

International Outlook for 2009

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After four years of strong growth, the world economy is falling into a major downturn and is forecasted to grow at only 2.2 percent in 2009.¹ This growth rate is at its lowest level since 2002 as concerns have intensified that the rich countries will face their deepest recession since the 1930s. Any growth in the world economy in 2009 will be almost entirely driven by the emerging and developing economies, whose growth will nevertheless sharply fall to 5.1 percent from 8 percent in 2007 and 6.6 percent in 2008. At the same time, inflation has risen to its highest level since 1997—reflecting the tightness in world commodity markets. The surge in inflation rates is particularly disturbing in emerging and developing markets where the substantial increase in the price of food is leading to a surge in social unrest.

Western Europe

Economies in Western Europe face many simultaneous adverse shocks. Since the end of the summer, the European news has become more depressing with each passing month. High growth countries like the United Kingdom, Ireland, and Spain have seen investments collapse and unemployment rates soar. In Spain, unemployment is expected to jump by 3.5 percent in 2009, reaching 14.7 percent—the biggest jump over the past thirty years. Economies in Western Europe will most likely contract by an average of 0.5 percent next year.

The economic deterioration is mostly due to financial system excesses, coupled with the effect of toxic assets. In the United Kingdom, mortgage lender Northern Rock had to be nationalized and the direct effect of the bursting housing bubble on the financial system seems quite

severe. However, not all European countries have had, or will see, comparable impacts of the property bust on their financial systems. On the other hand, the slowdown in consumption and the global credit crunch will be felt throughout Europe and will most certainly hurt some banks. In Europe, when the banks experience a crisis of confidence, it is a proportionately greater problem than in the United States because the European economy is mostly funded by the banks.

Following the lead of Britain and the United States, several Western European governments have announced plans to help their national banking system. But given the size of each country's GDP and the absence of a federal budget, the response to the crisis cannot be as strong as the U.S. \$700 billion troubled assets relief program. Furthermore, in response to this crisis, several European governments will also be constrained by the state of their public finances, unless of course they breach the Maastricht limit of 3 percent of GDP deficit.²

Inflation is the other important shock hitting Western European countries this year. If this were the only shock, it would be weathered easily. In fact, many economists lately have alluded to the risk of deflation. Presently, the inflation rate is above target in every large economy except Japan. Deflation will become a problem only if the recession lasts for an extended period.

Asia

Japanese economic growth has been quite fragile in the last six years. The Japanese do not consume much relative to savings rates, and domestic consumption has stayed extremely weak. The major issue facing Japan is a deteriorating balance of trade. Weaker exports to emerging

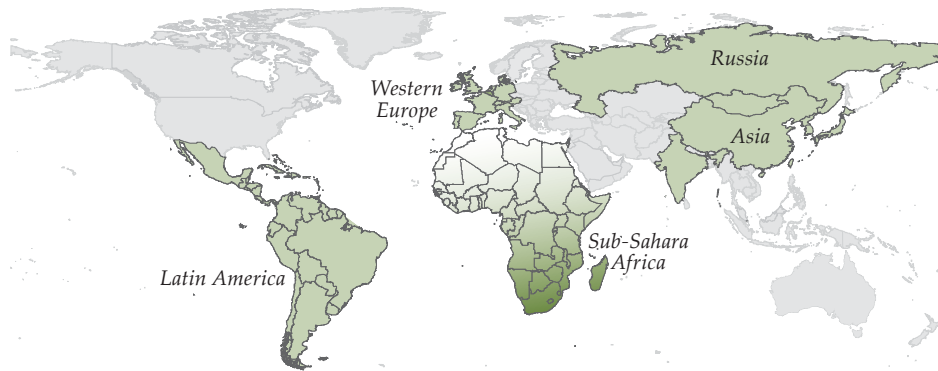
and developing economies in 2008 and 2009 will not provide enough support for growth, so the economy is forecasted to contract 0.2 percent next year.

