during that week. But it was simply not sufficient to bridge a political divide that had been enduring since at least Hong Kong. So, illusion number one to guard against is that it can be resolved essentially technically”. See “Report to the Trade Negotiations Committee by the Chairman of the Special Session of the Committee on Agriculture, Ambassador Crawford Falconer”, WTO Committee on Agriculture Special Session, JOB(08)/95, 11 August 2008.

¹⁰ For example, at the 2004 Annual Bank Conference on Development Economics of the World Bank, Professor Gerry Helleiner argued that “it is more important for the WTO and other rules systems to be broadly fair and acceptable, however long it may take to get them right, than to rush to further liberalization as interpreted by major economic powers. If the current round of WTO negotiations fails it will not necessarily be, as some suggest, a disaster for development”, as cited in C. Raghavan, “Even patched-up, procedural deal in Hong Kong will be worse than failure”, *South-North Development Monitor*, No. 5935, 13 December 2005.

that needed to be attained for the Doha Round to realize its development promise. As reported in *World Economic Situation and Prospects 2008*, these objectives embraced critical issues such as real market access for developing countries' exports of goods and services; improvements in multilateral trade rules to address existing asymmetries between developed and developing countries; adequate policy space for developing countries to align trade agreements with national development strategies and to allow a more effective special and differential treatment of developing countries; "development solidarity" in meeting the implementation costs implied in the adjustments that developing countries would be required to undertake; and coherence between regional and multilateral trade agreements. Failure to make real headway on these counts would appear to go a long way in explaining why the negotiations could not reach a successful and balanced conclusion.¹¹

The food crisis and the global financial crisis have increased concerns about appropriate trade policy strategies for developing countries

In addition, the critical situation of the world economy at the time of the July 2008 ministerial meetings may also have acted as a further constraint. There were already clear signs, particularly in the United States, that financial markets had become fragile, with potentially catastrophic consequences for all countries if a crisis were to break and spread to the real economy. The July ministerial meetings also coincided with growing concerns in many developing countries about their food and energy security. In addressing them, some net importers of grains were overwhelmed by the skyrocketing costs of food subsidies, while many food producers introduced new export restrictions to enhance national food security. It hardly seems surprising, therefore, that one of the stumbling blocks leading to the halt of negotiations related to provisions allowing developing countries to temporarily increase tariffs on agricultural products in times of economic and social difficulty.¹² It is also not surprising, therefore, that the WTO ministerial meeting scheduled for December 2008 was cancelled, as positions had not changed and no progress in the negotiations was to be expected.

Now, the overriding issue for trade negotiators is the financial crisis that has already caused economic problems in advanced countries and is rapidly spreading to developing countries. There is growing recognition that global financial conditions weigh heavily in shaping trade patterns. Therefore, the financial architecture should not be set aside from trade negotiations. In particular, it has become evident, as discussed earlier, that unregulated finance in a global setting has also expressed itself through commodity and currency speculation, leaving countries totally unprotected in a largely liberalized trading system.

The current context calls for a more integrated approach to regulating both trade and finance

Hence, the present circumstances call not only for meaningful reforms of the institutional arrangements that emerged from Bretton Woods to address new threats to global economic stability but also for a more integrated perspective on the reform agenda which would move beyond the false dichotomy between trade and finance issues. Regulating trade and finance should be considered jointly. Moreover, a proper, fair and well-regulated system of global finance and currency exchanges has to be in place for develop-

¹¹ Again, the remarks of Ambassador Crawford Falconer are telling: "But our task does not begin and end with SSM. I need only mention Cotton—one of the other three or four potential deal-breakers, which was not at all seriously addressed before things broke down with SSM. There is tariff quota creation. There is tariff simplification. Yes, one might well take the view that these can fall into place. But we also have to actually make that happen. And, while one might well rightly have held the view that key elements elsewhere were essentially on the brink of resolution, not all of those affected were in the room, and that would have needed further effort to ensure finalisation." See WTO Committee on Agriculture Special Session, *op. cit.*

¹² For a detailed review of the WTO negotiations, see, for example, International Centre for Trade and Sustainable Development, *Bridges Weekly Trade News Digest*, vol. 12, No. 27, 7 August 2008.

ment concerns truly to become the centre of multilateral trade negotiations. This was well understood by the original architects of the Bretton Woods system. John Maynard Keynes explicitly argued for such a comprehensive approach: “Whilst other schemes are not essential as prior proposals to the monetary scheme, it may well be argued, I think, that a monetary scheme gives a firm foundation on which the others can be built. It is very difficult while you have monetary chaos to have order of any kind in other directions... [I]f we are less successful than we hope for in other directions, monetary proposals instead of being less necessary will be all the more necessary. If there is going to be great difficulty in planning trade owing to tariff obstacles, that makes it all the more important that there should be an agreed orderly procedure for altering exchanges... [S]o far from monetary proposals depending on the rest of the programme, they should be the more necessary if that programme is less successful than we all hope it is going to be”.¹³

At this critical juncture, as policymakers seek a stable and efficient system for global finance, it is important that it not be separated from the goal of a fair and inclusive system for international trade which allows for the full participation of developing countries in line with their development objectives and potential. Devising a coherent, rule-based and authentically multilateral international system requires an integrated approach. Given the open channels between the international trade, financial and banking systems, a truly global, cooperative and non-partisan approach to tackling the most important issues, such as commodity and currency speculation, must be found. But developing countries have only a limited voice in international financial institutions. The global institution that possesses the most credibility for implementing such an approach is therefore, more than ever, the United Nations. The Member States of the United Nations recognized the need for a more integrated approach of that nature and for better coordination among the institutions on global economic governance at the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha from 28 November to 2 December 2008. The outcome document calls for a “review of the international financial and monetary architecture and global economic governance structures in order to ensure a more effective and coordinated management of global issues. Such a debate should associate the United Nations, the World Bank, IMF and the World Trade Organization, should involve regional financial institutions and other relevant bodies and should take place in the context of the current initiatives aimed at improving the inclusiveness, legitimacy and effectiveness of the global economic governance structures”.

The United Nations is in a privileged position to support an inclusive process for revisiting the state of global trade and finance issues

¹³ J. M. Keynes, “Letter to Lord Addison, May 1944” in *The Collected Writings of John Maynard Keynes*, Volume XXVI: Activities 1941-1946, Shaping the Post-War World, Bretton Woods and Reparations, ed. Donald Moggridge (London: The MacMillan Press. Ltd., 1980), pp. 5-6.

Chapter III

Financing for development

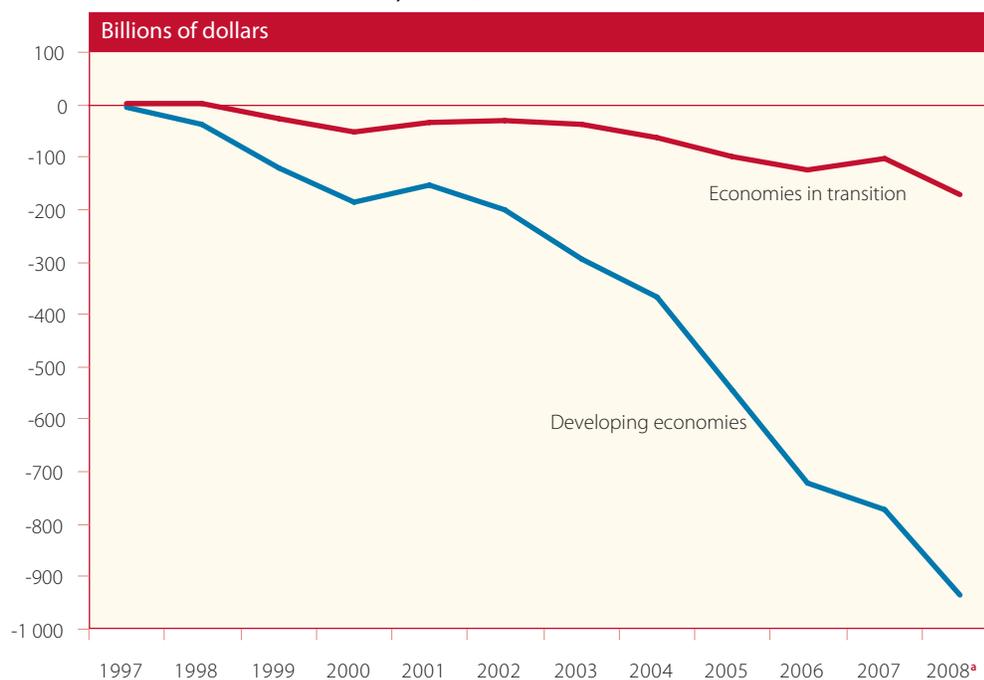
Net resource flows from poor to rich countries

Amidst the unfolding global financial crisis, developing countries continued to make increasing substantial net outward transfers of financial resources to developed countries, reaching an all-time high of \$933 billion in 2008 (see figure III.1 and table III.1). After a moderation in the rate of increase in 2007, outward transfers increased more rapidly again in 2008. Net financial transfers are defined as net financial inflows less net factor and investment income payments to abroad which have become increasingly negative, implying resource flow out of developing economies. This trend has been continuing for over a decade.

Much of the increase in the outflow during 2008 was concentrated in Western Asia and Africa, as the economies in these regions generated increasing trade surpluses, largely owing to the surge in oil and commodity prices in the first half of the year. As capital inflows also remained relatively strong up until the third quarter of the year, these regions were able to further increase international reserve positions in the aggregate. Net transfers from countries with economies in transition also increased, from \$101 billion in 2007 to \$171 billion in 2008, owing mainly to the strong increase in the trade surplus of the Russian Federation. In contrast, in Latin America and the Caribbean and East and South Asia, net outward transfers declined in 2008 as a consequence of the financial turmoil, leading to a significant reduction in private capital flows from the third quarter of the year onwards.

Net resource outflows from poor to rich developing countries reached an all-time high in 2008

Figure III.1
Net financial transfers to developing countries
and economies in transition, 1997-2008



Source: Table III.1.

Note: Net financial transfers are defined as net capital inflows less net interest and other investment income payments abroad.

^a Partly estimated.

Table III.1
Net transfer of financial resources to developing economies and economies in transition, 1996-2008

Billions of dollars													
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
Developing economies	20.6	-4.1	-37.6	-118.9	-185.4	-154.5	-200.3	-295.8	-365.4	-545.4	-720.8	-773.3	-933.4
Africa	-8.4	-7.0	13.0	2.5	-31.4	-16.6	-5.1	-19.6	-36.4	-64.7	-78.8	-67.0	-125.9
Sub-Saharan Africa (excluding Nigeria and South Africa)	5.2	7.0	11.9	9.1	3.0	7.2	4.5	5.8	2.5	0.3	-8.4	-6.0	-28.6
East and South Asia	18.9	-31.1	-128.0	-137.2	-119.8	-116.5	-145.0	-170.4	-177.7	-254.7	-375.2	-485.9	-431.9
Western Asia	10.6	11.5	34.2	6.7	-31.4	-24.4	-19.7	-44.0	-70.7	-136.7	-158.0	-144.9	-315.6
Latin America and the Caribbean	-0.5	22.4	43.1	9.1	-2.8	3.0	-30.4	-61.8	-80.6	-89.4	-108.8	-75.5	-60.0
Economies in transition	-8.7	1.6	0.7	-25.1	-51.5	-33.2	-28.6	-39.2	-63.3	-100.7	-124.6	-101.1	-171.2
Memorandum item:													
Heavily indebted poor countries (HIPC)	6.7	7.1	8.5	10.5	8.2	8.9	12.4	10.1	12.8	14.4	12.8	21.6	26.1
Least developed countries	11.5	10.1	13.5	11.5	6.6	9.7	9.6	8.9	8.1	3.3	-5.4	-4.3	-22.3

Sources: UN/DESA, based on IMF, World Economic Outlook Database, October 2008; and IMF, Balance of Payments Statistics.

Note: The developing countries' category does not include economies in transition; hence, data in this table may differ from those reported for country groupings reported in the IMF sources.

a Partly estimated.

The unwinding of imbalances will affect net flows of financial resources

The effects of the financial turmoil are expected to be felt even more strongly and more widely in 2009, not only through withdrawals of capital from emerging markets, but also through a significant slowing of export prospects as the global economy decelerates. Countries will face lower external surpluses in some cases or wider external deficits in others and will increasingly draw on international reserves. The emerging markets will be hit most directly through financial channels, propelled by declining investor sentiment, which has already led to an unwinding of carry trades. The sell-off in high-yielding currencies and emerging market equities is evidence not only of a broad-based risk aversion among investors but also of weakening growth prospects in the emerging economies. Low-income countries will feel the consequences of the crisis more significantly through trade channels. How strongly this will influence the pattern of net financial transfers will depend on the prospects for private capital flows, official development assistance (ODA) and debt relief, as discussed in the following sections.

Private capital flows to developing countries

Developing countries continued to attract private capital flows until the second quarter of 2008

Developing countries have been attracting high and growing levels of private capital flows (see table III.2) since 2002, and this trend continued until the end of the second quarter of 2008. With the exception of net portfolio investments, all components registered significant gains.

Given the significant change in financial conditions facing developing countries since the beginning of the third quarter of 2008, the ability of a number of them to raise capital has become severely compromised. The current financial turmoil is unlike any other in over three decades. In distinct contrast to the Latin American debt crises of the 1980s and the East Asian financial crises in the late 1990s, financial distress has been

Table III.2
Net financial flows to developing countries and economies in transition, 1995-2009

Billions of dollars							
	Average annual flow		2005	2006	2007	2008 ^a	2009 ^b
	1995-1998	1999-2004					
Developing Countries							
Net private capital flows	148.3	79.6	141.7	86.0	379.1	391.1	135.3
Net direct investment	113.0	145.8	207.6	179.7	298.4	350.6	312.7
Net portfolio investment ^c	51.5	-20.3	-23.6	-122.6	47.4	-11.9	-100.7
Other net investment ^d	-16.1	-45.9	-42.2	29.1	33.5	52.6	-76.4
Net official flows	10.7	-15.4	-87.4	-125.1	-133.5	-149.1	-129.5
Total net flows	159.0	64.1	54.3	-39.1	245.7	242.0	5.7
Change in reserves ^e	-70.4	-206.0	-490.6	-609.1	-1054.3	-1123.7	-809.4
Africa							
Net private capital flows	7.5	5.4	29.2	36.8	42.6	52.3	70.0
Net direct investment	5.1	16.7	29.1	29.2	43.9	45.9	47.2
Net portfolio investment ^c	4.7	0.0	4.6	18.6	15.0	5.1	9.5
Other net investment ^d	-2.3	-11.3	-4.5	-10.9	-16.1	1.6	13.5
Net official flows	2.3	0.6	-6.1	-17.8	-2.1	5.0	2.6
Total net flows	9.8	6.1	23.2	19.0	40.5	57.4	72.6
Change in reserves ^e	-7.0	-14.9	-63.2	-76.8	-85.9	-145.1	-116.3
East and South Asia							
Net private capital flows	54.5	45.5	90.8	43.8	155.5	277.6	8.6
Net direct investment	55.8	64.1	105.0	96.2	159.7	223.9	180.5
Net portfolio investment ^c	17.8	-2.3	-9.3	-110.7	13.9	-25.3	-108.4
Other net investment ^d	-19.1	-16.3	-4.9	58.3	-18.1	79.1	-63.5
Net official flows	1.5	-6.7	-20.9	-21.8	-37.4	-10.2	-19.4
Total net flows	55.9	38.8	69.8	22.0	118.1	267.4	-10.8
Change in reserves ^e	-44.9	-165.7	-301.8	-386.9	-684.0	-780.7	-562.1
Western Asia							
Net private capital flows	18.4	-3.4	-16.4	-4.1	83.6	-32.0	-24.2
Net direct investment	6.1	7.7	21.2	26.9	15.3	7.1	14.2
Net portfolio investment ^c	2.2	-10.3	-24.1	-17.1	-14.0	-14.7	-20.4
Other net investment ^d	10.1	-0.8	-13.5	-13.9	82.3	-24.4	-17.9
Net official flows	-0.8	-16.0	-29.5	-66.9	-94.0	-146.3	-114.9
Total net flows	17.6	-19.4	-45.9	-71.0	-10.4	-178.3	-139.1
Change in reserves ^e	-9.1	-16.5	-91.8	-95.9	-153.5	-123.9	-110.7
Latin America and the Caribbean							
Net private capital flows	67.9	32.0	38.1	9.5	97.4	93.2	80.8
Net direct investment	46.0	57.4	52.3	27.3	79.5	73.7	70.8
Net portfolio investment ^c	26.8	-7.8	5.1	-13.4	32.6	23.1	18.6
Other net investment ^d	-4.9	-17.6	-19.3	-4.4	-14.6	-3.6	-8.6
Net official flows	7.8	6.6	-30.8	-18.6	0.0	2.3	2.2
Total net flows	75.6	38.7	7.2	-9.1	97.4	95.5	83.0
Change in reserves ^e	-9.4	-8.9	-33.8	-49.5	-130.8	-74.0	-20.3

Table III.2 (cont'd)							
	Average annual flow		2005	2006	2007	2008 ^a	2009 ^b
	1995-1998	1999-2004					
Economies in transition							
Net private capital flows	-1.1	5.6	42.9	73.1	141.6	41.2	51.5
Net direct investment	5.4	8.2	15.3	29.6	35.8	37.2	47.0
Net portfolio investment ^c	1.4	-0.8	-6.0	12.7	16.5	-0.2	5.7
Other net investment ^d	-7.9	-1.8	33.6	30.8	89.2	4.2	-1.2
Net official flows	0.1	-6.2	-20.0	-29.2	-4.7	-7.0	-3.6
Total net flows	-1.0	-0.7	22.9	43.9	136.9	34.2	47.9
Change in reserves ^e	1.8	-25.5	-80.9	-138.2	-171.7	-131.7	-96.8

Source: IMF, World Economic Outlook Database, October 2008.

- ^a Partly estimated.
- ^b Forecasts.
- ^c Including portfolio debt and equity investment.
- ^d Including short- and long-term bank lending, and possibly including some official flows to data limitations.
- ^e Negative values denote increases in reserves.

exported from the United States to Western Europe, and then to the developing world. While at the onset of the financial crisis net commercial bank lending to emerging market economies was quite stable, despite the weakness in mature credit markets, heightened concerns about the quality of global credit have now affected most developing markets. The deterioration in investor confidence was mainly triggered by the impact of the United States sub-prime mortgage crisis on balance sheets of banks across the global economy, but especially on those in the United States and Europe. With the failure of major financial institutions in developed countries, global interbank funding conditions have deteriorated significantly. As a direct result, emerging market sovereign bond spreads widened dramatically (see chapter I, figure I.5).

The spread on JPMorgan's emerging market bond index (EMBI) broke 800 basis points in October 2008. This spread, which reflects how much more yield investors demand to hold emerging market debt compared to safe haven United States Treasury bills, was the highest since November 2002. Consequently, the cost and availability of financing have become more difficult in emerging economies and asset prices in equity markets in these nations have declined sharply. The latter development is derived in particular from the fact that institutional investors have withdrawn investments from emerging economies to cover margin and redemption calls at home or in other developed country markets (figure III.2).

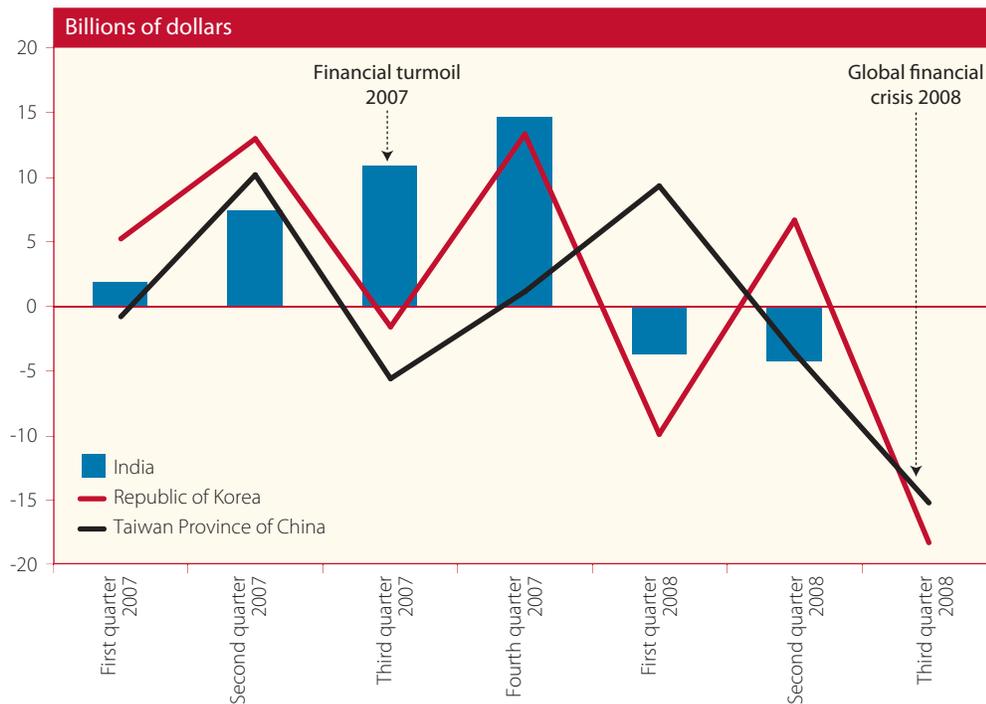
In times of distress, when a country loses access to markets, there is evidence that credit default swap (CDS) spreads are a better indicator of sovereign risk than the EMBI.¹ CDS spreads represent the marginal cost of debt, while a country's EMBI is more representative of the average cost of traded debt. During distress, it is the marginal cost that is often more relevant: although CDS spreads are a derivative of the cash bond market, their volatility and absolute levels may lead to a sell-off in the underlying bonds. This distinction is important since the EMBI has a much greater duration owing to the weighted average of all cash bonds. The CDS spreads for a sovereign bond are usually quoted for no longer than a five-year maturity; hence, their duration is much shorter than for cash bonds.

¹ Manmohan Singh, "Are credit default swap spreads high in emerging markets? An alternative methodology for proxying recovery value", IMF Working Paper, No. 03/242, December 2003.

The interest-rate spread on emerging market debt has increased sharply

Credit default swap spreads are a better sovereign risk indicator in times of distress

Figure III.2
Portfolio investment inflows to selected countries, 2007-2008



Sources: Balance-of-payment data from national central bank websites.

Table III.3
Credit default swap spreads and annual probabilities of default in selected emerging market countries, 31 December 2007 and 23 October 2008^a

	Credit default swap (annual probabilities of default)	
	31 December 2007	23 October 2008
Brazil	103 (1.3)	571 (6.3)
Hungary	57 (0.7)	574 (6.4)
Korea, Republic of	47 (0.6)	620 (6.8)
Mexico	70 (0.9)	580 (6.4)
Russian Federation	86 (1.1)	1 056 (10.1)
Turkey	168 (2.1)	777 (8.1)
Ukraine	238 (2.9)	2 535 (16.3)
Venezuela, Bolivarian Republic of	455 (5.2)	2 224 (15.5)

Sources: Deutsche Bank Research, available from <http://www.dbresearch.com> for 2007 data and Bloomberg for 2008 data.

^a Credit default swap spreads in basis points and annual probabilities of default in percentage.

As can be seen from table III.3, at the end of October 2008, the bankruptcy risk of emerging market Governments had increased substantially, compared with very low default probabilities for most of 2007. In our sample, Ukraine has the highest CDS premium (16.3 per cent), followed by the Bolivarian Republic of Venezuela (15.5 per cent) and the Russian Federation (10.1 per cent). These premiums compare with Iceland, for instance, whose Government was the first victim of financial market turmoil in 2008 and

Higher bankruptcy risk in emerging markets ...

is rumored to be on the verge of insolvency, with a default probability trading at 25 per cent in October 2008.

... has led to additional capital outflows

As a result, capital outflows from developing countries have intensified, leading to tighter international and, in some cases, domestic liquidity conditions. The pronounced reduction in investors' appetite for risk has resulted in a retrenchment in short-term capital flows to emerging markets, exerting pressure on local markets, and sharply raising costs of credit.² Together with slowing global growth, this results in a very challenging environment for several developing countries. The Institute of International Finance (IIF) estimates that for a group of 30 emerging markets, net short-term lending (by both banks and non-banks) was \$253 billion in 2007 and \$141 billion in 2008, compared to average annual net inflows of just \$25 billion for the period 1997-2006.³ This is a clear indication that this leaves some emerging markets more vulnerable to a reversal of short-term flows than at any time since 1996. The reversal of short-term interbank flows to both the Republic of Korea and the Russian Federation has been a key source of stress in these two economies.

A number of countries face multiple solvency risks

Another group of countries is facing solvency risks, as they are not only relying heavily on short-term foreign financing to meet large current-account deficits but are also compromised in their policy options, owing to low international reserves and a substantial stock of external debt. At the time of writing, Belarus, Hungary, Pakistan and Ukraine have resorted to the International Monetary Fund (IMF) for emergency loans as they are facing increased debt-servicing problems.

Emerging market currencies have come under pressure from a number of sources

The unwinding of carry trades, which has led to a massive reversal of currency positions out of high-yielding assets in emerging markets back into currencies of developed countries, in particular the Japanese yen, is another indicator that enormous liquidations by international investors have had a widespread impact in the developing world. An enduring credit crunch and a declining global economy have clearly affected several emerging market currencies, even those that are running a large aggregate current-account surplus. A broader group of currencies is suffering as investors have withdrawn money from their markets. Moreover, plunging raw-material prices are weighing on currencies in commodity-producing nations from Latin America and the Caribbean to sub-Saharan Africa to the Russian Federation.

Capital flow reversals make net private capital flows difficult to forecast

Amidst the current turmoil, any forecast of net private flows in 2009 will involve a delicate balancing act, as it will not only be necessary to consider the current stop and reversal in net private flows, but also to make assumptions about a possible recovery in flows that might be expected as the year progresses. The fact that key economic indicators in several developing countries (economic growth, prospective returns and nominal interest-rate spreads) continue to appear more attractive than in mature markets suggests a rebound of the current trend in private flows during 2009. At present, the correction in world markets is characterized by a general flight from risk rather than by economic fundamentals, with equity markets and interbank flows experiencing some of the biggest declines. Farther down the road, the focus of international investors on economic growth differentials between developed and developing countries may reverse this trend, although this will depend on how developing countries are able to stimulate domestic demand to offset weakening foreign demand. In this regard, those developing countries that have large current-account deficits and are financed by short-term financial flows will be the

² International Monetary Fund, *Global Financial Stability Report—Financial Stress and Deleveraging: Macroeconomic Implications and Policy* (Washington D.C.: IMF, October 2008).

³ Institute of International Finance, report on "Capital flows to emerging market economies", 12 October 2008.

most vulnerable, and investors will differentiate among emerging markets by paying more attention to economic fundamentals.

From a regional perspective, the impact of the global financial turmoil on Africa has thus far been limited, as the risks of the majority of financial markets in the region are not correlated with those in mature economies. However, during the course of 2008, portfolio inflows have come under some pressure as global liquidity has tightened (see table III.2). According to the IMF, issuances of foreign currency-denominated bonds by African countries ceased in the first half of 2008, after doubling yearly from \$1.5 billion in 2005 to \$6.5 billion in 2007.⁴ An additional concern in Africa is the indirect effect of volatile and falling commodity prices, particularly that of crude oil, on export revenue and the inflow of capital into the region. In the short term, countries such as South Africa are financing a very large current-account deficit, about 8 per cent of gross domestic product (GDP),⁵ with private capital flows. If the capital flows dry up, South Africa will have to contract this deficit.

In East and South Asia, Governments are more adversely affected by the global financial crisis. The dramatic reversal in portfolio equity flows (see table III.2) reflects the net selling of equities by foreign investors. This selling pressure has been both a cause and an effect of sustained weakness in emerging equity markets through 2008. The equity sales have been particularly pronounced in the Republic of Korea, where investors have withdrawn a massive net \$45 billion in 2008.⁶ Despite the enormous accumulation of foreign-currency reserves in all major East and South Asian countries over the past few years, the widespread wave of currency weakness experienced in the region and the rise in dollar-funding pressures for banks show that vulnerabilities remain. These developments are also an important indicator of the high degree of interconnectedness within the global financial system. While the recent fall in oil and food prices has reduced the upward pressure on inflation in many Asian countries, food prices remain at a very high level relative to last year's record.

The largest expansion of credit flows to Western Asian borrowers on record in 2007⁷ was sharply reversed in 2008 (see table III.2). Along with the global credit crunch, Kuwait, Saudi Arabia and the United Arab Emirates, in particular, have experienced a severe contraction of interbank liquidity and rising spreads on corporate debt. While foreign-asset growth of oil-exporting countries in the first half of 2008 was well above 2007 levels, oil prices are no longer rising faster than domestic spending and investment, thus lowering the accumulation of international reserves. However, as both the Governments and the central banks remain in strong financial positions, tighter credit conditions are likely to have only a limited effect on investment activities in the region. Governments have started to stimulate domestic credit flows and investment.

While economic growth prospects remain positive for Latin America and the Caribbean, the economic and financial crisis in the United States has clearly heightened uncertainties in the region. The region has witnessed a slowdown in portfolio flows (see

Africa's exposure to the crisis has thus far been limited ...

... while East and South Asia have experienced more direct effects

Strong financial positions help Western Asian economies weather the storm

Latin America is facing an increasing number of downside risks

⁴ International Monetary Fund, *World Economic and Financial Surveys—Regional Economic Outlook: Sub-Saharan Africa* (Washington D.C.: IMF, October 2008).

⁵ See "South Africa releases the 2008 International Monetary Fund's Article IV Report and Financial System Stability Assessment Report", National Treasury of the Republic of South Africa, press release, 22 October 2008, available from http://www.finance.gov.za/comm_media/press/2008/2008102201.pdf.

⁶ Institute of International Finance, op. cit.

⁷ Bank for International Settlements, "International banking and financial market developments", *BIS Quarterly Review*, June 2008.

table III.2), large declines in stock price indices and significant currency adjustments. While financial conditions have not deteriorated more than in other regions in the current global economy, Latin America and the Caribbean's surplus is waning and will most likely turn into a modest deficit in 2009.⁸ The stagnation in economic growth of mature economies will affect Latin America and the Caribbean through several channels: a decline in the world's demand for the region's exports, falling remittances, weakening commodity prices, higher borrowing costs and the impact of tight monetary policies that the region has been pursuing to tame inflation. Thus, the cyclical downturn in Latin America and the Caribbean is now envisaged to be more pronounced and subject to a widening of downside risks in comparison to other regions.⁹ In Mexico, for example, remittances fell by 6.9 per cent year on year in July.¹⁰ Of further concern are oil prices, as oil exporters such as Ecuador, Mexico and the Bolivarian Republic of Venezuela are exposed to the effect of any further retreat of crude prices on fiscal balances.

The Russian Federation has seen a sharp reversal in short-term interbank flows

Falling oil prices, selling pressure in equity markets and a major pullback in net bank lending (see table III.2) provide a combination of factors affecting economies in transition. As a result, economic growth is set to slow in these countries, in particular in the Russian Federation. Most significantly, the sharp reversal of short-term interbank flows to the Russian Federation has been a key source of stress, and they are predicted to stay at low levels in 2009.

The sharp reversal in capital flows is putting an end to a phase of strong growth

In summary, the flow of foreign capital in recent years has become the main driver of the business cycle in quite a number of emerging market and other developing economies. That the process is driven primarily by variations in the availability of foreign capital rather than by developments in the host countries is strongly indicated by the significant size of variations in the overall flow of capital. When foreign investors develop an appetite for risk, there is a boom in capital flows; the bust is marked by a "flight to quality" (or risk aversion). Despite the fact that key economic indicators in several developing countries continue to appear more attractive than in mature markets, the sharp reversal in capital flows is now putting an end to a period of strong global economic growth and ample availability of liquidity in these countries. This development is already posing severe credit restraints, in particular in developing economies that are running current-account deficits. While the development of local-currency debt markets has led to progress in the reduction of currency mismatches in many developing countries, these markets are nevertheless characterized by short-term biases and have not solved problems of market liquidity. Most developing countries still lack sufficiently developed markets for corporate and government bonds, which further limits their scope for conducting counter-cyclical macroeconomic policies.

Foreign direct investment

More cautious business sentiment is leading to slowing FDI flows ...

Foreign direct investment (FDI) has historically been the more stable component of cross-border private capital flows over the past few years, buoyed by strong economic growth and improvements in the investment climate in a number of countries. While many devel-

⁸ Institute of International Finance, op. cit.

⁹ See Chapter IV of the present report, as well as World Bank, "Latin America and the Global Crisis", report prepared by the Office of the Chief Economist for the Latin America and the Caribbean region, 8 October 2008, available from <http://siteresources.worldbank.org/LACEXT/Resources/GlobalEconomy.pdf>.

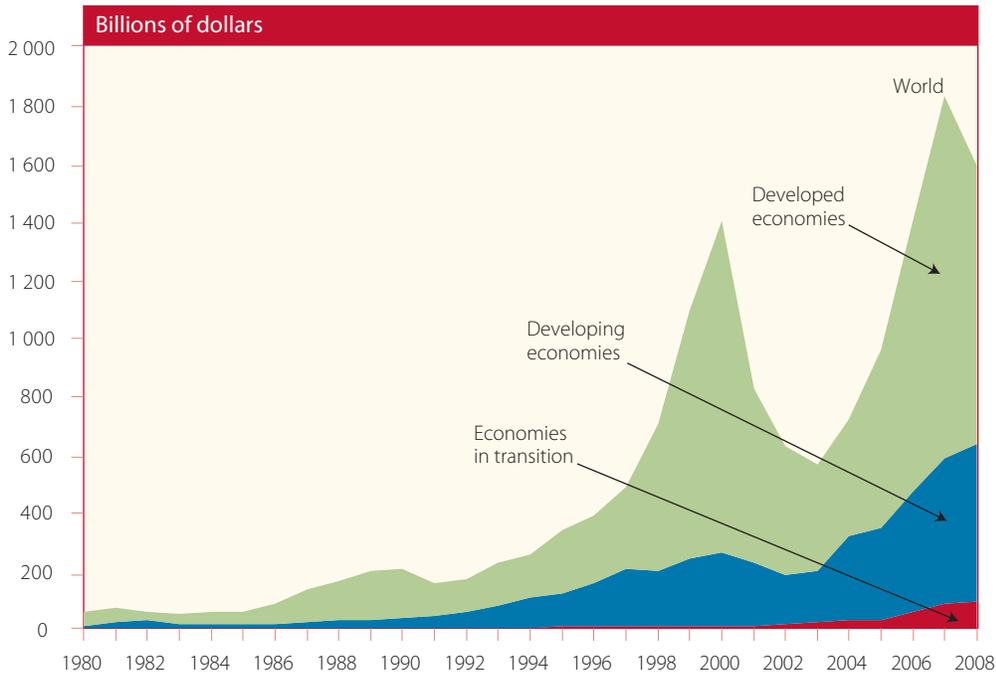
¹⁰ Data from Banco de México, the central bank of Mexico.

oping countries have attracted FDI through privatizations and mergers and acquisitions (M&As), funding for these activities will become harder to obtain in the coming months. The United Nations Conference on Trade and Development (UNCTAD) *World Investment Report 2007* predicts that FDI flows to emerging markets in 2008 will decline by 10 per cent.¹¹ Since global business sentiment will become far more cautious in the coming months, FDI flows may slow even further in 2009. The Organization for Economic Cooperation and Development (OECD) has estimated that outflows of FDI from OECD countries in 2008 could fall by about \$680 billion, or 37 per cent, from their 2007 levels.¹² Based on the historical relationship between developing country inflows and changes in OECD outflows, the OECD estimates that this could result in a decline in 2008 of about 40 per cent for developing country inflows from 2007 levels.

Worldwide, FDI inflows reached an estimated \$1.6 trillion in 2008 (figure III.3). In the three major groups of economies (developed countries, developing countries and economies in transition), the global economic slowdown and intensifying financial turmoil have had different impacts on FDI inflows. While the decline is more distinct in developed countries, several developing markets are still continuing to experience increasing FDI inflows (table III.4). Net FDI inflows are forecast to accelerate slightly to emerging European markets, the Middle East and Africa in the coming quarters. An increasing proportion of these flows takes the form of reinvested earnings.¹³ Up until the first half

... but the effects vary by region

Figure III.3
Inflows of foreign direct investment,
global and by groups of economies, 1980-2008



Source: UNCTAD FDI/TNC database and UNCTAD estimates for 2008.

¹¹ United Nations Conference on Trade and Development, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* (United Nations publication, Sales No. E.07.II.D.9).

¹² Organization for Economic Cooperation and Development, *Investment News: Results of the work of the OECD Investment Committee*, issue 7, June 2008.

¹³ Institute of International Finance, loc. cit.

Table III.4
Inflows of foreign direct investment and cross-border mergers and acquisitions,
by region and major economy, 2007-2008

Billions of dollars							
Region/Economy	Foreign direct investment inflows			Cross-border mergers and acquisitions			
	2007	2008 ^a	Growth rate (percentage)	2007		2008	Growth rate (percentage)
				First 10 months	Full year	First 10 months	First 10 months only
World	1 833.3	1 594.4	- 13.0	1 297.2	1 637.1	1 081.1	- 16.7
Developed economies	1 247.6	959.8	- 23.1	1 147.4	1 454.1	896.2	- 21.9
Europe	848.5	693.0	- 18.3	633.3	825.0	475.6	- 24.9
United States	232.8	175.6	- 24.6	313.7	379.4	328.4	4.7
Japan	22.5	15.0	- 33.6	20.9	21.4	14.9	- 28.6
Developing economies	499.7	540.9	8.2	124.2	152.9	161.4	29.9
Africa	53.0	62.3	17.5	7.9	10.2	25.8	226.6
Latin America and the Caribbean	126.3	147.5	16.8	25.9	30.7	26.0	0.6
Asia and Oceania	320.5	331.1	3.3	90.4	112.0	109.5	21.1
Western Asia	71.5	57.6	- 19.5	23.7	30.3	30.6	28.8
South, East and South-East Asia	247.8	272.5	9.9	66.7	81.5	78.6	17.9
Economies in transition	85.9	93.7	9.0	25.7	30.1	23.6	- 8.1

Source: UNCTAD.

Note: World FDI inflows are projected on the basis of 103 economies for which data are available for part of 2008, as of 10 November 2008. Data are estimated by annualizing their available data, in most cases the first two quarters of 2008.

a Preliminary estimates.

of 2008, FDI was bolstered by buoyant profits of transnational corporations (TNCs) and high commodity prices. Now that commodity prices have started to decline, commodity-related sectors will be somewhat less attractive. This could hurt Latin America and the Caribbean and Africa in particular in the months ahead.

Investors are facing limited financing options

Private equity firms, which account for one fifth of global cross-border M&As, are highly dependent on bank loans and will be severely limited in their financing options in the months to come. While the global outlook for the international expansion of TNCs still looks positive, particularly given the higher prospective economic growth rates in developing countries, a lower level of investor confidence and more prudence may influence investment plans in forthcoming quarters. As in previous financial crises, falling asset prices and the tightening of credit conditions will lead to insolvency problems for corporations and thereby to further asset deflation.

East, South and South-East Asia remain the preferred regions for FDI

East, South and South-East Asia remain the most preferred regions for foreign investment, followed by the European Union (EU), North America and emerging European markets. China is the most preferred investment location, according to a recent UNCTAD survey.¹⁴ Although, the overall environment for FDI remains positive, the Chinese Government has become more selective with respect to approving foreign involve-

14 United Nations Conference on Trade and Development, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge* (United Nations publication, Sales No. E.08.II.D.23).

ment in investment projects.¹⁵ The Chinese authorities are giving priority to projects in the interior of the country and those that promise a high degree of technology transfer.

While the services sector still accounts for the largest share of global FDI flows, there has been a significant increase in FDI flows to the primary sector, mainly in the extractive industries. The share of manufacturing in global FDI flows has continued to decline. The share of TNC investments in extractive industries has more than doubled since the 1990s. These industries account for a significant share of total FDI inflows in some economies, and for the bulk of inward FDI in a number of low-income mineral-rich countries. One of the challenges facing commodity-exporting countries, in particular those in Africa, is how to channel revenues obtained from commodity exports towards the areas of education, human resource development and infrastructure development, which are essential for productivity improvements and for industrialization in general, as well as for attracting FDI to the manufacturing sector.¹⁶ The current reversal in commodity prices will magnify these challenges.

Manufacturing represents a declining share in global FDI flows

International financial cooperation

Official development assistance

There has been a significant turnaround since the United Nations International Conference on Financing for Development held in Monterrey, Mexico, from 18-22 March 2002, when total net ODA was \$57.3 billion, or \$54 billion excluding debt-relief grants. The impulse for a revival in assistance from OECD countries provided by the Monterrey Consensus has weakened significantly in recent years. Net ODA has in fact declined in absolute terms from \$107.1 billion in 2005, to \$104.4 billion in 2006, and further to \$103.7 billion in 2007, representing a fall of 8.4 per cent in real terms. Excluding debt-relief grants, ODA to developing countries totalled \$95 billion in 2007, compared with \$82 billion in 2005 (figure III.4).

