

# **CHAPTER 2**

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## **INTERNATIONAL ECONOMIC DEVELOPMENTS**

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#### 2.1 The Global Economy

*... rising food and energy prices did not dampen growth evenly across regions... Growth in emerging and developing countries was high...*

The global economy, which witnessed low output growth in the wake of the recent financial and economic crises, regained momentum in the second half of 2010. High increases in food and energy prices as well as the debt crises in the Euro area did not dampen output evenly across the regions. Thus, while output growth was suppressed in the industrial countries, the emerging and developing economies were compensated with higher output which sustained the tempo of global recovery. The growth in the emerging and developing countries was driven by high aggregate domestic demand in the presence of weak external demand.

*Driving growth was the huge liquidity injections into national economies*

Driving the global rebound was the extraordinary amount of liquidity injected into the national economies through monetary and fiscal stimuli in the heat of the crises. At 5.0 per cent, growth rate in Sub-Saharan Africa was higher than in most regions except Developing Asia and Latin America/Caribbeans, with most of that growth coming from Nigeria, South Africa and Kenya. Nigeria's growth was particularly traceable to high domestic aggregate demand.

*During the review period, monetary policy was largely expansionary, and interest rates were generally low*

Monetary policy was largely expansionary across the regions, with interest rates down to record lows in most advanced and emerging market economies, while central banks' balance sheets expanded to unprecedented levels in key advanced economies (Table 2.1). In Nigeria, short term interest rates dropped to a record low in August 2010 when the interbank interest rate was 1.26 per cent. The global financial and economic crises led to large scale divestment of foreign portfolio investment from the Nigerian Stock Market, leading to substantial demand pressure in the foreign exchange market and the resultant reserve drawdown.

The recent growth in global demand and industrial production, together with weather-related disruptions to supply (like the flood in some countries) and the emerging political crisis in

*Higher growth, weather disruptions and emerging MENA crisis increased commodity prices*

Middle-East and North Africa countries (MENA), led to general rise in commodity prices during recent months. The rising trend in commodity prices led to a further upward revision of the near-term economic outlook for most countries' terms of trade. While core inflation remained low in most advanced economies, the increase in commodity prices resulted in a rise in headline inflation. Consequently, headline inflation was expected to pick-up in 2011 across the regions, especially if the high and rising food and energy prices and large scale natural disasters continued.

**Table 2.1**  
**Monetary Policy Rates of Selected Central Banks**

Central Bank	Current Rate	Reference Rate	Date and Rate of last Change
People's Bank of China	5.81%	Reserve Requirement Ratio	5.56% (Nov 2010)
Central Bank of Egypt	8.26%	Overnight Deposit Rate	8.27% (Jun 2010)
European Central Bank	1.00%	Overnight Rate	1.23% (Dec 2009)
Reserve Bank of India	6.25%	Repo Rate	6.00% (Oct 2010)
Reserve Bank of South Africa	5.50%	Repurchase Rate	6.00% (Oct 2010)
Bank of England	0.50%	Base Rate	0.63% (Dec 2009)
Bank of Canada	1.00%	Overnight Rate	0.75% (Aug 2010)
Bank of Japan	0.10%	Overnight Call Rate	0.50% (Dec 2007)
Federal Reserve USA	0.25%	Federal Funds Rate	1.00% (Dec 2008)
Central Bank of Nigeria	6.25%	Monetary Policy Rate	6.25% (Aug 2010)

Source: World Economic Outlook, IMF, BoJ, January 2011

\* As at end-December 2010

*Sovereign debt crises and poor current Account positions in the Euro area may negatively impact trade leading to currency valuation concerns*

The Euro area public debt crisis and growth divergences were of serious concerns across the group of industrial countries and the rest of the global economy. The disarray in the fiscal positions of some Euro area countries and in some cases, the accompanying current account deficits were expected to negatively impact on international trade and currency valuation across the world.

GDP growth in both Asia (excluding Japan) and the United States rose after a slowdown in mid-2010. At end-December 2010, global output growth was estimated at 5.0 per cent and the IMF projected that this growth trend would be sustained in 2011 and 2012, though with moderations across the regions. Output growth in the emerging and developing countries as a group, had been projected to remain robust in 2011. Growth performance in Sub-Saharan Africa was projected to remain high (Table 2.2).

