Global and European setting

World economic activity

Global economic slump in 2008 Q4

The global economy's slide accelerated rapidly in the fourth quarter of 2008, and world trade is likely to have fallen sharply. One key reason was that the financial markets were rocked by renewed turmoil triggered by the collapse of US investment bank Lehman Brothers. Market segments which had hitherto remained largely unscathed were also affected severely. Moreover, emerging market economies and developing countries, particularly several central and eastern European states, were also sucked into the maelstrom of the crisis. Stock prices fell sharply worldwide, and spreads on corporate bonds as well as some government bonds surged. Moreover, an increase in capital flight put downward pressure on the currencies of several emerging market economies. The fact that emerging market economies are being increasingly affected, combined with their growing economic importance, have made the current downturn much more of a global phenomenon than previous cyclical downswings. Also worth noting is the high degree of co-movement of the downward trend among the various countries.

Transmission channels

In the hardest-hit industrial countries – specifically, the United States and the United Kingdom – the massive disruptions to the financial system were transmitted to the real economy primarily by the tightening of financing conditions for enterprises and households and as a result of negative wealth effects and losses in confidence. This was accompanied by a strong levelling-off in import demand. For the more export-oriented industrial countries, such as Japan and Germany, as well as some emerging market economies, this meant a considerable reduction in exports. Oil and commodity exporting countries in the Middle East, Latin America and Africa were also hurt by the significant cyclical price corrections in these markets.

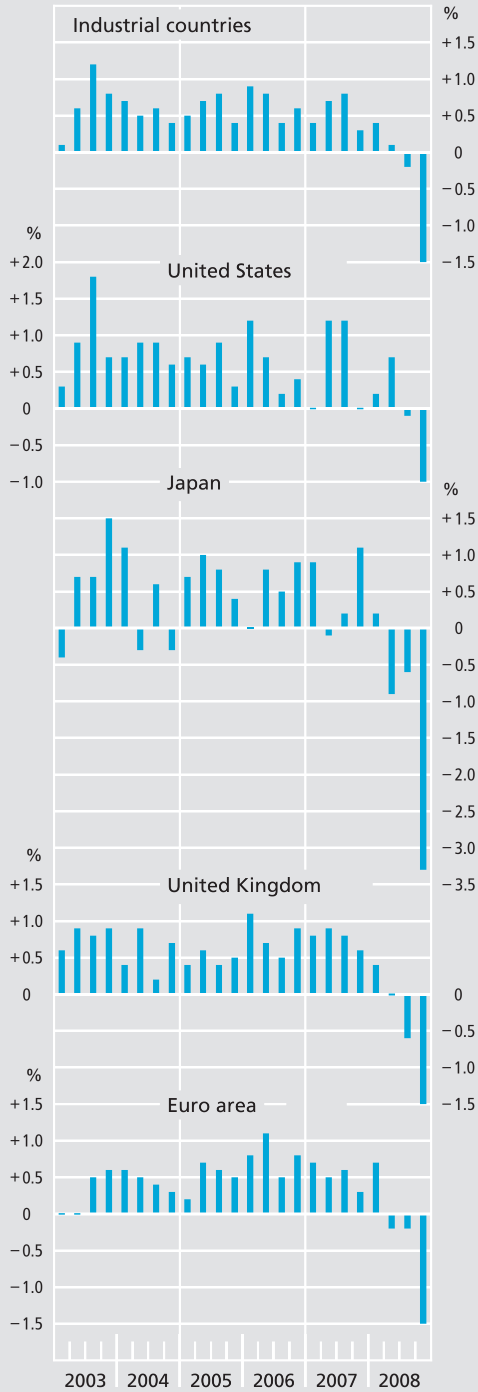
World economy supported by falling inflation and expansionary economic policy

In the fourth quarter, the retarding elements in the world economy were so strong that even the distinct improvement in the price climate, which – in and of itself – provided a considerable boost to purchasing power, was incapable of meaningfully lessening the impact of the global economic slump. However, account must also be taken of the oil exporting countries' lost income, which has dampened their growth. In the fourth quarter, consumer prices in the industrial nations were up by a seasonally adjusted 1.1% on the period. Year-on-year growth fell from 4.3% in September to 1.0% in December. Excluding energy and food, inflation fell during this period by 0.6 percentage point to 1.7%. The moderate inflation rate allowed central banks, particularly in the industrialised countries, to slash interest rates. In the meantime, governments have taken extensive measures to stabilise the financial markets and re-inject capital into the ailing banking system. Moreover, many governments have also adopted (in some cases sizeable) economic stimulus packages, which are expected to provide perceptible positive stimuli over the course of this year.