Net ODA has declined in absolute terms since 2005

As a share of gross national income (GNI) of the member countries of the Development Assistance Committee (DAC) of the OECD, ODA remained unchanged compared with 2006, at 0.25 per cent; this share is only slightly higher than the pre-Monterrey share of 0.23 per cent, but is well below the 0.33 per cent level of the early 1990s, and well short of the intermediate target of 0.35 per cent set for 2010, to which DAC members have committed themselves.¹⁷

Only five countries have met the United Nations target for ODA

Only five countries—Denmark, Luxembourg, the Netherlands, Norway and Sweden—have met the United Nations target of 0.7 per cent of GNI, reaffirmed through the Monterrey Consensus. ODA provided by the Group of Seven (G7) countries, in contrast, averages no more than 0.23 per cent of their combined GNI, with the United States and Japan (despite being the largest donors in absolute amounts) providing the least ODA in relative terms (0.16 per cent and 0.17 per cent of GNI, respectively).

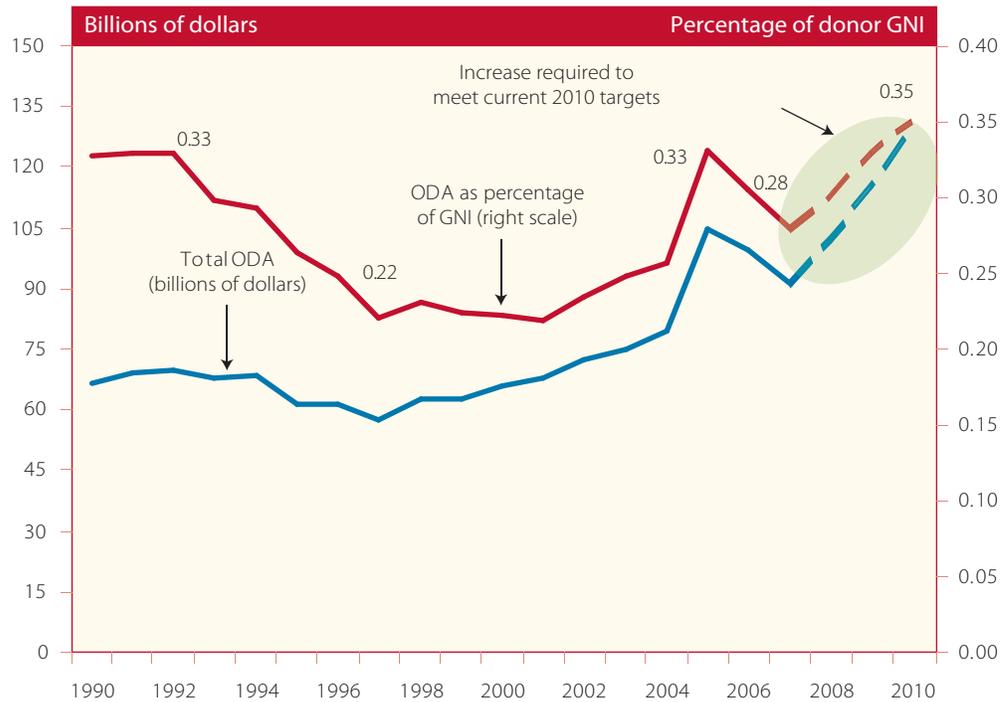
Japan's share in global ODA had declined from 14 per cent in 2002 to just 8 per cent by 2007, and the United States share is projected to fall from the current 23.5 per

¹⁵ World Bank, *Global Development Finance 2008: The Role of International Banking* (Washington, D.C.: The World Bank, June 2008).

¹⁶ United Nations Conference on Trade and Development, *World Investment Directory, Volume X: Africa 2008* (United Nations publication, Sales No. E.08.II.D.3).

¹⁷ See United Nations, MDG Gap Task Force Report 2008, *Delivering on the Global Partnership for Achieving the Millennium Development Goals* (United Nations publication, Sales No. E.08.I.17).

Figure III.4
DAC members' net ODA, 1990-2007, and DAC secretariat simulations to 2010



Source: OECD/DAC database and United Nations, *MDG Gap Task Force Report 2008*.

Note: Figures are in 2004 prices. Data for 2008-2010 are based on DAC Secretariat simulations.

cent to below 19 per cent by 2010, compared with a forecast increase of the EU share to 64 per cent, up from 55.6 per cent in 2007. ODA by the EU-15 countries, which accounts for 60 per cent of the total, currently amounts to 0.40 per cent of their GNI, with a commitment to reach the 0.7 per cent target by 2015.

The least developed countries receive about one third of all aid

Landlocked and small island developing countries, whose special needs were recognized in the Monterrey Consensus, received about \$2.5 billion and \$12 billion of ODA in 2007, respectively. The 49 least developed countries (LDCs) continue to receive about one third of all aid. Although their share of ODA, excluding debt relief, had increased from a low of 15 per cent in 1998 to 38.5 per cent by 2006, the total DAC aid of \$29.4 billion to these countries constitutes only 0.09 per cent of their GNI, far short of the target of 0.15-0.20 per cent of GNI to be achieved by 2010 in accordance with the Brussels Programme of Action for the Least Developed Countries for the Decade 2001-2010. By 2006, only 8 countries had met this target: Belgium, Denmark, Ireland, Luxembourg, the Netherlands, Norway, Sweden and the United Kingdom of Great Britain and Northern Ireland. Achieving the target of 0.16 per cent of GNI, on average, for DAC donors would require increasing the aid volume to LDCs to about \$62 billion per annum, that is to say, double the current level.

ODA needs to be stepped up to meet agreed targets

The rate of growth of ODA will have to increase markedly if the international community is to meet the targets that they set for financing the internationally agreed development goals, including the Millennium Development Goals (MDGs). If the commitments at the 2002 Monterrey Conference and the 2005 Group of Eight (G8) Summit at Gleneagles are taken as the benchmark, ODA (at constant prices) from major donors would have increased by more than 60 per cent over the six years from 2004 to 2010. However, halfway through this period, ODA from OECD donors has risen by only 15 per cent.

In order to meet the overall target of \$130 billion by 2010 confirmed at the 2005 Gleneagles Summit, net ODA needs to increase by nearly \$13 billion in constant

2004 dollars, or about \$18 billion per year between 2008 and 2010 at July 2008 exchange rates.¹⁸ Aid to sub-Saharan Africa has increased at a faster rate, but still not fast enough to double to the \$50 billion in real terms by 2010 pledged at Gleneagles. Net ODA to Africa needs to increase by over \$6 billion per year in 2005 prices to reach the targeted increase of at least \$25 billion a year by 2010. So far, only about \$4 billion of this has been programmed into donors' spending plans.

Some developing countries have become important sources of aid for other developing countries in recent years. Development cooperation provided by such donors has grown strongly, even though the total volume is still small. Disbursements by non-DAC donors have reached an estimated \$8.5 billion, or 7.5 per cent of total aid flows in 2006, of which about \$7.1 billion came from other developing countries. Recent studies, however, put the latter's disbursements between \$9.2 billion and \$11.8 billion, which means their share in total aid flows would have increased to between 7.6 and 9.6 per cent as of 2006.

Currently, the largest donors from the South, each providing at least \$1 billion per year, are China, India, Saudi Arabia and Venezuela (Bolivarian Republic of), and if recent large pledges materialize, the total flows might grow to about \$15 billion by 2010. Saudi Arabia and the Bolivarian Republic of Venezuela have achieved the target of 0.7 per cent, and the average grant element of all loan commitments by China, Brazil and India was about the same as other countries, one third in 2005-2006. In addition, some non-DAC countries have made substantial progress in 2007, although the increases have come from a relatively small base; for instance, Lithuania raised its aid by 74 per cent, the Republic of Korea by 43 per cent, and Latvia by 23 per cent.

Overall, most donors are not on track to meet their commitments to scale up aid unless they make unprecedented increases in their aid budgets. This implies an average annual growth rate of ODA of over 14 per cent in real terms over the remaining part of the decade, compared with the 4.6 per cent observed since the 2002 Monterrey Conference. ODA to sub-Saharan Africa will have to increase by an average annual rate of 18 per cent, compared with 9 per cent in 2002-2006, if donors are to honour their pledges to Africa. These pledges were reconfirmed at the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha, Qatar, from 29 November to 2 December 2008, where donors promised to honour their commitments and emphasized that the financial crisis should not stand in the way of their doing so. A further challenge for international development cooperation is the additional resources required to meet the costs of dealing with climate change and improving energy and food security (see box II.1 for estimated investment requirements to deal with the food crisis; for innovative sources of financing, including those needed to address climate change, see below).

Aid effectiveness

Important steps towards improving the quality of aid were made by the Paris Declaration on Aid Effectiveness in 2005 and the subsequent efforts aimed at its implementation. The 2003 Rome Declaration on Harmonization and the 2005 Paris Declaration reflected a commitment by over 100 Governments and international organizations to improve the quality of aid as called for in the Monterrey Consensus. The signatories recognized the principles of country ownership and acknowledged that development could not be imposed from above, and that aid therefore had to be aligned to national development strate-

Some developing countries are becoming an important source of ODA

Sharp increases in aid budgets are needed

The Paris Declaration marked an important step in improving aid effectiveness

¹⁸ Ibid.

gies. The Third High Level Forum on Aid Effectiveness, which took place in Accra from 2 to 4 September 2008, adopted the Accra Agenda for Action (AAA), which made only fitful progress in realizing the Paris Declaration commitments.

Aligning aid to national development goals remains a challenge

A multitude of challenges exist in aligning aid to national development and ensuring aid effectiveness. In the context of the conceptual acceptance of “national ownership”, action on this principle would require a decoupling of development assistance from conditionality and giving countries the policy space to choose their own development path. The DAC Working Party on Aid Effectiveness and Donor Practices has set out indicators to monitor aid delivery and improve aid delivery mechanisms. As indicated by the 2006 and 2008 surveys conducted by the DAC secretariat, progress in each of the areas of national ownership, harmonization, alignment, results and mutual accountability has been slow and has fallen short of expectations. In Africa, for example, the greatest progress was made in the areas of donor coordination and the alignment of technical assistance with country programmes; planned programmable aid is expected to increase by 38 per cent between 2005 and 2010. However, transaction costs associated with aid remain high and only 46 per cent of aid flows were disbursed according to schedule in 2007.

Significant progress has been made on increasing untied aid

The amount of resources reported as untied had reached 95 per cent of bilateral aid by 2006, with some countries untying all of their aid, signalling considerable progress on the 2001 DAC agreement to untie aid to LDCs. However, a major issue is the transparency of donors’ untied aid programmes. Currently, data do not cover important countries, such as the United States, or certain forms of aid, such as technical cooperation or the administrative costs of delivering aid. Many countries striving to reach the MDG goals did not receive sufficient aid in spite of improved macromanagement, debt management and increased capacity for aid flows.

The smoothing of aid flows can help to avoid a multitude of problems

Selectivity is still a defining feature of the present system of allocation of aid flows, creating a situation where a few countries have a very large share of total flows. At the same time, donors have not been able to resolve the problems of predictability, volatility and herding. Aid surges in selected countries have led to a mistaken belief that low-income countries may not have the capacity to absorb aid effectively and may suffer from Dutch disease. These issues would not have arisen if the aid flows had been better distributed among countries and if sudden surges were avoided by stretching out the inflow over a longer time frame.

Even developing countries at more advanced stages of development have problems managing a surge of flows within a short timespan. Short-term difficulties should not be interpreted as indicative of long-term absorptive capacity. Lessons can be drawn from countries which have had aid surges involving budgetary support. The conditions attached to the aid inflows did not allow countries to use the excess liquidity generated for productive investments. The failure of the international financial institutions (IFIs) to correctly gauge the implications of an expenditure framework generating excess liquidity led to costly sterilization policies and an ensuing build-up of domestic debt. Lack of flexibility in allowing countries to allocate the inflow based on their own priorities proved costly as it reduced the fiscal space for development expenditure.

Development resources are only a part of overall aid

In actual practice, the resources released for development have been smaller than aid statistics have indicated. The decomposition of aid-flow statistics gives a more realistic estimate of the resources available for development. For instance, debt relief accounted for a substantial part of the increase in ODA in 2005-2006; this included the large debt-relief packages for Iraq and Nigeria. Total net aid statistics also include emergency and technical assistance. In order to assess programmable resources, an emerging priority

is the setting-up of an accounting framework to correctly report the resources available for development. The United Nations provides a platform for working towards a multilaterally agreed concept. The outcome document for the Doha conference on financing for development adopted on 2 December 2008 calls for a more universal and accountable framework for aid accounting and requests the Secretary-General, in cooperation with OECD-DAC and IFIs, to report on the matter to the Development Cooperation Forum of the United Nations Economic and Social Council.

Innovative sources of development financing and the new aid “architecture”

There has been considerable progress in implementing initiatives to finance development through innovative channels under the rubric of “innovative sources of financing” in the 2002 Monterrey Consensus. An important challenge will continue to be the building of consensus around pilot projects and, more generally, how to implement the reform agenda for the aid architecture. Moreover, further exploration of new sources of innovative financing is expected. The Fourth Plenary Meeting of the Leading Group on Solidarity Levies to Fund Development, held in Dakar on 22 and 23 April 2008, addressed the following issues: the feasibility of taxing currency transactions; the stemming of illicit financial flows from developing countries (a working group on which was established under the chairmanship of Norway); remittances; and innovative financing mechanisms for environmental protection. Senegal and the next rotating Presidency, Guinea, were given the mandate to prepare the Group’s contribution to the Doha follow-up conference to Monterrey. At the Fifth Plenary Meeting of the Group, held in Conakry in October 2008, a Declaration on Innovative Financing for Development as a new mode of development aid was adopted and presented to the Doha conference.

In the context of the broader aid architecture, innovative sources of financing have thus far raised only a relatively small amount of funds. Other potentially more significant sources of innovative financing need to be developed. For example, there is renewed interest in a currency-transaction tax in the light of the fact that such transactions can be tracked in the same way that international transactions are monitored for anti-terrorism and anti-drug money-laundering purposes. There are other proposals for internationally coordinated taxes, such as on carbon emissions and arms purchases.

By providing resources in a stable and predictable manner, such taxation schemes would efficiently complement ODA, which suffers from swings and fluctuations in its levels due to donors’ politically dependent budget considerations. They could also have the advantage of correcting certain negative externalities, in addition to providing significant sources of development financing. For instance, a carbon tax could be justified on environmental-efficiency grounds. Some members of the Leading Group on Solidarity Levies to Fund Development have also expressed interest in expanding efforts to combat tax evasion and capital flight under the rubric of innovative sources of financing.

It is important to stress that innovative financing should generate resources complementary to traditional official development aid, without prejudice to the manner in which these resources are reported. It should also be part of efforts to improve the quality and efficiency of existing official development aid, especially with regard to predictability and stability of funding to address long-term needs, early mobilization of funds for urgent action and tailoring aid to the repayment capacity of countries. In addition, the new funding sources should explicitly address market failures, including through means of advanced market commitments, development investment funds and counter-cyclical facilities.

Exploring new sources of innovative financing for development remains a challenge

Complementarity is an important characteristic of innovative financing

New sources of aid and an increased number of donors have emerged without systematic coordination

With the proliferation of new sources of money for aid, the landscape in development cooperation has changed. As mentioned above, non-DAC donors, including those from the South, private foundations and philanthropic channels, are growing in significance. It is estimated that these sources now constitute roughly one fourth of global aid flows.

This recent proliferation of donors and alternative sources of development financing has created a new challenge for international development cooperation: to ensure adequate checks and balances for the provisioning and use of aid from all sources. The new arrangements have evolved without systematic coordination among donors, international financial institutions and recipient countries. The resultant number of donor missions in each recipient country is burdensome, leaving little time, space or human resources for independent policymaking. In view of these new actors and institutions, aid architecture has become an even more complex, uncoordinated and fragmented system that lacks a centrally directed political or technical framework.

Recipients hold little power in influencing development guidelines

There is a clear imbalance in development cooperation relations, as recipients have very little power to influence development cooperation guidelines. “Ownership” is closely linked to “representation”, but recipients of aid have very little voice in the governance of aid. The actual role of parliamentarians in the governance of aid is often trumped by that of civil society. Aid recipients have a limited voice in the IMF and the World Bank, both of which provide decisive access to aid. The World Bank’s Country Policy and Institutional Assessments, which have been found to be unpredictable and subjective, play a major role in aid allocation, while developing countries themselves have little voice in how they are being rated.

Bilateral flows dominate the composition of aid but offer no formal mechanism for the voice of recipient countries to be heard, as bilateral donors are answerable only to their legislative bodies. The changing landscape makes reform more urgent, and the Doha conference provided an ideal opportunity to review and rebalance international development cooperation.

External debt relief

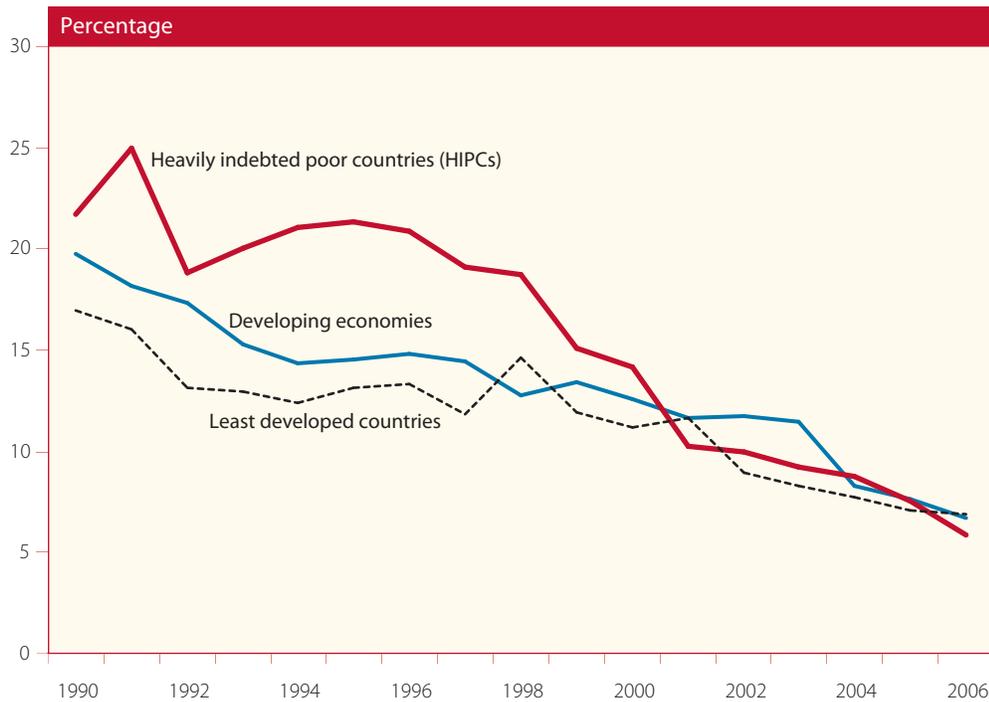
Lower debt levels have led to a reduction in debt-service payments

The Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) have provided countries with an opportunity to reduce their external debt-service burden. Along with these major debt-relief initiatives, the shift from bilateral ODA loans to grants has significantly reduced the debt burdens of many low-income countries, particularly those that have reached the HIPC completion point and received additional debt relief from the MDRI. The HIPC status report of March 2008 estimated that debt relief in all forms, including HIPC, MDRI, traditional debt relief and other “voluntary” bilateral debt relief, would reduce debt stocks for the 33 post-decision-point countries from \$105 billion to \$9 billion, a reduction of more than 90 per cent. The debt service-to-export ratio for all developing countries declined from almost 12.5 per cent in 2000 to 6.6 per cent in 2006, and to about 3 per cent in 2007 (figure III.5).¹⁹ The average debt-service payment relative to GDP has been halved as a result of the initiatives, falling from 3.2 per cent of GDP in 2001 to 1.5 per cent of GDP in 2007. For the HIPCs, the reduction in debt burdens has created a better environment for investment and future growth.

The total assistance allocated to HIPCs so far amounts to \$117 billion in nominal terms, including \$49 billion under the MDRI, representing on average about 50 per

¹⁹ Ibid., pp. 28-29.

Figure III.5
Debt-service payments as a proportion of export revenues, 1990-2006



Sources: UN/DESA, based on data from Millennium Development Goals Indicators, available from <http://mdgs.un.org>, and World Bank Global Development Finance database.

cent of these countries' 2007 GDP. The total cost to creditors of HIPC Initiative debt relief for all eligible countries is estimated at \$71 billion in end-2007 net present value (NPV) terms. Nearly half of the cost represents irrevocable debt relief to the 23 post-completion-point countries. Thus far, 33 out of 41 countries that have been found eligible or potentially eligible for debt relief under the HIPC Initiative have received debt reduction.

Post-conflict countries have been encouraged to make efforts to become eligible for HIPC. Thus, the Comoros, Côte d'Ivoire, Eritrea, Kyrgyzstan, Nepal, Somalia, the Sudan and Togo are pre-decision-point countries, and some could receive debt relief. The estimated cost of HIPC Initiative debt relief to these eight interim countries is estimated to be \$20 billion, most of which is attributable to three countries: Côte d'Ivoire, Somalia and the Sudan. Among the above-mentioned countries, the Comoros, Côte d'Ivoire and Togo are making progress towards the decision point. This year, Côte d'Ivoire and Togo cleared arrears to major creditors and could reach their decision points by the end of 2008.

The principal aim of the HIPC Initiative was to release resources for development and thereby reduce poverty. Some low-income countries that received debt relief have demonstrated remarkable efforts in this regard, increasing their public expenditures on social sectors and poverty reduction programmes. In nominal terms, total poverty-reducing expenditures amounted to about \$21 billion in 2007, which represents an increase of almost \$15 billion since 2001. Poverty-reducing expenditures have increased in sectors such as health, rural infrastructure and education. For the 33 post-decision-point countries, such expenditures have increased on average from 6.7 per cent of GDP in 2001 to 8.8 per cent of GDP in 2007.

The success of the implementation of the HIPC Initiative requires sustained efforts on behalf of the international creditor community. Important challenges are still to be met to fully implement the HIPC Initiative and enable the remaining 18 pre-

Some recipient countries have shown remarkable efforts in reducing poverty

Considerable challenges remain in achieving the implementation of the HIPC Initiative

completion-point countries to reach their completion points. These include ensuring full participation by all creditors and mobilizing additional resources to finance debt relief to all remaining HIPC. Although most multilateral financial institutions have provided debt relief under the HIPC Initiative and the MDRI, some small multilateral institutions still need to be encouraged to participate in the HIPC Initiative.

While Paris Club members have made strong efforts in their debt-relief commitments, the participation of non-Paris Club official creditors has been low, delivering only about 40 per cent of their expected share in debt-relief operations for HIPCs. So far, only 8 non-Paris Club creditors have delivered full relief and 22 creditors partial relief, but 21 creditors have not yet delivered at all on HIPC Initiative debt relief. The participation of commercial creditors also remains low. They are estimated to have provided 33 per cent of their commitments in 2008, which is better than only 5 per cent the preceding year. Another issue related to the implementation of the HIPC Initiative concerns the litigation actions by commercial creditors against low-income countries. Even though the amounts involved are small in relation to total debt, the costs of litigation or resolution are significant in relation to debtor countries' export earnings and public budgets.

Reducing debt to a sustainable level remains an issue for many HIPCs. These countries are far from achieving debt sustainability. Risks of debt distress remain high among them, including those that have received full debt relief. Only 10 out of the 23 post-completion-point HIPCs could be classified as being at "low risk" of debt distress, highlighting the fact that many countries continue to be vulnerable. Indeed, several middle- and low-income countries are suffering from debt distress but are not eligible for the HIPC Initiative. These countries have no access to debt relief or to orderly sovereign debt workouts, as granting debt relief is conditional and only countries with unsustainable levels of debt are eligible.

Risks of debt distress remains high among HIPCs

Rehabilitating the global financial system

As analysed in chapter I, policymakers in developed countries fell behind the curve in dealing with the emerging global financial crisis, having underestimated the depth and breadth of the problems in financial markets and their link to the global imbalances. During October 2008, piecemeal approaches were shed and policymakers in developed countries moved to manage the crisis in a more coordinated fashion. However, the path towards swift and improved policy coordination is hampered by the lack of institutionalized mechanisms to this end and by deficiencies in global governance structures. During 2008, further discussions have taken place on how to improve the regulation and supervision of a globalized financial system; how to improve the governance structure of the international financial institutions; how to strengthen the foundations of surveillance and policy cooperation on key systemic issues; and how to address the role of official financing of emerging market and developing countries. These issues remain far from being resolved, but the current crisis has increased the urgency of making further progress in this regard.

A lack of institutionalized mechanisms and deficient global governance structures hamper better policy coordination

Regulating the global financial system

While tackling the financial fallout is an immediate priority, measures to address the underlying causes of the disarray need to be taken. The final report of the Financial Stability Forum (FSF) on this issue was presented in April 2008 and was endorsed by the G7

Addressing the crisis requires more fundamental changes to the financial system

Finance Ministers and the International Monetary and Financial Committee (IMFC).²⁰ The guiding objectives of the report are to recreate a financial system that operates with less debt and more capital, that is more transparent, that is immune to the kind of misaligned incentives at the root of the current crisis, and that boasts stronger prudential and regulatory oversight. There are policy recommendations on key areas, including prudential oversight of capital, liquidity and risk management; transparency, disclosure and valuation policies; the role and uses of credit ratings; and the authorities' responsiveness to risks and their arrangements for dealing with stress in the financial system.

The G7 accepted a number of FSF recommendations that had been identified as immediate priorities for implementation by the end of 2008. These include prompt and robust risk disclosure; improvement of the accounting, disclosure and valuation standards for off-balance sheet entities; the strengthening of risk management practices, including liquidity risk management; and the revision of the code of conduct for credit-rating agencies.

The FSF also called for additional measures relating to international interaction and consistency of national emergency arrangements and responses to address the current financial crisis; the scope of financial regulation, with a special emphasis on unregulated institutions, instruments and markets; and better integration of macroeconomic oversight and prudential supervision.

The FSF-inspired measures to strengthen the global financial system, which are basically confined to improved disclosure, prudential controls and risk management, are now generally seen as not going far enough to address the inherent pro-cyclicality of the financial system, which tends to foster asset price bubbles. Regardless of the specific source of disturbance, almost all episodes of systemic financial distress have at their root very rapid credit growth, excessive risk-taking and overextension of balance sheets in good times, all masked by the strength of the real economy and extraordinary increases in asset prices.

As also argued in chapter I, recent developments have highlighted the importance of expanding the macroprudential tools of current regulatory frameworks. The approach would be to encourage the build-up of sufficiently high buffers (capital requirements, for example) in good times, when the market price of risk falls and imbalances might develop, in order both to restrain expansion during upswings and to provide a greater cushion against losses when disruptions occur. While financial leverage is a key ingredient of the private risk-taking necessary for investment and economic growth, it also tends to amplify both booms and downturns. By developing policy instruments to lower or raise capital requirements depending on the specific situation, authorities would be better equipped to utilize market incentives to reduce systemic risk.

The FSF report did not address pro-cyclicality per se because of the urgency of making concrete recommendations in other areas. However, the Forum has alluded to some aspects of pro-cyclicality from a longer-term perspective, including the capital regime, loan-loss provisioning practices, compensation arrangements, and the interactions

The G7 accepted a number of FSF recommendations

FSF proposals are not going far enough to deal with the pro-cyclicality of the financial system

The build-up of buffers in good times can provide a cushion in a downturn

²⁰ See Financial Stability Forum, "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", 7 April 2008, available from http://www.fsforum.org/publications/r_0804.pdf. Based on the original proposals, the Financial Stability Forum submitted a follow-up report on 10 October 2008 which reviews the implementation of the recommendations set forth by the April report in five areas: (a) strengthened prudential oversight of capital, liquidity and risk management; (b) enhanced transparency and valuation; (c) changes in the role and uses of credit ratings; (d) strengthened responsiveness of authorities to risks; and (e) robust arrangements for dealing with stress in the financial system.

between valuation and leverage.²¹ To this end, assessing the potential pro-cyclical impact of the New Basel Capital Accord (Basel II) is considered one of the most important priorities for supervisory authorities and central banks.

Global financial integration has been accompanied by a lack of international governance

The crisis has also highlighted the importance of greater international cooperation in financial sector monitoring and regulation, which are still basically national in nature. There is growing tension between global financial integration and deficits in international governance inconsistent with current global realities. There is a need to move towards an international macroprudential and regulatory architecture that is more integrated in its approach, has coordinated standards and structures, and that involves greater clarity of respective responsibilities and objectives as well as closer and more effective cross-border coordination and collaboration among supervisors, regulators, central banks and fiscal authorities. This global system of financial regulation, based on credible international rules, may require an international body (or bodies, such as the colleges of supervisors for systemically important financial institutions, as proposed by the FSF) that would have an explicit mandate for financial oversight and monitoring, as well as early-warning capabilities and the force and authority to ensure that those warnings are acted upon.

Consistent principles for international cooperation in crisis management need to be agreed in advance

It is equally important to develop ex ante agreed and consistent principles and practical guidelines for cross-border cooperation and contingency planning for crisis management. Indeed, much of the preparatory work to facilitate management of the international financial crisis has not yet been carried out.²² Nevertheless, national authorities now better understand the need to have pre-existing plans for dealing with strains involving cross-border financial institutions, including large funding needs. Another important issue is clarifying the arrangements for coordination of deposit insurance for cross-border institutions.

International consultations on the financial crisis have intensified

The idea of a series of global summits on the reform of the international financial system—dealing with basic principles, regulations and institutions—has gained currency. On 15 November 2008, the United States convened the first such summit in Washington, D.C. in the form of the Group of Twenty (G20), plus the United Nations, the IMF and the World Bank. At this summit, there was still conflict, even among major economic powers, over the extent to which international financial regulation should be reformed, and the outgoing United States Administration could not accede in this regard. However, a work programme, which includes accounting standards, supervision and regulation and information exchange, was set out for consideration in a follow-up meeting to be held in April before the Spring 2009 meetings of the Bretton Woods institutions. At the same time, the President of the United Nations General Assembly created a Commission of Experts on Reforms of the International Monetary and Financial System, led by Professor Joseph Stiglitz of Columbia University, to report on proposals to reconfigure mechanisms and institutions of global economic governance based on lessons learned from the financial crisis. The outcome document of the 2008 Doha conference, which enjoys the consensus of all Member States of the United Nations, also stresses the need for a strengthened and more effective intergovernmental structure that would carry out the

²¹ Statement by Mario Draghi on the “Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience: Follow-up on implementation”, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from <http://www.imf.org/external/am/2008/imfc/statement/eng/fsf.pdf>.

²² See, for example, “International governance for the prevention and management of financial crises”, speech by William R. White, Economic Adviser and Head of Monetary and Economic Department of the Bank for International Settlements, at the Bank of France International Monetary Seminar, Paris, 10 June 2008, available from <http://www.bis.org/speeches/sp080708.htm>.

financing for development follow-up and would review progress in the implementation of commitments, identify obstacles, challenges and emerging issues and propose concrete recommendations.

The series of substantial equity contributions to troubled financial institutions in industrialized economies has led to the sudden visibility of sovereign wealth funds (SWFs) from emerging and developing countries and to numerous calls for the regulation of their activities. The IMF International Working Group (IWG) of Sovereign Wealth Funds, comprising 25 member countries, was established in May 2008. It was set up to produce principles that properly reflect the governance and investment practices of SWFs.

In October 2008, the IWG published a set of 24 principles (the Santiago Principles) designed to ensure an open international investment environment. The purpose of the Santiago Principles is to establish a transparent and sound governance structure; to ensure compliance with applicable regulatory and disclosure requirements; to ensure that SWFs invest on the basis of economic and financial risk and return-related considerations; and to help maintain a stable global financial system and free flow of capital. The OECD has been undertaking parallel work in drawing up a similar set of guidelines for recipient countries. It is important that the guidelines for SWFs are no more onerous than those for other large institutional investors and that they do not introduce an element of bias and lack of evenhandedness in financial surveillance.

Equity contributions have increased the visibility of sovereign wealth funds

Governance reform at the Bretton Woods institutions

Voice and voting power

During 2008, only a disappointing amount of progress was made in reforming the governance structures of the IMF and the World Bank in line with twenty-first century economic realities. On 28 April 2008, Governors from 180 of the 185 member countries of the IMF did, however, cast their vote on the proposed resolution on the quota and voice reform package. Of these, 175 countries, representing 93 per cent of total voting power in the Fund, voted in favour of the package. Three countries voted against, two abstained, and five did not participate in the vote.²³

Progress on reforming governance of the IMF and the World Bank has been disappointing

The package includes a second round of ad hoc quota increases of close to 10 per cent based on a new quota formula, the tripling of basic votes and the appointment of a second Alternate Director for constituencies consisting of at least 19 members. The resolution also requested the Executive Board to recommend further realignments of members' quota shares in the context of future general quota reviews, beginning with the Fourteenth General Review of Quotas, to ensure that members' quota shares adequately reflect their relative position in the world economy.

The realignment of quota and voting shares will lead to a net increase of 2.7 percentage points in the voting share of emerging markets and other developing countries as a whole. This very modest increase was only made possible owing to the use of a compression factor; the application for several emerging market and developing countries of a weight to the purchasing power parity (PPP) GDP measure greater than that for other countries; and, most importantly, the willingness of several advanced countries to forgo part of the quota increases to which they would have been eligible by a straight application of the proposed formula.

²³ See "IMF reform secures backing by wide margin", *IMF Survey Magazine*, 29 April 2008, available from <http://www.imf.org/external/pubs/ft/survey/so/2008/POL042908A.htm>.

These ad hoc adjustments suggest that the new formula per se has not achieved the stated goal of providing a simpler and more transparent means of reflecting members' relative positions in the global economy. Indeed, without alterations, the voting shares of developing and emerging market countries would actually have declined by 1.6 percentage points. It is hardly rational to utilize, as an appropriate foundation for periodic reviews over the longer run, a formula that produces changes in shares that move farther away from a closer alignment of the voting power with economic realities.

The agreed changes are too modest to achieve significant change

The reform package recognizes the need for changes to the formula. According to the Executive Board, further work is necessary on measuring trade openness; addressing the treatment of intra-currency union flows; developing a method of capturing financial openness; and measuring variability to adequately capture members' potential need for Fund resources.²⁴ The agreed changes in members' quota and voting shares are too modest to influence the operation of the Fund.

The institutional framework determines the legitimacy and effectiveness of governance

Quotas and voting shares are only one aspect of IMF governance. Its legitimacy and effectiveness depends importantly on the institutional framework through which members' voting power is exercised. In this regard, there is a proposal to reduce the number of chairs on the Executive Board from 24 (of which 9 are currently being held by Europeans) to 22 in 2010 and, further, to 20 in 2012, while preserving the present number of developing country and emerging market country ones.²⁵ A more balanced composition and smaller-sized Board is considered important for transforming the Fund into a more effective global institution. In September 2008, the Managing Director announced the appointment of a Committee of Eminent Persons to assess the adequacy of the Fund's current framework for decision-making.

The current IMF deficit prevents it from playing a credible role in the international financial architecture

The IMF is currently running a deficit as a result of the decline in demand for Fund resources since the late 1990s. This jeopardizes its ability to play a credible role in the international financial architecture. Before the full scale of the global financial crisis became generally recognized, agreement had been reached at the IMF on both expenditure and income measures, including an expenditure reduction in the order of 14 per cent (\$100 million) in real terms over the next three years. A new income model²⁶ that moves away from primarily lending-based income sources towards more predictable and sustainable investment-based ones was part of the package. The new income and expenditure framework is expected to cover the \$400 million shortfall projected in the medium term.

Institutional reforms at the World Bank continue

The World Bank has launched its own process of voice and participation reform. The first phase of the exercise will include the creation of an additional seat for sub-Saharan Africa on the Bank's Board of Executive Directors and the doubling of basic votes. The dilution of the voting power of larger developing and transition countries will be mitigated through an exceptional allocation of unallocated shares. Further realignment of Bank shareholding will be taken up by the Board in a shareholder review, with the ultimate goal of moving over time towards equitable voting power between developed and developing members. At its 2008 Annual Meeting, the Development Committee asked

²⁴ International Monetary Fund, "Report of the Managing Director to the International Monetary and Financial Committee on Reform of quota and voice in the International Monetary Fund", 7 April 2008, p. 3, available from <http://www.imf.org/external/np/pp/eng/2008/040708.pdf>.

²⁵ Statement by Henry M. Paulson, Jr., Secretary of the Treasury of the United States of America, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from <http://www.imf.org/external/am/2008/imfc/statement/eng/usa.pdf>.

²⁶ See "IMF Board of Governors approves key element of IMF's new income model", International Monetary Fund press release No. 08/101, 6 May 2008, available from <http://www.imf.org/external/np/sec/pr/2008/pr08101.htm>.

the Board to develop proposals by the 2010 Spring Meeting, and no later than the 2010 Annual Meeting, with a view to reaching consensus on realignment at the subsequent meeting in 2011.²⁷

Multilateral surveillance

As regards its assigned responsibility for multilateral surveillance, there remains a strong perception that the Fund has been sidelined in the handling of the present crisis. The IMF reacted to events as they occurred, endorsing the actions taken by major developed countries. Since it is indisputable that the global financial crisis requires global solutions, the world economy now more than ever needs a credible IMF with a governance structure that is more representative of developing country interests, and one which can exercise strong policy leadership.

The major thrust of the ongoing reform of IMF surveillance mechanisms, which has assumed greater urgency in the light of the crisis, is to strengthen the analysis of macrofinancial linkages, integrating multilateral perspectives in bilateral surveillance, and enhancing the work on financial markets. It is recognized that the Fund will need to develop new and better analytical instruments to enhance its ability to detect emerging risks, including the extension of the vulnerability exercise to advanced countries, in order to improve the understanding of transmission mechanisms both within global financial markets and between financial markets and the real economy.

Since the 1980s, the IMF has mainly been focused on problems in emerging markets and developing countries, devoting insufficient attention to major financial centres and vulnerabilities in global financial markets. The ongoing financial crisis underscores the need for the Fund to maintain a sharp focus on risks in the major developed countries, especially the reserve currency-issuing countries, and their potential spillover effects. Consequently, much work still needs to be done to improve surveillance over the mature financial markets and advanced economies. This will be essential for ensuring that a reformed IMF remains relevant and properly discharges its mandate in promoting global economic and financial stability.

One of the most important areas of the Fund's work is surveillance over the exchange-rate policies of its members. In June 2007, the Executive Board approved an updating of the 1977 surveillance decision.²⁸ The update puts exchange-rate assessment at the centre of IMF bilateral surveillance, while external stability becomes the overarching principle of the surveillance framework.

The 2007 decision aims at providing a coherent framework within which exchange-rate issues can be assessed in the overall context of external stability. However, an over-reliance on quantitative models may divert attention away from a meaningful analysis of external and internal stability as well as from consideration of economic policy as a whole.

The assessment of a member's external stability should not be restricted to exchange-rate developments. The Fund's analysis should remain comprehensive, taking into account the overall macroeconomic situation, with emphasis on the consistency and

The IMF has been sidelined in handling the present crisis

New and better analytical instruments are needed to detect emerging risks

Surveillance of mature financial markets needs to be improved

While exchange-rate assessment lies at the centre of bilateral surveillance ...

... there remains a need for a comprehensive approach

²⁷ Communiqué of the Development Committee, the Joint Ministerial Committee of the Board of Governors of the Bank and the Fund on the transfer of real resources to developing countries, Washington, D.C., 12 October 2008, available from <http://siteresources.worldbank.org/DEVCOMMIT/NewsAndEvents/21937474/FinalCommunique101208.pdf>.

²⁸ See, "IMF Executive board adopts new decision on bilateral surveillance over members' policies", International Monetary Fund, Public Information Notice (PIN), No. 07/69, 21 June 2007, available from <http://www.imf.org/external/np/sec/pn/2007/pn0769.htm>.

sustainability of the overall policy mix. The surveillance should be focused on the relevant challenges in individual countries and should avoid exchange-rate issues' crowding out attention to other important elements which determine macroeconomic stability in specific contexts. In this regard, it has been argued that more needs to be done in this field to ensure effective and evenhanded implementation of the decision.²⁹

It is also considered important that surveillance over exchange-rate policies strike the right balance between candor and confidentiality of advice. It is essential that the Fund remain cautious and nuanced in presenting its exchange-rate assessments in view of the large margin of error and market impact.

In addition to the new surveillance decision, the IMF Executive Board reached agreement on a "Statement of Surveillance Priorities" in the context of the 2008 Triennial Surveillance Review (TSR). The four key policy objectives identified in the Statement are: to resolve financial-market distress; to strengthen the global financial system; to adjust to sharp changes in commodity prices; and to promote the orderly reduction of global imbalances. The fundamental goal of this effort should be to strengthen the spirit of cooperation by reaching a consensus among all members on the role of surveillance in assisting governments in dealing with the challenges of the integrated global economy.

