

Global Financial Crisis 2008: Decline In Short-Term But Recovery By 2010

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2008

World economic growth is set to slow to 3.9% in 2008 (from 5.0% in 2007) according to IMF revisions released in October 2008. Forecasts have deteriorated owing to a crisis in global financial and credit markets in September and October 2008, which some analysts consider to be the most serious since the Wall Street crash of 1929. Strong inflationary pressures continue to be led by oil and food prices, which remain comparatively high, and while prospects for the 2009-2012 period are uncertain, most projections conclude that the global economy should start to recover in 2010.

Key points

Global economic growth will slow to 3.9% in 2008 and 3.0% in 2009, according to IMF revisions of October 2008. The forecasts have been downgraded in the wake of the financial and stock market crises of September and October 2008, which saw the failure of several prominent financial institutions, a crash in most world stock markets and the partial nationalisation of several major banks in advanced economies. In 2010, however, world growth is expected to rebound to 4.2% and then stabilise at 4.8% in 2011 and 2012;

Emerging economies can expect to be less affected than advanced economies by the wider economic and financial downturn, although even developing regions have proven to be highly vulnerable to problems elsewhere, despite earlier analysis that they may have decoupled from the US economy. Prominent among these developing economies are China and India, where growth is projected to remain relatively robust "if falling slowly" over the 2008-2012 period;

Growth is set to be sluggish in developed markets over 2008 and 2009, particularly in the UK, the USA and many eurozone countries. Some analysts expect these to enter recession in 2009. Economic growth is likely to pick up in 2010, partly thanks to predicted upturns in the housing and credit markets and an easing in commodity and food prices, after the high levels of 2007 and 2008;

Global inflation will peak in 2008 at 6.2%, driven chiefly by the knock-on effects of high oil prices, which reached a historical high of US\$147 per barrel in July 2008 before falling sharply to under US\$80 per barrel in October 2008. Inflation is expected to fall to 4.6% in 2009 and stabilise at around 3.5% per year in 2011-12. Inflation will, however, remain problematic in the short-term for both developed and developing economies, restraining consumer spending and wider economic growth;

Certain underlying factors will have a more predictable effect on medium-term growth than others. These include the end of cyclical downturns in housing markets such as the UK or Spain, which should start to recover by 2010, and the conclusion of the sub-prime credit crisis in the USA;

Other factors are far more uncertain and make future projections difficult. These include commodity prices, especially those of oil, which is affected not only by supply and demand factors but also by speculation, and of food, where unpredictable climatic factors play a role;

Further risks include geopolitical issues in areas such as the Caucasus or the Middle East and Iran, while the US presidential election in November 2008 may add to turbulence and uncertainty.

Advanced economies face recession but emerging regions vulnerable

While many advanced markets are set to experience stagnant or negative growth in 2008 and 2009, developing economies have not been as immune as previously thought:

Growth in developed economies, including the USA and the eurozone, are forecast to rise substantially in 2010 and 2011 as the housing and credit markets begin to improve. In the USA, the world's largest economy, real GDP growth is projected to be 2.0% in 2010 compared to 0.1% in 2009;

It is also likely that the USA and several eurozone countries such as France and the UK will fall into recession in 2009, as the effects of the stockmarket crash in October 2008 are filtered down to the real economy and cause large-scale job losses;

The major developing economies, including China and India, are also set to experience a noteworthy slowdown in growth

over 2008-2009, perhaps more than had previously been expected. In Developing Asia, growth is projected to rise to 8.4% in 2010 after reaching 7.7% in 2009 and stabilise at around 8.5% per year in 2011-2012;

The outlook for the Middle East is the most stable of all regions, thanks to the knock-on effects of high oil prices, which have created large amounts of liquidity. However, growth is still set to slow from 2009 and other problems, particularly high inflation and an overdependence on uncertain hydrocarbon revenues, will threaten prospects. Some parts of the region, for instance the UAE, have also been hugely reliant on foreign capital and credit, the scarcity of which is now likely to contribute to a slowdown.