The continued decline in the price of crude oil was the main reason behind the fall in consumer price inflation in the fourth quarter of

Overall economic output in industrial countries*

Seasonally adjusted, quarter-on-quarter change



* The United States, Japan, the United Kingdom and the euro area.

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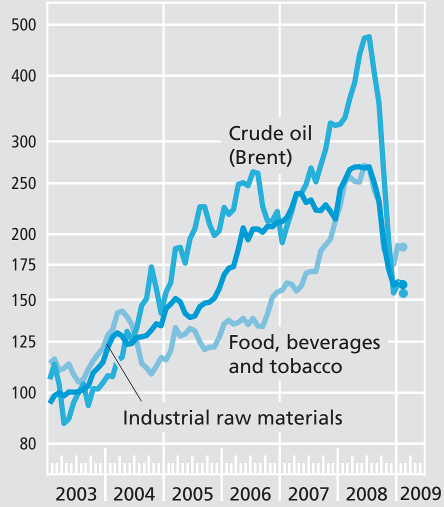
World market prices for crude oil and industrial raw materials as well as food, beverages and tobacco

US dollar basis, 2000 = 100, log scale



Sources: Thomson Reuters and HWWI. — • = 13 February or 16 February 2009 (crude oil).

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Recent stabilisation in commodity markets following clear fall in prices in Q4

2008. Denominated in US dollars, the price of crude oil, having already plunged by 34¾% from its mid-July peak until the end of September, slid faster still in the autumn months. The price of crude oil dropped by no less than US$57 to US$37¼ per barrel between early October and the fourth week of December. However, the price has been trending slightly upwards since then. This is due in part to heightened geopolitical tensions in the Middle East and the perceptible production cutbacks by the OPEC nations. In mid-February, crude oil was being quoted at US$45 or €35 per barrel. Prices for other commodities likewise fell visibly in the fourth quarter; in December US dollar prices were down by one-quarter on the year. However, they, too, have been rising slightly since the turn of 2008-09. One reason is that the expected drought-related crop failures in Brazil and Argentina have led to higher prices for food, beverages and tobacco.

GDP down in industrial countries in Q4

The industrial countries remained at the centre of the global downturn. Their overall output shrank by a seasonally adjusted 1½% from its level in the third quarter, in which it had already fallen by ¼%. It was down on the year for the first time since 1982, by 1¼%. On an average for the year, however, it still grew by ¾%. All major countries and regions saw a considerable drop in their GDP in the fourth quarter of 2008. The list was headed by Japan, with a fall in GDP of a seasonally adjusted 3¼%, followed by the United Kingdom and the euro area (each -1½%) and the USA (-1%).

Updated IMF forecast

According to the January update of the forecast issued by the International Monetary Fund (IMF), world GDP is expected to grow only ½% in 2009, compared with a rise of 3½% in 2008.[1] The sharp slowdown in global growth is attributable, for one thing, to the probable contraction of the industrial countries' overall output by 2%. For another, the IMF is expecting growth in the emerging market economies and developing countries to be halved to around 3¼%. Next year, however, world growth is forecast to rebound distinctly to 3%. According to the new projection, world trade will shrink by 2¾% in

1 This forecast is based on calculations of world GDP in terms of purchasing power parity. According to the global projection, aggregated at market exchange rates, and in which the industrial countries' comparatively unfavourable figures have a greater weight, world output is expected to fall by ½% in 2009 after having risen by 2% in 2008.

2009 – its greatest decline since 1975 – and rise relatively moderately (by 3¼%) in 2010.

