



International economy in the first quarter of 2009

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The economic development in the first quarter of 2009 was influenced by the turmoil repercussion and uncertainty stemming from the financial crisis at the beginning of the fourth quarter of 2008. After a marked contraction of the economy in the last quarter of 2008, this development continued also in the first quarter of 2009. Inflation pressures decreased as a result of the development of commodity prices, conditions on the labor market and the economic development itself.¹

¹ The article is based on data with cut-off date as of June 15, 2009.

GLOBAL ECONOMY

The GDP development in OECD countries recorded a further decrease in the first quarter of 2009 – the largest decrease since 1960 –, by 2.1% as compared to the previous quarter. The GDP fell by 2.0% in the fourth quarter of 2008. The economy fell by 4.2% year-on-year as compared to a decrease by 1.7% in the fourth quarter of 2008. Confidence indicators decreased again in the first quarter of 2009, but the dynamics of the decrease slowed down and signs of stabilization appear on the horizon. These indicators even grew slightly in April and May. Nevertheless, confidence indicators continue to be below the 100 point limit, which is a sign of continuing negative expectations of the economic development.

The price development in the first quarter of 2009 was – just like in the previous 6 months of 2008 – considerably influenced by the development of commodity prices and reduced economic activity. In March, the rate of inflation slowed down again in OECD countries and reached 0.9% compared to 1.5% in December 2008. Energy prices decreased by 11.8% year-on-year in March (against 8.9% decrease in December 2008) and food prices increased by 4.5% year-on-year (against 6.0% year-on-year growth in December). Core inflation also decelerated slightly to 1.8%, compared to 2.0% in December.

The global economic development continues to be quite uncertain. The risk of a further worsening of the financial crisis continues; further worsening would mean a considerable slowdown for the world economy and an increase in risks to its further development. On the other hand, some signs emerge, which suggest the reaching of the bottom and a stabilization of the current economic situation. The decrease in commodity prices and anti-crisis measures carried out in some countries should also have a positive impact on the economic development.

COMMODITIES

Following a considerable decrease in oil prices in the last quarter of 2008, the oil prices stabilized in

the first quarter of 2009 or started to grow slightly. Nevertheless, the average oil price fell to 45 USD/barrel in the first quarter compared to 55 USD/barrel in the fourth quarter 2008. At the beginning of June, the oil price reached 67.67 USD/barrel, which represented an increase by 57% since the beginning of 2009.

Following considerable oil price volatility in 2008, the prices stabilized and the volatility decreased on the markets in 2009. The oil prices depend on the expected economic development and due to its slowdown a lower demand for oil is expected for 2009 compared to 2008. Despite some stabilization of the oil market prices and some positive prospects for a recovery of the economic activity at the end of May, the market continues to show negative sentiment as regards the development of oil demand in 2009.

Just like the oil prices, the prices of other world commodities recorded stabilization in the first quarter of 2008 after a marked fall in the second half of 2008. At the end of the first quarter, there has been a moderate growth of the prices of metal commodities as a result of increased demand from China. The prices of metal and non-metal commodities considerably depend on the global economy development and on the stance of the global economic activity. The prices of agricultural commodities also showed stabilization in the first quarter, but their further development depends not only on demand, but also on the development of weather related factors.

UNITED STATES

The US economy recorded a considerable decrease in economic activity in the first quarter of 2009. The GDP contracted by 5.7% in annualized terms in the first quarter compared to 6.3% in the previous quarter. The economy recorded a year-on-year contraction by 2.5% in the first quarter 2009, while there had been a negative growth of 0.8% in the previous quarter.

Decreased investment spending and inventories affected the GDP development very negatively. A decrease in investment spending was



recorded mainly in the business sectors. Exports fell again as a result of the global economy development. However, due to the decline in commodity prices and the recession in the USA, imports fell more than exports and net exports have a growth effect on the economy. Despite deteriorating labor market conditions and negative wealth effects stemming from house and equity price, household consumption has a positive contribution to GDP growth. Consumption of durable goods recorded stronger increase. Federal and local government expenditure also recorded a decline.

