

GLOBAL ECONOMY IN 2009

The year 2009 was still a difficult year for the global economy, mainly because advanced economies faced an extensive economic downturn. According to the IMF, global growth fell from 3% to -0.8% in 2009. However, the bottom of the recession in advanced economies came in the first and the second quarters, and in the second and the third quarters, there was a shift towards recovery as a result of the wide-ranging monetary and fiscal policy measures taken by the central banks and governments of these countries. Monetary policy interest rates were reduced to historical lows of 0.0–0.25% in the USA and to 1% in the euro area, and state budget deficits increased to almost 10% of GDP in some advanced countries. Together with shrunken inventories, these measures laid the foundation for the recovery of growth and the abatement of the credit and liquidity crisis that had hit the financial sector. At the end of 2009, economic growth accelerated, but the crisis was so extensive and deep that a rapid return to sustainable growth in advanced countries is still not expected. The global economic outlook is better, and GDP growth in 2010 is estimated at 3.9%.

Regionally, economic growth was very uneven in 2009 and the differences between advanced countries also deepened over the year. While the decline in GDP in advanced economies totalled to 3.2%, growth in emerging economies remained positive, although it slowed to 2.1%. The fastest economic growth was seen in developing Asian countries, where it was 6.5%, while China's economic growth was 8.7%, only one percentage point lower than in 2008. Central and Eastern Europe, in contrast, witnessed a deep recession, with the GDP of the region declining by 4.3% compared to the previous year. Among advanced economies, the GDP of the USA fell by around 2.5%. The economic downturn in the euro area was even deeper at 3.9%, and in Japan, GDP contracted by as much as 5.3%. Lower economic activity led to a rapid rise in unemployment, which reached 10% in the USA

and the euro area and 5.7% in Japan.

As total demand weakened, the inflation rate dropped remarkably in 2009, and was negative in all the G3 countries in the middle of the year. In advanced economies, total inflation dropped from 3.4% to 0.1%, which was caused, inter alia, by the base effect as a result of a decline in the prices of energy commodities. However, the return of commodity prices to growth at the beginning of 2009 and economic revival in the second half of the year laid the ground for the recovery of inflation. Inflationary pressures nevertheless remained weak in advanced economies due to high unemployment and underutilised production capacity. Japan still faced deflation with a 0.8% annual price decline.

In 2009, global financial markets showed signs of stabilisation, lower volatility and an improved economic outlook. The main stock indices of the G3 countries increased by 20–25% over the year, offsetting nearly half of the decline of 2008. As already noted, commodity prices also started to go up; the CRB index, which covers the prices of 22 major raw materials, increased by 34% over the year. The price of crude oil rose by 78% and there was still strong demand for gold, the price of which rose by 24% to over 1,000 dollars per ounce. The lowering of monetary policy interest rates and state support for the financial sector contributed to the fall in interest rates in the interbank money market. On the government bond market, short-term interest rates remained relatively low and stable due to weak economic growth while long-term interest rates rose somewhat.

UNITED STATES AND JAPAN

In 2009, the US faced an economic downturn, as GDP was 2.5% down compared to the previous year. The scale of the downturn is reflected by annual growth in industrial production, which had fallen to -13.3% by June. The bottom of the

recession was reached in the second quarter, and in the second half of the year a significant revival in economic activity could be observed. In the fourth quarter, annual GDP growth was already positive at 0.1%.

Falling production forced companies to cut costs and dismiss employees more vigorously. Unemployment, which had started rising in 2008, continued to grow at a fast pace almost throughout most of the year, increasing from 7.4% to 10% in 12 months. Unemployment peaked in October at 10.1%, then in the final months of the year the labour market stabilised.

Rising unemployment and the uncertain economic outlook had a negative impact on private consumption. Private consumption bottomed out in April when annual growth in the retail trade had fallen to -10%. In the second half of the year, the retail trade started to pick up again and in December annual growth stood at 5.4%. The housing market, which had played a major role in triggering the economic crisis, stabilised slightly and sales of non-new houses started to rise in the second half of the year. However, the depth of the depression in the housing market is still reflected in the fact that the sales of new homes continued to fall and at the end of the year, stood at their lowest level in 30 years. Consumer confidence started to increase a little in the first quarter but was still low.