Liquidity provisioning both during and for the prevention of crises

The provision of liquidity has become a key aspect of dealing with the crisis

Amidst the current financial market turmoil, the need for providing official liquidity has once again become the primary focus of Governments around the world. In its turn, the IMF has activated its emergency procedures—a mechanism to speed up lending in a crisis. As of mid-October 2008, several countries (Hungary, Iceland, Pakistan and Ukraine) had asked the IMF for financial assistance. According to the Managing Director of the Fund, the conditions of the loans will be fewer and they will be more targeted than in the past.³⁰ While the IMF has more than \$200 billion worth of funds available for loans and can raise more money, if necessary, by tapping agreements to borrow from several member countries, the expected volume of the rescue packages could exhaust IMF resources given the current state of financial markets.

Assistance is also needed to address the food crisis

In addition to the financial crisis, the international community has had to deal with the food crisis. At its Spring 2008 meeting, the Development Committee requested the Fund and the Bank to be ready to provide timely policy and financial support to vulnerable countries dealing with negative shocks, including those from food prices.³¹ As of October 2008, 11 countries had received about \$200 million in additional assistance under existing lending programmes supported by the Poverty Reduction and Growth Facility (PRGF). Five new PRGF arrangements for about \$274 million to help in part with commodity-price shocks were also approved. The IMF Executive Board also approved changes to the Exogenous Shock Facility (ESF) to make it more useful to low-income members. The changes are aimed at enabling the Fund to provide more rapid and effective assistance in

²⁹ See, for instance, statement by Stefan Ingves, Governor of Sveriges Riksbank, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from <http://www.imf.org/external/am/2008/imfc/statement/eng/swe.pdf>.

³⁰ "IMF in talks on loans to countries hit by financial crisis", *IMF Survey Magazine*, 22 October 2008, available from <http://www.imf.org/external/pubs/ft/survey/so/2008/new102208a.htm>.

³¹ Communiqué of the Development Committee, the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the transfer of real resources to developing countries, Washington, D.C., 13 April 2008, available from http://siteresources.worldbank.org/DEVCOMMIT/NewsAndEvents/21728301/Apr_2008_DC_Communique_E.pdf.

the event of shocks, with faster disbursement based on up-front policy commitments and streamlined procedural requirements. However, further revisions of the ESF are considered necessary to increase the level of access and to streamline conditionality.³²

The World Bank announced in May 2008 that it would support international efforts to overcome the global food crisis with a new \$1.2 billion rapid financing facility to address immediate needs, including \$200 million in grants targeted towards the vulnerable in the world's low-income countries. The \$1.2 billion funding ceiling should be reached by May 2009.³³

Along with addressing immediate member needs, the Fund has launched a review of its lending role with a view to reaching decisions before the 2009 annual meetings. The priorities of the review include finalizing a new crisis-prevention instrument, re-examining lending facilities for low-income countries and reviewing access limits and financing terms for using Fund resources.

At least in part, the review has been a response to recent low demand for IMF facilities. The decline in demand for IMF credit over the last decade can be attributed to some extent to a rather long period of positive international economic conditions. At the same time, the Fund's lending toolkit might have failed to keep pace with the evolution of the global economy.

The review of the IMF's financial facilities should lead to a more coherent, transparent and predictable framework that will allow the institution to fulfill its mandate adequately. The IMF needs to move beyond its traditional stance of offering rigid instruments, with low access levels in comparison to countries' needs and with burdensome conditionalities. The reform should also aim at simplifying and streamlining the lending framework in order to provide clear signals to the markets, reduce its complexity and strengthen its effectiveness, while also enhancing the flexibility and adequacy of IMF financing.

The onset of the food crisis reignited interest in mechanisms to protect developing countries, particularly low-income countries, from external economic shocks. Existing compensatory facilities have high levels of conditionality and do not provide sufficient resources relative to the shock, thus limiting their effectiveness for events beyond the control of affected countries. Countries have responded to shocks either by non-concessionary borrowing or by tightening fiscal and monetary policy, thereby undermining their own reform processes in order to avoid the onerous conditionalities associated with existing facilities.

Over the past decade, developing and emerging economies have made significant progress in consolidating fiscal balances and improving macroeconomic policy frameworks. Many of them have also built buffers against external shocks in the form of significant reserve accumulation. However, the recent financial market developments have demonstrated that no country is immune to crisis and, hence, there is a strong need for a lender of last resort. In the face of an exogenous and sudden stop in external funding, emerging market and developing country domestic central banks are unable to inject sufficient liquidity in the form of domestic currency, since this will not only be inflationary but can also cause the domestic currency to depreciate, the domestic interest rates to rise considerably, or both. There is also no guarantee that, during a major capital reversal or global liquidity crunch, domestic central banks will have sufficient reserves to provide emergency

The IMF has launched a review of its lending role

The food crisis has led to increased interest in mechanisms to protect developing countries from external shocks

The recent crisis has highlighted the need for a lender of last resort

³² Communiqué of the Intergovernmental Group of Twenty-Four on international monetary affairs and development, 10 October 2008, available from <http://www.g24.org/10-08ENG.pdf>.

³³ "Update on key issues and World Bank Group activities", statement on behalf of the World Bank Group, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from <http://www.imf.org/External/AM/2008/imfc/statement/eng/wb.pdf>.

liquidity assistance in foreign exchange. Indeed, the current crisis has demonstrated how quickly a cushion in the form of foreign-exchange reserves could evaporate.

For these countries, the IMF, along with regional reserve-pooling arrangements and swap agreements with developed country central banks, could potentially play the role of international lender of last resort. Since the late 1990s, due to unusually benign global conditions, demand for IMF lending has almost evaporated, while many borrowers have made early repayments. However, it would be unrealistic to suggest that the need for an international lender will never resurface again. The Fund should stand ready to help its emerging market and developing country members cope with liquidity problems in an environment of large and volatile capital flows. To this end, both appropriate facilities and amounts of financing relevant to members' needs are required.

In this regard, there have been proposals to increase normal access limits significantly above the current 300 per cent of quotas. Over the past 10 years, access limits—either measured as a share of GDP, trade or capital flows—have declined for emerging market and developing countries. This has led to a more or less permanent need to provide exceptional access, at exceptional financial and political costs, for countries experiencing capital reversals. Despite the quota and voice reform package, the limits for non-exceptional access will likely continue to shrink further in comparison to members' potential needs. Accordingly, there is a view that quotas are not an appropriate metric on which to base access to the Fund's resources and that alternative ways could be explored.

In addition to increased normal access, there have been suggestions for examining the possibility of providing the IMF with mechanisms for the rapid granting of short-term or very short-term loans, probably with the participation of reserve currency-country central banks, to member countries affected by sudden international liquidity crunches. When systemic financial crisis occurs, speed is critical for the restoration of confidence in the financial system. The faster the access to funds, the smaller the amount of money needed. The creation within the Fund of instruments for quick provisioning of liquidity, similar to those used by central banks of advanced economies to cope with the current turbulence, may be worth studying. This, together with much higher normal access, could be the best response to the current crisis.

On 28 October 2008, the IMF Executive Board approved the Short-Term Liquidity Facility (SLF).³⁴ The new facility comes with no conditions once a loan has been approved, and offers large upfront financing to help countries restore confidence and combat financial contagion. To be eligible, countries should have a good track record of sound policies borne out by the most recent regular country assessment of the IMF. Disbursements of IMF resources can be as much as 500 per cent of quota, with a three-month maturity. Eligible countries are allowed to draw up to three times during a 12-month period.

As in the case of national central banks, an international lender must deal with the problem of moral hazard. There is almost a consensus that the best way to limit moral hazard is to develop a well-functioning prudential, regulatory and supervisory system. At the international level, moral hazard concerns could be addressed through existing mechanisms: the Financial Sector Assessment Program (FSAP); the preparation of Reports on the Observance of Standards and Codes (ROSCs); and the publication of Financial Soundness Indicators (FSIs). This surveillance, if performed diligently, should enhance the effectiveness of central bank-like emergency liquidity provisioning by the Fund.

There have been proposals to increase normal access limits ...

... but the design of instruments for quick liquidity provision also needs to be considered

The IMF Executive Board approved the Short-Term Liquidity Facility

Well-functioning regulatory systems are the best way to deal with moral hazard

³⁴ See "IMF to launch new facility for emerging markets hit by financial crisis", *IMF Survey Magazine*, 29 October 2008, available from <http://www.imf.org/external/pubs/ft/survey/so/2008/POL102908A.htm>.

Since IMF emergency lending in large volumes is meant mainly to respond to situations of capital reversals, policy conditionality should include measures to stem the size and volatility of capital inflows. The Fund should support government policies to exercise prudential regulations for managing the impact of external flows on domestic balance sheets, thereby minimizing financial injections in crisis situations.

*The Doha follow-up conference on financing
for development and broader reforms*

The financial crisis has broadened the consensus on the urgency of far-reaching reform of global economic governance and the international financial architecture. This effort is not likely to be completed at one meeting or in one specific forum. The G20-sponsored process will involve a series of meetings that will consider technical reports. Actual progress and effective reforms will depend on the political consensus that can build upon proposals that have already been discussed in many circles. It is therefore important that a genuinely political decision-making process, and one which is well-supported technically, provide the basis for the reform of the international system. Notable progress in this direction was achieved at the Doha follow-up conference on financing for development, but the process has only begun. As a genuinely universal body, capable of eliciting political commitment, the United Nations General Assembly should expand its participation in efforts towards this end.

The United Nations
General assembly should
expand its involvement in
reforming global economic
governance

Chapter IV

Regional developments and outlook

Developed market economies

Economic activity plummeted precipitously in the developed country region over the course of 2008, with many of the major economies now technically in recession.¹ Concerns of policymakers over inflationary pressures in the summer of 2008, resulting from the surging commodity prices and possible second-round effects via increasing wage pressures, have shifted quite dramatically to concerns over real activity and the heightening risks of a protracted recessionary period.

Slumping housing markets that led to downturns in consumer spending and, more importantly, that exposed dangerous weaknesses in banking systems causing severe problems in credit markets have been a major drag on activity since autumn 2007. But the situation entered a more dangerous phase in September 2008, with risk aversion rising dramatically in many financial markets leading to a full-scale financial crisis. Investment spending is now slowing sharply in most economies in the region, and with negative growth impulses spreading across the globe, developed market exports, particularly those to fast-growing Asian and oil-producing countries, are now slowing dramatically.

North America: How severe will the recession in the United States be?

The economy of the United States of America has fallen into a recession. At issue are its depth and duration. The economy has been fragile since 2007, but until mid-2008, the major drag had been a slump in the housing sector, while strong external demand and a sizeable fiscal stimulus package had kept the economy growing at a mild pace. The situation deteriorated significantly in the second half of 2008 as the credit crisis intensified dramatically. The severe credit crunch has turned a sector-led slowdown into a full-scale retrenchment of households and businesses affecting the economy at large. In response to the financial meltdown, the Government has drastically strengthened its policy stance, including by passing the Emergency Economic Stabilization Act (EESA), which, among other measures, allocated \$700 billion to enable the Government to recapitalize banks.² Effective implementation of the EESA, along with further monetary easing, might eventually stabilize financial markets, but the package came too late to prevent the real economy from falling into recession. In the baseline outlook, gross domestic product (GDP) growth is forecast to be -1.0 per cent in 2009, compared with an estimated, still positive, growth of 1.2 per cent for 2008 (see table A.1). Risks for a much deeper and longer recession remain high should all the policy measures fail to thaw the credit markets soon.

¹ A technical recession is defined as two consecutive quarters of negative, quarter-on-quarter growth.

² See chapter I for details of the rescue plan and other unorthodox policies in use to combat the financial crisis.

The housing sector is continuing to weaken

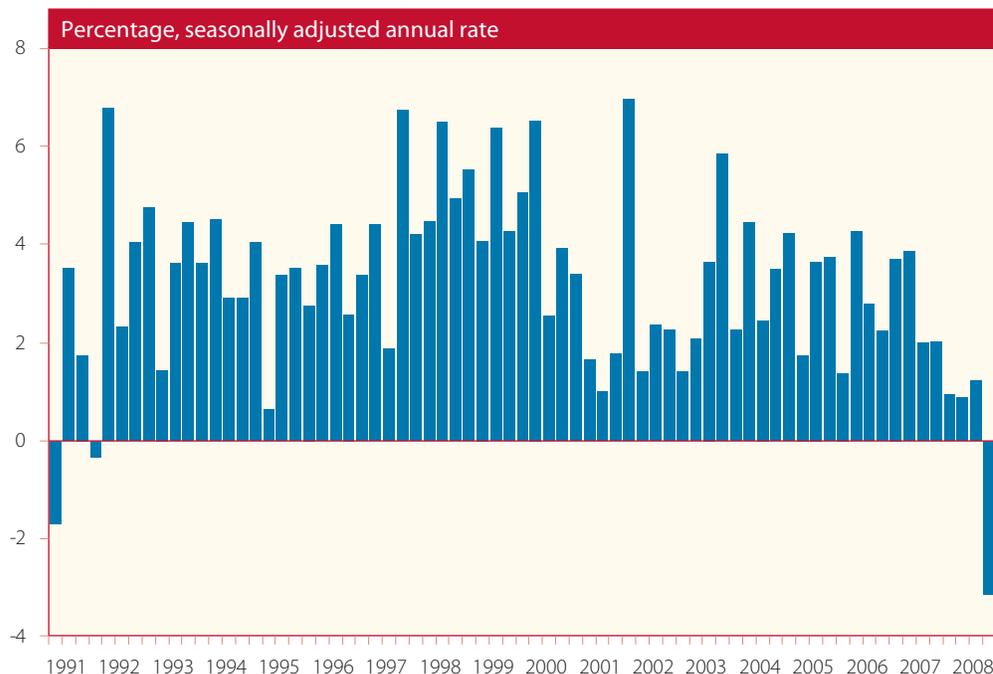
The housing sector, which was the trigger for the financial crisis, has been in a slump for two years. New home sales have dropped by 60 per cent from their peak of 2006, and existing home sales have fallen by about 40 per cent. Builders continue to reduce supply, pushing housing starts to their lowest level in more than 15 years. Although inventories of unsold homes have started to drop, they are still at a high level. House prices continued to fall in 2008, by about 16 per cent as measured by the Standard and Poor's S&P/Case-Shiller Home Price Index for twenty cities. In the outlook for 2009, the tightened credit conditions will make it difficult for the housing sector to recover, and a weakening broad economy, particularly one with rising unemployment, will continue to exert strong downward pressure on the demand for houses.

Household consumption is declining for the first time since 1991

Household consumption spending is expected to decline (see figure IV.1). Households are facing massive constraints: wage and salary income is decelerating as unemployment rises, negative wealth effects are rapidly accumulating from the sharp depreciation in the value of equities and houses, and credit is more difficult to obtain; this at a time when consumer debt is historically high and the savings rate low (outstanding household debt as a share of disposable income was 133 per cent in 2007, while the savings rate was 0.6 per cent). Moreover, consumer confidence has plunged to its lowest level in more than two decades.

Business capital spending is also expected to fall notably. Spending by businesses on machinery and equipment has in fact been falling since the beginning of 2008, although corporate spending on non-residential construction has been growing. Credit tightening, falling equity prices and softening corporate profits are all constraining business investment. The risk of the private sector's cutting capital spending on construction is also high: besides the tightened financing for commercial real estate, the demand for retail and office space is also diminishing as consumer spending and employment decline.

Figure IV.1
Quarterly growth of personal consumption expenditure in the United States, 1991-2008



Source: United States Department of Commerce, Bureau of Economic Analysis, National Economic Accounts.

The rate of unemployment is expected to rise to above 7 per cent in 2009 (see table A.7). During 2008, non-farm payrolls declined each and every month, and that decline has intensified since September. Job losses had been concentrated in construction and manufacturing, but have now spread to almost all sectors, including services. Unemployment surged to a rate of more than 6 per cent in the second half of 2008, up from the low of 4.5 per cent in 2007. Moreover, the number of discouraged workers, those who are unemployed but have given up searching for a job, has also increased dramatically.

After peaking at an annual rate of 5.6 per cent in mid-2008, headline inflation has been moderating, along with a significant correction in energy and food prices. Core inflation has remained well above 2 per cent, which is perceived as the upper bound of the comfort zone for the Federal Reserve (Fed). However, with the sharp slowing in economic activity, with no further increases in commodity prices envisaged and with inflation expectations dropping significantly from late 2008, the outlook for 2009 is for core inflation to drop below 2 per cent, with headline inflation even lower (see table A.4).

Exports of the United States have been growing at an exceptionally strong pace over the past two years. In volume terms, exports are estimated to have increased by almost 10 per cent in 2008. In contrast, the volume of imports has dropped by about 2 per cent, reflecting weak domestic demand. In the outlook, the growth of exports is expected to decelerate notably in 2009 as global demand slows. Meanwhile, imports are expected to fall further, as both consumption and investment face a retrenchment. The current-account deficit improved during 2008, standing at about \$700 billion, and is expected to narrow further in 2009, to \$540 billion, reflecting continued weak import demand, as well as a lower oil import bill.

On the policy front, both monetary and fiscal policies have almost exclusively focused on battling the financial crisis, and are expected to continue to do so in 2009.

Since the eruption of the financial crisis in late 2007, the Fed has reduced the federal funds rate, as well as the discount rate, in a dramatic manner, the former to a level of 1.0 per cent in October 2008. The Fed has also adopted a full gamut of unorthodox monetary measures to inject liquidity into markets in an attempt to quell the credit crunch.

The Government has also adopted various fiscal measures, in a broad sense, in tackling the crisis. The first fiscal stimulus package, which mainly included a tax cut for households and businesses, managed to keep GDP growing at a moderate rate until mid-2008, but it was clearly too small to avert a recession in the face of an unprecedented credit crisis of mammoth proportions. The Government also took a number of unorthodox fiscal measures. In the outlook, another fiscal stimulus package is expected in 2009.

Risks of the economy falling into a much deeper and longer recession than in the baseline forecast remain high. A self-reinforcing cycle between the financial meltdown and the recession in the real economy could form a tumultuous downward spiral: the credit freeze could lead to an additional retrenchment of consumer and business spending, followed by more job losses, further deterioration in the housing market, more losses in and failures of financial institutions, and, in turn, more severe credit tightening.

The Canadian economy will see a pronounced slowdown in growth from 2.7 per cent in 2007 to 0.4 per cent in 2008, before rebounding somewhat to 0.8 per cent in 2009. On the domestic side, higher inventories will cut into growth, as will the fading positive effect of tax cuts that took effect in the first half of 2008. Weaker investment owing to more pessimistic sentiment will generally add to the more challenging picture; fiscal policy will have only limited space in which to provide growth impulse, in view of weaker revenue growth and political reluctance to embark upon more elaborate deficit spending.

Inflationary pressures are finally starting to ease

The Fed is easing policy dramatically

Fiscal policy has also been brought to bear, with expectations of more to come

Canada's growth will be dragged down by the slowdown in the United States

On the external side, the weak United States economy will be a major drag on activity, especially through its negative effect on exporters of manufactured products in areas such as the automotive industry. At the same time, lower oil and commodity prices will slow the economic boom in the western provinces.

Lower inflation will create room for further easing of monetary policy

The financial turmoil led monetary policymakers to reduce the policy interest rate by 200 basis points from 4.25 per cent at the end of 2007 to the current level of 2.25 per cent. Moderating inflation in view of lower oil and commodity prices, as well as the slowing growth performance combined with rising unemployment, will create increasing room for further interest rate cuts in 2009.

Western Europe: Sharp deceleration with many countries now in recession

The euro area, along with most of Western Europe, started the year on a high note, with (quarter-on-quarter) growth of 0.7 per cent in the first quarter of 2008, a significant rebound from the fourth quarter of 2007. Activity decelerated sharply thereafter, however, to the point where the region is now in a technical recession. Of the major economies, Germany, Italy and the United Kingdom of Great Britain and Northern Ireland are all in recession; Spain experienced its first quarter of negative growth since 1993 and has experienced the sharpest absolute deceleration; and France has narrowly escaped a technical recession, but activity is very weak. Despite this, the strong carryover from the first quarter of the year has led to an estimated GDP growth of 1.1 per cent for the year as a whole; however, with no carryover into 2009 and no significant rebound expected in the second half of that year, GDP is expected to decline by 0.7 per cent in 2009. This would mark the first annual decline in GDP since 1993 (see table A.1).

High frequency data are revealing the speed and depth of the decline

Higher frequency data reveal the sharp drop in activity and provide a useful comparison to previous slowdowns (see figure IV.2). Industrial production remained robust in the first quarter of the year but fell sharply thereafter. Survey results show a continued worsening of growth prospects into the fourth quarter. The European Commission's economic sentiment indicator for the euro area is now well below its long-term average, and is below the troughs of 2001 and 1996 and nearing those of 1992 and 1993, when, if a regional aggregate of what has now become the euro area is made, growth registered 1.2 and -0.7, respectively.³ Country-specific surveys paint a similar picture. Germany's Ifo overall business climate index, for example, peaked at the beginning of 2007 but has since seen a very sharp decline. As of November 2008, it was just above the value registered in 1993, the lowest point since German reunification, while the component reflecting German business expectations is now at a record low within this same timespan.⁴

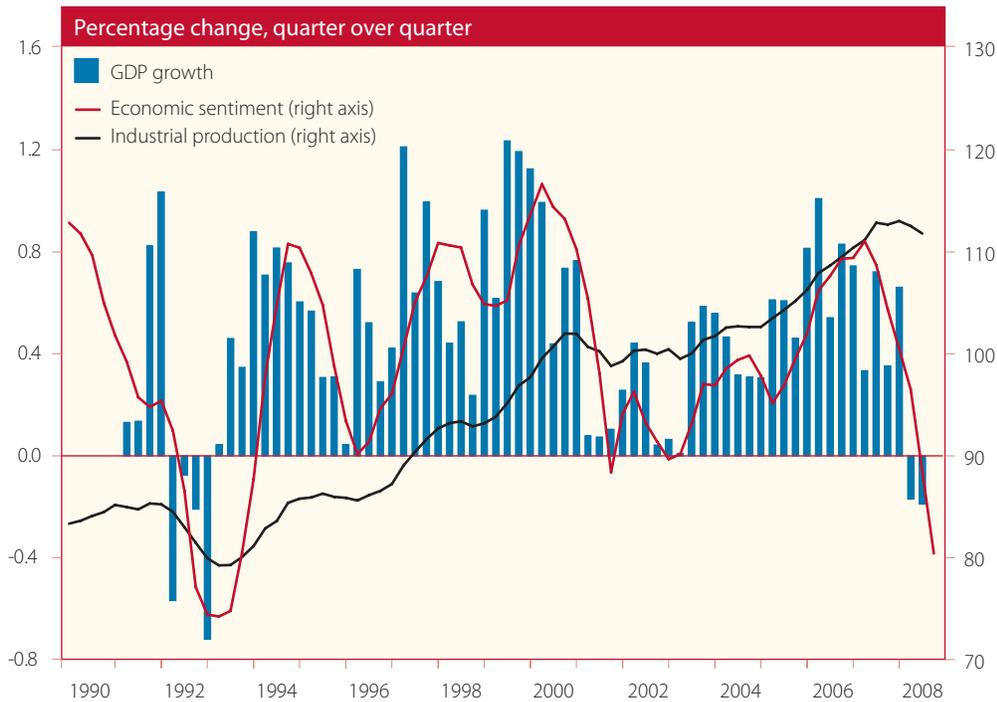
Consumption expenditure is slowing

Consumption expenditure contracted in the euro area in the first half of 2008, a pattern shared by a number of countries in the region. Sharply higher inflation that choked off any improvement in real disposable income and deteriorating confidence, stemming from fears surrounding future economic activity as well as the intensifying global financial crisis, were the major drivers. Retail sales figures have been drifting downwards since the fourth quarter of 2007, and as of September stood at 1.6 per cent below the previous year. Lending conditions to households have tightened, with higher bank lending rates

³ See Organization for Economic Cooperation and Development, *Economic Outlook*, vol. 2008/1, No. 83, June 2008.

⁴ See Ifo Institute for Economic Research, Ifo Business Climate Germany, available from <http://www.cesifo-group.de/portal/page/portal/ifoHome/a-winfo>.

Figure IV.2
Economic activity in the euro zone, 1990-2008



and tighter credit standards, and loans to households are clearly decelerating.⁵ Household wealth has been hit by declining equity markets and housing values, the latter having particular significance in countries where house prices have experienced a sharp run-up in the past, such as in Denmark, Ireland, Spain, the United Kingdom and, to a lesser extent, France. Current labour-market conditions remain favourable, but expectations for the outlook have deteriorated, with employment and wage prospects diminishing. Business surveys are already indicating that firms are expecting to reduce hiring. Some impetus can be anticipated from decelerating inflation, thus yielding moderate improvement in real compensation, but consumption expenditure is expected to be of only minimum support over the forecast period.

After a strong first quarter, investment spending has also been hit sharply, slowing external demand being a major negative impulse.⁶ In the early stage of the present global slowdown, the impact of the deterioration in the United States had been dampened by continuing robust demand from East Asia and oil-producing countries, particularly the Russian Federation, but these economies have now joined the general slowdown. Order books have deteriorated significantly and forward-looking surveys have plummeted. Capacity utilization, while still relatively high, is on a declining path. Balance sheets of non-financial corporations were still reasonably sound towards the end of 2008, stemming from high past profitability, but corporate profitability is severely deteriorating and stock markets have plummeted, which could lead to dangerously worsening balance sheets in

Investment spending is dropping sharply

⁵ See European Central Bank's "The Euro area bank lending survey", October 2008, available from http://www.ecb.int/stats/pdf/blssurvey_200810.pdf; and the discussion on "The results of the 2008 bank lending survey for the euro area" in the European Central Bank's *Monthly Bulletin*, November 2008, pp. 19-25, available from <http://www.ecb.int/pub/pdf/mobu/mb200811en.pdf>.

⁶ Some of the good performance in the first quarter can be attributed to mild weather, which boosted construction expenditure, but that reversed in the second quarter.

2009. The cost of external financing has increased significantly: corporate bond spreads have widened and banks are reporting rising margins for loans and higher credit standards. Bank lending to non-financial corporations remains strong but has been slowing continuously, registering a growth of 12.1 per cent in September of 2008 versus 14.6 per cent in the first quarter of the year. Going forward, it is probable that the deterioration in credit markets will slow borrowing further. Investment in the housing sector remains very weak and in some countries has plummeted, and there is no expectation of any significant rebound over the forecast horizon.

Exports are succumbing to a slump in global demand

Export volumes decelerated sharply in the second quarter of 2008. They are estimated to grow by only 3.8 per cent in 2008 in the EU-15 and are actually expected to decline in 2009 (see table A.16). Slowing global demand, coupled with continued strong regional currencies, provides powerful headwinds. The retreat of the euro and other regional currencies from their July peak, with further depreciation expected, provides some relief.⁷ For some countries, a favourable product mix and orientation towards fast-growing Asian and oil-producing countries, as well as strong competitiveness, provide some cushion, but all countries are expected to see significant slowing in exports, and the region as a whole is expected to continue to lose market share. Import volumes are also expected to slow in line with declining domestic demand, albeit by less than exports thereby causing net exports to detract from GDP growth.

Inflation has moderated

Headline inflation surged to its highest level in twelve years during 2008, reaching a peak of 4.0 per cent in both June and July in the euro area, but has since retreated to an estimated 3.2 per cent in October. Most of the acceleration can be attributed to the sharp rise in oil and food prices. The pass-through to general prices, a major concern for policymakers, was muted, with core inflation hovering just below 2 per cent since the beginning of 2007. Wage growth has been picking up and, with productivity slowing in the early stages of the downturn, unit labour costs have risen. But in the current negative environment, wage increases are expected to be limited. Over the past few years, the increasing strength of the euro has put significant downward pressure on prices and has, to some extent, mitigated the full impact of the rise in oil prices. While the depreciation of the euro in the second half of the year will eliminate this dampening effect, the sharp fall in oil prices (as well as in food and other commodity prices), coupled with GDP falling well below potential, is expected to lead to a further tapering off of inflation and a slow reversion towards 2 per cent. Inflation expectations,⁸ which were running significantly above 2 per cent in mid-2008, have since fallen back.

Unemployment rates reached multi-year lows but will deteriorate further in the outlook

The labour market has been a bright spot in Europe for the last few years, with unemployment trending down to multi-year lows, but it is now expected to deteriorate significantly as growth falls well below potential over the entire forecast horizon. Firms are increasingly challenged by the weaker demand outlook and tighter financing conditions. Labour costs have also risen, but are expected to remain contained going forward. Employment data are published with a significant time lag, but they show a clear deceleration in growth from the first quarter of 2007 through the second quarter of 2008. Unemployment data are timelier and show a gradual upward trend since the low point of 7.2 per cent for the euro area in the first quarter of 2008, reaching 7.5 per cent in August and September

⁷ On a trade-weighted basis, the euro peaked at a 40 per cent appreciation in July compared to its low in 2000. It has since fallen by more than 7 per cent from its peak, but still remains historically high.

⁸ Inflation expectations are measured here as the spread between French inflation-indexed and non-indexed bonds.

of 2008. To put this in perspective, unemployment is still relatively low, being well under the previous cyclical trough of 7.8 per cent in 2000. It would be necessary to go back to the 1980s to find unemployment rates as low as they are currently. So far, the construction sector has been the hardest hit, with Denmark, Ireland, Spain, and the United Kingdom most affected, but as the downturn continues, unemployment is expected to increase in all countries in the region, rising by about 1 percentage point for the region as a whole.

Fiscal positions are expected to deteriorate significantly over the forecast horizon. On the revenue side, slowing growth and falling asset prices are expected to dampen tax revenues. On the expenditure side, automatic stabilizers in the guise of social benefits and transfers will increase significantly. Some discretionary fiscal stimulus is assumed in the outlook, but it is increasingly likely that more may be necessary, at least in those countries with budgetary space, and perhaps by an even larger group. Measures to combat the intensifying global financial crisis may well dwarf these traditional policy measures. So far, the former have included capital injections into financial institutions; State-backed guarantees for bank loans; higher levels of minimum deposit insurance; and actual bailouts of financial firms, including a wave of partial nationalizations of banks in late September and October. These types of measures are likely to continue to be deployed.

At the beginning of 2008, while most central banks in the region were using traditional policy instruments to suppress increasing inflationary pressures (headline inflation rates being well above declared targets), they were, at the same time, combating problems in credit markets using unorthodox measures. The European Central Bank (ECB) raised its main policy interest rate, the minimum bid rate, by 25 basis points (bps), to 4.25 per cent in July, and during the year there was further tightening elsewhere by 75 bps in Sweden and 50 bps in Norway, while the Swiss National Bank maintained the tight policy stance it had in 2007. The unorthodox measures focused on the direct injection of liquidity into the money markets, with central banks acting as both a lender of last resort and a market maker. The ECB, for example, accepted an increasingly wide range of collateral and counterparties in its discount and repurchase operations, and at an increasing range of maturities.

As global economic conditions deteriorated further, however, policy stances shifted. The Bank of England was the first to react, lowering rates in February and April. Later, on 9 October, after the financial crisis had begun to enter a more dangerous phase in September and indicators of economic activity had begun to fall to levels associated with a recession, central banks changed course and joined in a coordinated rate cut of 50 bps. The ECB,⁹ the Bank of England, the Sveriges Riksbank and the Swiss National Bank (25 bps) all joined in the action. The Bank of Norway also cut its rate by 50 bps later in the month. Since then, the ECB has made another 50 bps cut, bringing its rate to 3.75 per cent, while the Bank of England made a staggering cut of 150 bps in November. The other central banks also loosened policy further. The cumulative change in policy rates by the end of November was 150 bps for the ECB, 200 bps for the Bank of England, 100 bps for the Sveriges Riksbank, 175 bps for the Swiss National Bank, and 100 bps for the Norges Bank.

In the outlook, policy is expected to loosen further. The ECB is assumed to cut its main policy interest rate further during the fourth quarter of 2008 from its current level of 3.25 per cent to 2.75 per cent by the end of the year, and in early 2009 another 50 bps

Fiscal policies are likely to be unorthodox

Monetary policy is shifting to rapid easing

⁹ The ECB also changed its operating procedure so that its main refinancing operations would be carried out through a fixed-rate tender procedure with full allotment at the interest rate on the main refinancing operation. This replaced its policy of setting a minimum bid rate for variable rate tenders and effectively provides sufficient liquidity to satisfy demand at the fixed rate.

Regional exchange rates
were highly volatile
during 2008

cut is assumed, with no further action for the rest of the year. Similar policy is assumed for the other regional central banks.

In the first half of the year, regional currencies continued their long period of appreciation against the United States dollar and the yen—to no small degree on account of the large and persistent global imbalances—with the euro reaching a peak of \$1.60 and ¥169. Superimposed on this long-run trend, are short- to medium-term dynamics in currency markets that have been driven largely by relative outlooks for growth, interest rates and risk assessments, the latter at times generating significant flights to safety into and out of currencies. All of these factors, both long- and short term, favoured the euro in the first half of 2008: growth was holding up, monetary policy was still tight and potentially tightening, and the risks stemming from the financial crisis were concentrated mostly in the United States. But this shifted dramatically in July as the outlook for the euro area deteriorated significantly and it also became clear that the ECB would have to cut rates in response to the slowdown. This led to a sharp decline in the euro against both the United States dollar and the yen during the summer months. In mid-September risk assessments shifted further against the United States as market participants reacted to the latest proposed bailout plan, which raised the Government's debt burden significantly. This led to a rebound of the euro, but it was short-lived, as the economic news in Europe had deteriorated further and the financial turmoil that had spread across the continent at the end of September produced a serious jolt to risk perceptions. The euro resumed its downward path reaching lows of nearly €1.25 against the dollar, while against the yen it fell to lows of nearly ¥117, as these higher risk perceptions led to a reversal of the carry trade and a repatriation of funds.

In the outlook, the euro is expected to remain close to current levels of about \$1.28 in the fourth quarter of 2008 and to depreciate further in 2009, reaching \$1.20 as interest rate differentials with the United States narrow further. Similarly, the euro is assumed to remain at ¥126 in the fourth quarter and to reach ¥109 in 2009.

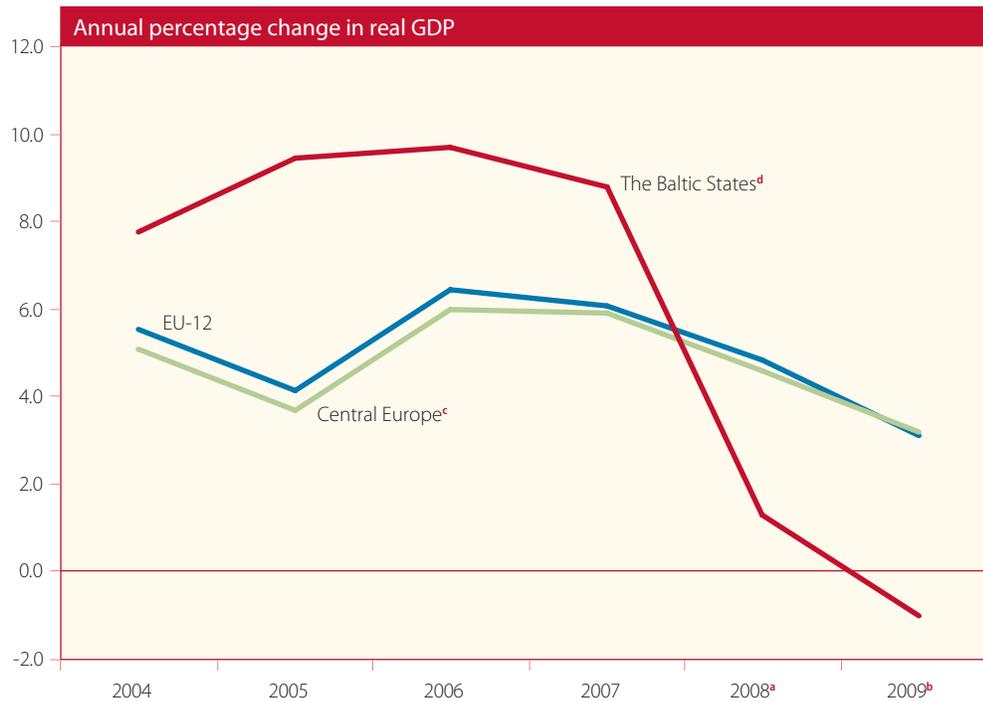
Downside risks
are worrying

Risks to the outlook are significant and biased towards the downside. The key assumption in the present outlook is that problems in financial markets will subside and that real activity will begin to stabilize in the second half of 2009. This might be optimistic as problems have continued to intensify towards the end of 2008. The longer these problems persist, the more severely private investment will be hit. Moreover, housing markets could deteriorate further and remain in a slump for a longer period of time, dragging down overall economic activity even more in some economies in the region. In addition, the economies in East Asia and oil-producing countries could be hit harder than currently expected, which in turn would further reduce demand for European exports. Another major risk could come from a collapse of the dollar which would push regional currencies back to and beyond the elevated levels of the summer of 2008, pricing many exporters out of key markets.

The new European Union member States: A divergent growth pattern in 2008, a slowdown in 2009

Following several years of buoyant economic expansion in the new European Union (EU) member States, aggregate GDP growth in 2008 is expected to slow to 4.9 per cent in 2008 and to decline further to 3.1 per cent in 2009 (see figure IV.3). While a number of economies, such as Bulgaria, Poland, Romania and Slovakia, managed to sustain or even accelerate their growth rates in or into the 5-8 per cent range, the three Baltic economies witnessed a sharp slowdown. Growth in Estonia and Latvia turned negative in 2008, with

Figure IV.3
Pattern of economic growth in the new EU member States, 2004-2009



Sources: United Nations Economic Commission for Europe; Eurostat.

a Partly estimated.

b Forecasts, based on Project LINK baseline scenario.

c Consists of the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

d Consists of Estonia, Latvia and Lithuania.

further contraction expected in 2009. Growth in the remaining countries in the region was moderate in 2008 but is also expected to slow further in 2009, as their main driving force, robust domestic demand, is weakening in response to higher credit costs and accelerated inflation. In Hungary, further fiscal tightening and harder borrowing conditions will lead to negative growth in 2009. Export growth for these economies is also expected to decline owing to the economic slowdown by their main trading partners.

The generally strong growth in the region over the past several years was driven by vibrant domestic demand, underpinned by increasing real wages and the expansion of domestic credit, but it was also accompanied by a number of dangerous trends: sizeable current-account deficits that were often financed by interbank borrowing; FDI flows into much of the region that were financed by lending from parent companies, increasing the indebtedness of the private sector; a large fraction of investment that was channelled into real estate in a number of the economies, especially the Baltic countries and Bulgaria, producing domestic housing bubbles; and, finally, a sizeable percentage of loans in the region that were denominated in foreign currencies.

The tightening of global financial markets has begun to reduce the ability of the business and banking sectors to maintain their levels of foreign borrowing. As a result, domestic credit growth has declined and banks have tightened their lending policies. The generally large current-account deficits have made the region especially vulnerable to the deterioration in global credit conditions. In Hungary, the high stock of short-term private debt, denominated in foreign currencies, created a serious liquidity squeeze. To avoid a financial crisis, the country had to seek assistance from the ECB, the EU and the International Monetary Fund (IMF), which was provided quickly and in sufficiently large amounts to contain the crisis and the potential for regional contagion. Although the financial sectors of the new EU members are not significantly exposed to United States sub-prime debt, there

Economic expansion was often financed by foreign borrowing

The region is vulnerable to the global credit squeeze

is an extremely high level of foreign ownership, largely by EU-15 banks, and should these experience serious difficulties, the financial stability of the region would be seriously impacted. If the cut-off in foreign borrowing is too sharp, a true credit crunch could develop.

In 2008, domestic inflationary pressures caused by continuing wage growth, sometimes in excess of productivity gains, and increases in excise taxes and regulated prices were amplified by the surge in global food and energy prices. The impact of rising world market prices for food and oil on overall domestic inflation differed across the new EU member States on account of differences in weights for food prices in consumer price indices; differences in the degree of competition in services and in the retail sectors, explaining different cost mark-ups; and differences in exchange-rate regimes. Inflation reached double-digit levels in the Baltic States and Bulgaria, whose fixed exchange-rate regimes prevented nominal appreciation from accommodating some of the inflationary pressure. Currency appreciation dampened inflation in the Czech Republic, Hungary and Poland in the first half of 2008. By mid-2008, headline inflation had peaked and had started to subside, reflecting, among other things, the drop in world oil and commodity prices.

In response to accelerating inflation in the first part of 2008, and in the light of the shared key policy goal of a return to a disinflationary path, interest rates were increased in the Czech Republic (at the beginning of the year), Hungary, Poland and Romania. In addition, certain measures were undertaken to constrain domestic credit, such as the increased credit supervision in Slovenia. But with slowing economic growth and declining world commodity prices, policy concerns are shifting. Monetary easing has already taken place in the Czech Republic and in Hungary, but concerns about currency depreciation may limit the room for a further loosening of monetary policy.