The price development slowed down gradually in the first quarter of 2009, as consumer prices decreased by 0.4% year-on-year in March. The decrease continued in April, when it reached a year-on-year level of 0.7%. The slowdown of inflation was influenced by the contraction of global economy and the base effect resulting from a decrease in commodity prices. The development of core inflation was relatively stable in the first quarter of 2009. Core inflation reached a year-on-year level of 1.8% in March, remaining unchanged compared to December, and it grew moderately to 1.9% in April.

At its meetings in the first quarter, the Federal Open Market Committee (FOMC) kept the target federal funds rate unchanged, so that the rate continues to be close to zero. The Federal Committee continues to signal preparedness to use unconventional instruments to ensure proper functioning of the financial market and to support the economy. It decided to carry out a purchase of government securities and securitized mortgages. At its meeting of April 2009, the FOMC also kept the target rate unchanged.

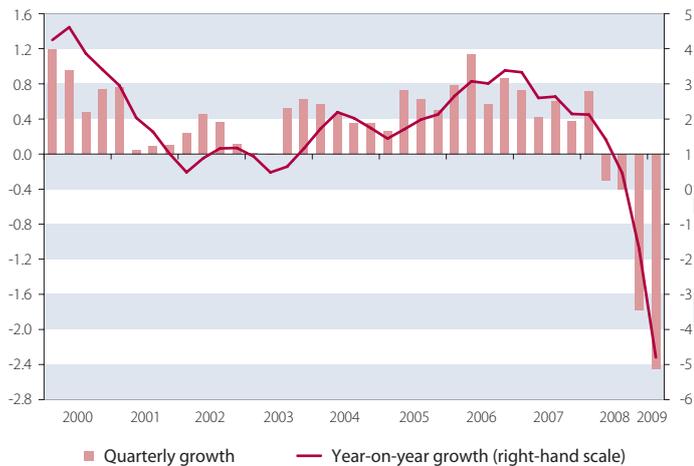
EURO AREA

The contraction of the euro area economy deepened again in the first quarter of 2009. The gross domestic product decreased by 2.5% compared to the last quarter of 2008 (while it fell by 1.8% in the fourth quarter of 2008). The economic decline also intensified on a year-on-year basis and reached 4.8% (as compared to 1.7% in the fourth quarter of 2008).

The most significant factors contributing to the economic contraction was a decrease in inventories and a continuing slump in investment demand, which has been decreasing for 4 consecutive quarters. Net exports continued to have a dampening effect on the economy, as a considerable decrease in exports (8%) continued to exceed a decrease in imports (7.1%). For the second consecutive quarter the decline of private consumption also contributed to slowdown of the economy, while general government consumption was the only GDP component to have a slight pro-growth effect.

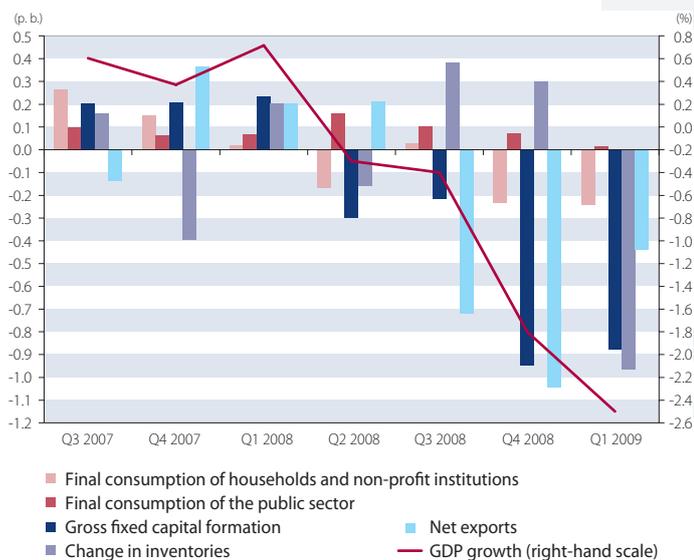
In terms of the individual economy sectors, the worst situation continued to prevail in the industry, where value added fell by 8.8% (compared to 5.7% in the fourth quarter of 2008). A decrease in

Chart 1 Economic growth in the euro area (current prices in 2000)