South and east Asian emerging market economies in throes of global downswing

Several south and east Asian emerging market economies were hit by a massive decline in exports in the fourth quarter of 2008. China, too, saw its exports fall year-on-year in November-December for the first time in quite a while. Year-on-year GDP growth stood at 6¾% in the fourth quarter, compared with 9% in the third quarter. China's overall output was likewise up by 9% for 2008 as a whole.[2] The positive purchasing power effects of the further decline in the inflation rate from 6.3% in July 2008 to 1.0% in January 2009, however, were counteracted by negative wealth effects stemming, most notably, from plummeting stock prices and growing uncertainty caused by mounting layoffs and business failures. The IMF forecast has growth in China slowing down to 6¾% in 2009, while some of the region's other countries, particularly Korea, Singapore and Taiwan, are even expected to see a perceptible decline in real GDP.

Latin America affected particularly by falling commodity revenue and capital flight

Owing mainly to the continued drop in commodity prices amidst falling deliveries, the Latin American economies, having intermittently posted strong growth rates in the summer months, felt the full impact of the global economic downturn in the fourth quarter. In addition, foreign investors withdrew capital; in many cases, this led to a sharp depreciation in these countries' currencies but also entailed a tightening of financing conditions. In the fourth quarter, Brazilian industrial output fell by 9½% from its third-quarter level after seasonal adjustment and therefore contracted year-on-year for the first time since the second and third quarters of 2003. Of the major countries in the region, Mexico was probably hit the hardest. This was related not only to falling oil revenues but also to its high degree of economic integration with the United States. Exports to its northern neighbour fell off considerably, and workers' remittances from the United States likewise continued their decline. Owing to currency depreciation, inflation in Brazil and Mexico rose in the fourth quarter to slightly over 6%.

Negative cyclical effects in CIS countries amplified by structural weaknesses

In the fourth quarter, the Commonwealth of Independent States (CIS) was hit hard for very similar reasons. In Russia, where the rouble depreciated sharply despite extensive intervention by the central bank, it was, above all, the deterioration of financing conditions which put a considerable damper on domestic activity, with numerous commercial investment projects being either postponed or cancelled altogether. Households have cut back substantially on their purchases of, above all, durable goods, especially automobiles. In addition, it must also be noted that inflation in January, at 13.5%, was still very high. Export revenues, moreover, fell significantly. The economic situation in Ukraine deteriorated even further in the fourth quarter. In November, the government needed to borrow from

2 In mid-January, China's National Bureau of Statistics revised nominal GDP growth upwards by 3% for 2007, leading to a correction in the real growth rate by one percentage point to 13%. China's total output, based on market exchange rates, thus surpassed Germany's for the first time, moving the People's Republic of China up to the rank of the world's third largest economy following the United States and Japan. On the basis of purchasing power parity, the Chinese economy has already been in second place behind the United States for quite some time.

the IMF in order to stabilise its currency and banking system. The Ukraine economy was hit particularly hard by the global collapse in the demand for steel since exports of metals and metal products had been by far its main generator of foreign currency revenue in the past few years.

United States

As announced in December 2008 by the Business Cycle Dating Committee of the US National Bureau of Economic Research (NBER), the US economy has been in recession since the end of 2007. This choice of date is based mainly on employment trends, which have clearly pointed downwards throughout 2008. Job cuts have accelerated considerably in the past few months. In the September 2008 to January 2009 period, non-farm payroll employment fell by over 2 million persons after seasonal adjustment. Since the end of 2007, as many as 3½ million jobs have been lost. Three-quarters of a million jobs were axed in construction, and manufacturing saw the elimination of a million jobs. In January, the unemployment rate stood at 7.6%, or 3.2 percentage points above its cyclical low in March 2007. Along with negative wealth effects, considerable losses in confidence, and a growing credit crunch, the gloomier outlook on the job market placed severe constraints on private consumption in the fourth quarter. These effects far outweighed the positive purchasing power effects of the rapid reduction in consumer price pressures, with US inflation, owing mainly to lower energy prices, falling from 4.9% in September to 0.1% in December. Consumer price inflation excluding energy and food likewise decreased over the same period, by 0.7 percentage point to 1.8%. Growth of the core personal consumption deflator slowed down by 0.6 percentage point to 1.7%.