Housing and credit prospects

A core problem across all regions has been the drying up of credit markets and a downturn in housing markets. This is likely to recover in the medium-term:

In some cases, for instance the UK and Spain, the downturn in the housing market was partly cyclical – although prompted and greatly exacerbated by the credit and banking crisis in the USA – and followed a sustained period of growth in property prices. The slump is generally projected to bottom out by early 2010 and then enter a new period of growth;

The impact of the sub-prime mortgage crisis, which exposed high-risk credit in the financial sector of the USA and some Western European countries, is also likely to be largely over by late 2009. This should help to revive consumer and corporate credit markets and provide a stimulus for consumer spending. However, it is widely believed that greater regulation of credit markets is required;

Given the importance of the housing and construction sectors in many developed markets, this has had a significant impact on economic growth by causing job losses, business closures and reduced demand for materials. The higher cost and greater difficulty of obtaining credit has dampened consumer spending and added to the wider economic slowdown.

Uncertain inflation

A key factor in determining the economic outlook will be inflation, which is strongly affected by global oil and food prices. These remain uncertain:

Oil prices reached a record high of US\$147 per barrel in July 2008 before dropping to less than US\$80 per barrel in October 2008. The global economic slowdown will reduce demand for oil as output declines. However, it is possible that prices will rise again in the medium-term as demand increases and supply-side problems surface, including a forecast lack of investment in refining capacity;

Food prices remain partially dependent on climatic conditions and harvests, for instance with drought in parts of East Asia and Australia in 2008 cutting rice production and raising prices. Given rising global food demand and the ongoing use of crops for biofuels, future crop failures could place more upward pressure on prices. Many analysts believe the era of cheap food has come to an end;

Globally, the IMF predicts that inflation will peak at 6.2% in 2008 before falling to 4.6% in 2009 and dipping further until 2012. Although most economies will follow this trend, inflation will remain highest in developing countries. For instance by 2010, inflation will still be 11.3% in the Middle East and 10.2% in the Commonwealth of Independent States (CIS) and Mongolia. This is mainly due to excess liquidity generated from the export of commodities, chiefly oil and minerals, which is being reinvested domestically and is rapidly adding to local money supply.

Other risks

Projections for the medium-term economic outlook vary widely and much volatility is expected. A series of risks may conspire to make projections seem overly optimistic:

Currency markets remain uncertain. The US dollar rallied strongly in September 2008, reaching a two-year high against the UK pound, for instance, but future fluctuations are difficult to predict and could have effects on large trading blocs including the USA and the eurozone. A continued rise in the value of the US dollar would make US exports less competitive and is likely to put upward pressure on US interest rates when lower rates would normally be more beneficial to a recovering economy;

It is possible that further exposure to bad credit will be uncovered in either developed or developing economies. This would hinder the recovery of credit markets and restrict lending to consumers and businesses, although the partial nationalisation of banks in October 2008 in the UK and USA, for instance, would help to insulate any impact;

Certain major emerging markets may well grow more slowly than expected, thus limiting demand for industrial imports or consumer products. Others may experience economic or political crises of their own;

Unemployment is likely to rise in many advanced economies as the global downturn reduces demand for manufactured goods, for instance, and many companies are forced to cut back on labour in order to avoid failure;

Geopolitical factors remain uncertain, for example, with regard to Russia, Eastern Europe and the Middle East. The US presidential election in November 2008 will be closely watched to determine the economic and political direction to be taken by the world's largest economy.

Future scenarios

The economic downturn which began in 2007 and will continue through 2009 is expected by many analysts to be amongst the most severe in the past 100 years. While the scale of the downturn remains uncertain, the full impact on the real economy has not yet been felt and more bad news is still to come. Although a global rebound is expected in 2010, even emerging economies have proven considerably more vulnerable than previously believed, demonstrating the integrated nature of global financial and credit markets.

Real GDP growth in more advanced markets such as the USA or UK is projected to rebound from 2009 and stabilise by 2012. Meanwhile, the longer-term trend in key developing markets such as China or India will be a gradual slowdown in growth over the same period. Inflation forecasts are clouded with uncertainty and commodity prices – especially those of oil – will play a key role in determining the growth outlook for most countries.

Regulation in the financial and banking markets is likely to be overhauled in order to prevent a similar crisis reoccurring in the future. Government intervention is set to dramatically alter the banking and financial landscape, at least in the medium-term, and prompt ongoing volatility and uncertainty amongst businesses and consumers worldwide.

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