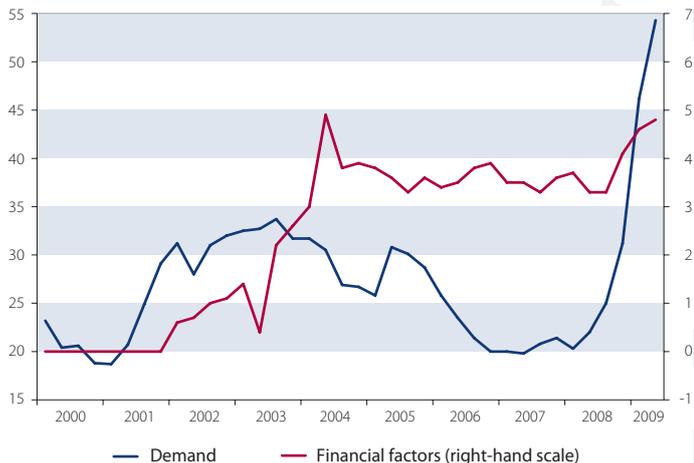
Source: Eurostat.

Chart 2 Contributions to quarterly GDP growth



Source: Eurostat, NBS calculations.

Chart 3 Factors limiting production (balance of responses)



Source: European Commission.

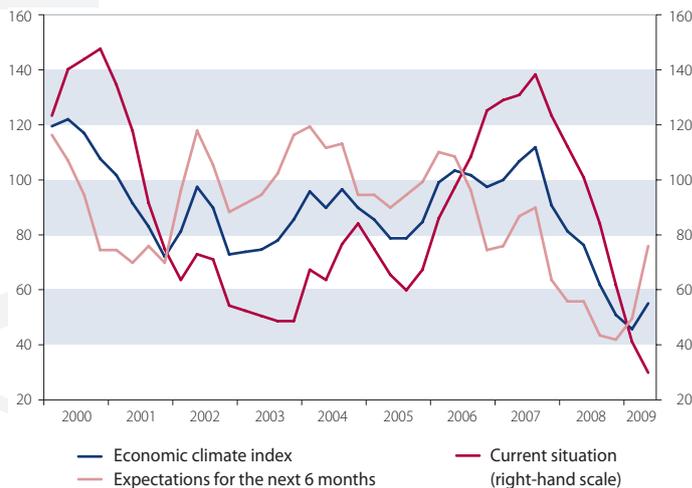


Chart 4 Economic sentiment and confidence indicator in industry and services in the euro area



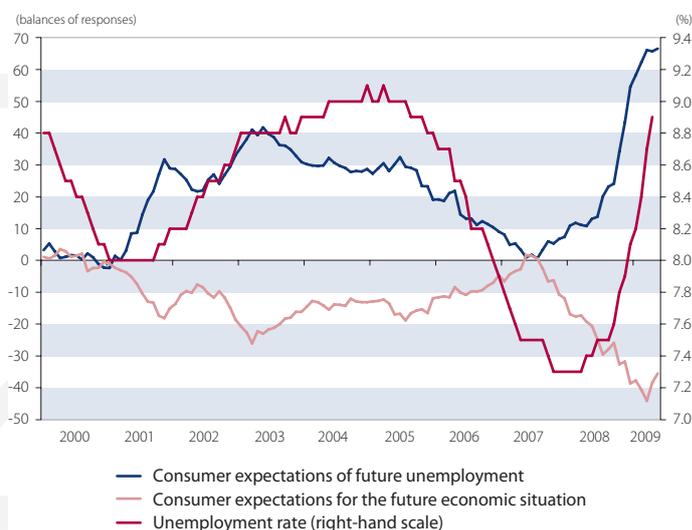
Source: European Commission.

Chart 5 IFO Economic Climate Index (2000=100)



Source: Ifo Institute for Economic Research.

Chart 6 Unemployment rate and consumer expectations for the next 12 months



Source: Eurostat, European Commission.

value added was mainly recorded in the manufacturing (by 10.1%), compared to a 6.2% decrease in the last quarter of the last year. Based on surveys in the industry, businesses indicate a gradual decrease in the utilization of production capacities and a loss of competitiveness both on the domestic market and on EU and non-EU markets. Businesses consider demand and financial factors the most limiting factors for production.

Several short-term indicators and surveys have indicated recently that the decrease in economic growth should moderate. The economy should continue to contract in the next future, but probably at a more moderate pace.