Conditions attached to accession to the European Monetary Union remain a main focus for macroeconomic policies in the region. Slovakia will adopt the euro in January 2009, but no further accessions are anticipated for several years. The Maastricht criteria, especially the inflation target, are proving difficult to meet. Budget deficits have been reduced towards achieving the target, but not without creating a pro-cyclical impulse to a slowing economy. In the outlook, the slowdown will make it more difficult to meet fiscal targets and reduce the deficit further. However, given the limitations of using monetary policy for macroeconomic stabilization, especially under a fixed exchange-rate regime, additional fiscal stimulus will be needed to counteract the economic slowdown.

The employment situation in the new EU member States continued to improve in 2008; in Poland, for example, unemployment reached 9.6 per cent in mid-2008 compared to 19.0 per cent as recently as 2004. Nevertheless, structural problems in labour markets continue as labour-force participation rates remain low in a number of these economies. The sharp economic slowdown being forecast in the Baltic States in 2009 may lead to a 1 or 2 percentage point increase in their unemployment rates, which are currently in the range of 5 to 6 per cent. In other economies, the rate of job creation has also slowed, and the continuing return of migrants from the EU-15 back to their home countries may exert additional pressure on the labour markets. Since 2004, almost one million workers migrated to the United Kingdom alone; approximately two thirds of these came from Poland.

External deficits declined significantly in the Baltic States in 2008, reflecting an improvement in their trade balances as weakening domestic demand led to a contraction in imports. In Central Europe, however, the improvement in current-account deficits was only marginal, and in some countries the deficits increased, reflecting a decline in exports. In 2009, current-account deficits will continue to decline in the Baltic States, but will remain at about the same level in Central Europe.

Inflation surged in response to higher energy and commodity prices, but is expected to subside in the outlook

Monetary policy tightened in 2008

Labour markets continued to improve, but the worsening economic situation will reverse this positive trend

Current accounts deficits declined in the Baltic States, but remain the same in the rest of the region

In the outlook, the most serious risk faced by the region is a protracted slowdown in the EU-15; for the countries with large external deficits and a high dependence on foreign borrowing, it is the possibility of a sharp reversal of capital flows.

Developed Asia and the Pacific: Japan's economy enters recession and will contract further in 2009

In Japan, economic activity contracted in the second and third quarters, bringing another major economy into recession. Weaker export demand owing to lower growth in international markets and negative exchange-rate effects were the primary causes. Annual growth is expected to register only 0.4 per cent in 2008 and -0.3 per cent in 2009 (see table A.1). The negative effect of the global financial crisis through the external account has increasingly outweighed the country's only limited exposure to sub-prime loans in the United States as well as its strong capital position due to the high level of domestic savings. In the baseline, the economy is forecast to remain in recession into the first half of 2009 before seeing a return to positive growth rates in the third quarter of 2009.

On the domestic side, slower growth in private consumption will be a major drag on overall growth performance. The weaker trading environment for exporters and rising input costs, notably in the energy sector, exert increasing pressure on corporate profits, which will translate into softer labour demand and wage growth. In parallel, the continued relatively high consumer-price inflation due to higher commodity prices will cut into consumers' purchasing power, further eroding the potential impulse from private consumption for overall growth.

The room for fiscal stimulus seems limited in the light of the country's level of public indebtedness. Japan's public debt ratio has surged to become the highest in the industrialized world since the extensive fiscal support measures during the recession in the 1990s (see figure IV.4). The Government's looser fiscal policy stance in the form of two recent stimulus packages to support economic growth will be only temporary. In the medium term, the outlook for public finances remains bleak, as the option of higher income and consumption taxes remains on the table, holding significant downside risk for private consumption.

Business investment has shown a more moderate expansion, especially in view of the weaker external trading environment, but momentum will pick up in the second half of 2009 as firms will aim to ensure their competitiveness through technological upgrades in their production processes. Similarly, private residential investment will support growth as the slowing effect of regulatory changes fade.

On the external side, exports are suffering from the slowdown in the United States, Japan's biggest export market, as well as a stronger yen. Demand from emerging markets, especially China, has so far been a strong counterweight to slower export demand from developed countries, but the negative impact of the global crisis on economic activity in emerging markets will put further pressure on Japan's export performance.

Consumer prices are being pushed higher by the increase in energy and commodity prices. However, inflation will moderate along with the slowdown of the global economy, lower commodity prices and the appreciation of the yen. In 2008, the inflation rate is estimated at 1.6 per cent and is expected to decelerate to 1.1 per cent in 2009 (see table A.4).

In view of the weakening growth picture, the Bank of Japan cut its policy interest rate from 0.5 per cent to 0.3 per cent in October. Rates are assumed to stay at their current levels through 2009.

Consumption will be weak ...

... while the potential for fiscal stimulus remains limited

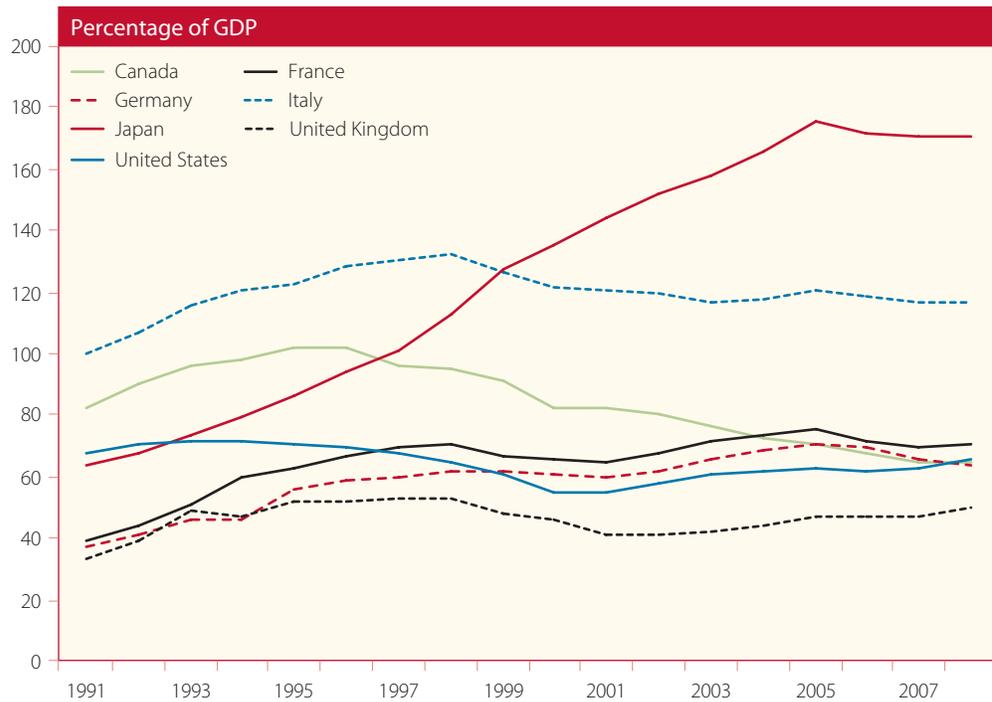
Investment remains a bright spot in the outlook

Weaker export demand will drag down growth

Inflation will moderate

Monetary policy remains on hold

Figure IV.4
General government gross financial liabilities, 1991-2007



Source: OECD.

Capital flowing into yen-denominated assets will sustain the appreciation trend

After depreciating against the dollar for much of 2008, the deterioration of conditions in global financial markets has led to increased global demand for yen-denominated liquid assets and a substantial appreciation of the yen. This trend is expected to continue in view of economic weakness and uncertainty in the United States, looser monetary policy in other major economies and increased risk aversion in the wake of the turmoil in financial markets. The latter implies a further reduction in carry-trade positions, with traders buying back the yen to close out their long positions in higher-yielding currencies that were opened by borrowing in the lower-yielding yen.

The outlook is subject to the significant downside risk of a more pronounced slowdown in Japan's main export markets. A worst-case scenario would imply a synchronized shock in the form of weaker-than-expected demand from developed economies, especially the United States, and emerging markets such as China.

Weakening consumption will reduce Australia's growth

Economic growth in Australia slowed to 2.6 per cent in 2008, from 4.4 per cent in 2007, and is projected to decelerate further to 1.1 per cent in 2009, with private consumption emerging as a major drag on overall activity. Real household incomes are being squeezed from various sides, including high interest rates, tighter credit conditions, a weakening housing market and flat real wages due to continued inflationary pressures. Sharp increases in the negotiated price for iron ore and coal, in turn, will benefit net exports and the external account into 2009, although lower commodity prices will put pressure on the trade balance thereafter.

Inflation will fall amid further monetary policy loosening

After an increase to more than 4 per cent in 2008, consumer price inflation is expected to fall towards the upper limit of monetary policymakers' target corridor of 2-3 per cent in 2009 following weaker domestic demand that will outweigh emerging inflationary pressure from a weakening Australian dollar. In view of the spreading global

financial crisis, policymakers have cut interest rates three times, from 7.25 per cent in September to 5.25 per cent in November, and there will probably be further monetary policy loosening in 2009 in order to alleviate the financial strains of households and to stimulate private consumption.

New Zealand's economic growth is expected to reach a very modest 0.6 per cent in 2008, but should rebound slightly to about 1.1 per cent in the baseline forecast for 2009. The slowdown in 2008 has been fairly broad-based, with private consumption suffering from higher inflation, high debt levels and the drop in housing prices. While business investment will remain under pressure from a weakening New Zealand dollar and relatively high interest rates, government spending is expected to provide the necessary stimulus in 2009 to prevent the economy from sliding into recession. Export growth is expected to recover in 2009 on the heels of currency depreciation and a stronger performance in the agricultural sector, as drought conditions give way to more favourable weather forecasts.

Inflation continues to exceed the central bank's target range of between 1 and 3 per cent, driven by higher food and energy prices, high capacity utilization rates and tight conditions in the labour market. However, the upward pressure on prices is forecast to recede owing to weaker domestic demand, the softening housing market and flattening commodity prices. Policymakers have begun cutting interest rates from their recent high and are expected to maintain their loosening stance in 2009 in an attempt to counter slowing economic growth as well as higher financing costs for businesses in the wake of tighter global credit conditions. The resulting smaller interest-rate differentials in favour of the New Zealand dollar, combined with increased risk aversion in financial markets, will put downward pressure on the currency, especially in the light of the closing-out of speculative positions driven by carry trades that borrow in lower-yielding currencies, such as the Japanese yen, to buy the New Zealand dollar. However, any more pronounced depreciation of the currency would create renewed inflationary pressure and, thus, limit monetary policymakers' space for further interest rate cuts.

New Zealand's slowdown will be cushioned by fiscal spending

Monetary policymakers' accommodative stance will be limited by the inflationary effect of currency depreciation

Economies in transition

In 2008, the economies in transition generally showed a surprising resilience to the impact of the global financial crisis. Despite a certain deceleration from the previous year, strong economic growth continued both in South-eastern Europe and in the Commonwealth of Independent States (CIS). Aggregate GDP in economies in transition grew by about 7 per cent, reflecting an increase of 7.1 per cent in the CIS and 5.2 per cent in South-eastern Europe (see table A.2). Two main factors underpinned the continued robust performance of these economies. First, direct financial contagion from the global crisis was initially relatively limited, not least due to underdeveloped financial systems in the region and weak financial integration with the rest of the world. Second, economic growth in most economies was mainly driven by domestic demand, while a slowdown in export demand only mildly affected domestic output during 2008. The surge in world energy and food prices during the first part of the year pushed domestic inflation sharply upwards, especially in the CIS, but also in the economies in South-eastern Europe. In late 2008, inflationary pressures started to subside following the steep fall in world commodity prices.

Despite the favourable outcomes in 2008, the outlook for the economies in transition has deteriorated considerably. With the deepening of the global financial crisis

Resilient growth amidst the global turmoil, but considerable deterioration is expected in 2009

and the developed countries' entering into recession, the economies in transition are expected to see a significant slowdown in the baseline projection for 2009, with aggregate GDP growth falling by 2 percentage points or more compared with 2008.

South-eastern Europe: Another year of good performance, though with activity likely to weaken

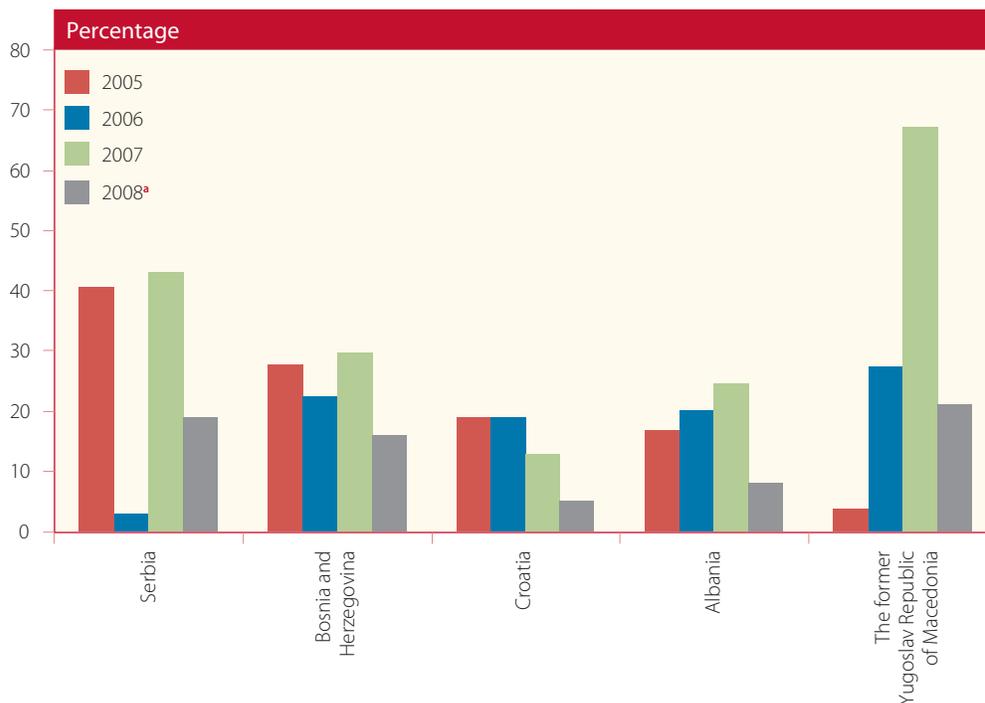
All economies in South-eastern Europe continued to grow at relatively robust rates in the order of 5 per cent or higher in 2008, with the exception of Croatia (see table A.2). Growth in 2008 continued to be largely driven by domestic demand, underpinned by rising real wages, strong FDI inflows and domestic credit expansion (see Figure IV.5). However, in the course of the year, and with the escalation of the global financial crisis, these growth factors started to lose steam and will weaken further in 2009. Hence, a further moderation in the pace of growth to about 4.5 per cent for the region as a whole is expected in the baseline scenario for 2009, down from 5.2 per cent in 2008.

The inflationary surge seems to be subsiding

Inflation accelerated in South-eastern Europe in the first half of 2008, driven by surging world food and energy prices, strong domestic demand and rising real wages. The acceleration was quite pronounced in Bosnia and Herzegovina, Croatia, Serbia and the former Yugoslav Republic of Macedonia (see table A.5). However, during the second half of the year, inflationary pressures weakened as world commodity prices started to fall from their highs and domestic inflationary pressures subsided. Given the overall domestic and global macroeconomic prospects, this trend is likely to gain further ground in 2009.

Employment conditions improved in all South-eastern European economies along with the continued dynamic economic performance in much of 2008. Nonetheless,

Figure IV.5
Growth of domestic credit in South-eastern Europe, 2005-2008



Source: IMF, *International Financial Statistics*.

^a End-2007 to mid-2008.

unemployment rates remain very high (about 16 per cent on average); only Croatia has a single-digit rate of unemployment. Nevertheless, positive labour-market developments are expected to continue in 2009 as a result of new investments in production capacity and the implementation of infrastructure projects. In Croatia, though, the rate of unemployment may increase in response to weaker performance of the tourism industry.

The general government budgets in most South-eastern European economies have become more balanced and were fortified by higher tax revenue following strong economic growth in recent years. There was some fiscal loosening in a number of countries in 2008, in part because of their electoral cycle. Fiscal deficits are expected to widen as a result of the economic slowdown and anticipated expected fiscal responses in 2009, but larger deficits do not pose an immediate threat to macroeconomic stability.

In contrast, there was a notable tightening of monetary policy in 2008, partly in response to rising inflationary pressures. Central banks increased their policy rates in Albania, Serbia (in stages) and the former Yugoslav Republic of Macedonia, while mandatory reserve requirements were increased in Bosnia and Herzegovina and Croatia. The domestic monetary tightening was coupled with deteriorating conditions of access to international financial markets. The rising cost of credit is likely to further dampen economic activity in the region.

Against the backdrop of strong domestic demand and weakening import demand in the important European markets, imports by South-eastern European economies generally outpaced their exports in 2008. As a result, both trade and current-account deficits continued to widen in all countries and, in a number of cases, have reached alarming proportions. Financing these deficits up until the 2008 crisis did not pose a problem, but financing conditions have been changing for the worse, forcing a downward adjustment in domestic demand. In November 2008, Serbia reached an agreement with the IMF on a standby loan of \$518 million dollars, although it is not clear if any funds will be drawn. The restraining effect of unfavourable financing conditions is likely to increase further in 2009 and the deficits may decline somewhat in the short run.

Fiscal deficits are expected to widen in 2009

Monetary policy has tightened

Current-account deficits are high but a downward adjustment may be under way

The Commonwealth of Independent States: Despite some deceleration, growth remains impressive

While the pace of economic activity in the CIS moderated somewhat, it remained robust in 2008: GDP in most countries grew at rates of 6 per cent or higher (see table A.2). During the latter half of the year, growth in the Russian Federation slowed somewhat from its strong performance earlier on, owing to stagnating oil production and decelerating investment. Notably though, the Russian grain harvest in 2008 was the highest in the last 15 years. In Azerbaijan, the rate of GDP growth dropped compared with previous years as the impact of newly introduced oil and gas facilities faded, but it remained the highest in the CIS. A significant deceleration of economic activity was observed in Kazakhstan as a result of an abrupt cutback in foreign borrowing amidst global financial turmoil that also spilled over into neighbouring countries (see box IV.1). The military conflict in the Caucasus had only a limited effect on oil exports, but it did, nonetheless, affect growth performance in Georgia.¹⁰ In 2009, less favourable external circumstances, including lower commodity prices and increasing difficulties in obtaining external finance, are likely

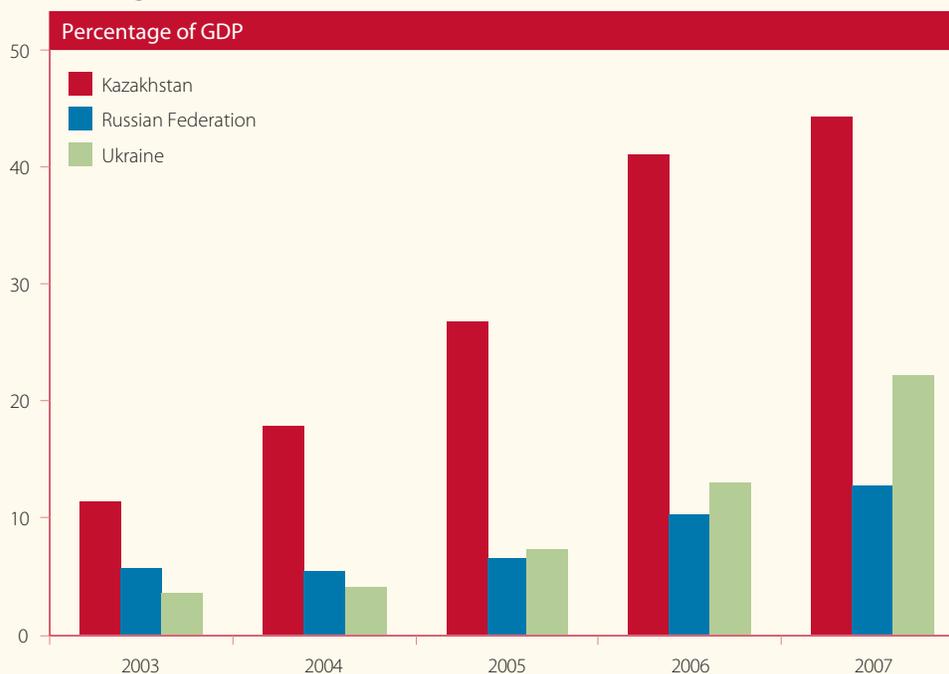
¹⁰ In September 2008, the Parliament of Georgia carried a motion to leave the Commonwealth of Independent States (technically this decision is due to enter into force in mid-2009). However, Georgia's performance is discussed in the context of this group of countries for reasons of geographic proximity and similarities in economic structure.

Box IV.1

The impact of the global financial turmoil on the banking sector of the Commonwealth of Independent States

The financial crisis, which originated in the United States sub-prime mortgage market, has also affected some of the economies of the Commonwealth of Independent States (CIS). Increased financial integration, including access to external finance, has created new channels for the transmission of shocks. The impact of global turbulence has varied across the countries of the CIS, reflecting differences in the degree of financial development and the extent to which banks and companies have relied upon foreign financing. The external debt of the banking system has increased in the largest economies in recent years, albeit to significantly different degrees (figure A).

Figure A
Banking sector: external debt, 2003-2007



Sources: National Bank of Kazakhstan, Central Bank of the Russian Federation and National Bank of Ukraine.

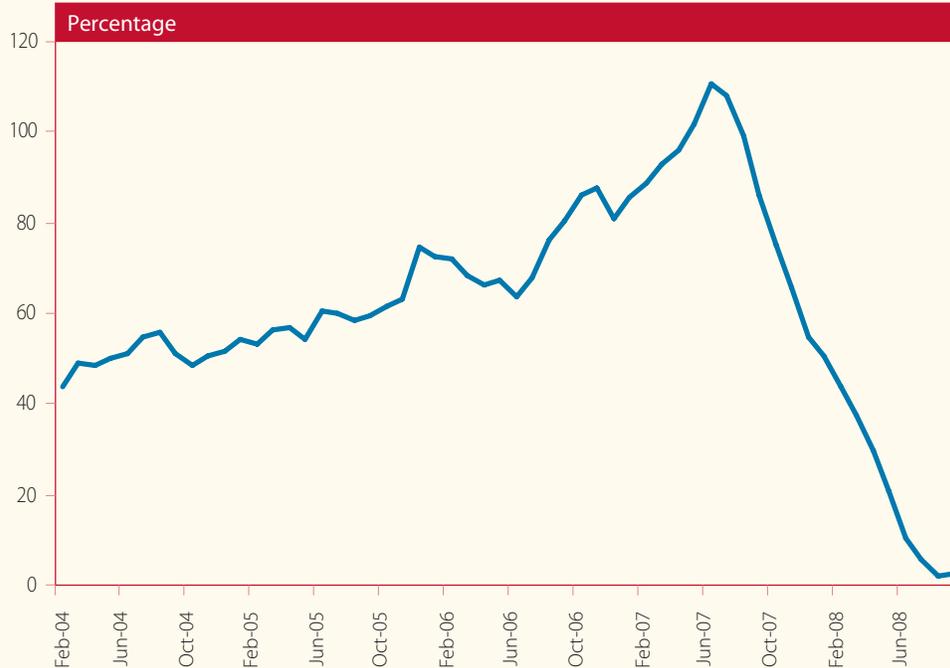
The consequences of the crisis have been the most severe in *Kazakhstan*, where the banking system has developed rapidly in recent years as a result of the strong growth of foreign liabilities fuelling fast domestic credit expansion. In recent years, these sources have covered about half of the funding needs of the sector. Good access to international markets was supported by a perceived strong regulatory and supervisory framework, improved investment grade ratings and favourable economic prospects.

The growing dependence on foreign funding was, however, also a source of vulnerability. While the authorities managed to reduce the share of short-term obligations, they did not succeed in curbing overall foreign borrowing. Global credit turmoil led to a sharp deterioration in access to external funding. In addition, falling confidence caused a temporary decline in household deposits and increased pressures over the exchange rate that required interventions by large central banks. Lending has fallen sharply, depressing growth in the non-oil sector and sharply reducing real estate prices, which, particularly in *Almaty*, had recently undergone rapid growth, fuelled by the availability of credit (figure B).

In the *Russian Federation*, the impact of the crisis was initially more muted, given the lower reliance of the banking sector on international capital markets. However, credit growth slowed

Box IV.1 (cont'd)

Figure B
Kazakhstan: annual credit growth, February 2004-September 2008



Source: National Bank of Kazakhstan.

down, and some banks with more aggressive expansionary policies funded by external financing experienced difficulties. Moreover, adverse market conditions led to the postponement of primary equity placements, which had been playing a larger role in corporate financing. The worsening of the global financial crisis in 2008 increased the severity of the problems confronting the Russian banking system. The widespread use of shares in Russian companies as collateral exposed the sector to a reversal in equity prices. A plummeting stock market led to margin calls, which reinforced downward pressures. The burgeoning domestic bond market has been negatively affected by mounting inflation and the overall liquidity problems. As market participants have become more sensitive to counterparty risk, interbank financing has suffered amidst declining trust.

Despite a current-account surplus and a solid reserve position, the private sector in the Russian Federation remains exposed to external financing conditions, including through the impact of capital flows on domestic liquidity. Capital outflows drained liquidity from the system and have forced banks to rely on short-term public funding. The Central Bank's interventions to shore up the rouble, which has been under pressure through the intensification of capital outflows, have had a contractionary impact.

Patterns of ownership in the banking sector have also acted as a channel for the regional transmission of shocks. Kazakh banks, enjoying good access to external finance, expanded into other countries in the CIS. In *Kyrgyzstan*, they accounted for almost half of total lending. The troubles of parent institutions have led to a temporary slowdown in credit growth in *Kyrgyzstan* as well. However, the low level of financial intermediation has limited the impact of this channel with regard to the transmission of shocks. In *Ukraine*, the degree of foreign ownership of the banking system initially proved to be a benign influence, as Western parent banks provided access to external financing in a difficult global environment. The situation deteriorated in late 2008, as concerns over exchange-rate stability, widening external imbalances and mounting political risks created refinancing difficulties.

The reaction of the monetary authorities to alleviate the impact of the credit crunch has been similar throughout the region and initially involved providing liquidity through various means, including widening the scope of repurchasing operations, easing reserve requirements or

Box IV.1 (cont'd)

using public institutions to inject resources into the banking system. Limits on deposit insurance were increased to shore up confidence. In addition, support programmes have addressed the refinancing needs of particular sectors, such as construction and small and medium enterprises in Kazakhstan. As the crisis deepened, fiscal allocations were made to support lending and the stock prices of State companies in the Russian Federation. Direct restrictions on new lending and deposit withdrawals were introduced in Ukraine. Government plans for the sector also include State-backed recapitalization of financial institutions through subordinated loans or direct equity stakes in the Russian Federation, Kazakhstan and Ukraine.

The global financial crisis has highlighted the dearth of domestic sources of long-term financing in the region, a common problem in the CIS, which had been temporarily overcome through access to international capital markets. In the short-term, future growth of banking assets will depend on ability to expand the deposit base. A more balanced funding structure will require a slowdown in lending, which will also be depressed by the need for increased provisioning. Ongoing inflationary pressures and exchange-rate volatility represent a challenging environment for raising deposits. State-owned banks, with their extensive branch networks, enjoy the advantage of acquiring deposits vis-à-vis other competitors, and may increase their market shares. These banks will be used as an instrument to support lending by the authorities. Some degree of banking consolidation appears unavoidable in most countries. Over the medium term, the development of domestic capital markets, including the presence of institutional investors, such as pension funds, would be necessary to provide alternative sources of financing.

Financial turbulence and credit constraints are leading to a global slowdown. Worsened economic prospects worldwide are also depressing the demand for commodities, which are critical for economic performance and investor sentiment in the CIS region. This has opened up a second channel for the transmission of negative shocks, contributing to an increase in the difficulties created by the persistence of an adverse global environment. For the banking sector, slower growth will add to concerns over the deterioration of asset quality.

to lead to a marked slowdown in the economic activity of the region, with aggregate GDP growth forecast at 4.9 per cent.

Robust domestic demand, especially private consumption, remained the main driver of economic expansion in the region. Rapid income growth, reflecting the continued robust economic performance and high inflows of worker remittances in the poorest countries, has underpinned strong consumer demand, despite the negative impact of surging inflation on purchasing power. Consumption growth compensated for the notable deceleration in fixed investment demand, including in the Russian Federation, reflecting a slowdown of construction activity and tightening credit supplies to businesses amid deteriorating confidence in economic prospects. In Kazakhstan, both private consumption and fixed investment decelerated sharply as lending to business and households stagnated because of the problems in the banking sector.

The pace of job creation in the CIS generally remained relatively strong despite the worsened performance of the labour-intensive construction sector. Armenia and Azerbaijan displayed the largest improvement in labour-market indicators. The Russian Federation has continued to attract significant migratory inflows from other CIS countries, spurred by rapid wage growth and the large wage differential vis-à-vis jobs in the home countries. In Kazakhstan, in contrast, registered unemployment increased, largely owing to a significant fall of output growth. Labour-market indicators are expected to deteriorate in 2009, however, as economic growth in the CIS is projected to slow down, the more so as construction activity enters into a slump.

Inflation rates remained high throughout the region and rose further in a number of countries in 2008 (see figure IV.6). Food spending accounts for a significant share of the

Domestic demand is driving the CIS economies

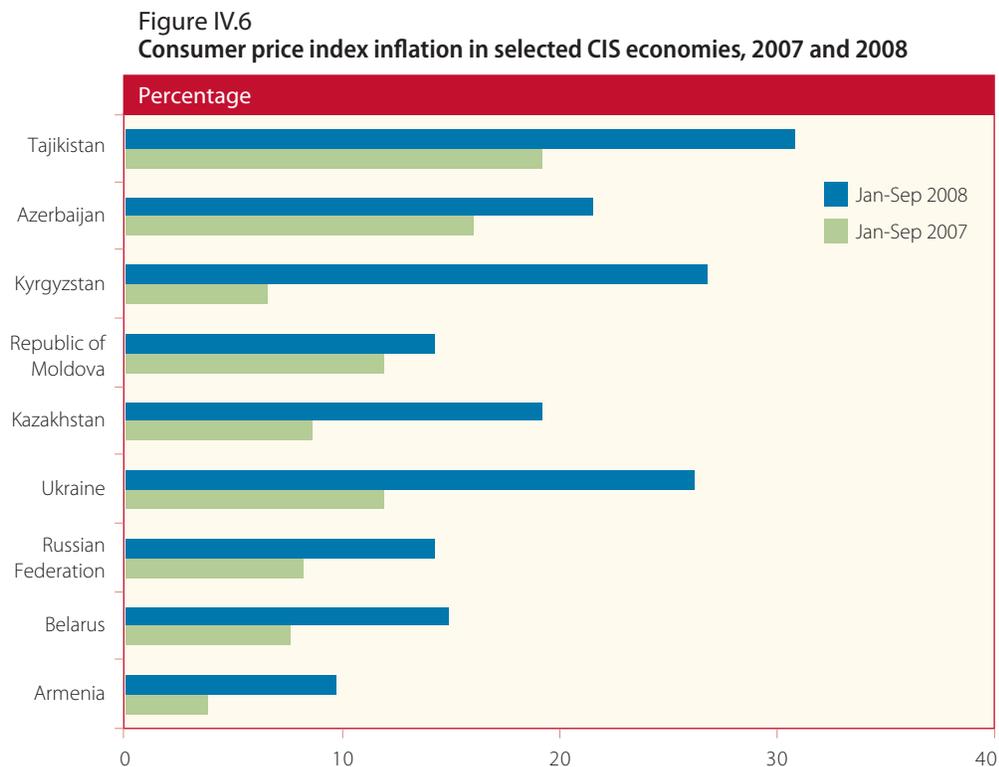
Employment growth was strong in 2008, but bleaker prospects are ahead

Inflationary pressures are high, but are abating

consumer basket in the CIS countries; hence, rising food prices have had a marked impact on headline inflation. In Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan and Ukraine, the annualized rate of consumer price inflation peaked above 20 per cent before starting to decline in the final months of the year. This reflected both external factors, such as high food and energy prices, and domestic influences, including broadly accommodative policies, and, in some cases, an ongoing adjustment of prices in regulated services. Policymakers in a number of countries resorted to various interventions in an attempt to curb inflationary pressures, such as tighter policies and exchange-rate appreciation in Armenia and export restrictions on food in Uzbekistan. In late 2008, headline inflation decelerated in most CIS economies as the effect of commodity price rises abated. Further lowering of commodity prices and more moderate domestic demand should support a moderation in inflation in 2009, which nevertheless is expected to remain relatively high.

Monetary authorities have been confronted by two major challenges, namely, strong inflationary tensions and the need to address the fallout from the global crisis, which have resulted in capital outflows and exchange-rate pressures during the second half of 2008. Monetary policies remained generally accommodative earlier in the year as the authorities, particularly in the Russian Federation and Ukraine, tolerated the monetization of strong capital inflows during this period. Reflecting the relatively loose policy stance, real interest rates were negative in a number of countries. In Kazakhstan, the authorities cut policy rates to offset the negative effects of the credit crunch on economic activity. In the second half of the year, the focus of attention, particularly in the Russian Federation, shifted to the supply of extra liquidity through a wide range of instruments to support the financial system in the face of intensified global turbulence. Currencies came under pressure, as capital flows reversed, and the authorities intervened in the markets to prop up exchange rates.

Monetary policy is driven by liquidity considerations



Source: UN/DESA, based on data from CIS Interstat Statistical Committee.

Fiscal policies have added to demand pressures

Solid growth, coupled with gradual improvements in tax administration, has boosted fiscal revenues throughout the region. Better revenue performance has generally been accompanied by strong increases in public expenditure, causing a weakening in the structural fiscal balances in many CIS countries. In Ukraine, higher social benefits and pensions have contributed to a significant widening of the fiscal deficit. In Azerbaijan, plans to develop infrastructure and raise social protection generated rising claims on public spending. In some of the low-income countries, fiscal measures have been used to shelter households from rising fuel and food costs. In the Russian Federation, after an overtly expansive fiscal stance in 2007, there has been some downward adjustment in 2008.

Export growth remained well below the expansion of imports in most of the smaller economies in the region, with Armenia, the Republic of Moldova and Tajikistan showing a particularly large gap. In the Russian Federation, rapid export growth in value terms resulted mainly from increasing oil and gas prices, while physical volumes stagnated. In volume terms, the expansion of imports continued largely to outstrip the increase of exports. By contrast, energy export volumes rose rapidly in Azerbaijan and Turkmenistan. In Kazakhstan, the positive effect of growing energy exports and high prices was coupled with a deceleration of imports as the economy cooled down. As a result, Kazakhstan's significant current-account deficit in 2007 moved into a surplus. The overall CIS current-account surplus widened due to the improved external position of energy-producing countries. In Ukraine, the external deficit widened sharply owing to continued acceleration in import growth and poor export performance. The country is expected to suffer a significant deterioration in its terms of trade in 2009 as a result of falling steel prices and a hike in Russian gas prices. A better export performance was observed in Belarus, but anticipated increases in the price of gas imports will also have a negative impact on its external position.

The global slowdown will affect growth in 2009

The difficulties experienced in the global economy have considerably increased the downside risks for the economic growth of the CIS. A severe and protracted global slowdown could further depress commodity prices, which remain a major factor in the economic performance of many countries in the region. Financial turbulence has exposed the dependence of the largest economies on external sources of long-term financing. In turn, an eventual downturn in the Russian Federation could impair the economic prospects of the smaller economies in the region through lower trade, remittances and FDI inflows. Most commodity-exporting countries have put in place fiscal arrangements, such as reserve funds, that give them the possibility of intervening in order to mitigate the effects of a possible downturn, including one related to external payments problems. By contrast, Ukraine, which built only modest reserves, has been forced to request IMF support to allay concerns about its ability to fund its large external financing gap. In any case, there is a risk of inadequate policy action given the lack of experience of most CIS countries in coping with a rapidly deteriorating external environment.

Developing economies

Although growth in the developing economies moderated to 5.9 per cent in 2008 from 7.1 per cent in 2007, the region was able to maintain its sixth consecutive year of growth of over 5 per cent. Growth was mainly supported by strong commodity-export revenues in the first half of 2008, accompanied by robust domestic demand and government expenditures on infrastructure development. East and South Asia again led growth in the region, as high commodity prices and industrial activity supported economic performance

throughout most of the year. Africa's growth, also above 5 per cent, was likewise driven by the commodity sector, but saw strong support from the recovery in agriculture and improved domestic demand.

Growth in all countries of the region is expected to slow considerably in 2009, to 4.6 per cent. The region, which initially seemed immune from the financial crisis, is now affected by the precipitous decline in commodity prices and is experiencing sharp foreign capital outflows as investors seek "safe havens", thus threatening the financial stability of some economies. Additionally, this has led to depreciating currencies and tightened credit conditions. As the impact of the global economic slowdown spreads throughout the region, it will have stronger adverse effects on export demand, commodity prices and, subsequently, investment and aid flows.

Africa: The end of the commodity boom

Amidst a deteriorating economic environment, growth in Africa slowed in 2008, but the region managed to maintain its fifth consecutive year of growth of over 5 per cent. Having been propped up by increased revenue from the continent's commodity exports in the first half of the year, as well as continued improvements in non-oil sectors, such as agriculture and tourism, growth dropped to 5.1 per cent, from 6.0 per cent in 2007 (see table A.3). This figure masks considerable disparities across the region as household spending has been constrained in many cases by rapid inflation growth, higher interest rates and, to a lesser extent, domestic disturbances. As the global economy and commodity prices weaken further, growth is expected to decelerate to 4.1 per cent in 2009.

Africa's lack of integration into the global financial system kept it relatively immune from the direct effects of the global financial crisis in 2008, but the region is already being affected indirectly through slower global growth and credit tightening, which is having an impact on investment flows, export demand, commodity prices and exchange-rate vulnerability. In South Africa, which had made considerable progress towards macroeconomic stability, the rand weakened by about 23 per cent against the United States dollar between September and November 2008 as a "flight to safety" triggered a sell-off in equities and bonds. The Government of Nigeria was forced to revise its 2009 budget downwards in response to lower oil prices, and there are growing fears about the stability of the country's currency, despite its ample foreign reserves totalling \$63 billion.

Although oil and other commodity prices have generally fallen in the second half of 2008, they remained high on average for the year by historical standards. Oil-exporting African countries grew at 6.1 per cent in 2008 compared with a 4.3 per cent growth rate in the net fuel exporters (see figure IV.7). High energy and food prices, and slowing aid and private capital inflows were among the key factors that contributed to the growth slowdown in the oil-importing African economies.

Growth decelerated in all subregions in 2008, with the exception of Central Africa, but remained generally strong owing to healthy commodity exports and a rebound in agricultural output in the first half of 2008. As the global downturn extends into 2009, weakened trade with Europe and the United States, along with dampened commodity exports to China and the rest of the world, will curtail growth in most economies of the region.

North Africa recorded a 5.1 per cent growth rate in 2008, as high oil revenues, the construction boom and tourism receipts boosted both public and private consumption in most countries; in Central Africa, however, robust growth was mainly due to the rebound in oil production in the Congo. In West Africa, growth in 2008 was supported by

Africa's growth slowed in 2008

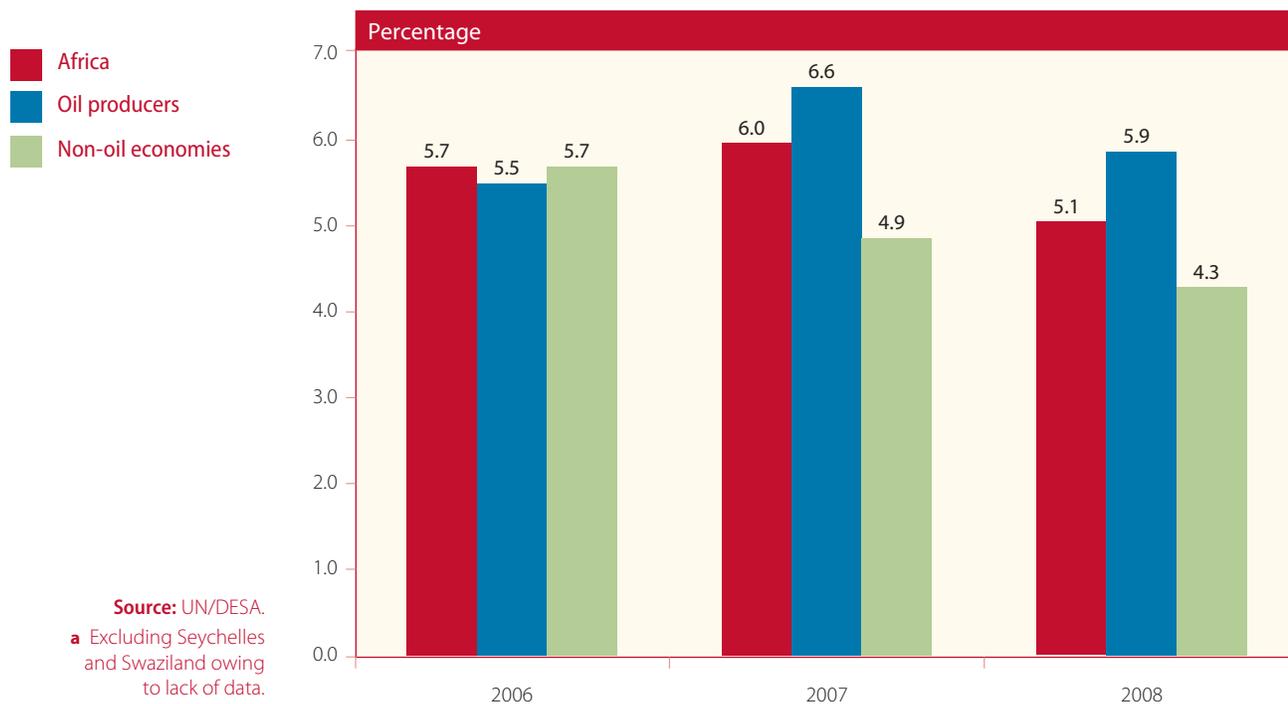
The global financial turmoil will have indirect effects on the region

Oil exporters benefited from strong revenues in the first half of 2008

The slowdown will accelerate in 2009

Subregional growth is supported by tourism, agriculture and recovery in conflict areas

Figure IV.7
Growth in Africa,^a oil versus non-oil economies, 2006-2008



conflict recovery and improved stability in Côte d'Ivoire and Liberia, increased oil production and prices in Nigeria and the expansion in mining activity, construction and tourism in many countries of the subregion.