US households' real consumption expenditure fell by 1% in the fourth quarter, a similar reduction to that in the third quarter. Reasons included both the decline in nominal disposable income and the perceptible rise in household saving, which, at 2.9% of disposable income, reached its highest level since the beginning of 2002. With a decline of 5½%, gross fixed capital formation fell even more sharply than private consumption. Housing investment was reduced by 6½%, and corporate investment by 5¼%. The contraction was slowed down by higher government spending and inventory investment. Where inventory growth was the result of an unexpectedly sharp deterioration in sales growth, however, it is to be expected that production will be adjusted accordingly in the following quarters. Looking just at the figures, foreign trade had no impact on overall growth in the fourth quarter. The period-on-period decline in exports, at 5½%, was somewhat larger than that in imports (-4¼%), yet the volume of exports was considerably lower than that of imports. All in all, real fourth-quarter GDP in the United States was down by 1% on the quarter after seasonal adjustment and by ¼% on the year. For 2008 as a whole, GDP still managed growth of 1¼%.

New US economic stimulus plan

A new economic stimulus plan recently came into force in the United States. The adopted measures, most of which are to be implemented this year and the next, will amount to a total volume of around US$790 billion or 5½% of 2008 GDP. Some two-thirds of the plan consists of additional spending, especially on infrastructure and financial assistance for the states, which are being forced by the recession to make significantly greater social benefit payments for the unemployed and the needy. The remaining one-third has been earmarked for tax relief for households and firms. Monetary policy is likewise sharply expansionary; in mid-December the Federal Reserve cut the federal funds rate to between 0% and 0.25%. In addition, the Federal Reserve provided support to the mortgage markets through direct purchases.

Japan

Real GDP in Japan fell by a seasonally adjusted 3¼% in the fourth quarter of 2008, a decline that was considerably sharper still than that of the other major industrial nations. Annual average overall output fell by ¾%. The economic slump in the last quarter of 2008 is attributable mainly to the drastic 14% fall in real exports (after seasonal adjustment) on the quarter. Since imports still rose perceptibly, real foreign trade alone dragged GDP growth downwards by three percentage points. This was joined by a negative ¼ percentage point contribution by domestic demand. Once again, falls in commercial investment (-5¼%) and private consumption (-½%) were the main causes. A certain contribution to righting the balance was made by housing construction (+5¾%) and government demand (+1%). Inventory investment, in and of itself, was able to slow down the fall in real GDP by just under ½ percentage point in the fourth quarter. However, this may have been due in part to extensive and involuntary inventory growth, which may well force firms to make further adjustments to production in the current quarter. The contraction in overall output has thus far led to, above all, a decline in overtime hours worked. In addition, the unemployment rate rose from 4.0% in September to 4.4% in December. Consumer prices fell by 0.6% in the fourth quarter after seasonal adjustment. In December, the year-on-year figure was only +0.4%. Excluding energy and food, prices remained unchanged from their end-2007 levels.

United Kingdom

In the final quarter of 2008, the UK economy contracted once again, by 1½% on the quarter. Overall output contracted by 1¾% on the year. The result for 2008 as a whole, however, at +¾%, remained positive. The sharp contraction in the fourth quarter was due mainly to a large decline in real value added in manufacturing (excluding construction), which reached a seasonally adjusted 4%. This decline would have been even greater had the pound not depreciated considerably, a development which slowed goods imports and counteracted the negative export trends. Activity in both the construction sector and the services sector fell by 1%. As a result of the severe economic downswing, the (standardised) number of unemployed persons went up by 400,000 since the cyclical trough in the fourth quarter of 2007 to 1.9 million in November; the unemployment rate stood at 6.2% as this report went to press. Owing to the pound sterling's depreciation, among other reasons, consumer price inflation did not diminish as strongly as in other industrial countries. It fell to 3.1% year-on-year in December. By contrast, house prices fell more sharply in the fourth quarter; their average for the quarter was 16¾% lower than a year earlier.