Following several quarters of decrease, the IFO Economic Climate Index for the euro area also showed an improvement in the second quarter of 2009. Evaluations of expectations for the following 6 months have indicated a more positive development for the second consecutive quarter, while the evaluation of the current economic situation has continued to deteriorate. However, the values of the total index, as well the values of its two components, remain at their historically low levels.

The contraction in economic activity continued to be accompanied by a relatively high growth of unemployment. The rate of unemployment in March 2009 was 8.7%, i.e. 0.6 percentage points more than in December 2008. In April it continued to increase again to 8.9%. Similarly to other economy segments, expectations of consumers regarding future economic development improved in April and May. The growth of their negative expectations of the future development of unemployment slowed down at the same time.

The moderation of negative development tendencies on the labor market is also indicated by the employment expectations surveys in individual industry branches (except for construction). However, these expectations are still on very low levels.

A falling trend of the price growth, which had started in the summer of 2008, continued in the first quarter of 2009. However, compared to the last quarter of 2008, inflation decreased more slowly. At the end of the first quarter, the growth of consumer prices decreased to 0.6% (i.e. by 1 percentage point since the end of the year). The price development continued to be affected mainly by energy and food prices. The year-on-year decrease in energy prices deepened quite considerably (from -3.7% in December to -8.1% in March) as a result of the base effect. The year-on-year growth of the prices of food, especially processed food, also decreased. Market components of inflation, particularly as a result of the March deceleration of the growth of the prices of services, also contributed in part to the slowdown in year-on-year inflation dynamics. Inflation stagnated at its March level in April, when its development faced the opposing influence of a deepening decrease in energy prices on the one hand, and a re-acceleration of the growth of



prices of services on the other. According to flash estimate of the Eurostat, the growth of consumer prices decreased again, as the prices stagnated on a year-on-year basis.

Slowing dynamics of the growth of processed food, as well as a lower growth of the prices of services, translated into a decrease of core inflation, which reached 1.5% at the end of the first quarter as compared to 2.1% at the end of 2008. After the growth of the prices of services has increased again in April, core inflation also increased slightly and reached 1.7%.

The development of the market components of inflation (industrial goods excluding energy and services) was relatively volatile in the first quarter and at the beginning of the second quarter. The slowdown of the growth in the prices of industrial goods in January was also reflected in their lower contribution to the year-on-year rate of headline inflation. The rise in prices in that segment accelerated gradually in the following months and at the end of the quarter, as well as in April, it reached the same level as in December. Overall, the impact of industrial goods prices excluding energy on the change in inflation was basically neutral. The rise in prices of services also slowed down in January, but especially in March, which was mainly due to a shift in seasonal factors. This was related to the different timing of Eastern in 2009 and 2008. The growth in the prices of services accelerated again in April almost to the level at the end of December. Prices of services thus contributed to a decrease of headline inflation in the first quarter; however, this impact disappeared as early as in April.

As a result of the financial crisis, the development of the EUR/USD exchange rate is characterized by a quite high volatility. In the course of the first quarter up to the beginning of March, the euro depreciated against the US dollar. This was the result of deterioration of economic growth expectations in the euro area, but also of a decrease in key ECB interest rates and expectations of their further cuts. However, from the second March decade onwards, the euro started to appreciate in connection with the announcement of additional non-standard monetary policy measures of the Fed. By the end of the quarter, the euro exchange rate has reached 1.3308 EUR/USD and has depreciated by about 4% since the beginning of the year. Exchange rate volatility continued in April, when the euro depreciated again almost all over the month. At the end of April, however, the euro appreciation trend was restored and it continued to the end of May, when the exchange rate was at 1.4098 EUR/USD. Thus, the euro has appreciated slightly against the US dollar since the beginning of the year (by about 1.3%).