East Africa, led by Ethiopia, continued to maintain the highest growth in the continent, benefiting from improved agricultural performance, healthy aid inflows and strong growth in tourism and investment in the first half of 2008. However, growth in most of the countries of this subregion remains constrained by infrastructure bottlenecks, especially those related to energy and transportation. In addition, reduced aid and investment flows in 2009 will significantly curtail growth.

In Southern Africa, economic performance moderated from 6.2 per cent in 2007 to 4.2 per cent in 2008, led by sharply lower growth in South Africa owing to a tightening in consumer spending and the slowdown in mining and quarrying. Delays in donor funding, power shortages and high interest rates weakened growth in the other countries of the region.

Inflation in Africa, excluding Zimbabwe, was 10.7 per cent in 2008, up from 6.4 per cent in 2007. Over 90 per cent of the 51 African countries with available data recorded a 5 per cent or more rate of inflation in 2008, up from 60 per cent in 2007. Only three countries (the Central African Republic, Côte d'Ivoire and the Comoros) had inflation rates of less than 5 per cent in 2008, while Zimbabwe's hyperinflation rate of over 11 million per cent remains the highest in the continent. Most of Africa's recent inflation has been imported through high energy and food prices in world markets, but domestic factors have also played a role, including widening government deficits and strong domestic demand growth, especially in the oil-exporting countries of the region. Poor harvests in Burundi, Eritrea, Ethiopia and Kenya placed additional domestic pressure on food prices, leading to double-digit increases in inflation in 2008 and widespread food insecurity

South Africa experiences a sharp slowdown

Inflation is up in 2008, but is expected to subside in the outlook

throughout the region. Although improvements in food supplies from the fall harvests and lower international commodity prices should lower prices and lead to a deceleration of inflation in 2009, the food crisis still exists and remains a long-term challenge for the region (see box IV.2).

Unemployment is expected to increase throughout Africa, as the expansion in the services, construction and public works sectors, which helped to boost employment creation in urban areas, particularly in North Africa, is expected to weaken. Slower formal sector job creation will also push a greater number of workers into the already large informal economy.

Employment conditions will deteriorate

Box IV.2

Africa's response to the food crisis

Over the last four decades, Africa has witnessed frequent food shortages leading to heavy dependence on food imports and aid, making Africa particularly vulnerable to shocks in the international food market. One third of the population of sub-Saharan Africa suffered from chronic hunger in the period 1990-1992, a proportion that had declined by only 4 percentage points by 2003-2005, while the absolute number of people suffering from hunger increased from 169 million to 212 million over the same period.^a

The situation worsened dramatically following the most recent global food crisis, especially for African net food importers. It is estimated that an additional 24 million people in sub-Saharan Africa were malnourished in 2007 owing to the increase in food prices; inflation also increased from 6.4 per cent in 2007 to 10.7 per cent in 2008, driven mainly by increases in prices for food, transport and energy.^b Although food and oil prices have come down in the second half of 2008, the problem persists, as the recurrent crises in Africa are largely the result of longer-term issues related to the neglect of the agriculture sector and poor and inconsistent agricultural development policies.

As a short-term response to the food crisis, the international community increased food aid to the worst affected countries; at the domestic level, policies focused on stabilizing food supplies, controlling prices and increasing transfers (see table below). These policies had mixed effects, some of which contributed to further price increases. For example, in Egypt, subsidized bread was diverted to feed animals, thereby exaggerating the shortage in the market, while export restrictions may have led to panic and hoarding of certain commodities (see chapter II, box II.1).

Most African countries have also started to introduce measures to increase supply. In Senegal, where prices for rice have doubled between July 2007 and 2008, fertilizer subsidies have been expanded, leading to a substantial increase in areas devoted to the cultivation of food crops. Additionally, the forecast for total cereal production in Africa for 2008 has increased to 152.8 million tons, up from the 141.3 million tons estimated for 2007, and slightly higher than the 2006 harvest.

Although short-term supply increases may help to mitigate the crisis in the near term, in the long run, solving Africa's food crisis requires strategies to further enhance agricultural investment and productivity. High food prices have offered an incentive to increase private investment in agriculture, but more still needs to be done by Governments to provide an enabling environment. The African Union's decision in July 2008 to focus its long-term commitment on investments for increased productivity and risk mitigation, including enhanced institutional and human capacities for agricultural development, is a step in this direction. These strategies build on the New Partnership for Africa's Development (NEPAD) Comprehensive Africa Agriculture Development Programme (CAADP) framework that was agreed in 2003. Some components of the strategy include:

a) Increased agricultural productivity

In addition to more investment in better technologies, increasing agricultural productivity requires better access to credit and land, a revival of extension services and public investment in related infrastructure such as transport, communication, storage and irrigation. Although most African countries still have large areas of unused arable land with which to increase production, there are limits owing to high population growth and competing demands for non-

^a Food and Agriculture Organization of the United Nations, "Hunger on the rise: Soaring prices add 75 million people to global hunger rolls", briefing paper, 17 September 2008, available from <http://www.fao.org/newsroom/common/ecg/1000923/en/hungerfigs.pdf>.

^b Ibid.

Box IV.2 (cont'd)

Table
African Government policy responses to the food crisis, January 2006-August 2008

Country	Tax reductions on food staples	Trade restrictions	Trade liberalization	Consumer subsidy	Social protection	Supply increases
Algeria			×		×	×
Angola	×			×	×	
Benin			×	×		×
Burkina Faso	×		×	×	×	
Burundi	×				×	
Cameroon	×		×		×	
Comoros				×		
Congo			×			×
Côte d'Ivoire			×		×	×
Egypt		×		×	×	×
Ethiopia	×	×		×	×	×
Gambia			×			
Ghana			×			×
Guinea					×	
Guinea-Bissau			×			
Kenya						×
Liberia		×	×		×	×
Madagascar	×	×		×		
Malawi		×				×
Mali	×	×	×		×	×
Morocco	×		×	×		
Namibia				×	×	
Niger		×	×		×	×
Nigeria	×	×	×	×		×
Rwanda						×
Senegal			×	×		×
Sierra Leone		×	×	×	×	×
Somalia		×				
South Africa	×			×	×	
Sudan	×	×				×
Togo				×		×
Tunisia	×			×	×	
Uganda					×	×
United Republic of Tanzania	×	×	×	×		
Zambia	×	×				×
Zimbabwe	×		×	×		
Frequency	15	13	18	17	17	20

Sources: International Food Policy Research Institute (IFPRI), 2008 and World Bank, 2008.

Box IV.2 (cont'd)

food production and industry. In many African countries, dual property systems also exist, with State-regulated property rights and customary management overlapping. In such cases, it is important to strengthen land tenure security, which can in turn facilitate access to credit.

b) Market access and regionally integrated value chains

Regionally integrated value chains are important for expanding input and output markets, particularly for smallholder farmers who are often at a disadvantage regarding access to both domestic and export markets. Such integration can create the scope to exploit economies of scale and improve access to new technologies and complementary infrastructure and services. To enable smallholders to participate, however, requires coordination at the regional level in order to improve the quality and safety of products, harmonize standards and ensure adequate flow of information to potential value chain participants.

c) Mobilizing resources for investment in agriculture

The commitment by African countries to spend at least 10 per cent of national budgets on agriculture and rural development (see also chapter II, box II.1) will go a long way to making more resources available. However, given the huge gaps in research, information and financial support for agriculture, this effort needs to be complemented by development partners. In this regard, the proposal by the Conference of African Ministers of Finance, Planning and Economic Development, held in Addis Ababa on 2 and 3 April 2007, to establish a funding mechanism (in consultation with the African Development Bank and the International Fund for Agricultural Development) to scale up agricultural investment in the continent should be pursued. In addition, the Aid for Trade Initiative can play an important role in increasing investment and productivity in African agriculture. It is crucial that the current financial crisis not result in a reduction of aid; rather, donors should honour their commitments to increase the volume and quality of aid, including by ensuring better allocation in line with recipient priorities.

In most African economies, monetary policy is taking either a tightening or neutral stance in order to keep inflation under control. In Nigeria, the Central Bank increased the amount of foreign exchange sold to retail banks to offset the rise in government expenditures from windfall oil profits. As commodity prices fall and the dollar gains strength, currency depreciation is also a concern for some commodity exporters. In Ghana and Mozambique, the central banks switched to a tightening stance in 2008 to stabilize exchange rates and control imported inflation, the Bank of Ghana increasing its prime rate from 16 to 17 per cent in July in an attempt to combat inflationary pressures. In South Africa, however, the benchmark rate has held at 12 per cent since August, despite the continued rise in inflation and rand depreciation, owing to the weakness in the economy.

High energy and food prices pushed the proportion of oil-importing countries with fiscal deficits up from 76 per cent in 2007 to 86 per cent in 2008. On average, these countries recorded a fiscal deficit of -1.7 per cent of GDP, compared with a surplus of 7 per cent for oil-exporting countries. To maintain fiscal stability, many countries resorted to additional measures to control public spending and finance their deficits, such as reducing expenditures on development projects and service delivery. With a rapidly deteriorating external environment, these countries will likely be in need of further debt relief. A scaling-up of aid may also be necessary in order to sustain the progress made in the past few years in macroeconomic management and stability, as well as in achieving the Millennium Development Goals.

Relatively high energy and food prices, particularly in the first half of 2008, led to a widening of current-account deficits in oil-importing African countries, from -6.3 per cent of GDP in 2007 to -7.2 per cent as of September 2008. At the same time, the

Monetary policy remains a challenge as growth subsidies

Fiscal deficits are widening

Current-account balances also worsened in 2008

current-account surplus of oil-exporting countries increased from 10.5 per cent to 17.7 per cent. Therefore, the continent's overall current-account position, which was showing a surplus of 7.4 per cent in September 2008, is a reflection of the high revenues generated by oil-exporting countries. Although the current moderation in commodity prices should improve the terms of trade and lower the import bills of many net fuel importers in 2009, it comes at a time when export demand has weakened globally, thus potentially offsetting the overall effects. Similarly, while most African currencies for which data are available appreciated against the United States dollar in the first half of 2008, the trend reversed from the third quarter of 2008.

Risks remain tilted towards the downside

The continent's prospects for 2009 are subject to strong uncertainties stemming mainly from the recent global financial crisis. However, risks remain tilted towards the downside owing to the global slowdown. Although the decline in oil and food prices will ease the economic burden on the net fuel and food importers, there are adverse consequences from a sharp decline in commodity prices for the region as a whole. In general, a hard landing of commodity prices could set in motion a calamitous chain of events leading to capital flight, significant depreciation of currency, increased inflation and interest rates, and a further decline in growth. Also owing to the global financial crisis and economic downturn, lower aid and private capital flows, especially FDI and remittances would have a significant impact on growth in 2009. Moreover, despite some improvements in security, Africa remains vulnerable to political conflicts. An escalation of the conflict in the Democratic Republic of the Congo could have repercussions for political stability in other parts of the region.

East Asia: A continuation of deceleration

East Asian economic growth is still decelerating

As a consequence of the deepened international financial crisis, the deceleration of economic activity in East Asia will continue during 2009, as GDP growth is expected to drop to 6.0 per cent, down from 6.9 per cent in 2008 and 9.0 per cent in 2007 (see table A.3). The baseline scenario for the growth outlook assumes that there will be economic recovery in the developed economies in the second half of 2009. Should this not occur, however, GDP growth in the region would slow to 3.7 per cent in 2009.

The financial system is prudent, but is still subject to the impact from the global financial turmoil

Overall, East Asian countries initially seemed insulated at the onset of the financial turmoil emanating from the United States and Europe. Banks were prudently leveraged and had limited exposure to sub-prime mortgage debt. Additionally, the \$3 trillion in foreign-exchange reserves, which is more than 10 times the usable resources of the IMF,¹¹ gives economies some measure of confidence to defend their currencies in the event of a speculative attack. Nonetheless, there is growing evidence that the economies in the region will be hit hard. As the financial crisis and subsequent slowdown continued to unfold, some countries experienced sharp capital outflows, threatening financial stability towards the end of 2008. For instance, in the Republic of Korea, the won dropped 21 per cent in just two months, between August and October of 2008. Although a special \$30 billion swap line extended by the United States Fed helped stabilize the won, other countries in the region remain vulnerable to the substantial decrease in foreign-exchange reserves and may require emergency financial support.

Commodity-exporting countries suffered less from the global slowdown in 2008

The effect of the global slowdown on export demand, and subsequently on GDP growth, in 2008 was pervasive across countries in the region. In China, the region's locomotive, GDP growth dropped from 11.9 per cent in 2007 to a lower, albeit still high, 9.1 per cent in 2008. The decline would have been greater had it not been for the contin-

¹¹ November 2008 data.

ued strong growth in domestic final demand. Cambodia, the Philippines and Singapore, with their heavy reliance on manufacturing exports to industrialized countries, have been affected the most by the global slowdown, with GDP growth dropping by about 3 percentage points in 2008 compared with 2007. In contrast, record high prices of export commodities, including rice, palm oil and energy, in the first half of 2008 allowed countries such as Thailand, Indonesia and, to a lesser extent, Malaysia, to sustain growth rates in 2008 at levels similar to those in 2007.

On average, the year-on-year consumer price index (CPI) headline inflation rate is expected to drop to 3.6 per cent in 2009, from 6.4 per cent in 2008, as commodity and energy prices decline. During 2008, inflation climbed most steeply in South-East Asia, reaching a peak in July (see figure IV.8). In Hong Kong Special Administrative Region (SAR) of China, the Republic of Korea and Taiwan Province of China, the trend was less steep, but also peaked in July. In contrast, the inflation rate in China peaked in February and then started to decline owing to the gradual recovery in the production of meats and fresh vegetables; by October it had reached its lowest level in 16 months. As commodity prices continue to decline and export demand from industrialized countries cools further, all countries in the region are expected to experience a moderation of inflation in 2009.

As economic growth slows, the employment situation in some economies has already started to show signs of deterioration. Recent statistics for Hong Kong SAR, Singapore and Taiwan Province of China show rising unemployment rates from mid-2008. In some other economies, anecdotal evidence also points to a weakening of employment growth. Given the decline of economic growth in East Asia, unemployment rates for many countries are expected to increase by about 1 percentage point in 2009 over 2008.

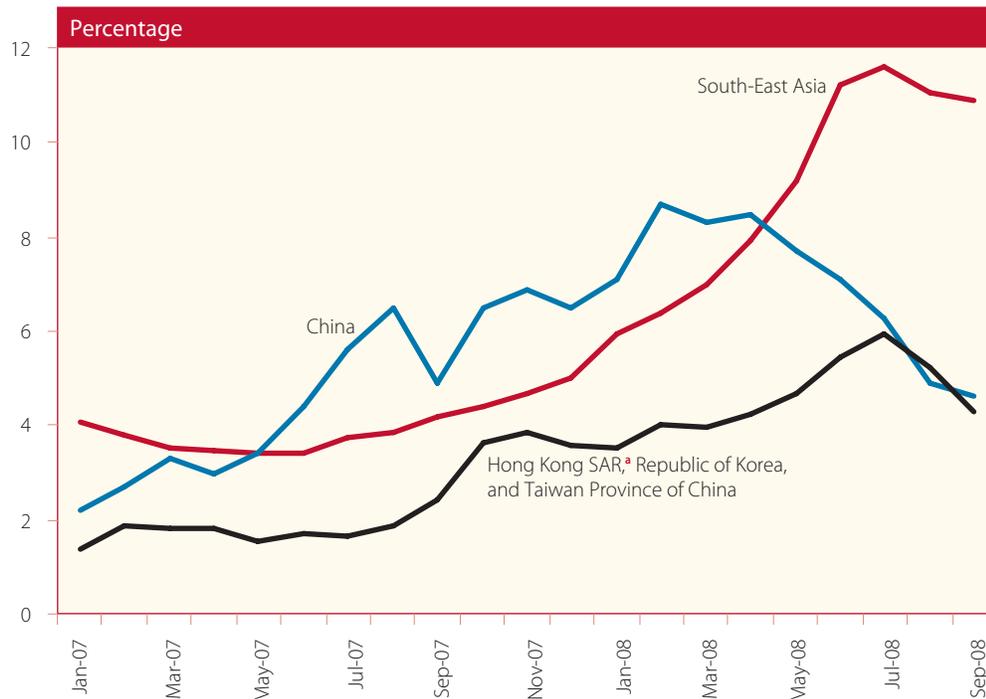
The monetary policy response to the twin risks of rapidly rising commodity prices and the international financial crisis varied across countries. In South-East Asia, where inflation increased most steeply in the first half of 2008, the central banks initially

Widespread inflation has peaked in East Asia

The employment outlook is not very bright

Monetary policy is displaying a mixed stance

Figure IV.8
Year-on-year headline consumer price index inflation rates, 2007-September 2008



Source: Various National Statistical Offices.
a Special Administrative Region of China.

reacted by increasing interest rates. The Bangko Sentral ng Pilipinas (the central bank of the Philippines), the Bank of Thailand and the Bank of Indonesia all had multiple increases in their key policy rates in mid-2008. By early October, however, the People's Bank of China and the Bank of Korea cut interest rates in concert with the loosening stance of the central banks in developed economies.

China is leading fiscal stimulus in the region

Fiscal policy was expansionary in East Asia during 2008. During the first half of the year, many countries implemented or expanded subsidy programmes to soften the impact of rapidly rising fuel and food prices on vulnerable groups, thereby worsening fiscal balances. In Malaysia, the cost of fuel and food subsidies tripled in 2008 compared with the previous year, increasing the fiscal deficit from 3.2 per cent of GDP in 2007 to 4.8 per cent in 2008. In the Republic of Korea, whose fiscal surplus dropped from 3.8 per cent of GDP in 2007 to 1.1 per cent of GDP in 2008, the Government implemented an economic stimulus package amounting to \$11 billion dollars (1.2 per cent of GDP); in China, the Government has introduced a massive stimulus package, in an amount that is almost equal to total government spending in 2006, to be implemented during 2009 and 2010. Although the details of the package have not yet been released, back-of-the-envelope calculations suggest that the package, while large (\$586 billion, or 15 per cent of GDP, to be spent over two years), would provide an additional stimulus of about 2 per cent of GDP per year, after deducting recent trend growth of public expenditures. The aim of China's package is to strengthen domestic demand through public investment in infrastructure. The targeted areas include low-income housing, rural infrastructure, water, electricity, transportation, the environment, technological innovation and rebuilding from several disasters, most notably the earthquake of 12 May. This package is also designed to boost the income of the poor through measures including higher subsidies and an increased government purchase price for grains in 2009.

Current-account surpluses fell and current-account deficits widened in 2008

External balances came under pressure across East Asia in 2008 owing to the high cost of commodities and weakened export demand. Nevertheless, most countries continued to exhibit current-account surpluses. China, for instance, experienced a reduction in its current-account surplus from 11.5 per cent of GDP in 2007 to 8.5 per cent of GDP in 2008, while in the Republic of Korea, a surplus of 0.6 per cent of GDP in 2007 turned into a deficit of 3.3 per cent of GDP in 2008 on account of the rising costs of commodity imports and increased tourism spending abroad. Consistent with these shifts in current-account positions, nominal exchange rates depreciated in most countries, with the exception of China, reversing previously appreciating trends.

Given the sombre outlook for the global economic environment, economic prospects in East Asia, too, face serious downside risk. The most compelling concern is the potential for a complete meltdown of the financial system in the developed economies that would directly undermine the financial sector in East Asia. This would drag down the regional growth rate by at least 1-2 percentage points.

South Asia: Expectations of a slowdown in robust growth

The slowdown will spread from the industrial to the service sector

Economic growth in South Asia remained robust in 2008 at 7.0 per cent, despite a slowdown in a number of countries in the region. Growth was upheld by high commodity export earnings in the first half of 2008 in Bangladesh, the Islamic Republic of Iran, Pakistan and Sri Lanka; there was also improved political stability in Nepal. However, the region's GDP growth is expected to slow to 6.4 per cent in 2009 amidst the fallout

from the global financial crisis. While the slowdown has thus far mainly been limited to the industrial sector, it is expected to spread to the service sector as the squeeze on costs becomes more pervasive and demand slackens.

Although financial institutions in South Asian countries had little direct exposure to the United States sub-prime mortgage market, the global financial crisis has had indirect effects on domestic financial markets, with money markets experiencing an unusual tightening of liquidity. In addition, outflows of foreign capital have posed serious problems in both India and Pakistan. In India, during the first two weeks of October 2008, foreign-exchange reserves fell by more than \$17 billion, partly due to foreign capital outflows. In the case of Pakistan, foreign-exchange reserves, which had stood at \$16.5 billion in October 2007, decreased to about \$7 billion a year later.

In India, economic activity, which had been growing at 9 per cent or more on average over the past three years, has been moderating in response to stepped-up monetary tightening, the hardening of commodity prices in international markets and global financial strains. Pakistan is forecast to see a fall in its growth rate to 3.8 per cent owing to continued political uncertainty, problems of law and order and severe electricity shortages. Growth in the Islamic Republic of Iran, which is the only net oil exporter in the sub-region, will moderate from 6.0 per cent in 2008 to 5.6 per cent in 2009, after robust growth momentum owing to high oil revenues as well as strong private consumption and investment. Some deceleration in growth is also expected in Bangladesh, Nepal and Sri Lanka because of weaker performance in the commodity-producing sectors and a slowdown in the service sector.

Inflation rates have increased throughout the region, owing mainly to higher international commodity prices. In India, inflation rose moderately from 6.4 per cent in 2007 to 8 per cent in 2008, but in Pakistan it increased by over 4 percentage points, to 12 per cent in 2008, with food inflation reaching 17.6 per cent. In Bangladesh, inflation was about 10 per cent—despite the fact that much of the increase in fuel oil prices had not been passed on to consumers—while in the Islamic Republic of Iran and Sri Lanka, prices increased by more than 20 per cent. The economic slowdown and lower energy and commodity prices will reduce inflationary pressures in 2009, although supply constraints and an upward revision in administered prices of fuel oil and electricity will offset part of these effects in some countries (Pakistan, for instance).

Most countries in the region, with the notable exception of the Islamic Republic of Iran, pursued strict monetary policies to contain inflation in 2008. In addition, some Governments introduced new or strengthened existing short-term measures to curb food-price increases. In Bangladesh, for example, these included the open-market sale of food grains at subsidized prices and a reduction in the interest rate on credits for food imports.

While government revenues increased in a number of countries, the increase in expenditures was much larger, owing primarily to increased subsidies and increases in public sector wages. In Pakistan, the budget deficit rose to 7.4 per cent of GDP in 2008, the highest level in the past 10 years, while in Sri Lanka, the budget deficit is estimated to remain at about 7 per cent of GDP. In India, increases in government salaries and subsidies on food, fertilizers and certain fuel oil products are expected to lead to a deficit of 3.5 per cent of GDP in 2008. In the outlook, however, as in a number of other countries in the region, India's fiscal deficit is expected to increase, owing to slower growth in tax revenues in the light of weaker economic growth as well as the likely need for further fiscal stimuli to overcome the negative impacts of the current global economic crisis.

The financial crisis has led to tighter liquidity and shrinking currency reserves

Growth rates will be lower across the region

High inflation will remain problematic

Monetary policies have been in a tightening mode

Fiscal balances will deteriorate further ...

... while weaker exports will keep external balances under pressure

The slowdown will negatively affect employment, although remittances will remain a stabilizing factor

Factors of uncertainty include a prolonged financial crisis and internal conflicts

The surge in prices of fuel oil, food and other commodities wreaked havoc on external balances in the region, as higher import costs have led to both deteriorating trade balances and further pressure on foreign-currency reserves. In Pakistan, for example, the value of imports in dollar terms was roughly double the value of exports in 2008, and the merchandise trade deficit of \$20 billion was about 12 per cent of GDP. In 2009, trade balances in the region will remain under pressure, as weaker demand in overseas markets will lead to a stagnating export performance.

Employment in the region will suffer in the light of the global economic crisis, whose effects will be especially felt in labour-intensive export industries such as textiles. However, the large amount of workers' remittances has so far remained a stabilizing factor for aggregate household income in the region. In Bangladesh, remittances increased by 32 per cent in 2008 and were close to \$8 billion; remittances in Nepal increased by about 20 per cent to roughly \$1.7 billion; and Pakistan received a record \$6.5 billion in terms of remittances in 2008. Since most of these remittances originate from the oil-rich Middle Eastern countries, if oil prices fall considerably over a sustained period, remittances will likely decline, with large shares of the population losing an important source of livelihood and aggravating the problem of poverty.

Risks to the outlook are mainly on the downside. The external environment is particularly uncertain at the present time because of the unfolding global financial crisis and the volatility of oil prices. The global financial crisis, if it worsens, will prolong the global slowdown, adversely affecting the economies of the subregion through export demand, investment flows and exchange-rate volatility. In addition, several countries in the subregion face political conflicts that add to the uncertainty.

Western Asia: Resilience amidst deteriorating external conditions

Economies remain resilient, but growth is slowing down markedly

Export revenues are dropping sharply as global demand weakens

Oil exporters benefited from high prices and increased production in 2008

The Western Asia region went through a rapidly changing external environment in 2008, showing considerable resilience to deteriorating global conditions. Driven by high average oil prices and strong consumption and investment spending, economic activity in the region expanded at a robust pace of 4.9 per cent in 2008, compared with 4.7 per cent in 2007 (see table A.3). Against the background of the global financial crisis, economic growth in the region is expected to slow down to 2.7 per cent in 2009.

The region will experience a sharp decline in export revenues in the outlook as average oil prices are forecast to drop by 35 per cent in 2009 amidst slowing global demand. In addition, tighter credit conditions and deteriorating business and consumer confidence are likely to weaken domestic demand throughout the region, possibly triggering delays in several large investment projects. The global credit crisis has had a severe impact on the banking sectors in Kuwait, Saudi Arabia and the United Arab Emirates owing to their direct linkages to international money and capital markets. However, decisive actions by central banks to ensure liquidity and guarantee bank deposits helped to stabilize the financial sector in the region. While the main oil exporting countries in the region are not immune to the crisis, their strong fiscal and external positions will cushion them against the global economic downturn and sharply lower oil prices.

Surging international commodity prices in the first half of 2008 and higher production volumes led to strong growth in energy-related sectors, including crude oil, liquefied natural gas and petrochemicals. In the countries of the Gulf Cooperation Council (GCC), robust growth in wealth in recent years, coupled with improved business and con-

sumer sentiment, negative real interest rates and large public sector salary hikes, boosted domestic demand in 2008. This contributed to a broad-based expansion in non-petroleum sectors, in particular, business and transport services, communications, finance and construction. Average GDP growth in the GCC countries increased to an estimated 6.2 per cent in 2008, but is forecast to drop to 3.2 per cent in 2009 as oil prices trend lower and investment growth decelerates.

Western Asian countries with more diversified economies continued to benefit from the buoyant conditions in the GCC countries through increased remittances, foreign direct investment flows, and tourism and export receipts. In Iraq and Lebanon, political progress and improved security conditions contributed to economic recoveries in 2008. While the more diversified economies in the region, with the exception of Turkey, have not experienced any significant direct effects from the financial crisis, the sharp economic downturn in the developed and GCC countries will have a negative impact on their growth in 2009.

The Turkish economy faces a severe slowdown as both external and domestic demand weaken. GDP growth is expected to average only 2.8 per cent in 2008—the lowest rate since 2001. The outlook for 2009 remains bleak as the economy is hit by the global credit crunch and probable recessions in major export markets. Weak demand will severely affect the manufacturing sector, most notably the automotive, textile and electronics industries. In spite of having stronger macroeconomic fundamentals than in the past, the Turkish economy remains vulnerable to deteriorating credit conditions and capital reversals owing to the size and composition of its current-account deficit. This became clear in October 2008, when Turkish bond spreads widened significantly and the Turkish lira dropped sharply against the United States dollar. However, market conditions improved in November 2008, and the country is expected to avoid recession in 2009.

Economic activity in Israel continued to expand at a robust pace throughout the first half of 2008, but slowed considerably later in the year. While the Israeli economy remains fundamentally sound, weaker export demand and reduced availability of venture capital and other financing sources are likely to have an impact on economic activity in the short run. GDP growth is forecast to decline from 4.0 per cent in 2008 to 1.8 per cent in 2009.

Despite the economic recovery in recent years, unemployment and underemployment rates, particularly among youth, remain staggeringly high in many Western Asian countries, most notably in the non-oil exporting economies. In Jordan, where unemployment declined slightly from 13.1 per cent in 2007 to 12.9 per cent during the first eight months of 2008, about three quarters of the unemployed are concentrated in the 15-29 year-old age group. In Turkey, the unemployment rate had started to rise even before the financial turmoil intensified, averaging 10.1 per cent during the first seven months of 2008. Meanwhile, unemployment in Israel dropped to a two-decade low of 5.9 per cent in the second quarter of 2008 as a result of the country's broad-based economic expansion.

Western Asian countries experienced further acceleration of consumer price inflation in the first half of 2008. Annual inflation is expected to surpass 10 per cent in all countries, except Bahrain and Israel, averaging 10 per cent for the region as a whole. Sharply higher food prices and housing costs were the main drivers of inflation. This resulted, in part, from trends in global markets, especially the rise in commodity prices and the weakness of the United States dollar, to which most countries in the region peg their currencies. Yet, domestic factors and policies continued to add to inflationary pressures as ample liquidity, the rapid expansion of consumer credit and increased subsidies fuelled domestic demand. In

Global slowdown clouds the outlook for diversified economies

Turkey has been severely hit by the financial turmoil and the recession in developed countries

Growth in Israel is slowing considerably despite sound fundamentals

Labour-market challenges have increased with the global crisis

Inflation soared owing to high commodity prices and buoyant domestic demand

addition, average wages were on the rise, particularly in the GCC countries, driven by public sector wage hikes and shortages of skilled labour in the private sector. Given the substantial decline in commodity prices and the strengthening of the United States dollar, inflation across the region is expected to fall gradually, but will remain at historically high levels.

GCC countries remain committed to exchange-rate pegs

In the GCC countries, central banks maintained stable foreign-exchange rates against nominal anchors, particularly the United States dollar, despite considerable debate and speculation about revaluations of national currencies. This is all the more important as authorities in GCC countries, with the exception of Oman, remain committed to the creation of a monetary union, even though the target date of 2010 is unlikely to be met (see box IV.3). Interest rates in the GCC countries, thus, largely followed United States interest rates downwards in 2008. As a result, central banks faced difficulties in implementing effective monetary measures to absorb excessive domestic liquidity and alleviate inflationary pressures.

Box IV.3

The creation of a Gulf Cooperation Council monetary union

a Michael Sturm and Nikolaus Siegfried, "Regional monetary integration in the member states of the Gulf Cooperation Council", European Central Bank, Occasional Paper Series, No. 31, June 2005; United Nations Economic and Social Commission for Western Asia, "Macroeconomic policy analysis for regional cooperation in the ESCWA region: The effect of real exchange rate variability on intraregional trade", Doc. No. E/ESCWA/EAD/2003/1, 31 March 2003.

b Dubai International Financial Centre, Office of the Chief Economist, "An Assessment of the progress toward GCC monetary union", Economic Note No. 1, 19 August 2008.

Since its inception in 1981, the Gulf Cooperation Council (GCC) has progressively worked towards advancing the economic integration of its member countries. This process includes the creation of three key institutional frameworks: a customs union, a common market and a proposed monetary union. The GCC Customs Union was launched in January 2003, and the GCC Common Market was declared in January 2008; the target for a single currency was set for January 2010.

While major technical and legislative obstacles remain, the member countries, with the exception of Oman, have repeatedly emphasized their commitment to the target date for the monetary union. At a meeting in September 2008, the GCC finance ministers approved a set of proposals for the creation of a monetary council as a precursor to a GCC central bank as well as for a draft charter for the monetary union. As GCC policymakers have increasingly become aware of the necessity for coordinated multilateral actions to promote economic stability among member States, a new set of institutional arrangements are expected to be established after endorsement by the GCC Heads of State at its summit in December 2008.

In addition to geographic proximity and a similar cultural background, GCC member countries share similar economic structures dominated by the production and export of hydrocarbons (crude oil and natural gas) and similar economic diversification strategies. Although similarities in macroeconomic structures, dynamics and trade patterns have led to a high degree of monetary convergence, fiscal convergence has remained less prominent.^a Following the precedent set by the European Monetary Union, GCC member countries agreed to meet a set of convergence criteria before introducing a common currency. A recent study conducted by the Dubai International Financial Centre^b shows that all monetary and fiscal criteria have been met, except inflation targets and a common foreign exchange-rate regime with all currencies pegged to the United States dollar. As of 31 December 2007, Qatar and the United Arab Emirates had not met the inflation criterion. Moreover, surging headline inflation in most member countries in the first half of 2008 has further impeded meeting that target. As for the foreign-exchange rate criterion, Kuwait is the only GCC country outside the criteria, as it has dropped the peg to the United States dollar and instead now pegs its currency to a basket of currencies of its major trading partners.

Recent economic events, such as the surge in international commodity prices, have highlighted the issue of real parity among the national currencies. Figures A and B below show the estimated nominal effective exchange rates (NEER) and the real effective exchange rates (REER) of the GCC countries. Owing to the peg to the United States dollar and similarities in trade structures, a close convergence among member countries, with the exception of Kuwait, has been achieved in the NEER. However, cumulative differences in domestic inflation rates have led to a divergence in terms of the REER, particularly since 2005. This situation implies different possibilities for price adjustments after the introduction of the single currency, depending mostly on expectations. Price levels

Box IV.3 (cont'd)

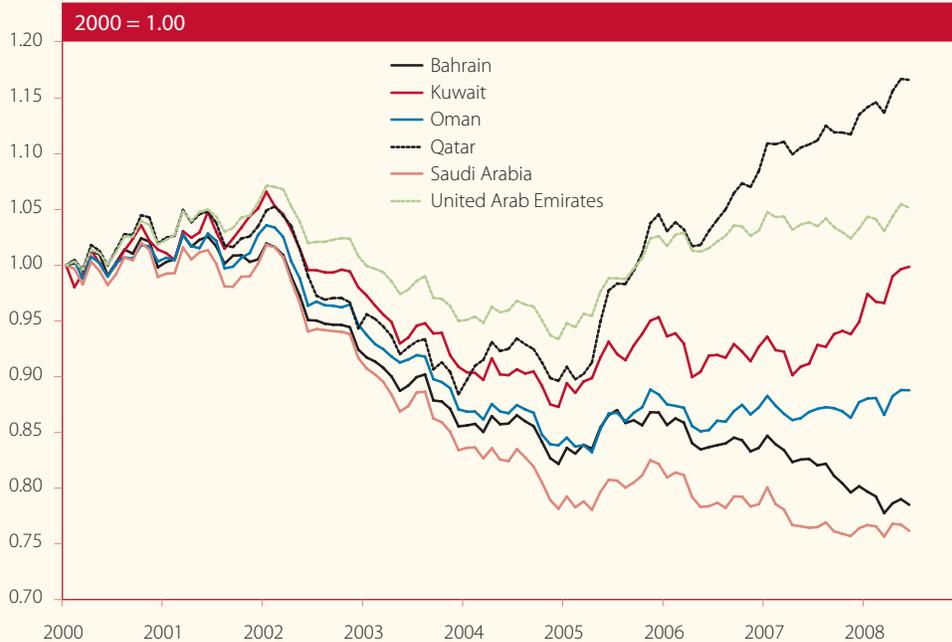
Figure A
Nominal effective exchange rates of the
Gulf Cooperation Council (GCC) countries, 2000-2008



Source: United Nations Economic and Social Commission for Western Asia, staff estimates.

Note: The nominal effective exchange rate (NEER) measures the nominal value of a national currency against a basket of currencies of major trading partners (China, India, Japan, Republic of Korea, the euro zone, United States, United Kingdom and regional partners).

Figure B
Real effective exchange rates of the
Gulf Cooperation Council (GCC) countries, 2000-2008



Source: United Nations Economic and Social Commission for Western Asia, staff estimates.

Note: The real effective exchange rate (REER) measures the value of a national currency against a basket of currencies of major trading partners (China, India, Japan, Republic of Korea, the euro zone, United States, United Kingdom and regional partners), adjusted by domestic and foreign price levels.

Box IV.3 (cont'd)

c See "Adopting the euro: economic and communication challenges," *European Economy News*, No. 2, April 2006.

d It is still unclear whether the introduction of a single currency will take place in one stage, including cash changeover, or in multiple stages starting with the introduction of a common currency unit that is equivalent to the European Currency Unit (ECU).

may converge downwards towards those of Saudi Arabia, the largest economy in the GCC. However, this favourable scenario would most likely require highly integrated goods, capital and labour markets. Another possibility is that price levels will converge upwards in line with market expectations. For example, the cash changeover to the euro in 2002 resulted in high perceived inflation in the euro area, as opposed to a rather stable actual inflation.^c Such high perceived inflation, if it were to occur in the GCC countries, could translate into higher actual inflation through wage pressures. Considering recent price dynamics, a short-term transitory acceleration of inflation in several countries is therefore likely if the planned introduction of the single currency includes an imminent cash changeover^d.

It should be emphasized that the monetary union is well placed to be a catalyst for further economic integration and economic development of GCC member countries. The resulting integration of money and capital markets will have scale effects, thereby reducing the financing costs in member countries and encouraging economic diversification. However, several technical and legislative obstacles still remain, in particular the effective harmonization of national institutions, including payment systems, financing facilities of central banks and money markets, and the jurisdiction of financial transactions, as well as a harmonization of policy infrastructure. In addition, policymakers need to decide upon the institutional and governance structure of a supranational central bank. That includes, among other things, the amount of foreign currency reserves that the common central bank would maintain. Given that, in 2007, all countries met the foreign reserves target (which requires that total holdings cover at least four months worth of goods' imports), this decision seems relatively uncontroversial, with total foreign reserves of a common central bank expected to slightly exceed \$100 billion.

Increased subsidies strain government budgets in the more diversified economies

Governments in most Western Asian countries pursued expansionary fiscal policies in 2008, including higher spending on health, education and infrastructure. Despite strong expenditure growth, the GCC countries ran substantial fiscal surpluses in 2008. In countries with a weaker revenue base such as Jordan, Lebanon, the Syrian Arab Republic and Yemen, high international commodity prices became a serious fiscal burden as subsidies on basic food items and fuel products increased sharply, prompting Jordan and the Syrian Arab Republic to reduce fuel subsidies in 2008.

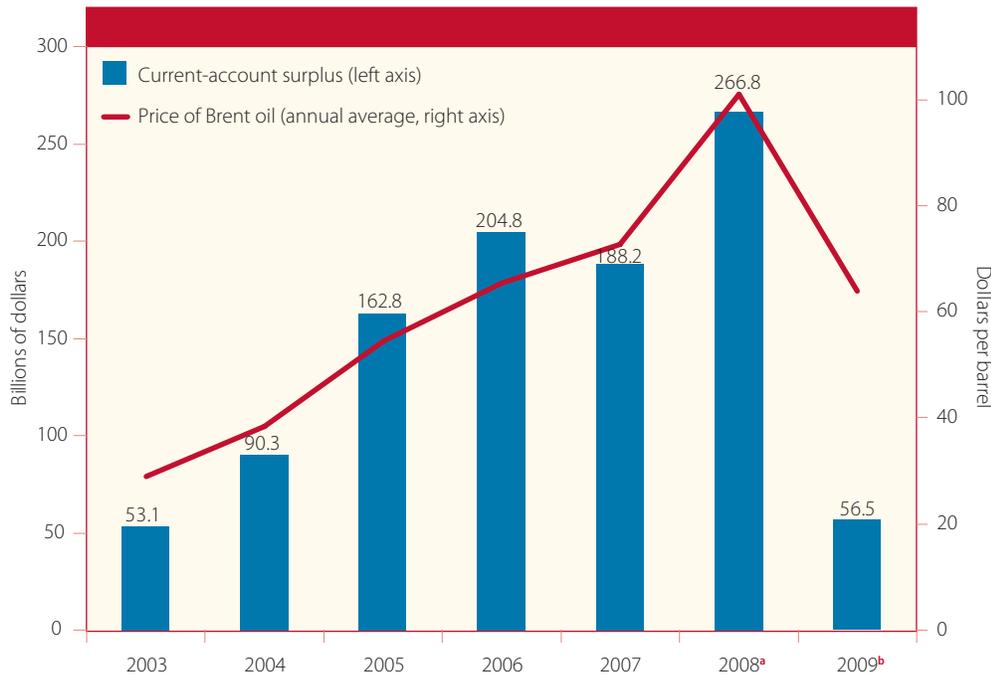
Current-account surpluses in the GCC countries were reaching record levels in 2008

Trends in trade and current-account balances differ sharply between the oil-exporting and importing economies. Higher average prices for oil and gas, along with increased production, led to massive increases in export earnings in the GCC countries and Iraq. Despite strong import growth, current-account surpluses in those countries, in 2008, are expected to exceed the already high levels of 2007 (see figure IV.9). In 2009, trade and current-account surpluses of oil-exporting countries will drop substantially. In Jordan, Lebanon, Turkey and Yemen, rising import costs outpaced increased export revenues, resulting in widening current-account deficits. However, these deficits have been well financed by the inflows of foreign capital and remittances as the countries recorded a steady increase in foreign reserves. While lower oil and food prices are expected to reduce import spending in 2009, financing of the current-account deficits is likely to become more difficult as FDI inflows decline and access to credit tightens.