New EU member states

Economic activity also slowed significantly in the new EU member states in the fourth quarter of 2008. This particularly affected industrial activity, which was down by 7½% on the quarter and on the year after seasonal adjustment. The Baltic countries were hit the hardest. However, considerable declines were also felt by most of the other countries in this group, including Slovakia, where the automobile industry has a large share in overall output. Given this situation, it comes as no surprise that unemployment in the new EU member states has risen somewhat since October, hitting 6.6% at the close of 2008. As in western Europe, price pressures receded distinctly in the autumn months; inflation fell from 6.3% in September to 4.5% in December. In this region, the brunt of the financial market problems is being borne by those countries which, in the past few years, had seen overheated property markets, posted high current account deficits and considerable external debt, some of which is denominated in foreign currency, and also possess only a low amount of foreign reserves. All in all, the vulnerability of central and east European countries relative to other emerging market regions may be regarded as rather high.

Macroeconomic trends in the euro area

Overall euro-area output was down in the fourth quarter by 1½% on the period after seasonal adjustment, its third successive period of negative growth and its sharpest contraction since the beginning of monetary union in January 1999. Output was 1¼% lower than in the fourth quarter of 2007. However, thanks to the good start to 2008, the euro-area economy still managed to expand by ¾% for the whole year. The contraction of real GDP is attributable to adverse developments in nearly all euro-area countries, including its four largest members, for which information is available up to the final quarter of the year. Germany's economy contracted the most, followed by Portugal and Italy. Only Cyprus and Greece saw their economies grow. The European Commission's latest forecast predicts that the economic slide will last until mid-2009, followed by a stabilisation of business activity and a gradual recovery during the course of 2010. The Commission expects output to fall by 2% in 2009 and to rise by ½% in 2010. In its view, absent the national economic stimulus programmes that have been announced to date, real euro-area GDP would actually be down even further, by ¾% this year and by between ⅓% to ½% next year.

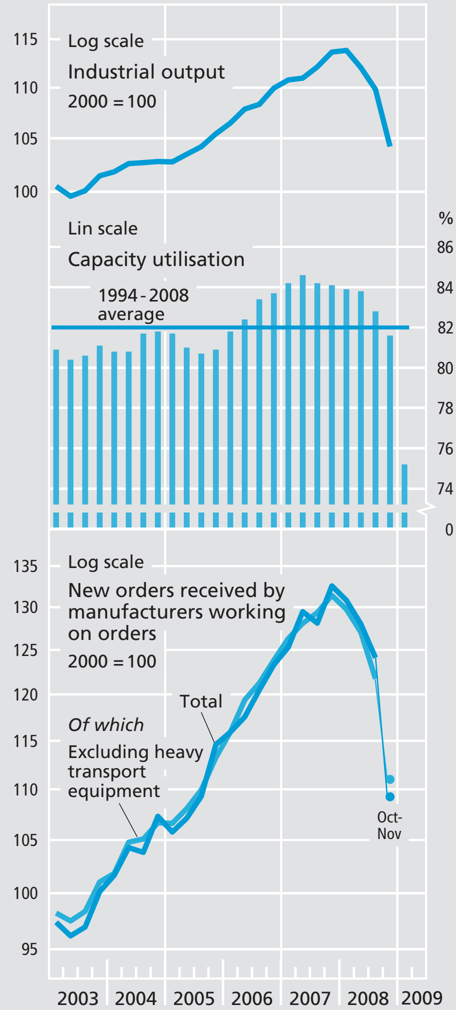
GDP down sharply in 2008 Q4

Industrial activity at forefront of economic slowdown

In a sectoral view, the sharp cutback in industrial output – by a seasonally adjusted 5% on the quarter and 8½% on the year – was the main reason for the fourth-quarter contraction of real GDP. The largest individual year-on-year declines were sustained by the manufacturers of intermediate goods (-13%), consumer durables (-11¼%) and capital goods (-8½%). The production of non-durable goods and energy each fell by 3¼%. The sharp contraction of manufacturing output involved a renewed drastic decrease in capacity utilisation, which in January 2009 was at its lowest level since the early 1980s. The business cycle is unlikely to have bottomed out just yet because, among other things, new orders continued their precipitous drop in October-November, by a seasonally adjusted 12% on the quarter and by 21% on the year. In addition, the industrial confidence indicator fell by no less than 21 points in the September to January period, reaching a new all-time low. One positive signal – the significance of which, however, should not be overstated – is that the Purchasing Managers Index for the manufacturing sector, which had previously come under intense pressure, stabilised in January. Nevertheless, the indicator remains well within contractionary territory.