In emerging Asia, the economies that are the most affected are those that export commodities, those facing problems of attracting foreign capital, and those experiencing liquidity problems.

The International Monetary Fund forecasts China to grow at 9.7 percent in 2008 and 8.5 percent in 2009. While this is still robust growth, it is substantially lower than 2007's 11.9 percent growth. China is a frugal nation whose industrial development has been driven by U.S. consumer demand and foreign direct investment. But U.S. consumers, producers, and investors are not in the mood for excessive consumption, and capital doesn't flow as fast as it used to in China. To reinvigorate its economy, China must rely on domestic spending and therefore has designed a "massive infrastructure and social spending program" to boost its slowing economy. This stimulus plan is estimated at about \$600 billion, or about 15 percent of China's GDP. The Chinese government can afford this plan due to a budget surplus in 2007 and a relatively modest debt-to-GDP ratio. The rest of the world should welcome this stimulus package in hopes of a richer Chinese consumer market to tap in the future.

India, Asia's third largest economy, also felt some adverse effects from the financial crisis, including a decline in foreign investors' exposure to its domestic assets and a stock market collapse. As a result, India's economy has weakened and is expected to grow at around 6.3 percent in 2009—down from 9.3 percent in 2007. The other major issue is containing inflation because of its

impact on India's hundreds of millions living in poverty. Contrary to China, India is not really in a position to launch a grand stimulus package, but the central bank has actively tried to bolster market sentiment and increase availability of money in the system despite the dollar outflows.



a staggering number of individuals to extreme levels of poverty, resulting in what the International Committee of the Red Cross has called "the tragedy of the decade." Outside economic forces are also part of the problem, such as the present drought (the worst since 1984). Additionally, high food prices (which are leading to increased social unrest) and the world's financial meltdown (which will reduce the level of remittance from African émigrés) will likely further worsen the general stability of the region and weaken its growth prospects.

Russia

While previous years have shown robust domestic spending as well as very favorable terms of trade, there have also been rising pressures on prices in an economy where food is a large component of household consumption. The strains created by the financial crisis have deteriorated the growth prospect in the region—mostly because of the large loss of confidence by investors who are pulling back their capital for equity markets. Growth is forecasted to fall to around 3.5 percent in 2009 from 6.8 percent in 2008 and 8.1 percent in 2007. The adverse effects of inflation are of particular importance in Russia, where a stronger policy stance is needed for long-term inflation control.

quite substantial in Latin American economies. This has led to a strong depreciation of local currencies, which will likely make it more expensive for domestic firms to import machines or pay bills that are denominated in dollars. Thanks to their robust external positions, the central banks of Mexico and Brazil have responded to these strong turbulences by taking extraordinary measures and flooding their markets with dollars to help fight depreciating currencies. But for those commodity-exporting countries, the further decline of prices, while moderating the risk of inflation, could put more strain on the economic prospect of the whole region.

Latin America

The impact of the global financial crisis on Latin America's emerging markets is significantly weakening the value of their domestic currency vis-à-vis the dollar. The banks there had no exposure to the toxic assets, but U.S. portfolio managers are cashing out their positions and the inflow of dollars has been

Sub-Saharan Africa

For several Sub-Saharan African countries, we can talk about the mixed blessing of higher commodity prices. On one hand, high commodity prices have helped some economies take advantage of their imports and generate very favorable terms of trade. On the other hand, the high share of food in the average household's consumption basket of goods and services has driven

Conclusion

Regardless of the direction we look, the prospects for the near future are not good. Some countries are facing the strong backlash of their financial industry and some are indirectly suffering from the consequences of that crisis. World growth is for the first time driven by the emerging and developing countries in what appears to be more than ever a very large global market. All recessions end and this one will not be an exception to the rule. Thus, it is probably prudent to speculate that by the beginning of the next decade we will have a more uniform, healthy, and sustainable world economy. ■

Notes

1. Data in the article are from the International Monetary Fund, available online at www.imf.org.
2. As discussed in the Maastricht Treaty of 1992.