Downside risks include the collapse of oil prices and the sudden reversal of capital flows

There are substantial downside risks to the economic outlook for the Western Asia region, including, most importantly, a collapse of oil prices and a further deterioration of global financing conditions that result in a sudden reversal of capital flows. A sharp and lasting decline in oil prices would not only impact private and public investment in oil-exporting countries, but would also have adverse spillover effects on the more diversified economies in the region. Additionally, sharply higher borrowing costs and massive capital outflows are a serious threat for the economies in the region that face large external imbalances, especially Turkey.

Figure IV.9
Oil prices and combined current-account surplus in
Western Asian oil-exporting countries, 2003-2009



Source: UN/DESA, based on IMF International Financial Statistics and national sources.

Note: Oil-exporting Western Asian countries include: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates and Yemen. Iraq is excluded due to lack of data.

a Estimated.

b Forecasts.

Latin America and the Caribbean: Significant slowdown in 2009

GDP growth in Latin America and the Caribbean is expected to decrease significantly in 2009. Following five consecutive years of GDP growth over 4 per cent, economic growth is expected to slow significantly, to 2.3 per cent in 2009, down from 4.3 in 2008 and 5.5 per cent in 2007 (see table A.3), owing to a significant drop in commodity prices, weaker external demand and a tightening of financial conditions.

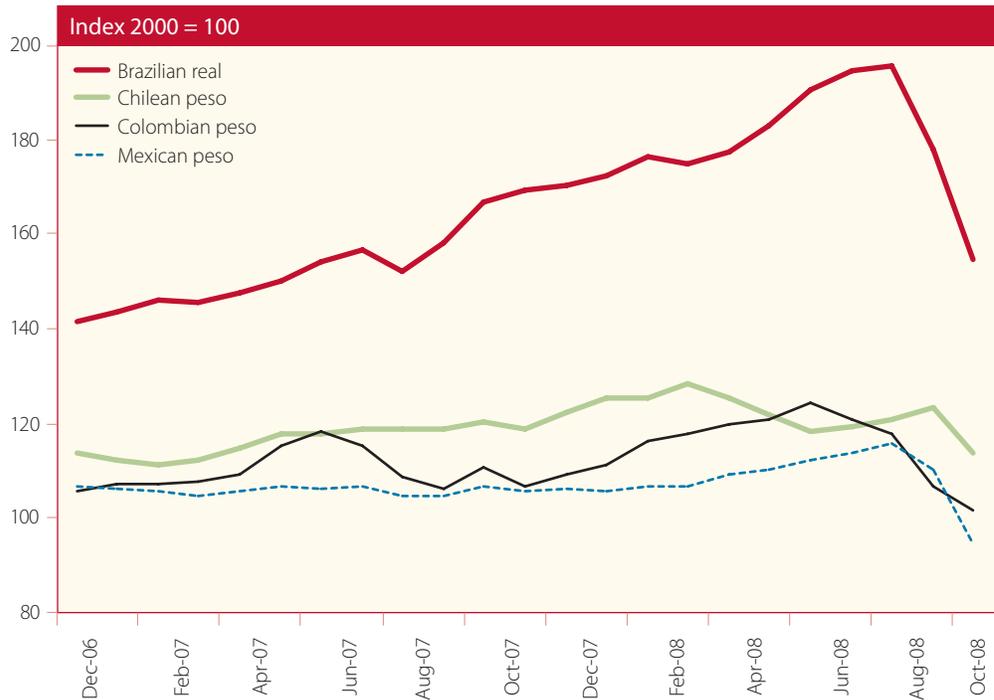
In the fallout from the global financial crisis, financial flows are expected to exhibit a reversal in the region, as investors cope with substantial market uncertainty. Additionally, the six-year-long appreciation trend for Latin American currencies has come to an end as regional currencies were down about 23 per cent against the United States dollar between end-June and October 2008. This depreciation of national currencies against other major currencies, notably in Brazil, Chile, Colombia and Mexico (see figure IV.10) is another clear sign of the contagion effects of the global financial crisis. Yet, the region is better equipped to deal with the crisis than it has been in the past, owing to lower external debt and the large accumulation of foreign reserves.

High commodity prices and buoyant internal demand, the main driving forces of economic growth in 2008, will be less favourable in 2009. In 2008, the average terms-of-trade index for the region as a whole was 45 per cent higher compared to that observed in the 1990s. Terms of trade also improved on average for the year 2008, driving GDP growth along with strong consumer demand and increased demand for gross fixed investment. These factors compensated for the weaker external demand for other exports from the region and explain the better-than-expected performance during the first half of 2008.

The region is better equipped to deal with the crisis

High commodity prices and expanding internal demand drove economic growth in 2008

Figure IV.10
Real currency depreciations in Latin America, December 2006–October 2008



Source: JPMorgan Chase.

However, in 2009, external shocks are expected to worsen growth prospects, albeit to varying degrees across countries.

Mexico and Central America will be the most strongly affected by the global economic slowdown

In South American countries, where export revenues are mostly derived from oil, metal or mineral products, lower commodity prices will negatively affect the terms of trade. In addition, domestic demand will slow because of tighter financing conditions, as has already become evident in Brazil during the last quarter of 2008. GDP growth for South America is expected to fall to 2.9 per cent in 2009, down from 5.4 per cent in 2008. Growth in Central America and Mexico is expected to fall to 0.9 per cent in 2009, from 2.2 per cent in 2008. The subregion will be directly hit by the recession in the United States, which provides the market for most of its manufactured exports and jobs for its migrant workers. The Caribbean countries are equally highly sensitive to the United States economic downturn but, being net importers of commodities, are expected to see some compensation through an improvement in the terms of trade; fiscal stimulus through public investment in infrastructure (for example, in Trinidad and Tobago) is also likely to mitigate some of the growth deceleration caused by the global slowdown.

Lower inflation rates are expected in 2009

In most Latin American and Caribbean countries, inflation surged during 2008, owing mainly to the increased costs of energy, transportation and food, but lower inflation rates are expected in 2009. Central American and Caribbean countries were particularly hard hit, since they are commodity importers. In the Bolivarian Republic of Venezuela, however, prices rose more than 30 per cent in 2008, because of the gap between strong domestic demand and shortages in the supply of consumer products. As, more recently, the global downturn has reduced commodity demand expectations, inflation pressures are expected to decelerate in 2009. For the region as a whole, the inflation rate is expected to decline from an average 8.1 per cent in 2008 to 7.3 per cent in 2009.

However, further depreciation of national currencies in the short run amidst the global financial turmoil will become a major factor in keeping inflationary pressures high, despite the reduced influence of world commodity prices.

As economic growth slows, unemployment rates are expected to rise above 8 per cent in 2009, reversing the positive trend of formal sector job growth during the past five years. Until the second half of 2008, the steady expansion of economic activity had been reflected in improved labour-market indicators. Unemployment rates declined from 9.1 per cent in 2005 to an expected rate of 7.5 per cent in 2008, and job quality improved, as reflected in an increase in the share of formal wage employment.

The region is expected to register a deficit in the current account in 2009, after several years of surpluses and a relatively small deficit in 2008. Since the last quarter of 2007, imports have been growing at a faster pace than exports, owing to strong demand for foreign capital goods, increased energy prices, currency appreciation and lower export expansion. In addition, remittances slowed, increasing by only 3.3 per cent in 2007, compared to 20.1 per cent in 2006, owing essentially to a deteriorating United States labour market. In 2008, only a small number of countries, including Argentina, Ecuador and Venezuela (Bolivarian Republic of), ran current-account surpluses, attributable to an improvement in their terms of trade. In the outlook, the significant economic downturn in the United States and the euro zone will aggravate the external balances of Mexico, Central America and the Caribbean. Although many of the net importers of fuel and other commodities in this subregion will see their situation improve, the export sector will be less dynamic and inflows of remittances are expected to decrease. In South America, adverse terms of trade and lower global demand for commodity exports will lead to lower current-account surpluses or widening deficits.

The fiscal position of the region as a whole will deteriorate as oil and non-oil commodity exporters face a sharp fall in commodity prices and export demand, affecting government revenue. The previously higher export revenues had a positive impact on public revenues and primary surpluses, while reducing public debt and allowing expansionary fiscal policies. However, structural budget positions (when expenditures and revenues are projected according to the trend values of their determinants) have weakened. Public revenues are expected to fall along with slowing economies and the fall of commodity prices that commenced in mid-2008. In countries highly dependent on oil revenues, such as the Bolivarian Republic of Venezuela, the Government will not be able to continue to expand public consumption at the same pace as in recent years.

During 2009, central banks are expected to ease monetary policies in response to emerging liquidity shortages stemming from the ongoing global financial crisis. This is a turnaround from 2008, when interest rates were increased in attempts to control inflationary pressures. At the same time, if export demand falls sharply and uncertainty induces a credit crunch, authorities will be forced to take counter-cyclical measures. The scope for doing so, however, is limited in many countries of the region. As mentioned above, exchange-rate depreciation is exerting new inflationary pressures limiting monetary expansion, while high levels of public indebtedness will limit fiscal expansion. The space for counter-cyclical measures may be larger in those countries with effective fiscal stabilization funds already in place, with structural budget rules or with ample foreign-exchange reserves.

Further downside risks mostly depend on the external situation. A deeper economic slowdown in the United States would affect Mexico, Central America and the Caribbean more directly, while South America will be more sensitive to lower economic

Unemployment rates are expected to rise

Current-account deficits will increase in 2009

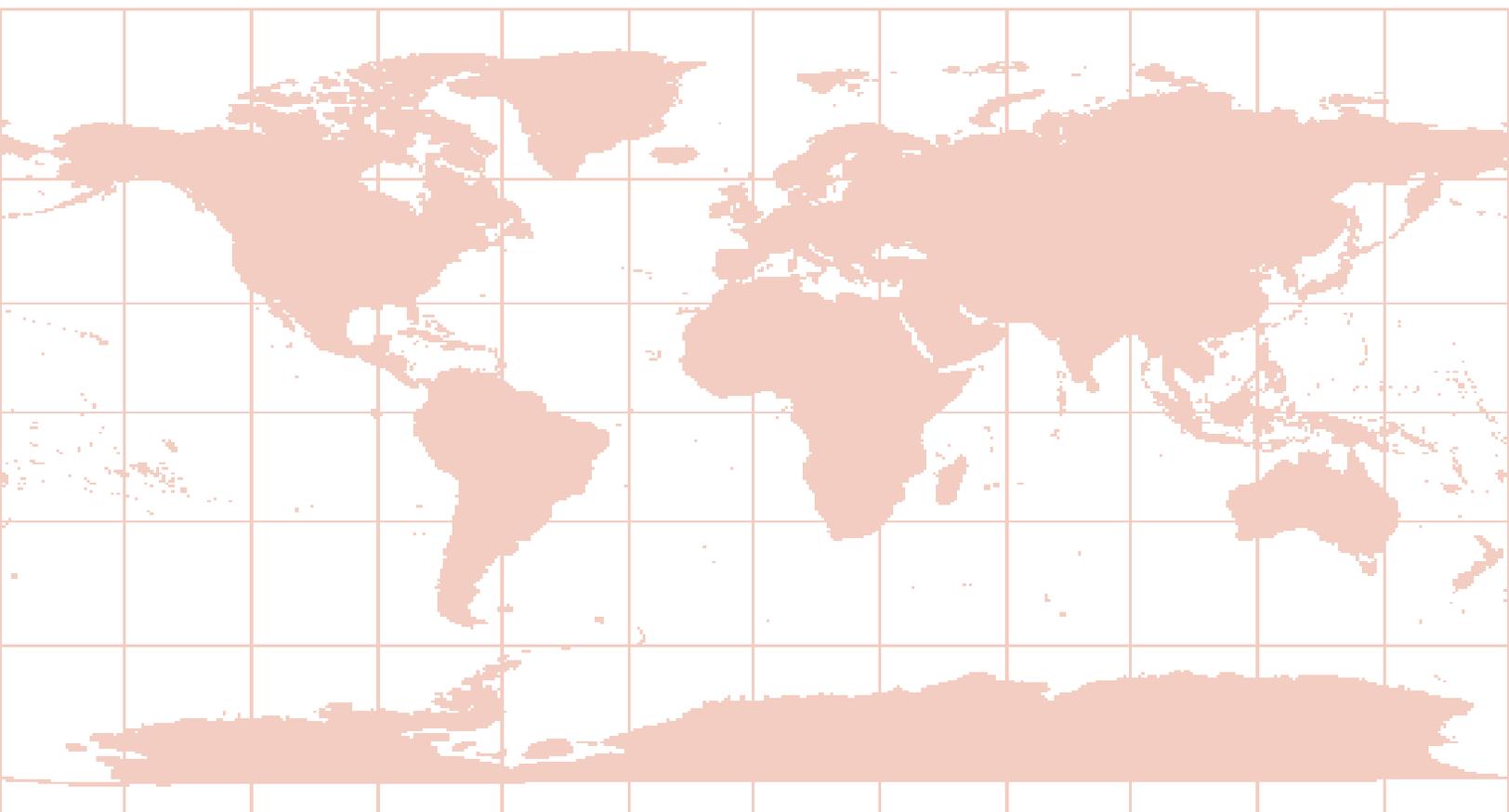
Fiscal positions will deteriorate, as public revenues are expected to fall

Interest rate cuts are expected in response to liquidity shortages

Downside risks are mainly external

dynamism in Europe, China and other important Asian export markets. Additionally, increased risk aversion by foreign investors could reverse capital flows, cause exchange-rate volatility and strong pressure on national currencies to depreciate, and severely tighten domestic credit supplies. As mentioned, fiscal sustainability remains a challenge for many countries in the region. In order to stimulate the economy and mitigate the social effects of external shocks, countries will need to see their fiscal stimulus measures supported by internationally concerted policies to reactivate the global economy (as argued in chapter I) with a view to keeping the burden on future incomes within manageable proportions.

Statistical annex



Annex

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Table A.1
Developed economies: rates of growth of real GDP, 1999-2009

Annual percentage change												
	1999-2007 ^a	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Developed economies	2.5	3.2	3.7	1.3	1.4	1.8	3.0	2.4	2.9	2.5	1.2	-0.5
United States	2.7	4.4	3.7	0.8	1.6	2.5	3.6	2.9	2.8	2.0	1.2	-1.0
Canada	3.2	5.5	5.2	1.8	2.9	1.9	3.1	2.9	3.1	2.7	0.4	0.8
Japan	1.5	-0.1	2.9	0.2	0.3	1.4	2.7	1.9	2.4	2.1	0.4	-0.3
Australia	3.4	4.4	3.6	2.1	4.0	3.4	3.2	3.2	2.5	4.4	2.6	1.1
New Zealand	3.6	4.7	3.8	2.4	4.7	4.4	4.3	2.7	2.5	3.0	0.6	1.1
European Union	2.4	3.1	3.9	2.0	1.2	1.3	2.5	2.0	3.1	2.9	1.3	-0.5
EU-15	2.3	3.1	3.9	1.9	1.2	1.2	2.3	1.8	2.9	2.7	1.1	-0.7
Austria	2.4	3.3	3.7	0.5	1.6	0.8	2.5	2.9	3.4	3.1	1.9	0.1
Belgium	2.3	3.4	3.7	0.8	1.5	1.0	3.0	1.8	3.0	2.8	1.2	-0.2
Denmark	1.9	2.6	3.5	0.7	0.5	0.4	2.3	2.4	3.3	1.6	0.4	-0.7
Finland	3.4	3.9	5.0	2.6	1.6	1.8	3.7	2.8	4.9	4.5	2.1	0.2
France	2.2	3.3	3.9	1.8	1.0	1.1	2.5	1.9	2.2	2.2	0.8	-0.2
Germany	1.5	2.0	3.2	1.2	0.0	-0.2	1.2	0.8	3.0	2.5	1.6	-0.9
Greece	4.2	3.4	4.5	4.2	3.4	5.6	4.9	2.9	4.5	4.0	3.0	1.8
Ireland	6.6	10.7	9.2	5.8	6.4	4.5	4.7	6.4	5.7	6.0	0.4	-2.2
Italy	1.4	1.5	3.7	1.8	0.5	0.0	1.5	0.6	1.8	1.5	-0.2	-1.0
Luxembourg	5.1	8.4	8.4	2.5	4.1	1.5	4.5	5.2	6.4	5.2	2.7	1.7
Netherlands	2.4	4.7	3.9	1.9	0.1	0.3	2.2	2.0	3.4	3.5	2.0	-0.1
Portugal	1.7	3.8	3.9	2.0	0.8	-0.8	1.5	0.9	1.4	1.9	0.6	-0.6
Spain	3.7	4.7	5.0	3.6	2.7	3.1	3.3	3.6	3.9	3.7	1.2	-1.8
Sweden	3.2	4.6	4.4	1.1	2.4	1.9	4.1	3.3	4.1	2.7	1.5	0.4
United Kingdom	2.8	3.5	3.9	2.5	2.1	2.8	2.8	2.1	2.8	3.0	1.0	-1.0
New EU member States	4.4	2.8	4.1	2.9	3.0	4.3	5.6	4.8	6.5	6.0	4.9	3.1
Bulgaria	5.0	2.3	5.4	4.1	4.9	5.0	6.6	6.2	6.3	6.2	6.5	5.0
Cyprus	3.8	4.8	5.0	4.0	2.1	1.9	4.2	3.9	4.1	4.4	3.6	2.6
Czech Republic	4.0	1.3	3.6	2.5	1.9	3.6	4.5	6.3	6.8	6.0	4.1	3.6
Estonia	7.2	-0.1	9.6	7.7	7.8	7.1	7.5	9.2	10.4	6.3	-2.0	-2.0
Hungary	4.0	4.2	5.2	4.1	4.1	4.2	4.8	4.0	4.1	1.1	1.5	-1.0
Latvia	8.1	3.3	6.9	8.0	6.5	7.2	8.7	10.6	11.9	10.2	-0.6	-4.0
Lithuania	6.4	-1.5	4.2	6.7	6.9	10.2	7.4	7.8	7.8	8.9	4.5	1.5
Malta	2.5	4.1	6.3	-1.6	2.6	-0.3	1.1	3.5	3.1	3.7	2.9	2.3
Poland	4.1	4.5	4.3	1.2	1.4	3.9	5.3	3.6	6.2	6.6	5.5	4.0
Romania	4.8	-1.2	2.1	5.7	5.1	5.2	8.5	4.2	8.2	6.0	8.0	4.3
Slovakia	4.9	0.0	1.4	3.4	4.8	4.7	5.2	6.5	8.5	10.4	7.8	5.0
Slovenia	4.5	5.3	4.1	2.8	4.0	2.8	4.3	4.3	5.9	6.8	4.2	3.6
Other Europe	2.3	1.7	3.5	1.6	0.9	0.4	3.2	2.7	3.0	3.5	1.5	0.3
Iceland	4.2	4.1	4.3	3.9	0.1	2.4	7.7	7.5	4.4	3.8	-3.4	-8.3
Norway	2.5	2.0	3.3	2.0	1.5	1.0	3.9	2.7	2.5	3.7	1.6	0.9
Switzerland	2.0	1.3	3.6	1.2	0.4	-0.2	2.5	2.5	3.4	3.3	1.7	0.2
Memorandum items:												
Major developed economies	2.3	3.0	3.6	1.1	1.2	1.7	2.9	2.2	2.7	2.2	0.9	-0.7
North America	2.7	4.5	3.8	0.9	1.7	2.4	3.6	2.9	2.8	2.1	1.1	-0.8
Western Europe	2.4	3.0	3.9	1.9	1.2	1.3	2.5	2.0	3.1	2.9	1.3	-0.5
Asia and Oceania	1.8	0.5	3.0	0.5	0.9	1.7	2.8	2.1	2.4	2.4	0.7	0.0

Sources: UN/DESA, based on OECD, *Main Economic Indicators* and individual national sources.

Note: Country groups are calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

^a Average percentage change.

^b Partly estimated.

^c Baseline scenario forecasts, based in part on Project LINK.

Table A.2
Economies in transition: rates of growth of real GDP, 1999-2009

Annual percentage change												
	1999-2007 ^a	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Economies in transition^d	6.9	4.8	8.8	5.7	5.1	7.4	7.7	6.5	7.8	8.3	6.9	4.8
South-eastern Europe^d	4.2	-1.3	4.1	4.2	4.5	4.3	5.7	4.9	5.4	6.2	5.2	4.5
Albania	6.8	13.5	6.7	7.9	4.2	5.8	5.7	5.8	5.5	6.0	5.8	5.2
Bosnia and Herzegovina	5.9	9.5	5.4	4.3	5.3	4.4	6.3	3.9	6.9	6.8	5.2	4.8
Croatia	4.0	-0.9	2.9	4.4	5.6	5.3	4.3	4.3	4.8	5.6	4.3	3.8
Montenegro	4.2	..	..	1.1	1.9	2.5	4.4	4.2	8.5	7.0	7.0	5.0
Serbia	3.5	-10.2	4.5	5.4	3.6	2.8	8.2	6.0	5.6	7.1	6.3	5.0
The former Yugoslav Republic of Macedonia	2.8	4.3	4.5	-4.5	0.9	2.8	4.1	4.1	4.0	5.0	5.0	4.6
Commonwealth of Independent States	7.2	5.5	9.3	5.9	5.1	7.7	7.9	6.7	8.1	8.5	7.1	4.9
Net fuel exporters	7.2	6.2	9.9	5.6	5.1	7.4	7.4	6.9	8.1	8.5	7.1	4.9
Azerbaijan	15.9	7.4	11.1	9.9	10.6	11.2	10.2	26.4	34.5	25.0	16.0	14.0
Kazakhstan	9.3	2.7	9.8	13.5	9.8	9.3	9.6	9.7	10.7	8.9	4.5	4.0
Russian Federation	7.0	6.4	10.0	5.1	4.7	7.3	7.2	6.4	7.4	8.1	7.1	4.8
Turkmenistan	7.7	16.5	5.5	4.3	0.3	3.3	4.5	12.9	11.1	11.6	7.0	6.0
Uzbekistan	5.8	4.4	4.0	4.2	4.0	4.4	7.7	7.0	7.3	9.5	8.0	6.8
Net fuel importers	6.8	0.9	5.6	7.9	5.5	9.1	11.4	4.9	8.1	8.2	6.8	4.0
Armenia	11.0	3.3	5.9	9.6	15.0	14.0	10.5	13.9	13.3	13.8	10.0	8.0
Belarus	7.2	3.4	5.8	4.7	5.0	7.0	11.4	9.4	10.0	8.7	10.0	8.0
Georgia	7.0	2.9	1.8	4.8	5.5	11.1	5.9	9.6	9.4	12.4	4.0	4.5
Kyrgyzstan	4.3	3.7	5.4	5.3	0.0	7.0	7.0	-0.2	3.1	8.2	6.0	5.0
Republic of Moldova	4.6	-3.4	2.1	6.1	7.8	6.6	7.4	7.5	4.8	3.0	6.0	5.0
Tajikistan	8.3	3.7	8.3	9.6	10.8	11.1	10.3	6.7	6.7	7.8	6.0	7.0
Ukraine	6.5	-0.2	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.6	5.7	2.1

Source: UN/DESA, based on data of the Economic Commission for Europe.

Note: Country groups are calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

- a Average percentage change.
- b Partly estimated.
- c Baseline scenario forecasts, based in part on Project LINK.
- d Excluding Montenegro before 2000.

Table A.3
Developing economies: rates of growth of real GDP, 1999-2009

Annual percentage change												
	1999-2007 ^a	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Developing countries^d	5.5	3.6	5.7	2.9	4.3	5.2	7.1	6.8	7.1	7.2	5.9	4.6
Africa	4.9	2.6	3.3	4.3	5.5	4.9	5.9	5.7	5.7	6.0	5.1	4.1
North Africa	4.4	3.1	2.6	3.7	3.5	5.7	4.9	5.0	5.3	5.3	5.1	4.0
Sub-Saharan Africa (excluding Nigeria and South Africa)	5.1	2.9	2.8	5.1	4.6	3.8	6.4	6.7	6.7	7.4	6.2	4.8
Net fuel exporters	5.7	2.5	3.3	4.2	8.3	6.5	6.6	7.0	5.7	6.9	6.1	4.9
Net fuel importers	4.3	2.8	3.3	4.4	3.6	3.8	5.4	4.8	5.7	5.2	4.3	3.5
East and South Asia	7.1	6.5	6.8	4.6	6.6	6.9	7.7	8.0	8.1	8.5	6.9	6.0
East Asia	7.3	6.7	7.7	4.7	7.1	6.9	8.0	7.6	8.4	8.7	6.9	5.9
South Asia	6.3	6.1	3.7	4.1	4.9	6.9	6.7	9.5	6.9	7.9	7.0	6.4
Net fuel exporters	5.5	4.3	3.5	4.5	6.7	7.0	5.4	5.3	6.2	6.5	5.5	5.2
Net fuel importers	7.2	6.7	7.0	4.6	6.6	6.9	7.8	8.1	8.2	8.6	7.0	6.1
Western Asia	4.3	0.1	6.4	-0.6	2.4	4.9	8.2	6.8	5.9	4.7	4.9	2.7
Net fuel exporters	4.5	1.2	5.9	1.9	1.1	5.5	8.5	6.5	5.9	4.7	6.2	3.4
Net fuel importers	4.0	-1.3	6.9	-3.5	4.1	4.3	7.9	7.2	6.0	4.8	3.2	2.0
Latin America and the Caribbean	3.3	0.6	4.4	0.8	0.5	1.8	5.9	4.6	5.5	5.5	4.3	2.3
South America	3.1	-1.4	3.3	1.0	0.0	1.8	7.1	5.1	5.4	6.4	5.4	2.9
Mexico and Central America	3.2	3.9	6.2	0.1	1.0	1.6	4.0	3.3	5.1	3.6	2.2	0.9
Caribbean	5.4	5.6	4.9	2.3	3.5	3.3	3.5	8.6	10.2	6.7	4.5	2.9
Net fuel exporters	3.1	0.4	4.7	0.1	-1.6	1.8	6.3	5.1	6.3	5.1	3.4	1.4
Net fuel importers	3.4	0.8	4.0	1.4	2.6	1.8	5.5	4.1	4.7	5.9	5.2	3.1
Memorandum items:												
Least developed countries	6.3	4.5	4.6	6.0	5.7	5.2	7.2	7.9	7.7	7.8	6.4	5.1
East Asia (excluding China)	5.2	5.9	7.2	1.8	5.4	4.1	5.9	5.0	5.6	5.8	4.3	3.0
South Asia (excluding India)	5.2	4.3	3.3	3.4	5.5	6.1	6.0	5.9	6.1	6.1	5.9	5.1
Western Asia (excluding Israel and Turkey)	4.5	1.3	5.7	2.0	1.3	5.3	8.3	6.3	5.6	4.7	6.1	3.4
Landlocked developing economies	6.6	3.6	4.9	6.7	5.6	5.7	7.8	7.8	9.3	8.5	6.4	5.5
Small island developing economies	5.4	6.0	7.1	0.4	3.6	3.4	5.9	7.4	8.4	6.9	3.8	1.8
Major developing economies												
Argentina	2.5	-3.4	-0.8	-4.4	-10.9	8.8	9.0	9.2	8.5	8.7	6.5	2.8
Brazil	3.1	0.3	4.3	1.3	2.7	1.1	5.7	3.2	3.8	5.4	5.1	2.9
Chile	3.8	-0.8	4.5	3.4	2.2	3.9	6.0	5.6	4.3	5.1	3.9	2.7
China	9.6	7.6	8.4	8.3	9.1	10.0	10.1	10.4	11.6	11.9	9.1	8.4
Colombia	3.6	-4.2	2.9	2.2	2.5	4.6	4.7	5.7	6.8	7.7	3.3	2.5
Egypt	5.1	5.4	3.5	3.2	4.1	4.1	4.5	6.8	7.1	7.1	6.5	5.0
Hong Kong SAR ^e	4.9	2.6	8.0	0.5	1.8	3.0	8.5	7.1	7.0	6.4	3.8	2.4
India	6.9	7.1	4.0	4.5	4.5	7.3	7.1	11.5	7.3	8.9	7.5	7.0
Indonesia	4.6	0.8	4.9	3.6	4.5	4.8	5.0	5.7	5.5	6.3	5.9	3.9

Table A.3 (cont'd)												
	1999-2007 ^a	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Iran, Islamic Republic of	5.2	4.2	2.8	4.0	6.7	7.1	5.1	4.7	5.8	6.2	6.0	5.6
Israel	3.7	2.9	8.9	-0.4	-0.6	2.3	5.2	5.3	5.2	5.4	4.0	1.8
Korea, Republic of	5.6	9.5	8.5	3.8	7.0	3.1	4.7	4.2	5.1	5.0	4.1	3.0
Malaysia	5.6	6.1	8.9	0.5	5.4	5.8	6.8	5.3	5.8	6.3	5.4	4.3
Mexico	3.1	3.8	6.6	0.0	0.8	1.4	4.0	3.1	4.9	3.2	2.0	0.7
Nigeria	8.1	0.5	5.3	8.2	21.2	10.3	10.6	7.1	5.2	6.0	6.1	5.7
Pakistan	5.1	4.3	2.0	3.1	4.6	4.8	7.5	7.7	6.2	6.0	5.8	3.8
Peru	4.6	0.9	3.0	0.2	5.0	4.0	5.1	6.7	7.6	8.9	8.9	5.2
Philippines	4.9	3.4	6.0	1.8	4.4	4.9	6.4	5.0	5.4	7.2	4.4	3.3
Saudi Arabia	3.3	-0.7	4.9	0.5	0.1	7.7	5.3	5.6	3.1	3.4	5.3	2.8
Singapore	6.0	7.2	10.1	-2.4	4.2	3.5	9.0	7.3	8.2	7.7	2.8	0.2
South Africa	4.0	2.4	4.2	2.7	3.7	3.1	4.9	5.0	5.4	5.1	3.1	2.5
Taiwan Province of China	4.2	5.7	5.8	-2.2	4.6	3.5	6.2	4.2	4.8	5.7	3.6	2.7
Thailand	4.9	4.4	4.8	2.2	5.3	7.1	6.3	4.5	5.1	4.8	4.6	3.2
Turkey	4.1	-3.4	6.8	-5.7	6.2	5.3	9.4	8.4	6.9	4.6	2.8	1.8
Venezuela, Bolivarian Republic of	3.2	-6.0	3.7	3.4	-8.9	-7.8	18.3	10.3	10.3	8.4	5.9	1.9

Sources: UN/DESA, based on data of Statistics Division; IMF, *International Financial Statistics*.

Note: Country groups are calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

a Average percentage change.

b Partly estimated.

c Baseline scenario forecasts, based in part on Project LINK.

d Covering countries that account for 98 per cent of the population of all developing countries.

e Special Administrative Region of China.

Table A.4
Developed economies: consumer price inflation, 1999-2009

Annual percentage change ^a											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Developed economies	1.6	2.5	2.3	1.6	1.8	2.0	2.3	2.4	2.1	3.5	1.8
United States	2.1	3.4	2.8	1.7	2.2	2.7	3.4	3.3	2.8	4.3	1.3
Canada	1.7	2.7	2.5	2.3	2.8	1.9	2.2	2.0	2.1	3.0	2.3
Japan	-0.3	-0.7	-0.8	-0.9	-0.2	0.0	-0.3	0.2	0.1	1.6	1.1
Australia	1.5	4.5	4.4	3.0	2.8	2.3	2.7	3.5	2.3	4.7	3.5
New Zealand	-0.1	2.6	2.6	2.7	1.8	2.3	3.0	3.4	2.4	4.1	3.3
European Union	1.8	2.6	2.7	2.3	2.1	2.1	2.2	2.2	2.2	3.4	2.2
EU-15	1.2	2.0	2.2	2.1	2.0	2.0	2.1	2.2	2.1	3.2	2.1
Austria	0.5	2.0	2.3	1.7	1.3	2.0	2.1	1.7	2.2	3.1	1.8
Belgium	1.1	2.7	2.4	1.6	1.5	1.9	2.5	2.3	1.8	4.3	3.1
Denmark	2.1	2.7	2.3	2.4	2.0	0.9	1.7	1.9	1.7	3.4	2.2
Finland	1.3	2.9	2.7	2.0	1.3	0.1	0.8	1.3	1.6	3.8	1.7
France	0.6	1.8	1.8	1.9	2.2	2.3	1.9	1.9	1.6	3.4	1.8
Germany	0.6	1.4	1.9	1.4	1.0	1.8	1.9	1.8	2.3	2.5	1.8
Greece	2.1	2.9	3.7	3.9	3.4	3.0	3.5	3.3	3.0	4.4	2.6
Ireland	2.5	5.3	4.0	4.7	4.0	2.3	2.2	2.7	2.9	3.6	2.0
Italy	1.7	2.6	2.3	2.6	2.8	2.3	2.2	2.2	2.0	3.2	1.8
Luxembourg	1.0	3.8	2.4	2.1	2.5	3.2	3.8	3.0	2.7	3.7	2.5
Netherlands	2.0	2.3	5.1	3.9	2.2	1.4	1.5	1.7	1.6	2.5	2.8
Portugal	2.2	2.8	4.4	3.7	3.3	2.5	2.1	3.0	2.4	2.6	1.6
Spain	2.2	3.5	2.8	3.6	3.1	3.1	3.4	3.6	2.8	3.8	2.3
Sweden	0.5	1.3	2.7	1.9	2.3	1.0	0.8	1.5	1.7	3.5	2.0
United Kingdom	1.3	0.8	1.2	1.3	1.4	1.3	2.1	2.3	2.3	3.5	2.7
New EU member States	10.9	12.8	9.2	5.2	3.6	5.1	3.4	3.1	4.1	6.0	4.1
Bulgaria	2.6	10.3	7.4	5.8	2.3	6.1	6.0	7.4	7.6	12.0	5.2
Cyprus	1.1	4.9	2.0	2.8	4.0	1.9	2.0	2.2	2.2	5.0	3.8
Czech Republic	1.8	3.9	4.5	1.4	-0.1	2.6	1.6	2.1	3.0	5.6	4.0
Estonia	3.1	3.9	5.6	3.6	1.4	3.0	4.1	4.4	6.7	11.0	6.0
Hungary	10.0	10.0	9.1	5.2	4.7	6.8	3.5	4.0	7.9	6.0	3.9
Latvia	2.1	2.6	2.5	2.0	2.9	6.2	6.9	6.6	10.1	15.0	6.5
Lithuania	1.5	1.1	1.6	0.3	-1.1	1.2	2.7	3.8	5.8	11.0	7.0
Malta	2.3	3.0	2.5	2.6	1.9	2.7	2.5	2.6	0.7	5.0	3.6
Poland	7.2	10.1	5.3	1.9	0.7	3.6	2.2	1.3	2.6	4.3	3.6
Romania	45.8	45.7	34.5	22.5	15.3	11.9	9.1	6.6	4.9	8.0	5.0
Slovakia	10.4	12.2	7.2	3.5	8.4	7.5	2.8	4.3	1.9	4.0	3.8
Slovenia	6.1	8.9	8.6	7.5	5.7	3.7	2.5	2.5	3.8	5.8	3.2
Other Europe	1.5	2.3	2.0	1.0	1.5	0.7	1.3	1.7	0.8	3.4	2.5
Iceland	2.1	4.4	6.6	5.3	1.4	2.3	1.4	4.6	3.6	15.2	18.5
Norway	2.3	3.1	3.0	1.3	2.5	0.5	1.5	2.3	0.7	4.0	3.1
Switzerland	0.8	1.6	1.0	0.6	0.6	0.8	1.2	1.1	0.7	2.4	1.3
Memorandum items:											
Major developed economies	1.3	2.1	1.9	1.3	1.7	1.9	2.3	2.3	2.1	3.4	1.6
Euro zone	1.2	2.3	2.5	2.3	2.1	2.2	2.2	2.2	2.1	3.2	2.0

Sources: UN/DESA, based on OECD, *Main Economic Indicators*; Eurostat; and, individual national sources.

a Data for country groups are weighted averages, where weights for each year are based on GDP in 2005, in United States dollars.

b Partly estimated.

c Baseline scenario forecasts, based in part on Project LINK.

Table A.5
Economies in transition: consumer price inflation, 1999-2009

Annual percentage change ^a											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Economies in transition^d	73.1	25.1	21.5	13.9	12.0	10.1	11.8	9.2	9.1	15.2	11.8
<i>South-eastern Europe^d</i>	14.0	25.3	31.1	7.6	3.8	3.9	6.4	6.2	3.9	7.7	4.9
Albania	0.4	0.1	3.1	7.8	0.5	2.3	2.4	2.4	2.9	4.2	3.2
Bosnia and Herzegovina	-0.6	1.7	1.8	0.9	0.2	-0.3	3.0	6.0	2.0	8.0	4.5
Croatia	4.0	4.6	3.8	1.7	1.8	2.1	3.0	3.2	2.9	6.4	3.9
Montenegro	..	..	22.6	18.3	6.7	2.2	2.6	3.0	4.3	8.4	3.5
Serbia	42.4	77.5	98.4	19.3	9.6	9.8	16.1	12.7	6.5	10.3	7.0
The former Yugoslav Republic of Macedonia	-1.3	6.6	5.2	2.4	1.1	-0.6	-0.7	3.3	2.8	8.0	5.0
<i>Commonwealth of Independent States</i>	78.5	25.1	20.6	14.4	12.8	10.6	12.3	9.5	9.6	15.9	12.4
<i>Net fuel exporters</i>	77.7	20.0	20.3	15.0	13.1	10.6	12.4	9.6	9.3	14.9	11.6
Azerbaijan	-8.6	1.8	1.6	2.8	2.1	6.7	9.6	8.3	16.6	22.5	20.0
Kazakhstan	8.3	13.2	8.4	5.8	6.4	6.9	7.6	8.6	10.8	19.7	12.0
Russian Federation	85.7	20.8	21.5	15.8	13.7	10.9	12.7	9.7	9.0	14.5	11.5
Turkmenistan	23.5	7.0	8.2	15.0	15.3	10.0	12.0	9.0	6.4	12.0	10.0
Uzbekistan	29.0	25.0	26.6	21.6	19.0	14.2	15.0	10.5	12.3	12.0	10.0
<i>Net fuel importers</i>	83.0	57.4	22.6	10.7	10.6	10.9	11.8	8.8	11.3	22.3	17.2
Armenia	0.7	-0.8	3.2	1.0	2.7	8.1	0.6	2.9	4.4	9.7	6.0
Belarus	293.7	168.9	61.4	42.8	28.5	18.3	10.4	7.0	8.4	15.5	10.2
Georgia	19.3	4.2	4.6	5.7	4.9	5.7	8.2	9.2	9.2	11.0	6.5
Kyrgyzstan	35.9	19.7	6.9	2.1	3.0	4.1	4.4	5.6	10.2	27.5	15.5
Republic of Moldova	45.9	31.3	9.8	5.3	11.8	12.5	12.0	12.8	12.4	15.0	9.5
Tajikistan	27.4	32.9	38.6	12.2	16.3	7.2	7.2	10.0	13.4	30.0	18.5
Ukraine	22.7	28.2	11.9	0.8	5.2	9.1	13.5	9.6	12.8	26.2	21.4

Source: UN/DESA, based on data of the Economic Commission for Europe.

- a** Data for country groups are weighted averages, where weights for each year are based on GDP in 2005, in United States dollars.
b Partly estimated.
c Baseline scenario forecasts, based in part on Project LINK.
d Excluding Montenegro before 2001.

