

External Sector

External Environment

The robust expansion in global economic activity witnessed in 2000 was followed by a marked slowdown in 2001. World output growth in 2001 is expected to be only 2.4 per cent. This is more than 2 percentage points lower than the 4.7 per cent growth witnessed in 2000. The deceleration in global output has been accompanied by a sharp reduction in the volume of world trade (Table 6.1). Energy prices are projected to suffer an absolute decline in 2001. Non-fuel commodity prices are expected to have fallen significantly underlining depressed market sentiment, and lack of demand in the world economy.

6.2 The buoyant economic conditions and higher growth in global output in the year 2000 were attributable to sustained market expansion in the United States, modest revival in the Euro area, sharp pick-up in the newly industrialized Asian economies and strong growth performance by developing Asia and transition economies. In contrast, the scenario for the year 2001 is subdued. The downturn in the US economy has been formally declared as a recession. Japan is likely to experience its fourth economic recession of the last decade. Economic activity has also considerably dampened in the Euro area. With signs of revival absent in the G-3 and almost everywhere else in the world, the global slowdown

TABLE 6.1
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(Annual percent change unless otherwise noted)

	1999	2000	Projections	
			2001	2002
A. World output	3.6	4.7	2.4	2.4
Advanced economies	3.3	3.9	1.1	0.8
United States	4.1	4.1	1.0	0.7
European Union	2.6	3.4	1.7	1.3
Japan	0.7	2.2	-0.4	-1.0
Other advanced economies	4.9	5.2	1.5	1.9
Newly industrialized Asian economies	7.9	8.2	0.4	2.0
Developing countries	3.9	5.8	4.0	4.4
Developing Asia	6.2	6.8	5.6	5.6
China	7.1	8.0	7.3	6.8
India	6.8	6.0	4.4	5.2
ASEAN-4*	2.9	5.0	2.3	2.9
Countries in transition	3.6	6.3	4.9	3.6
Russia	5.4	8.3	5.8	3.6
B. World trade volume (goods & services)	5.4	12.4	1.0	2.2
C. World trade prices (in US \$ terms)				
Manufactures	-1.8	-5.1	-1.7	1.9
Oil	37.5	56.9	-14.0	-23.7
Non-fuel primary commodities	-7.0	1.8	-5.5	1.7
D. Net Private capital flows to emerging markets (in US \$ billion)	59.6	8.9	20.1	59.8

*: includes Indonesia, Malaysia, Philippines and Thailand.

Source: World Economic Outlook; December 2001; The International Monetary Fund.

BOX 6.1

Impact of Terrorist Attacks of September 11, 2001 on the Global Recovery

The terrorist attacks of September 11, 2001 on the United States of America have plunged the world into a deeper economic crisis by intensifying the existing global slowdown. The attacks forced downward revision of short-term growth projections (years 2001 and 2002) for almost all major economic regions of the world. The downturn in the US economy is now expected to get prolonged while the prospects for Japan have worsened. Business sentiments have worsened in the United States, as have the various downside risks in the form of uncertainties relating to investment levels in the economy, and perceptions regarding productivity growth and consumer confidence in expenditure. Equity markets have become more fragile in Japan. In the Euro area, domestic demand has been sharply squeezed and has been accompanied by downturns in equity markets in the technology sector. International capital markets have reacted adversely to the shock with the declines being more severe in emerging economies, particularly in Asia and Latin America.

The direct costs of the attacks for the US economy have been estimated at US \$ 21.4 billion which is around 0.25 per cent of the annual GDP. While more than US \$ 16 billion is attributable to damages in property (structure, equipment and software), the remaining pertains to various insurance losses. The attacks have resulted in sharp fall of private consumption in the domestic US market. The industries that have been worst affected are airlines, insurance, and other service industries like hotels, tourism, travel agencies, restaurants and civilian aircraft manufactures.

The long-term effect of the developments of September 11, 2001 on world economic recovery would depend upon the extent of increase in global transaction costs and their impact upon global output. Sharp increases are envisaged in global operating costs of businesses due to greater expenditures on security and insurance premiums. Inventory accumulation is likely to increase worldwide as are the risk premiums required by lenders. Country-specific reactions to combating terrorism may witness large reallocation of resources from civilian to military use. The higher transaction costs and disruptions in cross-border movement of goods and services are likely to affect global output.

The events of September 11, 2001 are anticipated to have far-reaching consequences for growth prospects in emerging markets and developing countries. Countries depending heavily on external demand and having large external financing requirements are likely to suffer the most from the erosion in business confidence and increase in risk premia. Weaker global demand for exports and lower commodity prices can accentuate poverty in low-income countries. There are other major concerns for the developing world in the form of undesirable increase in cross-border migration of refugees, sharp decline in private capital flows due to heightened risk perceptions of foreign investors, lower tourism earnings and higher trade transactions costs.

With downside risks to global economic recovery increasing, advanced economies have a key role to play in rejuvenating global growth. While liberal monetary policy measures have already been adopted in the US and the Euro area, it is important for automatic stabilizers to function unhindered. Determined structural reforms aiming to enhance productivity gains are important in Japan (banking and corporate sectors) and Europe (labour and product markets).

Sound and proactive policies intended for strengthening fundamentals and overcoming the downside risks are essential for emerging markets and developing countries. Poverty reduction must receive the highest priority in developing and low-income countries. This would call for increased disbursement of ODA (Overseas Development Assistance) by the richer nations, lowering transactions costs of aid for poorer nations, improving conditions for investment and growth, ensuring larger provision of global public goods and securing greater opportunities for poorer nations in the international trading system.

has assumed a synchronized, self-reinforcing dimension. The synchronicity of the current slowdown is the most marked in the last two decades.

6.3 The terrorist attacks in the United States on 11th September 2001 and subsequent retaliation by the United States in Afghanistan have further dampened the short-term prospects for global recovery. Regional growth projections have been further moderated in the aftermath of the attacks. The intensity of the setback to global recovery will depend upon the magnitude of the

damage inflicted upon consumer sentiment, business confidence and risk perceptions, particularly, in the emerging and low income countries (Box 6.1).

6.4 The on-going global slowdown has critically affected the growth prospects for most of the newly industrialized Asian economies and members of ASEAN. The downturn in the electronics cycle, which is unlikely to reverse in the coming months due to the depressed outlook for the US and Japan, has created serious difficulties for the newly industrialized Asian

economies (Korea, Singapore, Taiwan and Hong Kong SAR). Depressed global growth conditions have also slowed down the already faltering pace of recovery in ASEAN-4 (Indonesia, Malaysia, Philippines and Thailand). Only China seems to

have bucked the overall depressing trend in developing Asia and is expected to grow strongly in 2001, mainly due to buoyant private consumption and strong public investment.