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The Current Global Financial Crisis and the Recession in World Economy:

Prospects for Recovery

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Background

Since 2007, the world economy has been facing a major financial and economic downturn originated from the US subprime mortgage crisis which lead to the collapse of some most successful financial institutions, insurance companies and equity firms especially in the developed countries. As the crisis has been deepening with a global reach, many developing countries are now suffering a number of negative direct effects of crisis, including slowdown in their export growth, decrease in aid and FDI inflows, fall in remittances and contraction of private sector activities. As a result, both developed and developing countries are now facing the negative impacts of the global financial crisis which pushed the world economy into the current recession.

The world economy witnessed the sharpest decline in industrial production and trade volume in the fourth quarter of 2008, which, in turn, led to a contraction in the world real GDP in the first quarter of 2009. Nevertheless, starting in the second quarter of 2009, there are now increasing signs of slow recovery in some parts of the world with stabilizing in trade and industrial production, moderating decline in economic activity and partially improving in financial markets.

The current sluggish recovery in world economy is, in part, due to the fiscal stimulus packages and huge amount of funds injected in the financial markets by many developed countries and some emerging and developing countries. To a large extent, household consumption is still very low and domestic demand is mainly catalyzed by the public spending. Yet, despite of these positive signs of recovery, high unemployment rates and low business activity are still persisting. This clearly indicates that the world economic recession does not seem to be easily and fully recovered in the near future.

In the light of the most recent available projections, this brief report aims at investigating the prospects for the recovery of the world economy from the current recession by analyzing the
performance of the world economy as a whole and the performance of some major economies and groups of countries, in terms of some important economic and financial indicators.

**Signs of Recovery at Global Level**

World average real GDP growth rate is now rebounding with some major indicators like industrial output, merchandise exports and retail sales etc. are showing slow upward trends. These positive developments are considered as foundations for expected recovery in the world economy from the deep recession recorded in the second half of 2008.

**I- Real GDP Growth Rate**

After recording the deepest recession since World War II, world average real GDP growth rate started to rebound slightly in the second half of 2009 with increasing signs of recovery supported mainly by fiscal and monetary measurements adopted by many countries around the world. In July 2009, the world economic activity has been projected to contract by 1.4 percent for the whole year of 2009, which is 0.6 percentage point higher than the projections of April 2009. Moreover, the projections of July 2009 show an expansion of world economic activity by 2.5 percent in 2010. On a fourth-quarter-over-fourth quarter basis, real GDP growth is now projected at 2.9 percent for 2010 compared to to the earlier forecast in April of 2.6 percent. According to these projections, GDP growth rate in emerging and developing economies is more promising than the advanced countries, as while GDP growth in the advanced economies is projected to decline by 3.8 percent in 2009 before growing by 0.6 percent in 2010, GDP growth in emerging and developing economies is projected to decelerate to 1.5 percent in 2009 and rebound to 4.7 percent in 2010.

**Figure 1: Global GDP Growth (Percent; quarter-over-quarter, annualized)**

II- Industrial Production

After experiencing a steep decline in 2008, especially in the last quarter, industrial production has slightly improved across the globe associated with an improvement in economic outlook of some of developed and emerging economies. As shown in the Figure 2, for the first time in almost a year, industrial production in the emerging economies has moved into positive trend, recording a positive growth rate of 7.25% in first quarter of 2009. Although still with negative growth rates, world industrial production and that of the advanced economies are also showing upward trends.

