2008 was a difficult year for the global economy because of the sharp downturn in growth and the deteriorating outlook. By the end of the year, advanced economies had reached the deepest decline since World War II. The economic slowdown in the United States played a central role here. The fourth-quarter results were particularly negative. Decreasing demand in advanced countries had a negative effect also on emerging economies where growth had been largely export-oriented for many years. Global economic slowdown was accompanied by a credit and liquidity crisis, which caused difficulties for several major banks. According to the IMF, global growth decreased from 5.2% to 3.4% in 2008. Global GDP is expected to decline 1–1.5% in 2009; the GDP of advanced economies will decrease up to 3.5% (see Table 1).

Regional growth indicators varied considerably in 2008. In advanced countries growth reached only 1%, whereas developing countries posted 6.3% growth. Developing Asian countries were in the lead with 7.8%, with China's growth being even 9%. In Central and Eastern Europe growth went down from 5.4% to 3.2%. US economic growth shrank to an estimated 1.1% (2% in 2007). Euro area growth indicators were similar to US figures (1%) in 2008; Japan saw a slight decline (-0.3%). Compared to the forecast made at the beginning of the year, actual growth was 0.9 percentage points lower in the US, 0.8 percentage points lower in the euro area and 1.8 percentage points lower in Japan.[1] The situation of the labour market deteriorated because the change in the economic cycle brought about an increase in unemployment in all G3 countries.

The change in the inflation rate was strongly influenced by the price of oil that rose to a historical high at the beginning of July, exceeding USD 145 per barrel. This caused a consumer price increase in advanced countries: from 2.1% to 3.5%. However, the deepening economic crisis together with a sudden drop in the prices of oil and other commodities caused a rapid decrease in inflation in the second half of the year.

The deteriorating economic outlook reflected also on global financial markets. The robust decline on stock markets that had started in 2007 continued, and the main stock indices of the G3 countries decreased a further 40–50% over the year. As mentioned above, also commodity prices started to fall in the second half-year. Only the price of gold stayed between 700–1000 dollars per ounce last year; this was supported by heightened uncertainty. The leading central banks drastically cut the interest rates for monetary policy purposes. This affected the interest rates on government bonds and led to a robust decline in short-term as well as long-term interest rates. The extensive difficulties in the financial sector increased the crisis of trust between banks, which peaked in October. The US and euro area governments tried to support financial stability by implementing large-scale support measures. Although the actual effect of these measures will appear only in the future, they already provided some confidence in the financial markets.

[1] Consensus Forecasts, January 2008.

**Table 1. Global economic forecast (%)**

| | 2008 | 2009 | 2010 |
|---|---|---|---|
| **World** | 3.2 | -1.0... -1.5 | 1.5...2.5 |
| Advanced economies | 0.8 | -3.5... -3.0 | 0.0...0.5 |
| USA | 1.1 | -2.6 | 0.2 |
| **Euro area** | 0.9 | -3.2 | 0.1 |
| Japan | -0.7 | -5.8 | -0.2 |
| Emerging economies | 6.1 | 1.5...2.5 | 3.5...4.5 |

Source: IMF, "World Economic Outlook", March 2009

## UNITED STATES AND JAPAN

In 2008, growth in the US slowed significantly, economic problems aggravated and the annual GDP growth rate had reached -0.8% by the fourth quarter. The decline in real estate prices and housing sales, which had initiated the economic crisis, continued. The consistent weakening of the economy and growing unemployment had an adverse impact on private consumption, which constitutes almost two thirds of the US GDP. Consumer confidence deteriorated rapidly; the annual growth of retail trade reached as low as -10% in December.

The decline in demand reflected also in lower industrial production, which stood at -7.8% in December in terms of annual growth. Week demand hit the car industry hard and forced leading car manufacturers to decrease production and rely on government support in evading bankruptcy. The economic crisis caused a significant rise in the unemployment rate: in 12 months it rose from 4.9% to 7.2% in the United States.