Selected indicators of industrial activity in the euro area

Seasonally adjusted, quarterly



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Exports and investment affected more severely than private consumption

On the demand side, exports have been the main barometer of the economic downturn in the fourth quarter of 2008. In October-November – the most recent period for which data are available – euro-area exports to non-euro-area countries were down by a seasonally adjusted 6¾% from their third-quarter average and by 3¾% on the year. Imports were down to a similar extent from their third-quarter levels but were still up 1½% on their level of 12 months previously. Moreover, purchases of new machinery and equipment are also likely to have fallen off considerably; this is what the aforementioned comprehensive curtailment of production in this segment would seem to suggest. Measured in terms of production data, which in October-November were 1½% lower than in the third quarter, the decline in construction investment remained relatively muted. Consumer demand for retail goods likewise contracted in the fourth quarter, with real sales (excluding automobiles) posting a 1% quarter-on-quarter decline after seasonal adjustment. Furthermore, households also purchased far fewer automobiles. The number of new registrations in the euro area (which, however, also includes other groups of owners), fell by a seasonally adjusted 8½% – a decline that was considerably steeper than in the preced-

Euro-area consumer prices

Year-on-year percentage change

Item	2008 Q1	Q2	Q3	Q4
HICP, total	3.4	3.6	3.8	2.3
of which				
Energy	10.8	13.6	15.1	2.1
Unprocessed food	3.5	3.7	3.9	3.0
HICP excluding energy and unprocessed food	2.5	2.5	2.5	2.2
of which				
Processed food	6.4	6.9	6.7	4.3
Industrial goods	0.8	0.8	0.7	0.9
Services	2.6	2.4	2.6	2.6

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ing quarters – and was down by one-fifth on the year. Consumer confidence diminished again slightly at the beginning of the year.

Further deterioration in labour market situation

The labour market situation grew perceptibly gloomier in the second half of 2008. Employment in the euro area fell in the third quarter for the first time since the beginning of monetary union. Even though the number of employed persons was still up by 0.8% on the year, this margin is likely to have diminished significantly in the fourth quarter, which is evidenced by the accelerated increase of nearly 600,000 in the number of unemployed persons from the third quarter to the fourth. The standardised unemployment rate went up by 0.4 percentage point to 7.9% in the final quarter of 2008. Despite the marked deterioration in the labour market situation, year-on-year labour cost growth accelerated from 2.7% to 4.0% in the third quarter of 2008. However, the unadjusted year-on-year rates overstate the pace of acceleration owing to a calendar effect. The seasonally adjusted series produce a year-on-year climb of 3.6% for the third quarter of 2008 following 3.2% in the second. At 5.8%, the rise in labour costs was particularly pronounced in Spain, although unemployment there has already been trending upwards distinctly since mid-2007.

Declining inflation rates

Euro-area consumer prices fell by nearly 1% after seasonal adjustment over the course of the fourth quarter of 2008. Year-on-year inflation as measured by the Harmonised Index of Consumer Prices (HICP) therefore fell from 3.6% in September to 1.6% in December. Base effects also contributed to this marked decline. The annual inflation rate averaged 2.3% in the fourth quarter, following an average of 3.8% in the third. The energy component contributed the most to muting the inflationary trends. The sharp corrections in crude oil prices caused the year-on-year inflation rate for this group of goods to fall from 15.1% in the third quarter to 2.1% in the fourth. Food prices likewise rose at a much slower pace, at 3.8% following 5.6% in the third quarter. By contrast, price inflation for non-energy industrial goods rose slightly to 0.9%. Services price inflation held steady at 2.6%. The year-on-year rate of HICP fell further in January 2009 to 1.1%.