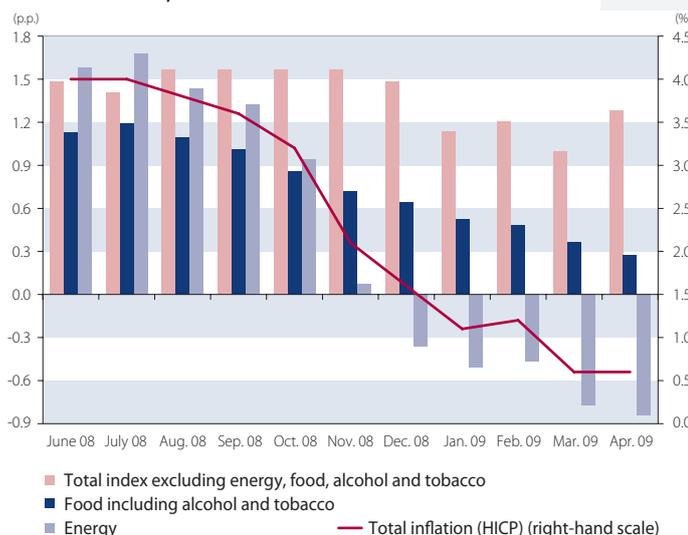
The ECB responded to the deepening of the financial crisis after Lehman-Brothers bankruptcy by gradually reducing the key interest rates. In the course of last quarter of 2008 the ECB lowered its rate for main refinancing operations by 2 percentage points to 2.5%. A continuing deterioration of

Chart 7 Expectations of the development of employment (balances of responses)



Source: Eurostat, European Commission.

Chart 8 Year-on-year headline inflation (HICP) and contributions of selected components in the euro area



Source: Eurostat, NBS calculations.

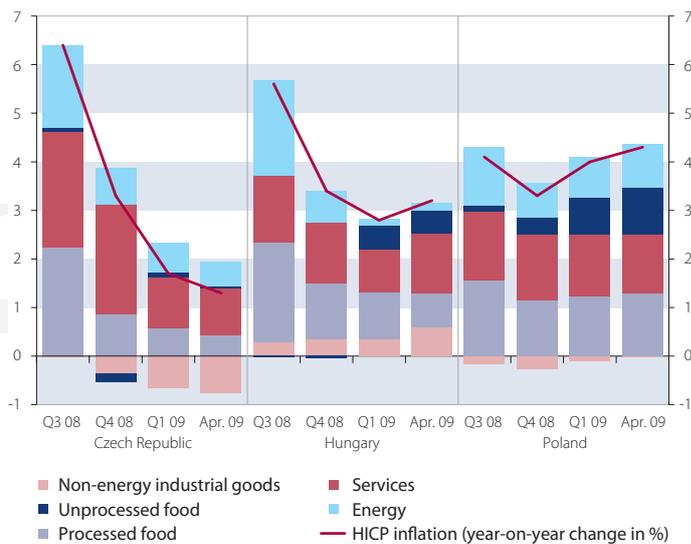
the economic growth prospects was the reason for a further decrease of the key ECB rates by 0.5 p.p. effective from 21 January. In accordance with a decision of the Governing Council of October 2008, the corridor of automatic operations, which was narrowed to 100 basis points with effect from 9 October 2008, was extended again to 200 basis points. A considerable decrease in economic growth forecasts for the years 2009 and 2010, together decreasing inflation impulses, were the reason for the decision to lower the key rates again in March (with effect from 11 March) by 0.5 p.p.

In the light of continuing signs of a contraction of economic activity with a dampening impact on inflation, the Governing Council cut the interest rate further in April by 0.25 p.p. Effective from 8 April, the rate for main refinancing operations was set at 1.25% and the rates for the marginal

2 For more information see www.ecb.int.

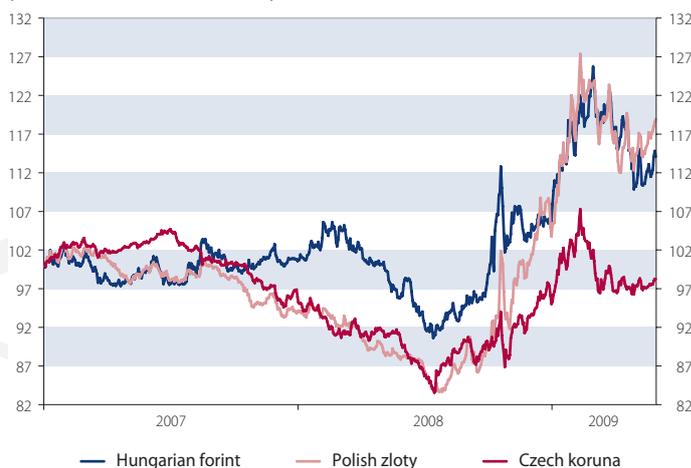


Chart 9 Contributions to HICP inflation (p.p.)