Table A.6
Developing economies: consumer price inflation, 1999-2009

Annual percentage change ^a											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Developing countries by region:	7.4	7.0	6.3	5.9	5.8	5.0	4.6	4.5	5.2	8.1	5.9
Africa	14.5	18.6	13.1	9.3	8.8	6.6	6.7	6.1	6.4	10.7	7.5
North Africa	2.4	1.1	1.1	0.7	2.3	4.7	2.6	4.5	5.3	9.6	7.0
Sub-Saharan Africa (excluding Nigeria and South Africa)	39.4	54.3	30.8	17.7	16.8	9.7	9.8	8.3	7.5	12.7	8.4
Net fuel exporters	21.7	26.2	17.2	11.6	12.5	10.6	8.4	6.2	6.5	9.9	7.8
Net fuel importers	9.1	12.8	10.0	7.5	6.0	3.5	5.4	6.0	6.3	11.2	7.3
East and South Asia	2.2	1.9	2.6	2.1	2.7	4.1	3.6	3.6	4.9	7.4	4.7
East Asia	0.9	0.9	2.0	1.0	1.8	3.5	2.9	2.7	4.0	6.4	3.6
South Asia	7.1	5.6	4.9	5.9	5.9	6.2	6.5	7.1	8.5	11.3	8.8
Net fuel exporters	16.0	10.6	8.4	11.5	13.1	12.8	11.9	10.6	14.9	23.3	17.0
Net fuel importers	1.6	1.5	2.3	1.6	2.2	3.7	3.2	3.3	4.5	6.7	4.2
Western Asia	24.1	19.9	19.9	17.4	8.6	4.0	4.5	5.9	5.8	10.0	7.8
Net fuel exporters	-0.4	-0.4	-0.2	0.3	1.1	1.4	2.4	3.7	4.9	10.8	8.4
Net fuel importers	46.6	38.5	38.4	33.0	15.5	6.3	6.5	8.0	6.7	9.2	7.3
Latin America and the Caribbean	10.0	8.9	6.6	8.8	10.8	6.9	6.3	5.2	5.3	8.1	7.3
South America	7.3	8.8	6.7	10.9	13.8	7.0	7.2	5.7	5.8	9.0	8.3
Mexico and Central America	15.4	9.2	6.4	5.1	4.6	4.9	4.4	3.9	4.3	6.1	5.1
Caribbean	5.6	6.9	7.9	5.3	18.0	30.4	7.2	8.2	7.1	13.1	9.5
Net fuel exporters	17.8	13.2	8.4	7.7	8.5	7.0	5.7	5.1	6.2	9.3	8.4
Net fuel importers	4.0	5.6	5.3	9.6	12.5	6.9	6.7	5.2	4.6	7.2	6.4
Memorandum items:											
Least developed countries	41.1	53.6	30.7	20.2	18.3	11.1	10.6	9.6	9.9	13.5	9.8
East Asia (excluding China)	3.3	1.6	3.5	2.9	2.5	3.2	3.9	3.9	3.1	6.4	4.2
South Asia (excluding India)	12.0	8.9	7.4	8.8	9.9	11.0	10.9	9.8	12.8	17.9	13.5
Western Asia (excluding Israel and Turkey)	-0.1	-0.2	0.2	0.7	1.5	1.8	2.8	4.3	5.1	11.1	8.6
Major developing economies											
Argentina	-1.2	-0.9	-1.1	25.9	13.4	4.4	9.6	10.9	8.8	9.0	7.9
Brazil	4.9	7.1	6.8	8.5	14.7	6.6	6.8	4.2	3.6	5.8	5.8
Chile	3.3	3.8	3.6	2.5	2.8	1.1	3.1	3.4	4.4	8.9	6.5
China	-1.4	0.3	0.5	-0.8	1.2	3.9	1.8	1.5	4.8	6.3	3.1
Colombia	10.9	9.2	8.0	6.3	7.1	5.9	5.0	4.3	5.5	7.3	5.5
Egypt	3.1	2.7	2.3	2.7	4.5	11.3	4.9	7.6	9.3	17.1	9.7
Hong Kong SAR ^d	-4.0	-3.8	-1.6	-3.1	-2.5	-0.4	0.9	2.1	2.0	4.5	4.3
India	4.7	4.0	3.7	4.4	3.8	3.8	4.2	5.8	6.4	8.0	6.5
Indonesia	20.5	3.7	11.5	11.9	6.6	6.2	10.5	13.1	6.4	10.3	8.0
Iran, Islamic Republic of	20.1	14.5	11.3	14.3	16.5	14.8	13.4	11.9	17.2	24.0	18.5
Israel	5.2	1.1	1.1	5.7	0.7	-0.4	1.3	2.1	0.5	5.1	3.2
Korea, Republic of	0.8	2.3	4.1	2.8	3.5	3.6	2.8	2.2	2.5	4.8	3.3

Table A.6 (cont'd)											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c
Malaysia	2.7	1.5	1.4	1.8	1.0	1.5	3.0	3.6	2.0	5.8	3.4
Mexico	16.6	9.5	6.4	5.0	4.5	4.7	4.0	3.6	4.0	5.4	4.7
Nigeria	6.6	6.9	18.9	12.9	14.0	15.0	17.9	8.2	6.5	7.6	7.9
Pakistan	4.1	4.4	3.2	3.3	2.9	7.4	9.1	7.9	7.6	12.1	9.1
Peru	3.5	3.8	2.0	0.2	2.3	3.7	1.6	2.0	1.8	5.6	4.4
Philippines	5.9	4.0	6.8	3.0	3.5	6.0	7.6	6.2	2.8	8.8	7.0
Saudi Arabia	-1.3	-1.1	-1.1	0.2	0.6	0.3	0.7	2.2	4.1	11.0	8.7
Singapore	0.0	1.4	1.0	-0.4	0.5	1.7	0.4	1.0	2.1	6.5	2.4
South Africa	5.2	5.4	5.7	9.2	5.8	1.4	3.5	4.6	6.5	11.2	7.0
Taiwan Province of China	0.2	1.3	0.0	-0.2	-0.3	1.6	2.3	0.6	1.8	3.7	1.7
Thailand	0.3	1.6	1.6	0.6	1.8	2.8	4.5	4.6	2.2	6.3	3.2
Turkey	64.9	54.9	54.4	45.0	21.6	8.6	8.2	9.6	8.8	10.2	8.5
Venezuela, Bolivarian Republic of	23.6	16.2	12.5	22.4	31.1	21.8	16.0	13.7	18.7	31.2	31.3

Source: UN/DESA, based on IMF, *International Financial Statistics*.

- a Data for country groups are weighted averages, where weights are based on GDP in 2005 prices and exchange rates.
- b Partly estimated.
- c Baseline scenario forecasts, based in part on Project LINK.
- d Special Administrative Region of China.

Table A.7
Developed economies: unemployment rates,^{a,b} 1999-2009

Percentage of labour force											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^c	2009 ^d
Developed economies	..	6.5	6.7	7.3	7.3	7.1	6.8	6.3	5.7	6.1	7.0
United States	4.2	4.0	4.7	5.8	6.0	5.5	5.1	4.6	4.6	5.7	7.2
Canada	7.6	6.8	7.2	7.7	7.6	7.2	6.8	6.3	6.0	6.1	6.4
Japan	4.7	4.7	5.0	5.4	5.3	4.7	4.4	4.1	3.8	3.8	3.8
Australia	6.9	6.3	6.8	6.4	6.1	5.5	5.1	4.9	4.4	4.2	5.0
New Zealand	6.8	6.0	5.3	5.2	4.6	3.9	3.7	3.8	3.6	3.9	3.9
European Union	..	8.7	8.5	8.9	9.0	9.0	8.9	8.2	7.1	7.3	8.1
EU-15	8.6	7.7	7.2	7.6	7.9	8.1	8.1	7.7	7.0	7.2	8.2
Austria	3.9	3.7	3.6	4.2	4.3	4.8	5.2	4.8	4.4	4.1	4.9
Belgium	8.5	6.8	6.6	7.5	8.2	8.4	8.5	8.3	7.5	7.1	7.4
Denmark	5.1	4.3	4.5	4.6	5.4	5.5	4.8	3.9	3.8	3.1	3.7
Finland	10.3	9.6	9.1	9.1	9.1	8.8	8.4	7.7	6.9	6.4	6.8
France	10.4	9.0	8.3	8.6	9.0	9.3	9.3	9.2	8.3	8.0	8.8
Germany	8.3	7.5	7.6	8.4	9.3	9.8	10.6	9.8	8.4	7.3	7.6
Greece	12.0	11.3	10.7	10.3	9.7	10.5	9.9	8.9	8.3	7.9	8.1
Ireland	5.7	4.2	4.0	4.5	4.7	4.5	4.4	4.5	4.7	6.2	8.1
Italy	11.0	10.2	9.1	8.7	8.5	8.1	7.7	6.8	6.2	7.0	7.5
Luxembourg	2.4	2.3	1.9	2.6	3.8	4.9	4.6	4.6	4.6	5.0	5.5
Netherlands	3.2	2.8	2.3	2.8	3.7	4.6	4.7	3.9	3.2	2.8	3.3
Portugal	4.5	4.0	4.0	5.1	6.4	6.8	7.7	7.8	8.1	7.5	8.3
Spain	12.5	11.1	10.4	11.1	11.1	10.6	9.2	8.5	8.3	11.1	15.1
Sweden	6.7	5.6	4.9	5.0	5.6	6.3	7.3	7.0	6.2	6.0	6.7
United Kingdom	5.9	5.4	5.0	5.1	5.0	4.7	4.8	5.4	5.3	5.6	6.3
New EU member States	..	12.2	13.0	13.7	12.9	12.8	11.9	10.0	7.6	7.8	7.8
Bulgaria	16.0	16.4	19.5	18.1	13.7	12.0	10.1	9.0	6.9	6.5	6.6
Cyprus	..	4.9	3.8	3.6	4.1	4.7	5.3	4.6	4.0	4.0	4.0
Czech Republic	8.6	8.7	8.0	7.3	7.8	8.3	7.9	7.2	5.3	5.5	5.8
Estonia ^e	11.3	12.8	12.4	10.3	10.0	9.7	7.9	5.9	4.7	5.5	6.8
Hungary	6.9	6.4	5.7	5.8	5.9	6.1	7.2	7.5	7.4	8.0	8.6
Latvia ^e	14.0	13.7	12.9	12.2	10.5	10.4	8.9	6.8	6.0	5.8	7.0
Lithuania ^e	13.7	16.4	16.5	13.5	12.4	11.4	8.3	5.6	4.3	4.6	5.4
Malta	..	6.7	7.6	7.5	7.6	7.4	7.2	7.1	6.4	6.5	6.5
Poland	13.4	16.1	18.3	20.0	19.7	19.0	17.8	13.9	9.6	9.6	9.0
Romania	7.1	7.3	6.8	8.6	7.0	8.1	7.2	7.3	6.4	7.0	6.8
Slovakia	16.4	18.8	19.3	18.7	17.6	18.2	16.3	13.4	11.1	10.9	11.2
Slovenia ^e	7.3	6.7	6.2	6.3	6.7	6.3	6.5	6.0	4.9	5.0	5.2
Other Europe	3.0	2.8	2.9	3.4	4.3	4.4	4.4	3.8	3.2	3.2	3.4
Iceland ^e	1.9	1.3	1.4	2.5	3.4	3.1	2.0	1.3	1.0	1.3	3.4
Norway	3.2	3.4	3.6	3.9	4.5	4.4	4.6	3.5	2.6	2.8	2.9
Switzerland	3.0	2.6	2.6	3.2	4.3	4.4	4.4	4.0	3.6	3.5	3.7

Table A7 (cont'd)											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^c	2009 ^d
Memorandum items:											
Major developed economies	6.0	5.6	5.8	6.5	6.6	6.3	6.2	5.8	5.4	5.8	6.7
Euro zone	9.2	8.3	7.8	8.2	8.7	8.8	8.8	8.2	7.4	7.6	8.6

Source: UN/DESA, based on data of OECD and the Economic Commission for Europe.

- a** Unemployment data are standardized by OECD for comparability among countries and over time, in conformity with the definitions of the International Labour Organization (see OECD, *Standardized Unemployment Rates: Sources and Methods* (Paris, 1985)).
- b** Data for country groups are weighted averages, where labour force is used for weights.
- c** Partly estimated.
- d** Baseline scenario forecasts, based in part on Project LINK.
- e** Not standardized.

Table A.8
Economies in transition and developing economies: unemployment rates,^a 1999-2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b
South-eastern Europe										
Albania ^c	18.4	16.8	16.4	15.8	15.0	14.4	14.2	13.9	13.2	13.5
Bosnia and Herzegovina ^c	39.0	39.4	39.9	42.7	44.0	44.9	46.6	47.7	46.0	46.0
Croatia	13.6	16.1	15.8	14.8	14.3	13.8	12.7	11.1	9.6	9.0
Montenegro	..	37.4	36.6	36.5	33.4	31.2	27.4	22.3	18.0	15.3
Serbia	..	12.1	12.2	13.3	14.6	18.5	20.8	20.9	18.1	15.5
The former Yugoslav Republic of Macedonia	32.4	32.2	30.5	31.9	36.7	37.2	37.3	36.0	34.9	34.4
Commonwealth of Independent States										
Net fuel exporters										
Azerbaijan ^c	1.2	1.2	1.3	1.3	1.4	1.4	1.4	1.3	1.2	1.1
Kazakhstan	..	12.8	10.4	9.3	8.8	8.4	8.1	7.8	7.3	6.9
Russian Federation	12.6	10.5	9.0	8.0	8.6	8.2	7.6	7.2	6.1	5.8
Turkmenistan ^c	..	2.4	2.5	2.5	2.5	2.5	..	..	..	..
Uzbekistan ^c	0.4	0.4	0.4	0.4	0.3	0.4	0.3	0.3	0.2	0.2
Net fuel importers										
Armenia ^c	11.5	10.9	9.8	10.5	10.2	9.4	7.6	7.2	6.6	6.3
Belarus ^c	2.1	2.1	2.3	3.0	3.1	1.9	1.5	1.2	1.0	1.0
Georgia	13.8	10.3	11.1	12.6	11.5	12.6	13.8	13.6	13.3	13.3
Kyrgyzstan ^c	3.0	3.1	3.2	3.1	2.9	2.9	3.3	3.2	3.2	3.1
Republic of Moldova ^c	..	8.5	7.3	6.8	7.9	8.1	7.3	7.4	5.1	5.0
Tajikistan ^c	3.0	2.7	2.3	2.6	2.3	2.0	2.1	2.3	2.5	2.5
Ukraine	11.6	11.6	10.9	9.6	9.1	8.6	7.2	6.8	6.4	6.4
Africa										
Algeria	..	..	27.3	25.9	23.7	17.7	15.3	12.3	13.8	..
Botswana	..	15.8	19.6	..	23.8	..	..	17.6	..	..
Egypt	8.1	9.0	9.2	10.2	11.9	10.3	11.2	10.7	9.0	8.7
Mauritius	..	6.7	6.9	7.3	7.7	8.5	9.6	9.1	8.5	7.8
Morocco	13.9	13.6	12.5	11.6	11.9	10.8	11.0	9.7	9.5	..
South Africa	..	26.0	27.9	30.0	29.8	27.0	26.6	25.5	24.3	23.2
Tunisia	16.0	15.7	15.1	15.3	14.5	14.2	14.2	14.3	14.1	..
Developing America										
Argentina ^{d,e}	14.3	15.1	17.4	19.7	17.3	13.6	11.6	10.2	8.5	8.2
Barbados	10.4	9.2	9.9	10.3	11.0	9.8	9.1	8.7	7.4	..
Bolivia ^d	7.2	7.5	8.5	8.7	9.2	6.2	8.1	8.0	7.7	..
Brazil ^{f,g}	7.6	7.1	6.2	11.7	12.3	11.5	9.8	10.0	9.3	8.5
Chile	10.1	9.7	9.9	9.8	9.5	10.0	9.2	7.7	7.1	8.0
Colombia ^h	19.4	17.3	18.2	17.6	16.7	15.4	13.9	13.0	11.4	12.0
Costa Rica	6.2	5.3	5.8	6.8	6.7	6.7	6.9	6.0	4.8	5.0
Dominican Republic	13.8	13.9	15.6	16.1	16.7	18.4	18.0	16.2	15.6	..
Ecuador ⁱ	15.1	14.1	10.4	8.6	9.8	9.7	8.5	8.1	7.4	8.2
El Salvador	6.9	6.5	7.0	6.2	6.2	6.5	7.3	5.7	..	..
Guatemala	..	..	..	5.4	5.2	4.4	..	..	..	..

Table A.8 (cont'd)										
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b
Honduras	5.3	..	5.9	6.1	7.6	8.0	6.5	4.9	4.0	..
Jamaica	15.7	15.5	15.0	14.2	11.4	11.7	11.3	10.3	9.9	..
Mexico	3.7	3.4	3.6	3.9	4.6	5.3	4.7	4.6	4.8	4.4
Nicaragua	10.7	7.8	11.3	11.6	10.2	9.3	7.0	7.0	6.9	..
Panama	13.6	15.2	17.0	16.5	15.9	14.1	12.1	10.4	7.8	6.0
Paraguay ^d	9.4	10.0	10.8	14.7	11.2	10.0	7.6	8.9	7.2	..
Peru ^{d,j}	9.2	8.5	9.3	9.4	9.4	9.4	9.6	8.5	8.4	8.0
Trinidad and Tobago	13.2	12.2	10.8	10.4	10.5	8.4	8.0	6.2	5.9	..
Uruguay ^d	11.3	13.6	15.3	17.0	16.9	13.1	12.2	11.4	9.6	8.2
Venezuela, Bolivarian Republic of	15.0	13.9	13.3	15.8	18.0	15.3	12.4	10.0	8.4	8.2
Developing Asia										
China	3.1	3.1	3.6	4.0	4.3	4.2	4.2	4.1	4.0	4.0
Hong Kong SAR ^k	6.2	4.9	5.1	7.3	7.9	6.8	5.6	4.8	4.0	3.6
India	..	4.3	..	..	..	5.0	..	..	..	..
Indonesia	6.4	6.1	8.1	9.1	9.5	9.9	11.2	10.3	..	..
Iran, Islamic Republic of	..	..	..	12.8	..	10.3	11.5	..	..	..
Israel	8.9	8.8	9.4	10.3	10.7	10.4	9.0	8.4	7.3	6.1
Jordan	..	13.7	14.7	14.4	14.8	12.5	14.8	14.0	13.1	12.9
Korea, Republic of	6.3	4.4	4.0	3.3	3.6	3.7	3.7	3.5	3.2	3.2
Malaysia	3.5	3.1	3.5	3.5	3.6	3.6	3.6	3.3	3.2	3.5
Occupied Palestinian Territory	11.8	14.1	25.2	31.3	25.6	26.8	23.5	23.6	21.5	25.7
Pakistan	5.9	7.8	7.8	8.3	8.3	7.7	7.7	6.2	5.3	..
Philippines ^{l,m}	9.6	10.1	9.8	10.2	10.2	10.9	7.8	7.9	7.3	7.7
Saudi Arabia	4.3	4.6	4.6	5.3	5.6	5.8	6.1	6.3	5.6	..
Singapore	2.8	2.7	2.7	3.6	4.0	3.4	3.1	2.7	2.3	2.1
Sri Lanka	9.1	8.0	7.7	8.7	9.2	8.5	7.2	6.5	6.0	5.4
Taiwan Province of China	2.9	3.0	4.6	5.2	5.0	4.4	4.1	3.9	3.9	4.0
Thailand	4.2	3.6	3.3	2.4	2.2	2.1	1.8	1.5	1.4	1.4
Turkey	7.7	6.5	8.4	10.3	10.5	10.3	10.3	9.9	9.9	10.0
Viet Nam ^d	6.7	6.4	6.3	6.0	5.8	5.6	5.3	4.8	4.6	..

Sources: UN/DESA, based on data of the Economic Commission for Europe (ECE); ILO LABORSTAT database and KILM 5th edition; Economic Commission for Latin America and the Caribbean (ECLAC); national sources.

a As a percentage of labour force.

b Partly estimated.

c End-of-period registered unemployment data (as a percentage of labour force).

d Urban areas.

e Break in series: new methodology starting in 2003.

f 6 main cities.

g Break in series: new methodology starting in 2002.

h 13 main cities.

i Covers Quito, Guayaquil and Cuenca from 2000.

j Metropolitan Lima.

k Special Administrative Region of China.

l Philippines definition: this partly adopts the ILO definition, that is to say, it does not include one ILO criterion which is "currently available for work".

m Break in series: new methodology starting in 2005.

Table A.9
Major developed economies: quarterly indicators of growth, unemployment and inflation, 2006-2008

Percentage											
	2006 quarters				2007 quarters				2008 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Growth of gross domestic product^a (percentage change in seasonally adjusted data from preceding quarter)										
Canada	4.2	1.6	1.1	2.1	4.1	3.9	2.3	0.8	-0.6	0.6	1.3
France	2.6	4.1	0.3	2.0	2.2	2.3	2.9	1.4	1.6	-1.1	0.6
Germany	3.4	6.1	2.8	4.3	1.7	1.4	2.4	1.4	5.7	-1.7	-2.1
Italy	2.8	2.0	1.3	4.0	1.1	0.5	0.7	-1.8	2.1	-1.8	-2.0
Japan	1.7	3.0	1.8	3.7	3.5	-1.2	2.3	1.8	2.5	-3.7	-0.4
United Kingdom	4.6	2.7	1.8	3.5	3.6	3.0	3.1	2.0	1.1	0.0	-2.0
United States	4.8	2.7	0.8	1.5	0.0	4.8	4.8	-0.2	0.9	2.8	-0.5
Major developed economies	3.8	3.1	1.3	2.5	1.5	2.8	3.4	0.6	1.7	0.3	-0.7
Euro zone	3.3	4.4	2.1	3.4	2.9	1.9	2.2	1.4	2.7	-0.7	-0.8
	Unemployment rate^b (percentage of total labour force)										
Canada	6.4	6.2	6.4	6.2	6.1	6.1	6.0	5.9	5.9	6.1	6.1
France	9.6	9.2	9.1	8.9	8.8	8.4	8.2	7.9	7.7	7.7	7.9
Germany	10.5	10.0	9.6	9.2	8.7	8.5	8.3	8.0	7.6	7.4	7.2
Italy	7.3	6.8	6.6	6.5	6.1	6.0	6.2	6.3	6.7	6.8	..
Japan	4.2	4.1	4.1	4.1	4.0	3.8	3.8	3.8	3.9	4.0	4.1
United Kingdom	5.2	5.5	5.4	5.4	5.5	5.3	5.3	5.1	5.1	5.3	5.6
United States	4.7	4.7	4.7	4.4	4.5	4.5	4.7	4.8	4.9	5.3	5.9
Major developed economies	6.0	5.8	5.8	5.6	5.5	5.4	5.4	5.4	5.4	5.6	..
Euro zone	8.7	8.3	8.1	7.9	7.6	7.4	7.4	7.3	7.2	7.4	7.5
	Change in consumer prices^c (percentage change from preceding quarter)										
Canada	2.0	4.5	0.2	-1.2	3.8	6.1	0.0	-0.1	1.3	8.5	4.3
France	1.2	4.2	0.5	-0.4	0.5	4.2	0.9	3.9	2.9	5.7	0.7
Germany	1.5	2.4	1.1	0.4	3.4	3.2	2.2	3.4	2.9	3.1	2.9
Italy	2.0	3.1	2.2	0.0	1.6	2.6	2.3	2.9	4.5	4.6	4.0
Japan	-0.4	1.7	1.1	-1.1	-2.1	1.9	0.8	1.6	-0.4	3.5	4.0
United Kingdom	0.1	5.3	2.6	2.9	0.6	4.2	-0.5	4.1	1.8	8.3	5.1
United States	2.1	6.9	2.3	-3.3	4.2	7.9	1.1	2.9	4.6	9.2	4.6
Major developed economies	1.4	4.8	1.7	-1.5	2.3	5.4	1.1	2.8	3.0	6.9	4.0
Euro zone	0.4	5.6	0.4	1.1	0.7	5.6	0.2	5.1	2.5	6.8	1.1

Sources: UN/DESA, based on Eurostat, Organization for Economic Cooperation and Development (OECD) and national sources.

- a** Expressed as annualized rate. Major developed economies is calculated as a weighted average, where weights are based on annual GDP valued in 2005 prices and exchange rates.
- b** Seasonally adjusted data as standardized by OECD.
- c** Expressed as annualized rate. Major developed economies is calculated as a weighted average, where weights are based on 2005 GDP in United States dollars.

Table A.10
Selected economies in transition: quarterly indicators of growth and inflation, 2006-2008

Percentage											
	2006 quarters				2007 quarters				2008 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product ^a										
Armenia	..	..	..	..	11.5	11.6	13.5	13.8	9.1	10.3	10.4
Belarus	11.3	9.6	8.7	10.7	8.2	8.7	8.4	7.3	10.9	10.1	..
Georgia	9.2	7.1	9.9	11.1	11.4	13.4	13.2	11.7	9.3	7.9	..
Kazakhstan	7.5	9.3	10.5	10.7	10.6	10.4	9.6	8.9	6.1	5.4	..
Kyrgyzstan	2.8	4.8	1.7	4.0	7.9	8.8	7.8	8.5	11.7	..	..
Russian Federation	6.3	7.4	7.5	8.0	7.4	8.1	7.3	9.5	8.5	7.5	..
Ukraine	4.7	7.5	8.3	10.4	8.9	8.7	7.7	7.6	6.5	6.5	6.9
	Change in consumer prices ^a										
Armenia	-2.0	1.7	6.7	5.8	4.9	4.3	2.1	6.3	7.8	10.1	11.3
Belarus	7.8	7.1	6.3	6.6	7.5	6.8	8.0	10.7	12.8	15.5	16.3
Croatia	3.5	3.8	3.3	2.3	1.6	2.1	2.8	4.9	5.8	6.5	7.5
Georgia	5.0	9.1	13.0	9.6	10.4	7.5	7.6	11.3	11.2	11.4	11.0
Kazakhstan	8.4	9.0	8.7	8.3	8.0	7.9	9.7	17.3	18.7	19.5	19.5
Kyrgyzstan	6.2	5.7	5.2	5.0	4.7	4.8	9.8	21.2	22.3	28.8	..
Republic of Moldova	10.8	11.8	14.2	14.1	11.8	10.6	13.2	13.8	15.0	16.4	12.0
Russian Federation	10.9	9.4	9.4	9.1	7.7	8.0	8.9	11.5	12.9	14.8	14.9
Ukraine	9.7	7.1	8.0	11.4	10.2	11.4	14.1	15.5	22.5	30.1	25.8

Sources: UN/DESA, based on data of the Economic Commission for Europe and national sources.

^a Percentage change from the corresponding period of the preceding year.

Table A.11
Major developing economies: quarterly indicators of growth, unemployment and inflation, 2006-2008

Percentage											
	2006 quarters				2007 quarters				2008 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Rates of growth of gross domestic product ^a										
Argentina	8.8	7.9	8.8	8.6	8.0	8.4	8.8	9.1	8.3	7.5	..
Brazil	3.9	1.2	4.4	5.0	4.0	4.8	5.1	5.3	5.5	5.7	..
Chile	5.0	4.4	3.2	4.8	6.2	6.2	3.9	4.0	3.3	4.5	4.8
China	10.2	10.9	10.7	11.0	11.1	11.5	11.5	11.2	10.6	10.4	9.9
Colombia	6.2	5.9	7.8	7.2	8.5	8.0	6.5	8.0	4.5	3.7	..
Ecuador	4.8	4.1	4.9	1.8	1.6	1.1	1.4	5.8	6.9	8.8	..
Hong Kong SAR ^b	9.0	6.2	6.4	6.6	5.5	6.2	6.8	6.9	7.3	4.2	1.7
India	10.2	9.6	10.1	9.3	9.7	9.2	9.3	8.8	8.8	7.9	7.6
Indonesia	5.0	5.0	5.9	6.1	6.1	6.4	6.5	6.3	6.3	6.4	6.1
Israel	5.3	6.9	4.8	3.8	5.5	4.2	4.9	6.8	5.2	4.9	5.1
Korea, Republic of	6.3	5.2	5.0	4.2	4.0	4.9	5.1	5.7	5.8	4.8	3.9
Malaysia	5.9	6.0	5.9	5.3	5.5	5.7	6.7	7.3	7.1	6.7	4.7
Mexico	6.0	5.1	4.9	3.7	2.5	2.6	3.4	4.2	2.6	2.7	1.6
Philippines	5.7	5.6	5.2	5.5	7.0	8.3	7.1	6.4	4.7	4.4	4.6
Singapore	10.4	8.2	7.4	7.0	7.0	9.1	9.5	5.4	6.9	2.3	-0.6
South Africa	4.9	4.9	4.8	6.6	5.8	4.9	5.1	4.6	3.8	4.4	2.9
Taiwan Province of China	5.0	4.9	5.5	3.9	3.8	5.5	7.0	6.4	6.2	4.6	-1.0
Thailand	6.4	5.3	4.8	4.5	4.4	4.4	5.1	5.7	6.0	5.3	4.0
Turkey	5.9	9.7	6.3	5.7	8.1	4.1	3.3	3.6	6.7	1.9	..
Venezuela, Bolivarian Republic of	10.3	9.4	10.2	11.4	8.8	7.6	8.6	8.5	4.9	7.2	4.6
	Unemployment rate ^c										
Argentina	11.4	10.4	10.2	8.7	9.8	8.5	8.1	7.5	8.4	8.0	7.8
Brazil	9.9	10.3	10.4	9.2	9.8	10.0	9.3	8.1	8.4	8.1	7.8
Chile	8.0	8.8	8.4	6.7	6.4	6.8	7.4	7.4	7.4	8.0	8.1
Colombia	9.4	8.5	9.7	8.9	9.8	11.2	10.9	9.8	12.1	11.1	11.4
Hong Kong SAR ^b	4.9	4.9	5.1	4.4	4.1	4.3	4.4	3.6	3.2	3.3	3.5
Israel	8.4	8.4	8.8	8.1	7.3	7.4	7.6	7.0	5.9	5.7	6.4
Korea, Republic of	3.9	3.4	3.3	3.2	3.6	3.3	3.1	3.0	3.4	3.1	3.1
Malaysia	3.8	3.4	3.1	3.0	3.4	3.4	3.1	3.0	3.6	3.5	..
Mexico	3.5	3.2	4.0	3.6	4.0	3.4	3.9	3.5	4.0	3.5	4.2
Philippines	8.1	8.2	8.0	7.3	7.8	7.4	7.8	6.3	7.4	8.0	7.4
Singapore	2.6	2.7	2.7	2.6	2.9	2.3	1.7	1.7	2.0	2.2	2.2
Taiwan Province of China	3.9	3.9	4.0	3.9	3.8	3.9	4.0	3.9	3.9	3.9	4.2
Thailand	1.9	1.7	1.2	1.3	1.6	1.6	1.2	1.1	1.7	1.4	1.2
Turkey	11.5	9.2	9.0	9.8	10.9	9.2	9.0	10.1	11.2	9.2	9.0
Uruguay	12.6	10.8	10.7	9.6	9.9	9.5	9.0	8.1	8.5	7.5	7.6
Venezuela, Bolivarian Republic of	11.1	10.0	10.1	8.9	10.3	8.4	8.5	6.7	8.2	7.3	7.1

Table A.11 (cont'd)											
	2006 quarters				2007 quarters				2008 quarters		
	I	II	III	IV	I	II	III	IV	I	II	III
	Change in consumer prices ^a										
Argentina	11.6	11.4	10.6	10.1	9.5	8.8	8.6	8.5	8.5	9.1	9.0
Brazil	5.5	4.3	3.8	3.1	3.0	3.3	4.0	4.3	4.7	5.6	6.3
Chile	4.1	3.8	3.5	2.2	2.7	2.9	4.8	7.2	8.0	8.9	9.3
China	1.2	1.4	1.3	2.0	2.7	3.6	6.1	6.6	8.0	7.8	5.3
Colombia	4.3	4.0	4.5	4.3	5.2	5.7	5.3	5.4	6.1	6.9	7.7
Ecuador	3.9	3.4	2.8	2.0	2.1	1.7	2.5	2.8	5.3	9.1	9.9
Hong Kong SAR ^b	1.6	2.1	2.3	2.2	1.7	1.3	1.7	3.5	4.6	5.7	4.6
India	4.5	5.9	6.2	6.5	7.0	6.3	6.7	5.5	6.3	7.8	9.0
Indonesia	16.9	15.5	14.9	6.1	6.3	6.1	6.5	6.7	7.6	10.2	11.9
Israel	3.1	3.6	2.0	-0.2	-0.6	-1.1	0.9	2.8	3.6	5.0	5.1
Korea, Republic of	2.1	2.2	2.5	2.1	2.0	2.4	2.3	3.4	3.8	4.8	5.5
Malaysia	3.8	4.1	3.6	3.0	2.6	1.5	1.8	2.2	2.6	4.8	8.4
Mexico	3.7	3.1	3.5	4.1	4.1	4.0	4.0	3.8	3.9	4.9	5.5
Philippines	7.3	6.9	6.1	4.8	2.9	2.4	2.5	3.3	5.5	9.7	12.2
Singapore	1.4	1.2	0.7	0.6	0.5	1.0	2.8	4.1	6.6	7.5	6.5
South Africa	3.8	4.0	5.2	5.5	5.9	7.0	7.0	8.4	9.9	11.7	13.5
Taiwan Province of China	1.3	1.5	-0.3	-0.1	0.9	0.3	1.5	4.5	3.6	4.2	4.5
Thailand	5.7	6.0	3.6	3.3	2.5	1.9	1.6	2.9	5.0	7.5	7.2
Turkey	8.1	9.6	10.8	9.8	10.3	9.5	7.1	8.2	8.8	10.3	11.7
Venezuela, Bolivarian Republic of	12.6	11.2	14.6	16.1	19.1	19.5	16.1	20.1	26.2	30.0	33.6

Source: IMF, *International Financial Statistics*, and national sources.

- ^a Percentage change from the corresponding quarter of the previous year.
- ^b Special Administrative Region of China.
- ^c Reflects national definitions and coverage. Not comparable across economies.

Table A.12
Major developed economies: financial indicators, 1999-2008

Percentage										
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a
	Short-term interest rates^b									
Canada	4.9	5.7	4.0	2.6	3.0	2.3	2.8	4.2	4.6	3.5
France ^c	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.8
Germany ^c	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.8
Italy ^c	3.0	4.4	4.3	3.3	2.3	2.1	2.2	3.1	4.3	4.8
Japan	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.2	0.7	0.7
United Kingdom	5.4	6.1	5.0	4.0	3.7	4.6	4.7	4.8	5.9	5.8
United States	5.3	6.5	3.7	1.7	1.2	1.6	3.5	5.2	5.3	3.0
	Long-term interest rates^d									
Canada	5.5	5.9	5.5	5.3	4.8	4.6	4.1	4.2	4.3	3.7
France	4.6	5.4	4.9	4.9	4.1	4.1	3.4	3.8	4.3	4.3
Germany	4.5	5.3	4.8	4.8	4.1	4.0	3.3	3.8	4.2	4.1
Italy	4.7	5.6	5.2	5.0	4.3	4.3	3.6	4.1	4.5	4.7
Japan	1.7	1.7	1.3	1.3	1.0	1.5	1.4	1.7	1.7	1.5
United Kingdom	5.1	5.3	4.9	4.9	4.5	4.9	4.4	4.5	5.0	4.7
United States	5.6	6.0	5.0	4.6	4.0	4.3	4.3	4.8	4.6	3.8
	General government financial balances^e									
Canada	1.6	2.9	0.7	-0.1	-0.1	0.8	1.6	1.0	1.0	-0.2
France	-1.8	-1.5	-1.6	-3.2	-4.1	-3.6	-2.9	-2.4	-2.7	-3.0
Germany	-1.5	1.3	-2.8	-3.6	-4.0	-3.8	-3.3	-1.5	-0.2	0.0
Italy	-1.8	-0.9	-3.1	-3.0	-3.5	-3.5	-4.3	-3.4	-1.6	-2.5
Japan ^f	-7.4	-7.6	-6.3	-8.0	-7.9	-6.2	-6.7	-1.4	-2.2	-2.0
United Kingdom	1.1	4.0	0.9	-1.7	-3.3	-3.4	-3.4	-2.7	-2.8	-4.2
United States	0.9	1.6	-0.4	-3.8	-4.8	-4.3	-3.1	-2.1	-2.8	-5.8

Sources: UN/DESA, based on IMF, *International Financial Statistics*; OECD *Economic Outlook*; and Eurostat.

a Average for the first nine months.

b Money market rates.

c From January 1999 onwards, represents the three-month Euro Interbank Offered Rate (EURIBOR), which is an interbank deposit bid rate.

d Yield on long-term government bonds.

e Surplus (+) or deficit (-) as a percentage of nominal GNP or GDP. Estimates for 2008.

f Deferred tax payments on postal savings accounts are included in 2000 and 2001.

Table A.13
Selected economies: real effective exchange rates, broad measurement,^a 1999-2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b
Developed economies										
Australia	104.4	100.0	95.7	99.6	110.8	120.2	126.8	132.1	140.7	145.5
Bulgaria	92.5	100.0	107.9	112.1	120.5	125.1	127.5	135.3	142.9	148.2
Canada	101.2	100.0	96.5	94.6	102.4	104.5	108.0	111.7	112.5	106.0
Czech Republic	99.7	100.0	106.6	118.2	117.0	121.2	129.0	133.2	138.7	157.5
Denmark	106.3	100.0	102.5	106.5	113.6	114.2	111.6	109.6	109.5	109.8
Euro zone	108.9	100.0	101.6	105.3	117.3	121.2	120.1	121.2	126.0	133.3
Hungary	100.7	100.0	107.1	113.3	115.0	118.8	118.9	115.5	119.6	122.3
Japan	95.0	100.0	88.7	82.8	82.7	83.4	79.0	72.0	67.1	71.1
New Zealand	111.5	100.0	99.4	111.4	130.5	140.2	147.2	135.9	146.3	138.6
Norway	100.2	100.0	102.9	108.9	108.7	110.5	116.7	122.0	131.1	136.5
Poland	95.0	100.0	110.7	107.2	99.0	101.8	111.0	113.3	117.1	127.8
Romania	86.8	100.0	107.8	112.9	116.9	126.6	153.2	170.9	190.3	180.9
Slovakia	95.0	100.0	102.1	104.0	112.3	116.8	116.8	118.2	128.3	130.2
Sweden	105.0	100.0	91.5	93.9	97.7	97.1	94.1	95.0	98.6	93.9
Switzerland	107.1	100.0	103.1	109.3	111.0	108.9	104.7	100.2	95.3	96.6
United Kingdom	101.9	100.0	97.2	98.2	95.5	99.6	97.1	96.9	98.9	89.0
United States	99.2	100.0	106.0	106.1	98.0	91.8	89.2	86.8	82.6	77.7
Economies in transition										
Croatia	98.5	100.0	105.5	106.5	109.6	113.5	114.3	115.2	116.4	123.7
Russian Federation	88.5	100.0	120.8	126.6	130.9	140.5	154.4	170.3	180.1	191.7
Developing economies										
Argentina	102.3	100.0	105.0	56.1	62.4	60.8	60.0	58.4	57.7	57.9
Brazil	84.1	100.0	90.2	89.7	98.5	105.8	129.6	140.7	155.5	180.2
Chile	95.4	100.0	94.7	93.0	91.9	100.0	111.7	117.9	117.2	122.4
China	97.7	100.0	105.5	102.9	97.9	95.9	98.2	101.1	103.3	111.7
Colombia	107.3	100.0	100.4	99.1	88.0	94.7	104.8	102.8	110.4	116.0
Ecuador	78.0	100.0	102.5	110.9	114.3	114.7	121.1	130.6	125.9	143.2
Egypt	98.0	100.0	91.1	81.6	65.4	66.1	71.9	74.1	76.3	87.9
Hong Kong SAR ^c	106.4	100.0	101.9	101.5	95.0	89.9	86.4	84.1	79.9	72.3
India	98.2	100.0	102.6	99.1	98.4	99.1	102.3	99.2	106.5	101.4
Indonesia	103.8	100.0	96.3	116.5	123.2	113.5	113.8	142.0	149.3	165.8
Israel	93.7	100.0	99.7	89.7	87.5	85.4	86.3	86.8	87.9	97.8
Korea, Republic of	93.8	100.0	90.6	93.5	92.8	95.0	104.9	110.0	107.6	93.9
Kuwait	97.5	100.0	107.5	109.3	102.3	94.9	96.2	95.2	93.2	96.7
Malaysia	99.3	100.0	103.9	101.6	98.6	100.7	103.3	107.0	112.7	112.7
Mexico	90.0	100.0	107.9	109.5	100.0	98.2	103.1	106.0	106.0	108.8
Morocco	99.6	100.0	98.2	98.5	98.7	97.1	94.5	94.5	93.4	93.1
Nigeria ^d	98.8	100.0	111.1	111.0	104.9	107.8	124.2	133.1	130.6	136.0
Pakistan	99.6	100.0	95.5	100.1	100.9	100.4	102.2	105.8	105.6	106.0
Peru	100.0	100.0	104.2	104.0	100.0	99.5	99.3	99.4	99.6	105.9
Philippines	103.0	100.0	107.6	112.5	107.6	100.7	107.1	129.5	136.0	129.7

Table A.13 (cont'd)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^b
Saudi Arabia	99.4	100.0	103.6	102.3	94.3	87.6	84.9	84.1	81.8	81.4
Singapore	99.4	100.0	97.8	95.9	95.4	102.2	106.7	112.1	119.5	125.3
South Africa	101.0	100.0	90.6	80.5	105.7	115.2	117.5	113.4	109.2	101.2
Taiwan Province of China	96.2	100.0	96.1	93.8	89.6	90.8	89.1	89.0	87.8	86.1
Thailand	102.5	100.0	97.0	101.2	100.3	100.0	102.7	111.6	124.8	124.2
Turkey	91.0	100.0	87.5	100.5	110.5	116.0	124.3	120.4	127.6	126.9
Venezuela, Bolivarian Republic of	96.4	100.0	109.4	92.6	93.5	98.8	99.2	107.9	119.7	132.2

Sources: JPMorgan Chase and IMF, *International Financial Statistics*.