Figure 2: Industrial Production (%)*


III- Trade

The sharp decline in world trade volume was one of the most negative impacts of the current financial crisis, particularly on the economies of many developing and emerging countries. This has been aggravated by the weaker demand for manufactured exports and commodities and falling commodity prices. World Trade Organization (WTO) estimates that the volume of global exports of goods and services will decrease by 9 percent in 2009 (WTO, 2009), while IMF projections signal for a deeper decline by 11 percent. Such a contraction would be the largest one ever since the World War II. However, recent data show that the growth in merchandise exports is stabilizing across the globe after reaching the lowest point in the last quarter of 2008 (Figure 3). Yet, growth rates are still negative and much below the pre-crisis level.
IV- Retail Sales

As shown in Figure 4, retail sales have also witnessed a steep decline in the second half of 2008, which has been reflected in a sharp decline in production activities and loss of jobs in many countries worldwide. However, there are increasing signs of improvement in retail sales across the globe. This positive development is predicted to stimulate the production and increase employment opportunities.
V- Financial Stress

Financial sector is also showing signs of improvement and, mainly due to the supportive measures taken by governments and central banks, confidence is rebuilding in the financial markets across the globe. Gradually, concerns regarding liquidity and counterparty risks in the banking sector have declined and interbank markets have resumed functioning. As a result, financial stress indexes for advanced and emerging economies have declined since the beginning of 2009 (Figure 5). However, great disparity exists in the performance of financial sector across the countries and the groups of countries. Bank lending conditions are still very tight especially in advanced countries while emerging and developing countries are also facing various constraints in securing external financing.

![Figure 5: Financial Stress in Advanced and Emerging Economies](chart)


VI- Unemployment Rate

Since early 2008, global unemployment rate increased by 3 percentage points to reach 8.3 percent in June 2009. To survive in these hard times, firms across the world continued to lay off their workers. However, recent data shows that unemployment rates have begun to level off in the second quarter of 2009. After having risen about 0.3 percentage points per month from January to May, the global unemployment rate increased just by 0.1 percentage points in June and July. This is very much in line with the predictions about the improvement in industrial sector and positive changes in business environment across the globe. An improvement in job prospects will increase the household income and consumer confidence, paving the way for a sustained economic recovery.
Signs of Recovery at Country Level

In major developed economies, particularly in the US, the contraction in real GDP has decelerated due mainly to increase in government expenditures while household expenditures and savings remained at very low levels. Unemployment rate is still high and is estimated to remain at a high level in coming months while speed of wage rate increase halved from one year ago. US housing market where the sub-prime mortgage crisis originated is also recovering and three major housing price indices have either started to rise or stabilized in May 2009.

EU economies are also showing some signs of recovery especially in the Western Europe. For the first time since the onset of the crisis, industrial production has shown upward trend in May 2009 in Germany, France and the Netherlands. However, while unemployment rate is averaged at 9.5 per cent for the Euro area, it is still higher than this level in some countries. For example, the unemployment rate in Ireland has increased to 11.7 per cent and in Spain to 18.7 per cent.

Japan’s economy has also stabilized and expected to register positive growth rate in the second quarter of 2009. This is mainly due to improvement in trade as demand for Japan’s exports has increased in China, EU and US. Yet, while government fiscal stimulus package contributed to the recovery by boosting domestic demand, job market and demand for bank loans continued to deteriorate due to low business investments. In Australia, fiscal and monetary stimuli helped boost consumer confidence and support retail sales. Yet, while exports continued to recover, business investment continued to decline and the unemployment rate remained steady in July at 5.8 per cent.
In the Common Wealth Independent States (CIS) the pace of contraction has been declined and industrial production is improving especially in Russia and Kazakhstan. Among the other economies in this region, in Ukraine GDP contracted by over 20 percent in the first quarter of 2009 while on the contrary Uzbekistan recorded an impressive growth of over 8 percent for the first half of the year. Meanwhile, countries in South-Eastern Europe continued their search for financial resources in the international capital markets to revive their domestic markets. Central banks in many of these countries cut their interest rates after availing the funds from international markets.