Source: Eurostat, NBS calculations.

Chart 10 Exchange rate indices of V4 currencies against the euro (29 December 2006 = 100)



Source: Eurostat, NBS calculations.

Note: A fall in value denotes an appreciation.

lending facility and deposit facility at 2.25% and 0.25%, respectively. A higher decrease of the euro area economy than expected was the reason for another cut in key rates at the beginning of May. With effect from 13 May 2009, the Governing Council decided to lower the rates for the main refinancing operations by 0.25 p.p. to 1.0% and the rates for the marginal lending facility by 0.5 p.p. to 1.75%. The interest rate for deposit facilities was not changed and was kept at the level of 0.25%. At its June meeting, the Governing Council kept its key interest rates unchanged. Overall, the level of the interest rate for main refinancing operations has been cut by 325 basis points since October.

In addition to key interest rates cuts, the ECB also carried out further measures to support the financial markets and ensure sufficient euro liquidity, but also liquidity in USD and CHF. At its

May meeting, the Governing Council decided to carry out three long-term refinancing operations with one-year maturity, as well as to purchase euro-denominated covered bonds.²

THE DEVELOPMENT IN POLAND, THE CZECH REPUBLIC AND HUNGARY

Reflecting the current economic and financial crisis the Central European economies continued to slow down in the first quarter of 2009. The deceleration of economic growth was mainly due to a decline in foreign trade and a considerable decrease in inventories. The Polish economy, as the only one in the region, reached a positive economic growth of 1.9%. However, the growth decreased by 0.8 p.p. compared to the previous quarter. The decrease in the Czech and Hungarian economy deepened in the first quarter, both by 3.3 p.p. Thus, the year-on-year decrease in their GDP was 3.4% and 5.4%, respectively.

The slowdown of the Polish economy in the first quarter was mainly due to a considerable decrease in inventories, but also a lower growth of investment demand and general government consumption. The growth of household final consumption decreased, but consumer demand continued to contribute most to GDP growth. The volume of exports and imports decreased, but the contribution of net exports to GDP was moderately positive. Likewise, a decrease in inventories and deepening of the decrease in investment demand contributed to the contraction of the economy in the Czech Republic. Net exports continued to have a dampening effect on the economy. The growth of household consumption accelerated moderately and general government consumption increased quite markedly. Similarly in Hungary, there was a considerable decrease in inventories and investment. However, as compared to the Polish and Czech economy, private consumption decreased sharply too. Net exports were the only component with a positive contribution to GDP, the decrease in imports having exceeded the decrease in exports.

The development of inflation in the first quarter of 2009 was substantially affected by easing of inflation pressures due to a lower economic activity and lower demand. Regarding energy prices, the dampening base effect of world oil prices was partly offset by depreciation of nominal exchange rates and in part also by administrative adjustments of energy prices. The depreciation of exchange rates also influenced other consumer basket components.

Inflation decreased again in the Czech Republic and Hungary as compared to the previous quarter. In Poland, by contrast, the price growth accelerated, mainly due to an increase in administrative prices of energy and services related to housing. Likewise, the depreciation of the Polish zloty from the previous periods was mainly reflected in fuel prices and in part in non-energy industrial goods prices, where the negative contribution to headline inflation ceased to exist. The faster rise in prices