The external balance of the US economy improved in 2009 as the current account deficit fell to 2.6% of GDP, a fall which was mainly caused by a considerable slowdown in domestic demand. Economic revival was accompanied by a turnaround in foreign trade, and in the second half of the year, goods turnover started to grow again.

The economic decline led to a fall in inflation, and in annual terms, the economy even recorded

deflation of 0.4%. Annual consumer price growth was negative from March to October and inflation recovered only in November. Excluding energy and food prices, inflation fluctuated between 1.4% and 1.9%.

In order to boost the economy and alleviate the financial crisis, the US Federal Reserve kept the key interest rate at its historical low (0.0–0.25%) throughout 2009 and adopted a policy of quantitative easing. Along with administrative measures, the government also supported the economy with an expansionary fiscal policy, which is why the state budget deficit increased from 5.8% to 12.5%.

In Japan, economic decline was deeper than in any other G3 country, as the economy shrank by 5.3%. The main reason was the heavy dependence of the Japanese economy on external demand, which fell sharply in the global crisis. Annual growth in industrial production dropped dramatically, to -36% in March, due to the decline in exports and weak domestic demand. In addition to sluggish external demand, the fall in exports was exacerbated by the strengthening of the yen. Japan's domestic demand has been relatively weak for years, and annual growth in the retail trade was negative throughout 2009. Unemployment rose from 4.3% to 5.1% in 12 months.

Due to robust growth in China and other Asian countries, the Japanese economy also started to grow in the second quarter, and was the first among the G3 countries. Despite the recovery of economic activity, inflation was still negative at the end of the year, with annual consumer price growth registering -1.7% in December. In order to reduce deflationary pressures and boost the economy, the central bank kept its key interest rate close to zero throughout 2009, and the state budget deficit increased to 10.5% as a result of the expansionary fiscal policy.

EURO AREA

In 2009, the euro area countries also experienced an extensive economic downturn. Compared to 2008, GDP in the euro area fell by around 3.9%. As in the USA and Japan, the activity of the industrial sector and the services sector of the euro area decreased significantly. In April, the growth rate of industrial production fell to its lowest level of -20.2%. The recession was deepest in the first half of the year, then in the second half growth gained momentum again and there was a moderate improvement. This was reflected mainly in the recovery of production growth, while private consumption and domestic demand remained quite weak. Unemployment rose from 8.2% to 10% in 12 months.

The euro area inflation dynamics were similar to those of the United States and Japan. Economic downturn and the decline in commodity prices led to a decrease in consumer prices in the middle of the year, but in the final months, price growth recovered slightly. Consumer prices in the euro area increased by 0.3% on average, compared to 2008.

The euro area monetary policy in 2009 was decisively aimed at alleviating the financial crisis and boosting economic growth. The key interest rate was lowered from 2.5% to 1.0% and was kept at that level throughout the year.

The economic discrepancies between the euro area countries became more pronounced as growth slowed further. Consequently, the spreads between the interest rates on long-term government bonds posted their strongest growth since the adoption of the euro. Given the deep economic downturn, the euro area countries were unable to keep their budget deficits within the limit of 3% set in the Stability and

Growth Pact. The total budget deficit of the euro area rose to 6.2%, while in some countries, notably Greece, Spain and Ireland, it exceeded 10%. This led to a significant increase in the interest rate spread of the bonds of these countries over the interest rates for German bonds. Although the situation improved somewhat in the first half of the year, at the end of the year, the problem became more acute and the need for a common strict fiscal policy was felt again.

The outlook for the euro area for 2010 has improved, owing to the economic revival. The International Monetary Fund expects growth of 1% in 2010 and the European Central Bank may start normalising its extremely loose monetary policy in the middle of the year.¹

¹ IMF "World Economic Outlook Update", January 2010.