- a** Indices based on a "broad" measure currency basket of 46 currencies (including the euro). The real effective exchange rate, which adjusts the nominal index for relative price changes, gauges the effect on international price competitiveness of the country's manufactures due to currency changes and inflation differentials. A rise in the index implies a fall in competitiveness and vice versa. The relative price changes are based on indices most closely measuring the prices of domestically produced finished manufactured goods, excluding food and energy, at the first stage of manufacturing. The weights for currency indices are derived from 2000 bilateral trade patterns of the corresponding countries.
- b** Average for the first ten months.
- c** Special Administrative Region of China.
- d** Data is from International Financial Statistics (IFS) only. Data for 2008 is until July.

Table A.14
Indices of prices of primary commodities, 1999-2008

	Non-fuel commodities					Combined index		Manufactured export prices	Real prices of non-fuel commodities ^a	Memo-randum item: Crude petroleum ^b	
	Food	Tropical beverages	Vegetable oilseeds and oils	Agricultural raw materials	Minerals and metals	Dollar	SDR				
1999	98	118	125	97	89	98	95	105	94	63.3	
2000	100	100	100	100	100	100	100	100	100	100.0	
2001	103	79	94	96	89	96	100	98	98	83.8	
2002	102	89	117	94	87	97	99	99	98	88.3	
2003	104	94	137	112	98	105	99	108	97	101.8	
2004	119	100	155	123	137	126	112	117	108	130.6	
2005	127	126	141	132	173	141	126	120	118	183.5	
2006	151	134	148	152	278	184	165	123	150	221.3	
2007	164	148	226	169	313	207	179	133	156	250.4	
2005	I	129	132	139	126	165	139	121	123	113	159.7
	II	125	132	144	129	167	138	122	120	115	178.8
	III	125	120	139	137	173	140	126	118	118	204.4
	IV	130	120	139	138	188	147	135	117	125	191.1
2006	I	151	136	137	149	220	167	153	119	141	209.0
	II	155	129	141	162	285	188	168	123	153	234.6
	III	148	133	149	155	301	189	168	125	151	238.4
	IV	151	139	164	143	304	190	169	127	150	203.1
2007	I	155	143	179	165	288	192	169	129	149	198.0
	II	154	142	209	169	336	207	180	131	158	235.5
	III	165	150	236	164	322	210	181	133	158	259.0
	IV	183	157	278	179	307	220	185	138	159	308.1
2008	I	223	182	342	207	358	262	216	140	187	335.2
	II	273	184	358	221	381	295	240	144	205	425.7
	III	244	191	305	219	355	271	226	..	..	411.3

Sources: UNCTAD, *Monthly Commodity Price Bulletin*; United Nations, *Monthly Bulletin of Statistics*; and *Middle East Economic Survey*, available from http://www.mees.com/Energy_Tables/basket.htm.

^a Combined index of non-fuel commodity prices in dollars deflated by manufactured export price index.

^b Effective 16 June 2005, OPEC basket is composed of 13 crudes.

Table A.15
World oil supply and demand, 2000-2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a	2009 ^b
World oil supply^{c,d} (millions of barrels per day)	76.9	77.1	76.9	79.8	83.3	84.3	85.0	85.6	86.4	86.3
Developed economies	18.5	18.3	18.3	17.8	17.4	16.5	16.3	16.4	16.2	16.4
Economies in transition	8.1	8.7	9.6	10.5	11.6	12.0	12.4	12.9	12.9	13.2
Developing economies	48.6	48.3	47.3	49.7	52.5	54.0	54.4	54.2	55.1	54.4
OPEC ^e	30.8	30.4	28.8	30.8	33.1	34.2	34.3	35.9	37.1	36.1
Non-OPEC	17.8	17.9	18.5	18.9	19.4	19.8	20.1	18.4	18.0	18.3
Processing gains ^f	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.1	2.2	2.3
World total demand^g	76.2	77.3	77.7	79.3	82.5	83.8	85.1	86.1	86.1	85.8
Oil prices (dollars per barrel)										
OPEC Basket ^h	27.6	23.1	24.4	28.1	36.1	50.6	61.1	69.1	96.9	60.2
Brent Oil	28.3	24.4	25.0	28.9	38.3	54.4	65.4	72.7	101.0	64.0

Sources: United Nations, World Bank, International Energy Agency, U.S. Energy Information Administration, and *Middle East Economic Survey*, available from http://www.mees.com/Energy_Tables/basket.htm (accessed on 13 November 2008).

a Partly estimated.

b Baseline scenario forecasts.

c Including crude oil, condensates, natural gas liquids (NGLs), oil from non-conventional sources and other sources of supply.

d Totals may not add up due to rounding.

e Includes Angola and Ecuador as of January 2007 and December 2007, respectively.

f Net volume gains and losses in refining process (excluding net gain/loss in the economies in transition and China) and marine transportation losses.

g Including deliveries from refineries/primary stocks and marine bunkers, and refinery fuel and non-conventional oils.

h New OPEC reference basket introduced on 16 June 2005 is currently composed of 13 crudes.

Table A.16

World trade: changes in value and volume of exports and imports, by major country group, 1999-2009

Annual percentage change											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a	2009 ^b
Dollar value of exports											
World	3.6	13.4	-3.9	4.8	16.4	21.5	13.8	14.9	15.6	18.9	-4.4
Developed economies	1.8	7.3	-2.8	3.6	15.1	18.5	8.3	11.9	14.4	13.9	-7.3
North America	4.5	13.4	-6.6	-4.2	5.0	15.1	10.8	11.3	9.7	12.8	2.0
EU plus Other Europe	-0.1	3.5	1.1	6.7	19.0	19.3	7.7	12.5	16.3	13.9	-11.7
Developed Asia	7.0	14.0	-13.6	3.1	13.3	20.2	7.0	9.3	11.2	15.4	4.3
Economies in transition	-1.4	34.2	-0.7	6.3	26.4	36.3	36.2	27.6	25.1	46.2	-4.1
South-eastern Europe	-6.5	16.6	3.1	6.5	20.6	30.8	24.4	17.5	27.4	26.1	0.8
Commonwealth of Independent States	-0.4	37.7	-1.0	6.3	26.8	36.7	36.9	28.1	25.0	47.2	-4.3
Developing economies	8.7	27.3	-6.3	7.2	18.2	26.1	21.9	18.4	16.3	23.2	-0.5
Latin America and the Caribbean	5.8	19.7	-3.6	1.0	8.5	23.0	20.8	18.2	12.5	21.3	-2.5
Africa	12.6	26.1	-8.2	3.4	23.4	29.3	37.1	18.6	20.1	38.3	-7.1
Western Asia	24.8	81.4	-7.0	5.0	22.5	31.0	33.1	19.1	17.3	37.7	-18.7
East and South Asia	7.2	19.2	-6.7	9.9	19.4	25.6	18.1	18.3	16.4	18.2	6.0
China	6.1	27.9	6.8	22.4	34.6	35.4	27.7	26.5	25.1	20.8	14.8
Dollar value of imports											
World	3.7	12.9	-3.5	3.7	16.3	22.0	13.8	14.8	15.6	18.9	-3.9
Developed economies	5.0	10.3	-3.6	3.0	16.0	19.3	11.8	13.2	13.6	14.7	-10.4
North America	11.5	17.6	-6.2	1.5	7.9	16.4	13.9	10.5	5.9	11.4	-7.1
EU plus Other Europe	1.1	5.3	-1.2	4.3	20.4	20.6	10.2	14.8	17.5	14.7	-12.9
Developed Asia	10.4	17.8	-8.3	-0.3	15.6	19.8	15.9	11.2	11.0	24.7	-1.6
Economies in transition	-21.0	14.8	14.1	12.0	25.6	28.6	26.2	29.7	39.0	36.4	12.2
South-eastern Europe	-6.8	12.9	13.9	20.2	19.1	21.9	17.4	15.2	30.7	24.5	3.5
Commonwealth of Independent States	-26.2	15.6	14.1	10.3	27.1	30.0	28.0	32.4	40.4	38.2	13.4
Developing economies	2.7	19.7	-4.4	5.0	16.4	27.9	17.4	16.9	17.5	25.3	5.7
Latin America and the Caribbean	-2.4	15.8	-2.1	-7.0	3.4	22.0	18.7	19.4	19.0	26.8	0.2
Africa	-6.6	1.0	0.2	3.4	20.3	26.3	22.5	19.5	25.5	29.1	6.6
Western Asia	2.1	21.7	0.0	7.2	17.4	36.5	15.2	14.7	28.1	23.2	-0.1
East and South Asia	4.1	20.6	-6.7	8.7	19.5	28.1	16.9	16.5	14.4	24.8	8.1
China	18.2	35.2	8.1	21.3	39.8	35.8	17.6	19.7	20.3	28.6	19.1
Volume of exports											
World	4.3	13.2	-1.1	4.4	5.6	11.2	8.0	8.8	6.3	4.4	2.1
Developed economies	4.4	12.6	-0.9	2.2	2.5	8.9	5.6	7.5	4.5	3.1	0.0
North America	3.5	14.0	-5.5	-2.4	0.5	9.0	6.3	5.5	4.8	4.6	1.3
EU plus Other Europe	4.8	11.9	2.3	3.1	2.1	8.2	5.4	8.2	3.9	3.6	0.4
Developed Asia	4.7	12.7	-6.6	6.6	8.1	12.1	5.5	7.6	6.8	-1.4	-4.0
Economies in transition	5.8	15.2	3.8	7.9	13.2	15.5	0.8	6.6	8.9	5.0	4.5
South-eastern Europe	-4.7	13.5	5.5	5.2	7.5	17.6	18.1	8.9	13.7	9.2	6.6
Commonwealth of Independent States	7.8	15.4	3.6	8.0	13.6	15.4	-0.2	6.4	8.6	4.7	4.4

Table A.16 (cont'd)											
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 ^a	2009 ^b
Developing economies	4.0	14.5	-1.9	8.6	10.8	15.0	12.5	10.9	8.8	6.2	4.8
Latin America and the Caribbean	0.5	4.6	-0.1	1.7	4.4	11.3	8.9	7.3	1.9	-2.0	4.1
Africa	3.1	-9.2	-2.0	4.7	10.0	9.0	17.9	0.2	10.1	10.6	3.6
Western Asia	7.9	37.2	3.0	4.5	8.9	8.0	6.0	5.6	6.2	5.8	3.9
East and South Asia	3.8	15.3	-3.5	12.0	13.0	17.8	14.0	13.6	10.5	7.4	5.2
China	17.6	35.8	9.3	29.8	28.5	28.6	25.4	21.4	19.2	9.5	6.2
Volume of imports											
World	6.1	13.8	-0.5	4.1	6.5	11.8	8.3	8.9	6.4	4.6	2.2
Developed economies	7.6	11.0	-0.6	2.5	4.6	9.5	6.5	7.0	3.9	1.1	-1.1
North America	11.1	12.3	-3.6	3.2	4.7	10.8	6.8	5.0	1.4	-4.1	-4.1
EU plus Other Europe	5.9	10.7	1.0	2.0	4.1	9.0	6.5	8.3	5.2	3.2	1.2
Developed Asia	6.6	9.0	0.3	3.1	7.1	8.2	5.7	5.5	3.7	5.8	-5.5
Economies in transition	-18.4	21.8	14.0	11.8	16.2	19.3	8.8	18.4	25.0	17.5	15.5
South-eastern Europe	-6.8	17.4	15.3	17.0	3.6	9.6	12.2	9.8	17.0	12.1	8.0
Commonwealth of Independent States	-22.9	23.9	13.8	10.7	19.1	21.2	8.2	20.1	26.3	18.3	16.7
Developing economies	4.0	20.8	-0.9	7.4	10.3	16.3	11.7	12.0	9.8	9.8	6.3
Latin America and the Caribbean	-0.9	17.5	-0.4	-4.1	6.2	7.5	10.4	13.0	9.1	8.6	3.6
Africa	-1.3	1.8	6.3	5.0	10.5	10.7	17.5	11.6	17.6	15.2	10.5
Western Asia	4.0	22.9	2.4	7.3	7.7	23.5	8.8	9.8	15.6	9.8	8.5
East and South Asia	4.6	20.3	-2.4	11.4	11.9	18.0	12.0	12.1	8.3	9.4	6.0
China	25.2	38.4	10.7	28.0	27.5	23.1	13.9	16.2	12.8	7.0	10.6

Sources: UN/DESA Statistics Division, ECA, ECE, ECLAC, ESCAP, ESCWA and IMF.

^a Partly estimated.

^b Baseline scenario forecasts, based in part on Project LINK.

Table A.17
Balance of payments on current accounts, by country or country group, summary table, 1999-2007

Billions of dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007
Developed economies	-182.6	-322.8	-265.2	-287.7	-317.8	-330.7	-505.0	-597.7	-555.3
Japan	114.5	119.6	87.8	112.6	136.2	172.1	165.7	170.4	211.0
United States	-299.8	-417.4	-382.4	-461.3	-523.4	-625.0	-729.0	-788.1	-731.2
Europe ^a	25.8	-27.2	21.8	66.2	90.5	144.5	87.0	51.8	19.1
EU-15	11.3	-60.5	-6.8	38.6	48.9	107.6	25.6	-6.0	-28.9
New EU member States	-23.2	-21.8	-18.6	-20.2	-27.4	-41.7	-35.7	-53.5	-79.9
Economies in transition	21.4	47.0	31.0	25.3	30.7	56.7	81.0	89.5	60.3
South-eastern Europe	-2.5	-1.3	-2.2	-5.0	-5.4	-7.0	-7.2	-8.0	-13.9
Commonwealth of Independent States	23.9	48.3	33.2	30.4	36.1	63.8	88.2	97.4	74.2
Developing economies	39.8	102.3	78.1	127.4	224.6	274.5	485.1	685.0	776.0
Net fuel exporters	-7.9	79.5	32.6	29.5	76.7	121.6	279.1	360.4	336.4
Net fuel importers	47.7	22.9	45.5	97.9	147.9	152.9	205.9	324.7	439.6
Latin America and the Caribbean	-55.8	-47.3	-52.5	-15.2	9.1	21.5	37.0	50.2	18.7
Net fuel exporters	-22.8	-14.1	-21.1	-0.6	11.0	12.6	26.6	35.3	21.0
Net fuel importers	-33.0	-33.2	-31.4	-14.6	-1.8	8.9	10.4	14.8	-2.3
Africa	-11.4	18.4	5.2	-7.7	2.6	12.3	35.5	53.7	29.6
Net fuel exporters	-2.3	26.7	12.0	-2.4	11.4	27.7	56.4	81.7	66.5
Net fuel importers	-9.1	-8.3	-6.8	-5.3	-8.8	-15.4	-20.9	-27.9	-36.9
Western Asia	3.0	37.8	32.2	23.9	44.9	63.1	152.5	190.5	181.5
Net fuel exporters	7.7	50.3	32.4	27.1	52.3	77.6	174.9	216.6	221.2
Net fuel importers	-4.7	-12.4	-0.2	-3.2	-7.3	-14.5	-22.4	-26.1	-39.7
East and South Asia	103.9	93.4	93.3	126.4	167.9	177.5	260.0	390.7	546.3
Net fuel exporters	9.4	16.6	9.4	5.4	2.0	3.7	21.2	26.8	27.8
Net fuel importers	94.5	76.8	83.9	121.0	165.9	173.9	238.8	363.8	518.5
World residual^b	-121.5	-173.5	-156.0	-134.9	-62.5	0.6	61.1	176.8	281.0

Sources: IMF, *World Economic Outlook*, October 2008; and IMF, *Balance of Payments Statistics*.

^a Europe consists of EU-15, new EU member States plus Iceland, Norway and Switzerland.

^b Statistical discrepancy.

Table A.18
Balance of payments on current accounts, by country or country group, 1999-2007

Billions of dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007
Developed economies									
Trade balance	-157.9	-296.4	-260.2	-264.3	-314.9	-423.7	-639.9	-780.1	-759.6
Services, net	89.4	82.3	76.4	96.4	113.6	166.3	206.6	256.1	344.7
Income, net	17.4	27.6	41.7	18.9	48.3	125.3	153.8	161.2	142.9
Current transfers, net	-131.5	-136.3	-123.0	-138.7	-164.9	-198.6	-225.5	-234.9	-283.3
Current-account balance	-182.6	-322.8	-265.2	-287.7	-317.8	-330.7	-505.0	-597.7	-555.3
Japan									
Trade balance	121.3	114.9	69.2	92.5	104.0	128.5	93.8	81.1	105.1
Services, net	-52.2	-45.9	-42.7	-40.7	-31.4	-34.3	-24.1	-18.2	-21.2
Income, net	57.4	60.4	69.2	65.8	71.2	85.7	103.5	118.2	138.6
Current transfers, net	-12.1	-9.8	-7.9	-4.9	-7.5	-7.9	-7.6	-10.7	-11.6
Current-account balance	114.5	119.6	87.8	112.6	136.2	172.1	165.7	170.4	211.0
United States									
Trade balance	-346.0	-454.7	-427.2	-485.0	-550.9	-669.6	-787.2	-838.3	-819.4
Services, net	82.7	74.9	64.4	61.2	54.0	61.8	75.6	85.0	119.1
Income, net	13.9	21.1	31.7	27.4	45.3	67.2	72.4	57.2	81.8
Current transfers, net	-50.4	-58.7	-51.3	-65.0	-71.8	-84.5	-89.8	-92.0	-112.7
Current-account balance	-299.8	-417.4	-382.4	-461.3	-523.4	-625.0	-729.0	-788.1	-731.2
Europe^a									
Trade balance	48.7	2.5	48.8	96.8	107.1	86.1	18.2	-54.7	-71.2
Services, net	63.4	56.3	58.9	78.6	96.4	145.8	164.3	201.2	262.8
Income, net	-16.4	-17.3	-20.8	-40.3	-27.7	18.2	31.4	36.5	-14.2
Current transfers, net	-69.8	-68.8	-65.1	-69.0	-85.4	-105.6	-126.9	-131.3	-158.3
Current-account balance	25.8	-27.2	21.8	66.2	90.5	144.5	87.0	51.8	19.1
EU-15									
Trade balance	67.2	8.0	51.9	95.2	105.6	81.9	3.6	-65.0	-65.6
Services, net	39.7	28.5	32.7	52.7	68.4	114.2	127.4	156.4	206.6
Income, net	-27.6	-28.5	-26.9	-40.7	-38.4	18.6	19.3	36.1	-8.0
Current transfers, net	-68.0	-68.4	-64.5	-68.5	-86.8	-107.1	-124.6	-133.5	-161.9
Current-account balance	11.3	-60.5	-6.8	38.6	48.9	107.6	25.6	-6.0	-28.9
New EU member States									
Trade balance	-28.7	-28.5	-26.1	-25.2	-28.5	-33.1	-33.1	-48.2	-66.8
Services, net	7.5	9.0	9.2	8.1	7.6	8.6	11.7	14.4	19.7
Income, net	-6.9	-7.4	-7.9	-10.7	-16.3	-27.7	-26.8	-34.4	-49.3
Current transfers, net	4.9	5.1	6.2	7.6	9.8	10.4	12.5	14.8	16.5
Current-account balance	-23.2	-21.8	-18.6	-20.2	-27.4	-41.7	-35.7	-53.5	-79.9
Economies in transition									
Trade balance	24.9	53.7	37.8	34.4	43.5	71.8	107.4	130.0	112.5
Services, net	-1.9	-4.3	-7.2	-8.3	-7.1	-10.8	-12.6	-11.7	-17.8
Income, net	-8.0	-9.6	-6.8	-8.9	-16.5	-17.0	-28.5	-44.9	-51.3
Current transfers, net	6.4	7.2	7.2	8.2	10.8	12.8	14.7	16.1	16.9
Current-account balance	21.4	47.0	31.0	25.3	30.7	56.7	81.0	89.5	60.3

Table A.18 (cont'd)									
	1999	2000	2001	2002	2003	2004	2005	2006	2007
South-eastern Europe									
Trade balance	-8.9	-9.0	-10.9	-14.1	-18.3	-22.1	-22.5	-24.4	-32.2
Services, net	1.9	2.6	3.5	3.5	6.0	6.3	6.8	7.8	9.1
Income, net	0.5	0.2	0.1	0.0	-0.4	-0.3	-0.9	-1.3	-1.6
Current transfers, net	4.1	4.9	5.2	5.6	7.3	9.1	9.3	10.0	10.9
Current-account balance	-2.5	-1.3	-2.2	-5.0	-5.4	-7.0	-7.2	-8.0	-13.9
Commonwealth of Independent States									
Trade balance	33.8	62.7	48.7	48.5	61.8	93.9	129.9	154.4	144.7
Services, net	-3.8	-6.9	-10.7	-11.8	-13.2	-17.1	-19.4	-19.5	-26.9
Income, net	-8.4	-9.7	-6.9	-8.9	-16.0	-16.7	-27.5	-43.6	-49.6
Current transfers, net	2.3	2.3	2.0	2.5	3.5	3.7	5.3	6.1	6.0
Current-account balance	23.9	48.3	33.2	30.4	36.1	63.8	88.2	97.4	74.2
Developing economies									
Trade balance	138.6	211.7	181.5	223.4	299.3	355.8	552.8	736.8	813.9
Services, net	-45.6	-53.0	-58.3	-60.8	-57.8	-59.0	-85.1	-100.4	-122.1
Income, net	-109.0	-116.7	-111.7	-113.8	-117.4	-140.0	-132.1	-120.5	-110.5
Current transfers, net	55.9	60.3	66.7	78.6	100.5	117.6	149.4	169.0	194.7
Current-account balance	39.8	102.3	78.1	127.4	224.6	274.5	485.1	685.0	776.0
Net fuel exporters									
Trade balance	64.7	168.6	115.7	121.0	171.1	231.5	386.0	478.2	488.0
Services, net	-45.9	-53.9	-51.4	-54.5	-58.4	-70.7	-83.4	-106.2	-134.5
Income, net	-21.9	-30.0	-27.1	-35.0	-39.2	-48.8	-44.4	-29.5	-32.5
Current transfers, net	-4.8	-5.2	-4.6	-2.0	3.2	9.7	20.9	17.9	15.4
Current-account balance	-7.9	79.5	32.6	29.5	76.7	121.6	279.1	360.4	336.4
Net fuel importers									
Trade balance	73.8	43.1	65.8	102.4	128.2	124.3	166.8	258.7	325.9
Services, net	0.3	1.0	-7.0	-6.3	0.6	11.8	-1.7	5.9	12.4
Income, net	-87.1	-86.7	-84.6	-78.8	-78.2	-91.1	-87.7	-91.0	-78.0
Current transfers, net	60.7	65.5	71.3	80.6	97.3	107.9	128.5	151.1	179.3
Current-account balance	47.7	22.9	45.5	97.9	147.9	152.9	205.9	324.7	439.6
Latin America and the Caribbean									
Trade balance	-9.3	1.6	-5.9	21.9	43.7	59.3	82.8	100.4	74.1
Services, net	-13.6	-14.3	-16.4	-14.6	-11.8	-14.8	-35.4	-40.8	-48.8
Income, net	-53.0	-56.0	-56.3	-52.1	-59.1	-66.0	-61.9	-70.6	-69.4
Current transfers, net	20.2	21.5	26.1	29.6	36.3	43.0	51.5	61.2	62.8
Current-account balance	-55.8	-47.3	-52.5	-15.2	9.1	21.5	37.0	50.2	18.7
Africa									
Trade balance	-2.5	31.8	16.4	5.9	18.1	33.3	63.9	81.5	74.5
Services, net	-7.0	-7.3	-7.9	-9.4	-9.3	-11.3	-15.6	-17.8	-22.4
Income, net	-16.7	-22.0	-19.6	-22.0	-27.1	-35.0	-44.2	-44.6	-62.1
Current transfers, net	14.9	15.9	16.4	17.8	21.0	25.4	31.4	34.6	39.6
Current-account balance	-11.4	18.4	5.2	-7.7	2.6	12.3	35.5	53.7	29.6

Table A.18 (cont'd)

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Western Asia									
Trade balance	27.1	67.8	64.8	64.2	86.4	112.3	188.2	237.9	248.3
Services, net	-18.9	-20.2	-21.0	-23.8	-21.5	-28.2	-31.3	-51.8	-72.8
Income, net	1.8	-1.6	-1.7	-5.6	-8.6	-11.4	3.8	17.5	24.7
Current transfers, net	-7.0	-8.2	-9.9	-11.0	-11.4	-9.5	-8.1	-13.0	-18.8
Current-account balance	3.0	37.8	32.2	23.9	44.9	63.1	152.5	190.5	181.5
East Asia									
Trade balance	135.4	119.7	117.6	139.2	166.4	180.7	255.2	367.7	484.1
Services, net	-6.0	-11.9	-13.9	-13.9	-17.0	-11.2	-13.3	-7.4	-0.3
Income, net	-34.9	-29.5	-27.5	-26.8	-14.8	-20.3	-19.8	-13.0	6.5
Current transfers, net	8.7	9.0	9.6	14.2	19.4	25.0	33.5	38.2	50.1
Current-account balance	103.1	87.3	85.9	112.7	154.0	174.1	255.6	385.5	540.4
South Asia									
Trade balance	-12.1	-9.2	-11.3	-7.8	-15.3	-29.8	-37.3	-50.6	-67.2
Services, net	-0.1	0.8	0.8	0.8	1.9	6.6	10.5	17.5	22.3
Income, net	-6.2	-7.6	-6.6	-7.3	-7.9	-7.2	-10.0	-9.8	-10.1
Current transfers, net	19.2	22.1	24.6	27.9	35.2	33.8	41.0	48.1	60.9
Current-account balance	0.8	6.1	7.4	13.7	13.9	3.4	4.3	5.2	5.9
World residual^b									
Trade balance	5.6	-31.1	-40.9	-6.6	27.9	3.9	20.4	86.7	166.7
Services, net	41.9	25.0	10.8	27.4	48.7	96.6	108.9	144.1	204.8
Income, net	-99.6	-98.6	-76.8	-103.8	-85.6	-31.7	-6.7	-4.3	-18.9
Current transfers, net	-69.3	-68.8	-49.1	-52.0	-53.6	-68.2	-61.4	-49.7	-71.7
Current-account balance	-121.5	-173.5	-156.0	-134.9	-62.5	0.6	61.1	176.8	281.0

Sources: IMF, *World Economic Outlook*, October 2008; and, IMF, *Balance of Payments Statistics*.

a Europe consists of EU-15, new EU member States plus Iceland, Norway and Switzerland.

b Statistical discrepancy.

Table A.19
Net ODA from major sources, by type, 1987-2007

Donor group or country	Growth rate of ODA ^a (2006 prices and exchange rates)		ODA as a percentage of GNI	Total ODA (millions of dollars)	Percentage distribution of ODA by type, 2007						
	1987-1996	1997-2006			2007	2007	Bilateral			Multilateral	
			Total	Grants ^b			Technical cooperation	Loans	Total	United Nations	Other
Total DAC countries	0.22	4.02	0.28	103 655	69.1	71.4	13.5	-2.3	30.9	6.6	24.2
Total EU	1.17	3.56	0.40	62 095	60.2	62.8	16.0	-2.6	39.8	7.4	32.3
Austria	1.30	8.94	0.49	1 798	72.9	74.5	9.5	-1.5	27.1	2.6	24.5
Belgium	-1.80	5.97	0.43	1 953	63.7	65.2	38.2	-1.5	36.3	3.1	33.2
Denmark	3.80	0.82	0.81	2 563	64.4	67.2	2.5	-2.8	35.6	13.6	22.0
Finland	-2.85	6.87	0.40	973	58.4	56.9	10.5	1.6	41.6	11.5	30.1
France ^c	1.87	0.38	0.39	9 940	63.4	67.8	25.6	-4.4	36.6	1.5	35.2
Germany	0.45	2.10	0.37	12 267	65.8	67.6	29.8	-1.8	34.2	1.9	32.4
Greece	..	5.11	0.16	501	49.8	49.8	27.6	..	50.2	3.0	47.3
Ireland	6.96	13.61	0.54	1 190	69.3	69.3	1.9	..	30.7	13.0	17.7
Italy	-3.56	2.03	0.19	3 929	31.2	30.3	2.2	0.9	68.8	11.3	57.5
Luxembourg	13.95	12.23	0.90	365	69.5	69.5	2.2	..	30.5	11.1	19.4
Netherlands	0.76	2.87	0.81	6 216	75.1	77.8	6.4	-2.7	24.9	8.5	16.4
Portugal	20.34	5.63	0.19	403	50.4	45.9	24.1	4.5	49.6	3.1	46.5
Spain	14.77	5.59	0.41	5 744	46.7	42.5	9.2	4.2	53.3	20.8	32.5
Sweden	0.71	5.02	0.93	4 334	68.2	68.0	4.2	0.2	31.8	12.1	19.7
United Kingdom	1.48	7.87	0.36	9 921	52.3	62.2	12.2	-9.8	47.7	7.8	39.9
Australia	0.11	1.84	0.30	2 471	85.5	83.7	44.7	1.8	14.5	2.8	11.7
Canada	-0.88	1.70	0.28	3 922	78.4	79.3	14.3	-0.9	21.6	5.7	15.9
Japan	1.67	0.90	0.17	7 691	75.8	78.5	24.3	-2.7	24.2	7.2	17.0
New Zealand	-0.50	5.22	0.27	315	77.3	77.3	14.7	..	22.7	11.2	11.6
Norway	1.32	3.27	0.95	3 727	76.4	69.5	12.2	6.9	23.6	16.0	7.6
Switzerland	3.11	4.14	0.37	1 680	75.4	74.4	..	1.0	24.6	7.6	17.0
United States	-3.34	8.06	0.16	21 753	86.9	90.6	..	-3.7	13.1	3.0	10.2

Source: UN/DESA, based on OECD, *The DAC Journal Development Co-operation Report 2007*.

^a Average annual rates of growth, calculated from average levels in 1985-1987, 1994-1996 and 2004-2006.

^b Including technical cooperation.

^c Excluding flows from France to the Overseas Departments, namely Guadeloupe, French Guiana, Martinique and Réunion.

Table A.20
Total net ODA flows from DAC countries, by type of flow, 1995-2007

	1995-1996 average	2002	2003	2004	2005	2006	2007
	Net disbursements at current prices and exchange rates (millions of dollars)						
Official Development Assistance	57 186	58 297	69 065	79 432	107 099	104 421	103 655
Bilateral grants and grant-like flows	36 380	39 818	50 888	57 246	83 453	79 450	74 009
of which:							
Technical co-operation	14 220	15 452	18 352	18 672	20 753	22 252	13 989
Humanitarian aid	2 152	2 779	4 360	5 193	7 110	6 751	6 282
Debt forgiveness	3 561	4 538	8 317	7 134	24 999	18 600	..
Bilateral loans	3 404	939	-1 153	-2 942	-1 008	-2 490	-2 342
Contributions to multilateral institutions ^a	17 401	17 540	19 330	25 127	24 653	27 461	31 988
	Share of total net flows (percentage)						
Official Development Assistance	32	80	55	50	35	34	..
Bilateral grants and grant-like flows	20	55	41	36	28	26	..
of which:							
Technical co-operation	8	21	15	12	7	7	..
Humanitarian aid	1	4	3	3	2	2	..
Debt forgiveness	2	6	7	4	8	6	..
Bilateral loans	2	1	-1	-2	0	-1	..
Contributions to multilateral institutions ^a	10	24	15	16	8	9	..

Source: UN/DESA, based on OECD, *The DAC Journal of Development Co-operation Report 2007* and DAC online database, available from <http://www.oecd.org/dac/stats/idsonline> (accessed on 14 November 2008).

^a Grants and capital subscriptions. Does not include concessional lending to multilateral agencies.

Table A.21
Commitments and net flows of financial resources, by selected multilateral institutions, 1998-2007

Millions of dollars										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Resource commitments^a	95 118	65 568	63 085	72 177	95 292	67 593	55 895	71 712	64 738	74 493
Financial institutions, excluding IMF	57 928	42 770	36 882	41 787	38 523	43 053	45 678	51 385	55 700	66 620
Regional development banks ^b	21 133	19 437	16 235	19 349	16 751	20 393	21 468	23 039	23 088	31 330
World Bank Group	36 352	22 899	20 238	22 004	21 382	22 230	23 743	27 677	31 901	34 691 ^c
International Bank for Reconstruction and Development (IBRD)	24 687	13 789	10 699	11 709	10 176	10 572	10 792	13 611	14 195	12 829
International Development Association (IDA)	7 325	5 691	5 861	6 859	8 040	7 550	8 387	8 696	9 506	11 867
International Financial Corporation (IFC)	4 340	3 419	3 678	3 436	3 166	4 108	4 564	5 370	8 200	9 995
International Fund for Agricultural Development (IFAD)	443	434	409	434	390	430	467	669	711	599
IMF (billions of dollars)	33	19	22	26	52	18	3	13	1	2
United Nations operational agencies ^d	4 290	4 198	3 803	4 690	4 569	6 740	7 617	7 708	8 345	6 255
Net flows	28 825	-7 450	-10 859	14 931	2 001	-11 655	-20 235	-39 609	-25 864	-6 772
Financial institutions, excluding IMF	9 525	5 150	-59	1 431	-11 199	-14 755	-10 235	835	5 208	-11 403
Regional development banks ^b	7 971	4 229	327	1 696	-3 904	-8 025	-6 570	-1 668	2 965	5 940
World Bank Group	1 554	921	-386	-265	-7 295	-6 730	-3 665	2 503	2 243	5 463
International Bank for Reconstruction and Development (IBRD)	-2 723	-3 019	-4 079	-4 570	-12 126	-11 241	-8 930	-2 898	-5 087	-1 767
International Development Association (IDA)	4 276	3 940	3 693	4 432	4 831	4 511	5 265	5 401	7 330	7 230
IMF (billions of dollars)	19	-13	-11	14	13	3	-10	-40	-31	-18
Memorandum item: (in units of 2000 purchasing power) ^e										
Resource commitments	87 264	62 446	63 085	73 650	97 237	62 586	47 774	59 760	54 863	56 010
Net flows	26 445	-7 095	-10 859	15 236	2 042	-10 792	-17 295	-33 008	-21 919	-5 091

Sources: Annual reports of the relevant multilateral institutions, various issues.

^a Loans, grants, technical assistance and equity participation, as appropriate; all data are on a calendar-year basis.

^b African Development Bank (AfDB), Asian Development Bank (ADB), Caribbean Development Bank (CDB), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IaDB) (including Inter-American Investment Corporation (IaIC)).

^c Data is for fiscal year 2007.

^d United Nations Development Program (UNDP), United Nations Population Fund (UNFPA), United Nations Children's Fund (UNICEF) and the World Food Programme (WFP).

^e Totals deflated by the United Nations index of manufactured export prices (in dollars) of developed economies: 2000=100.

Table A.22
Greenhouse gas emissions^a of Annex 1 Parties to the United Nations Framework Convention on Climate Change

Teragram CO ₂ equivalent												
	1990	2000	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c	Annual growth rate 1990-2009	Cumulative change between 1990 and 2009
Australia	416	495	510	518	524	530	536	550	554	553	1.5	32.8
Austria	79	81	87	93	92	93	91	93	93	92	0.8	16.1
Belarus	127	70	68	70	74	76	81	84	83	82	-2.3	-35.4
Belgium	145	146	143	146	146	142	137	136	133	128	-0.6	-11.2
Bulgaria	117	69	66	71	71	71	71	65	60	54	-4.0	-53.6
Canada	592	718	717	741	743	734	721	716	708	695	0.8	17.4
Croatia	33	26	28	30	30	31	31	32	33	34	0.2	3.0
Czech Republic	194	147	145	146	147	146	148	158	163	165	-0.8	-14.9
Denmark	70	69	70	75	69	65	72	66	63	59	-0.9	-15.8
Estonia	42	18	18	20	20	19	19	17	14	11	-7.0	-74.6
Finland	71	70	77	85	81	69	80	86	82	80	0.6	12.4
France	566	560	553	557	557	560	547	540	533	517	-0.5	-8.8
Germany	1 228	1 019	1 017	1 030	1 028	1 005	1 005	979	958	910	-1.6	-25.9
Greece	105	128	129	134	134	134	133	134	135	135	1.3	28.7
Hungary	98	78	77	81	79	80	79	76	73	70	-1.8	-28.7
Iceland	3	4	4	4	4	4	4	4	4	3	0.0	0.6
Ireland	56	69	69	69	69	70	70	71	66	59	0.4	6.9
Italy	517	552	559	574	578	578	568	575	572	562	0.4	8.8
Japan	1 272	1 348	1 356	1 361	1 355	1 358	1 340	1 361	1 358	1 338	0.3	5.2
Latvia	26	10	11	11	11	11	12	11	10	9	-5.8	-67.6
Liechtenstein	—	—	—	—	—	—	—	—	—	—	1.1	21.2
Lithuania	49	19	21	21	22	23	23	23	22	21	-4.4	-57.9
Luxembourg	13	10	11	12	13	13	13	13	13	12	-0.6	-10.7
Monaco	—	—	—	—	—	—	—	—	—	—	-1.1	-18.2
Netherlands	212	214	215	216	218	212	207	202	194	187	-0.7	-11.8
New Zealand	62	71	73	76	75	77	78	78	77	76	1.1	22.7
Norway	50	53	53	54	55	54	54	54	54	53	0.3	6.7
Poland	454	389	373	385	384	386	400	402	396	383	-0.9	-15.6
Portugal	59	82	88	83	85	87	83	85	88	88	2.1	49.2
Romania	248	139	150	157	159	152	157	158	160	158	-2.3	-36.1
Russian Federation	3 326	2 038	2 064	2 106	2 120	2 123	2 190	2 295	2 382	2 433	-1.6	-26.8
Slovakia	74	49	49	50	50	49	49	48	46	42	-2.9	-42.7
Slovenia	19	19	20	20	20	20	21	21	21	21	0.7	13.8
Spain	288	385	403	410	426	441	433	467	472	462	2.5	60.7
Sweden	72	68	70	71	70	67	66	65	63	60	-0.9	-16.2
Switzerland	53	52	52	53	53	54	53	54	56	58	0.5	9.6
Turkey	170	280	271	286	297	312	332	348	358	366	4.1	115.1

Table A22 (cont'd)												
	1990	2000	2002	2003	2004	2005	2006	2007	2008 ^b	2009 ^c	Annual growth rate 1990-2009	Cumulative change between 1990 and 2009
Ukraine	922	395	403	417	417	426	443	436	451	446	-3.7	-51.6
United Kingdom	772	674	657	662	661	659	656	631	595	545	-1.8	-29.4
United States	6 135	7 003	6 953	6 978	7 061	7 107	7 017	6 975	6 859	6 610	0.4	7.7
All Annex 1 Parties	18 734	17 616	17 628	17 871	17 995	18 039	18 019	18 110	18 000	17 577	-0.3	-6.2

Source: UN/DESA, based on data of the United Nations Framework Convention on Climate Change (UNFCCC) online database available from http://unfccc.int/ghg_emissions_data/ghg_data_from_unfccc/time_series_annex_i/items/3814.php (accessed on 17 November 2008).

Note: Based on the historical data provided by the UNFCCC for the GHG emissions of the Annex 1 Parties up to 2006, DESA/DPAD extrapolated the data to 2009. The extrapolation is based on the following procedure:

- First, GHG/GDP intensity for each country is modelled using time-series regression techniques, to reflect the historical trend of GHG/GDP. While the trend for each individual country would usually be a complex function of such factors as change in structure of the economy, technology change, emission mitigation measures, as well as other economic and environmental policies, the time-series modelling could be considered as a reduced form of a more complex structural modelling for these relations between economic output and GHG emissions.
- Second, GHG/GDP intensity for each country is extrapolated for the out-of-sample period (i.e., 2007-2009), using parameters derived from the time-series regression model.
- Third, in some cases, the extrapolated GHG/GDP intensity for individual countries was adjusted to take account for announced emission control measures taken by Governments.
- Finally, the projected GHG emissions were estimated using GDP estimates according to the *World Economic Situation and Prospects 2009* baseline forecast and the extrapolated GHG/GDP intensity.

a Without land use, land-use change and forestry.

b Estimated.

c Baseline scenario forecasts.

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Published by the United Nations

ISBN 978-92-1-109158-8

Sales No. E.09.II.C.2

08-57855—January 2009—4,860