Data for the first quarter of 2009 suggests that growth has rebounded in some African economies as well. There are high expectations of increase in economic activity in many African countries. For example, Kenya recorded year-on-year growth of 3.9 per cent in the first quarter while in Egypt and Malawi growth is expected to reach 4.5 percent and 7.9 percent respectively in this year. In addition, inflation has declined in many parts of the Africa as the food commodity prices fell amid the financial crisis. However, many countries are still suffering from high food prices mainly due to draughts and production shortfalls. Unemployment rate is also showing mixed trends across the region where some countries like Morocco managed to decrease the unemployment rate from 9.6 percent to 8.0 percent between the first and second quarter. South Africa, where unemployment rate is at about 23.5 percent, remained threatened by prevalence of high level of unemployment.

East Asian economies are also on the path of recovery. Massive fiscal stimulus packages combined with aggressive monetary easing helped strengthen domestic demand and industrial production has increased on a month-on-month basis across the region. East Asian economies also witnessed an improvement in exports and capital inflow. As a result, growth rates have been rebounded in the second quarter of 2009 in a number of these economies like China, Republic of Korea, Singapore, and Viet Nam. However, despite this positive outlook, full recovery in this region depends largely on the end of the future prospects in the developed countries.

Prospects for recovery in the South Asian economies are still gloomy. Many governments like in Bangladesh, India and Pakistan presented expansionary budgets for the new fiscal year 2009/2010 to
stimulate the economic growth and helping the poor. However, due to mismatch between growth in revenue and expansion in spending, the already large budget deficits are forecast to widen further.

In the Western Asian region, Turkish economy was hard hit by the crisis and industrial production especially in cars and commercial vehicles industry has shown significant decline (Figure 7). However, there are some signs of improvement in the Turkish economy as car production has risen month-on-month in both April and May 2009 while the unemployment rate has shown some decline from its peak level. Turkey’s unemployment rate increased from 10.3 percent in September 2008 to a record high level of 16.1 percent in February 2009, but decelerated to 13 percent in June 2009 (TUIK, 2008, 2009a, and 2009b). In Jordan, government prioritized the spending to overcome the increasing public budget deficit and to improve the country’s attractiveness for foreign investments.

Figure 7: Industrial Production Index for Turkey (2005=100)

Countries in the Latin American and Caribbean region are also showing signs of recovery. Industrial production has improved in Brazil by 0.2 per cent from May to June while decrease in Chili industrial output was less than expected in June. Peru recorded GDP growth rate of 0.5% in May 2009 compared to the same month in 2008. Meanwhile, due to improvement in commodity prices including metal and oil, stock market in the region has also shown positive trends. In contrast, trade volume of the region is decreasing, fiscal deficits are increasing and remittances inflows are still very low.
As for the OIC member countries, as a group, the average real GDP growth rate decreased to 5.1 percent in 2008 due to the early impacts of the slowdown in global economic activity triggered by the global financial crisis in the second half of the year. Moreover, the most recent projections show that it will further decelerate to 1.5 percent in 2009. Although only two countries recorded negative growth rates in 2008, this number is expected to increase to 7 in 2009 and only 10 countries are estimated to record improvement in their growth rate in 2009 compared to 2008.

Given this recent outlook of the world economy at global, regional and country levels, it can be concluded that, despite showing some signs of recovery, global economy is still suffering from recession. Household consumption is very low and domestic demand is mainly catalyzed by public spending. Across the world, financial sector is heavily dependent on public support while despite showing declining trend in the recent months; unemployment is still very high compared to the pre-crisis level. Therefore, it’s very much likely that recovery will be very slow and it will take some more time to put the world economy back on the pre-crisis growth path.
References


JPMorgan, Global Data Watch, Economic Research, August 2009.


* Annualized percent change of 3-month moving average over previous 3-month moving average
† Argentina, Brazil, Bulgaria, Chile, China, Colombia, Estonia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Romania, Russia, Slovak Republic, South Africa, Thailand, Turkey, Ukraine and Venezuela.
‡ Australia, Canada, Czech Republic, Denmark, euro area, Hong Kong SAR, Israel, Japan, Korea, New Zealand, Norway, Singapore, Sweden, Switzerland, Taiwan Province of China, United Kingdom and United States.