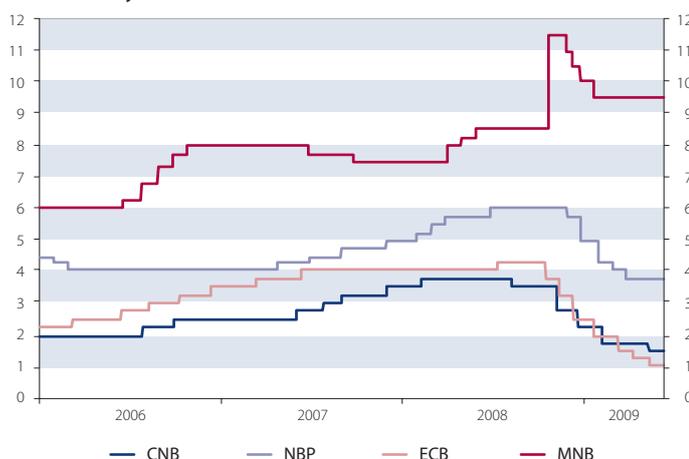


was also caused by an increase in excise taxes on alcohol and tobacco and a faster growth of food prices. Only the prices of services grew slower. In the Czech Republic the effects of reform measures taken in the beginning of 2008 gradually subsided with a moderate dampening effect on price development in the first quarter 2009. Just like in the case of Poland, some regulated prices were adjusted, mainly the prices of regulated rents, electricity and heat. Prices of services, energy and processed food grew more slowly compared to the previous quarter. By contrast, the decrease of the prices of unprocessed food stopped. Despite a longer-term depreciation of the Czech koruna, the negative contribution of non-energy industrial goods energy increased slightly again. Inflation in Hungary decreased by 0.6 p.p. to 2.8% in the first quarter of 2009. The price growth decelerated in the case of energy, processed food and services. The depreciation of the Hungarian forint translated to a growth of unprocessed food prices, which recorded a decrease in the previous two quarters. The growth of non-energy industrial goods also accelerated slightly. The slowdown of the price rising in April continued only in the Czech Republic (by 0.4 p.p. to 1.3%), in Poland and in Hungary inflation increased by 0.3 p.p. and 0.4 p.p. to 4.3% and 3.2% respectively.

All exchange rates of the countries under review continued to depreciate relatively sharply in the first quarter of 2009. The depreciation was primarily due to increased uncertainty of investors, which resulted from the problems encountered by some Eastern European economies and the fact that investors often perceive the whole of Eastern Europe as one investment unit. However, the increased risk aversion was, in part, also supported by domestic indicators, indicating a further economic slowdown. In mid-February, following a joint verbal intervention of central banks regarding the necessity to differentiate between the differing development of the economies of individual countries, the slump in exchange rates came to a halt and they even appreciated temporarily against the euro. However, they continued to show a relatively high volatility – primarily the Polish zloty and the Hungarian forint.

The depreciation of the Czech koruna compared to that of the other currencies was the lowest in 2009. After a global growth of risk aversion, outflow of short-term speculative capital and a subsequent fast depreciation of the exchange rate from the beginning of the year, the koruna exchange rate corrected in part, following verbal interventions, and appreciated until mid-March. In April, the exchange rate stabilized partly. The

Chart 11 Key interest rates of the NCBs of V4 countries (%)



Source: National central banks, ECB.

Polish zloty and the Hungarian forint recorded a similar development. Compared with the Czech koruna, however, those currencies depreciated more in the first months of 2009. The Polish zloty, similarly to the Czech koruna, recorded a partial correction in mid-February, while the Hungarian forint continued to depreciate until early March, thereby partially responding to the decrease of Hungary's ratings. The development of the zloty and forint exchange rate was relatively volatile in April. Compared with the end of 2008, the Polish zloty depreciated by 15.6% in the first quarter, the Hungarian forint by almost 13% and the Czech koruna by approximately 2%.

All neighboring central banks decreased their key interest rates in the first quarter of 2009, by which they continued with the tendency to easing of monetary policy from the last quarter of 2008. The Narodowy Bank Polski changed its reference rate three times, decreasing its rates by 0.75 p.p. in January, and both in February and in March by the same amount of 0.25 p.p. to the level of 3.75%. At its May meeting, the NBP also decided to lower the required reserve rate by 0.5 p.p. to 3% with the aim of providing banks with more incentives to expand credit activities. With effect from 6 February, the Česká národní banka cut its two-week repo rate by 0.5 p.p. to 1.75%. Likewise, the Magyar Nemzeti Bank decreased its basic interest rate by 0.5 p.p. to 9.5%. The main reasons for interest rate cuts in the region included a slowdown of domestic economic activity and foreign demand, expectations of weaker inflation pressures, particularly in Hungary and the Czech Republic, and lower credit activity of the banking sector.