The US external balance was affected by a drop in goods turnover (both the import and export volumes shrank). Consequently, also the trade balance deficit decreased significantly in the last months of 2008. The current account deficit stayed around 5% of GDP in the first three quarters.

As mentioned above, inflation fluctuated considerably, mainly owing to oil price volatility. While still at 5.5% in July, by December inflation had dropped to 0.1%. Excluding energy and commodity prices, inflation decreased to 1.7% by December. If economic difficulties persist or aggravate further, the slowdown in inflation may develop into a longer price decline, i.e. deflation.

The deteriorating economic situation forced the central bank and the government to implement extensive measures to stabilise the financial sector and the economy. The central bank continued drastic cuts on the key interest rate during the whole year, lowering it from 4.25% to 0–0.25%. The bank also expressed readiness to support the economy by keeping the balance sheet total at a high level through including a large amount of risk assets in its balance sheet. The government adopted measures aimed at supporting the financial sector and boosting the economy. Naturally, this required and will require lots of funds, which could lead to a budget deficit of 7–10% of GDP in the United States according to some forecasts.

In Japan, GDP growth slowed even more: from 2.2% to -4.6% over four quarters. The reason lies mainly in the strong dependence of the Japanese economy on external demand. The decline in exports reflected particularly in a decrease in industrial production: the annual growth rate dropped to -21% in December. The export decline was facilitated by low external demand as well as the strengthening of the yen, resulting from high risk aversion among investors.

Domestic demand in Japan has been relatively week for some years; in December retail trade growth went down to -2.2%. Unemployment rose from 3.8% to 4.4% in 12 months. This does not seem very high, but we must take into account that the Japanese labour market is not very flexible. Similar to other G3 countries, the inflation rate rose also in Japan at the beginning of the year, but dropped to 0.4% by the end of the year. Similar to the United States, the Japanese central bank had to lower the key interest rate: from 0.5% to 0.1% over the year. Japan's public debt is one of the highest among advanced countries, reaching 170% of GDP in 2007. Thus, Japan has very limited resources for boosting growth.

**EURO AREA**

Growth in the euro area slowed to an estimated 1% in 2008, whereas in the fourth quarter the annual GDP growth rate declined to -1.2%. Similar to the United States and Japan, the activity of the industrial sector as well as the services sector decreased significantly; industrial output growth shrank to -11% by the end of the year. In the second half of 2008, the economic downturn, financial sector crisis and worsening outlook brought about an abrupt decrease in consumer confidence also in the euro area. It diminished to the lowest level since 1985. Unemployment rose from 7.2% at the beginning of the year to 8% in December.

The euro area inflation dynamics was similar to that of the United States and Japan: the price pressures stemming from the rise in oil price increased annual consumer price growth to 4% in June-July. By December, however, the sudden drop of the oil price had lowered the inflation rate to 1.6%. The core inflation of the euro area remained relatively stable though and was 1.8% at the end of the year.

The euro area monetary policy in 2008 reflected the changing estimates of the European Central Bank regarding the situation and outlook of the economy. The key interest rate was 4% at the beginning of the year. In July, the ECB decided to raise it to 4.25% owing to increased inflation, although the economic slowdown had already clearly manifested itself. As inflation decelerated and economy slowed, the central bank started to cut the key interest rate in October and lowered it to 2% by the end of the year. The economic discrepancies in the euro area countries became more pronounced as growth slowed further. Consequently, the difference between the interest rates on long-term government bonds posted the fastest growth since the adoption of the euro. This, in turn, revealed fiscal problems in Greece, Spain, Ireland and some other countries, which could lead to a bigger budget deficit in these countries than the 3% set out in the Stability and Growth Pact. Although several countries adopted state support programs to facilitate growth, there is no single fiscal policy in the euro area. Therefore, more efforts should be made in that field.

The economic outlook for the euro area in 2009 is even weaker than the 2008 figures. The International Monetary Fund expects a 3.2% contraction in 2009.[2]

[2] IMF "World Economic Outlook Update", March 2009.