**Table 2.2**  
**World GDP**

	Year- average percentage change		Projections	Projections	Projections	Q4 over Q4 Projection	
	2008	2009	2010	2011	2012	2011	2012
World	3.0	-0.6	5.0	4.4	4.5	4.5	4.4
Advanced Economies	0.2	-3.4	3.0	2.5	2.5	2.6	2.5
Emerging & Developing Economies	6.0	2.6	7.1	6.5	6.5	7.0	6.8
Sub-Sahara Africa	5.5	2.8	5.0	5.5	5.8	5.9	6.2

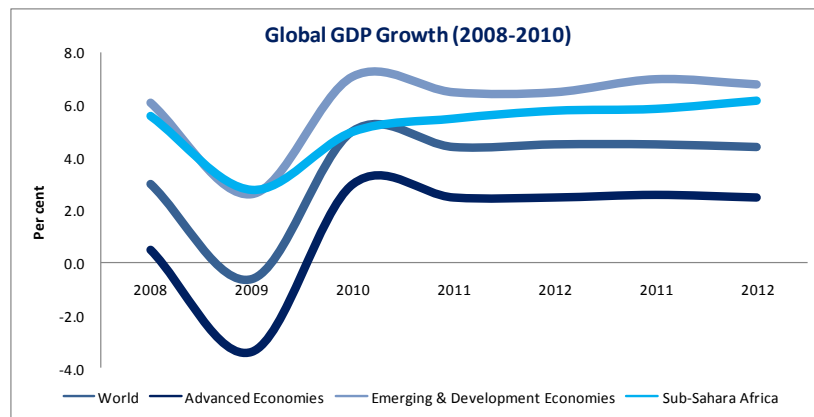
Source: World Economic Outlook (WEO), IMF January 2011

*Global unemployment remained generally high*

Despite these developments, there were differences in the amount of unused capacity around the world, as most developed countries continued to operate below their potentials. Also, unemployment rate remained high, and output growth in some countries was unlikely to return to the pre-crisis level, in the near term.

In the last two quarters of 2010, bond yields rose significantly in most major economies to their highest levels in a year. While interest rates remained generally low, the upward trend in bond yields, generally reflected the improved economic performance notably in the United States.

**Figure 2.1**



Source: World Economic Outlook (WEO), IMF January 2011

*Conditions in the financial markets improved generally except in the Euro area where public debt sustainability concerns were a threat*

Conditions in the major financial markets improved in the last quarter of 2010, with the notable exception of some Euro area countries, where concerns about the sustainability of their public debt exposures had reached a crisis level. This unease led to an extensive purchase of the sovereign debt of these countries by the European Central Bank (ECB). The successful securitization of some public debts and further discussions on the expansion of a Euro area support facility stabilized the Euro area financial markets.

The sovereign bonds of the emerging market economies were marginally affected by the European sovereign debt crisis. The spreads between yields on emerging markets US dollar-denominated sovereign debt and the US Treasury bonds remained largely unchanged in much of the second half of 2010. Corporate bond issuance in the United States remained strong while the spreads declined to about the levels recorded



before the emergence of the Greek sovereign debt crisis in May 2010.

..Sovereign bonds of the emerging market economies were not affected much by the European sovereign debt crisis.

The improved performance of the global economy and the renewed risk appetite of financial institutions provided a boost to most equity markets in the last quarter of 2010. However, performance among global equity markets, during 2010, as a whole was mixed. The United States and the emerging Asian economies recorded a strong equities market recovery while a decline in equity prices in China was recorded, a development traced to tight monetary policy in that country. In the Euro area, Japan and Australia, there was little change in overall equity prices in 2010.

## 2.2 Regional/Country Specific Developments

### 2.2.1 Economic Community of West African States (ECOWAS), Africa and the Middle East

#### (i) Economic Community of West African States (ECOWAS)

ECOWAS countries have limited integration to the global economy.. recorded marginal growth as a group... group inflation was on the average under 10.0%

The countries in the Economic Community of West African States had limited integration into the global financial markets. As a result, most ECOWAS countries were less affected by the effects of the global financial and economic crises unlike countries with more integrated financial markets. In the second half of 2010, most ECOWAS countries recorded marginal growth rates, indicating a slowdown of 1.0 per cent in 2010 and an inflation rate of below 10.0 per cent. Most central banks in the sub-region adjusted their monetary policy stance to reflect changes in economic and liquidity conditions once the risks of second-round effects of the global meltdown had crystallized. During the crises, most central banks, including the Central Bank of West Africa (BCEAO) lowered their refinancing rate and provided government with direct credits and refinancing guarantees. The low growth performance in ECOWAS countries in the second half of 2010 however, moderated by Nigeria's remarkable growth performance during the period. The inflation rate of 11.8 per cent for Nigeria as at December 2010 was however, above the targeted single digit rate.

**(ii) Sub-Saharan Africa**

*...SSA countries experienced high growth traced to sound macroeconomic management and sustained increased aggregate demand*

Sub-Saharan African countries experienced appreciable growth in the second half of 2010 and the trend was projected to continue in 2011. Overall, output growth was estimated at 5.0 per cent in 2010 and was expected to rise marginally to 5.5 per cent in 2011. Sound macroeconomic management and high domestic aggregate demand provided the key to the resilience of most sub-Saharan African countries during the global financial crisis. Before the 2007–2009 global shocks, most Sub-Saharan African countries experienced steady growth, low inflation, sustainable fiscal balances, rising foreign exchange reserves, and declining government debt. With the shocks, countries were able to use fiscal and monetary policies, to dampen the adverse effects of the sudden shifts in world trade, prices, and financial flows in the short run.

*Countries with strong manufacturing sectors had high unemployment rates. Recovery in the industrial countries is still shaky*

As a result of the crises, unemployment rose significantly in countries with strong manufacturing sectors while fiscal balances deteriorated, particularly in middle-income countries and oil exporters. While exports remained generally at their pre-crises levels, credit growth remained subdued with risks being weighted on the downside. On a region-wide basis, domestic elections were scheduled in at least 17 countries and these may slow the pace of reforms.

*falling aggregate demand in trading partner countries amidst rising oil prices would exert upward pressure on domestic exchange rates in the oil exporting countries to appreciate*

Oil exporting countries in the region such as Nigeria, Angola, Gabon and Ghana, stood to benefit from higher oil prices. Rising energy costs could slow the tempo of growth across the region and diminish the 2011 growth prospects for many countries in the sub-region. The problem of high oil prices was expected to worsen if the crisis in the Middle East and North Africa (MENA) countries continues or escalates to more countries in the region. However, falling aggregate demand in trading partner countries amidst rising oil prices would exert upward pressure on domestic exchange rates in the oil exporting countries to appreciate. The high oil earnings in the absence of fiscal restraint may trigger high fiscal expenditure in the oil exporting countries leading to higher inflation.

The five largest economies (South Africa, Nigeria, Angola, Ethiopia, and Kenya) account for two-thirds of Sub-Sahara Africa's output and just under half of its population. Of the five, only South Africa went into recession in 2009. The country had stronger global trade and financial linkages and was already experiencing economic downturn before the commencement of the global crises. Consequently, the economy experienced a loss of about 1 million jobs. In Nigeria and Kenya, real GDP growth actually increased from 5.6 and 2.1 per cent in 2009 to 7.85 and 4.1 per cents at end-December 2010, respectively; whereas in Ethiopia, the marginal fall in output still left growth at about 7.7 per cent.

### (iii) Middle East and North Africa

The wave of protests which erupted in some Middle East and North Africa (MENA) countries towards the end of 2010 led to a chain of events which sent strong signals to the international community on the implications of the developments for the international oil market; especially with regards to supply constraints and higher oil prices. Coming just as the global economy was recovering from the effects of the unsettling economic and financial crises, the MENA crisis, which was largely as a result of rising cost of living and high youth unemployment was capable of threatening global energy security. The uncertainties associated with the MENA crisis had strong implications for global oil output and growth expectations. While higher oil prices may imply higher oil export earnings for countries like Nigeria, such developments had potential for constraining aggregate demand and growth prospects in the trading partner countries. Similarly, increased foreign exchange from oil export earnings could cause an appreciation in the external value of the naira, requiring a more careful management of the foreign exchange market to avoid exchange rate volatility.

*.. the MENA crisis ,  
....., is likely to  
impact global  
energy security  
and prices, much  
higher than  
previously  
projected,.....*

*.. Asia recorded  
appreciable  
growth... In some  
countries,  
monetary policy  
was tight although  
real interest rates  
remained low*

### 2.2.2 China and the Rest of Asia

During the second half of 2010, economic activities in Asia remained robust, although it moderated towards a more sustainable pace. In the first half of 2010, economic activity continued its rebound from the global financial crisis. The pace of recovery and its composition remained different across the



region with the smaller export-dependent economies generally experiencing more pronounced growth than larger economies with sizable domestic demand. In particular, there was moderation in industrial production and export growth reflecting in part, the maturing of the global and regional inventory cycle, particularly in IT related products which were important for production and exports in many Asian economies. The short-term baseline outlook remained generally positive, with growth expected to settle at high but more sustainable levels. Growth was likely to remain particularly strong in the large, domestic-demand-driven economies of China, India, and Indonesia.

The sluggish recovery in the industrial countries was expected to support growth in Asia's exports, although below the very high rates of 2009 and early 2010. A gradual withdrawal of the policy stimulus, sustained improvements in labor market conditions, still accommodative financial conditions were expected to sustain domestic aggregate demand. Rising global liquidity, relatively robust growth and low public debt were expected to fuel capital flows to the region. Reflecting the slowing of export growth and strong domestic demand, Asia's current account surplus was projected to decrease to about 3 per cent of regional GDP in 2011.

The balance of risk was in the external environment where underlying sovereign and banking vulnerabilities in advanced economies remained a significant challenge. Despite Asia's strong growth potentials, trade and financial linkages with the industrial economies suggested that a further deterioration in global financial conditions and a slowing down of the global recovery would have serious implications for Asia. Inflationary pressures were observed in some countries indicating a compelling need to normalize policy stance across the region. With monetary and fiscal policies being largely accommodative, and output gaps closing rapidly, inflation pressures could intensify, resulting in the risk of pro-cyclical policies. Overall, in the medium term, sustaining robust growth in Asia required continued progress with rebalancing growth toward domestic demand.

The Chinese economy continued to record strong growth performance over the rest of Asia, especially in the third quarter of 2010 with GDP growth estimated at 9.7 per cent. The trend continued till the end of the year. However, food prices remained rather high, a phenomenon observed also in other economies in the Asian region. The thrust of Chinese monetary policy was to contain the upward trending inflation rate, which was 3.5 per cent, by December 2010. The Chinese authorities in the second half of 2010, announced a number of monetary policy measures to address mounting inflationary pressures, although monetary conditions appeared to remain upward trending. Consequently, The People's Bank of China raised its policy interest rate by 25 basis points to 5.81 per cent in late December 2010 and also raised the reserve ratios of banks twice over the past two months of 2010 (Table 2.1).

### 2.2.3 The Euro Area

In the euro area, prospects for strong economic recovery were generally high in the second half of 2010, but with large divergences across countries. For example, economic activities remained depressed in countries where sovereign debt concerns had been elevated. The estimate for GDP growth in the third quarter of 2010 in the United Kingdom for instance, indicated a fall, although this was partly explained by poor weather condition.

*In the euro area, prospects for strong economic recovery were high ..... Economic activities remained depressed in countries where sovereign debt concerns had been elevated.*

Economic conditions in Portugal, Italy, Greece and Spain (PIGS) remained largely constrained by rising sovereign debt crises and rising domestic unemployment. Inflationary threats and suppressed aggregate demand were also observed in some of the countries. With high public debt being above sustainable levels of GDP, and rising fiscal deficit concerns mounting, most of the PIGS countries struggled to limit government spending. Credit conditions remained generally tight, leading to suppressed output.

Despite concerns about high debt levels in the Euro area, the German economy continued to drive the region's economic recovery through the second half of 2010. Until 2010, Germany's average quarterly GDP growth was 0.29 per cent

reaching a historical high of 2.30 per cent in June 2010 after a record contraction of -3.50 per cent in March 2009. Accordingly, the German economy grew by 0.7 per cent between July and September compared with the Euro zone average of 0.4 per cent. In the fourth quarter, the economy grew by 0.40 per cent over the previous quarter. German unemployment, which had been approaching 11.0 per cent in 2005, was below 7.0 per cent at end-December 2010. The average unemployment rate for the Eurozone as a whole in October was close to 10.0 per cent.

Consistent with ensuring compliance and soundness of the financial system, a section of the banking system in Europe was under close surveillance, while a significant portion of its debt was scheduled to be refinanced in 2011. There was evidence of *tiering* in the Euro area interbank market. The stronger banks were able to issue instruments relatively easy, while the weaker ones were required to pay considerably more for funds and, in some cases, were entirely excluded from market funding. Market sentiments were generally in favour of monetary policy tightening by the ECB and the Bank of England in mid-2010. However, the timing of the tightening was earlier than previously anticipated, partly because of the less favourable inflation outlook, particularly in the United Kingdom.

#### 2.2.4 The United States of America

*Growth in the United States... was stronger than predicted a few months earlier.....*

Output growth in the United States, especially in the third quarter of 2010, was stronger than earlier predicted, with household consumption showing strong signs of recovery and major indicators of investment reflecting overall improvement. Conditions in the labour market, however, improved only modestly. The fall in the unemployment rate, which peaked in 2009, was partly explained by a decline in labour force participation. Conditions in the housing market, however, remained largely weak. Although, monetary policy had been tightened in several other economies, no increase was effected for the federal funds rate in 2010.

The US remained Nigeria's major trading partner, accounting for over 40.0 per cent of Nigeria's foreign trade. While conditions in the US remained promising for sustained recovery

and growth, the rising cost of oil could impact negatively on that growth. Rising US employment implies increased home remittances for Nigerians resident there and a rebound of the stock market due to increased foreign portfolio investment flow.