# THE IMPLICATIONS OF ECONOMIC AND FINANCIAL CRISIS ON GLOBAL ECONOMY

**GIANINA VIOLETA DRAGOTĂ, NICOLETA BUZILĂ**
TIBISCUS UNIVERSITY, FACULTY OF ECONOMIC SCIENCES, DALIEI STREET, NO. 1A, TIMIŞOARA
gianina_dragota@yahoo.com, nicoleta_buzila@yahoo.com

***Abstract:***
*The global financial and economic crisis has hit all the countries of the world, they have had strong growth and poverty reduction over the past years. However, though the most acute phase of the global financial and economic crisis has passed, recovery remains fragile. Persistent risks to economic health include high unemployment and low growth in developed countries and scarce international financing for developing countries. The poorest countries continue to need assistance to move beyond the crisis. These countries can play a key role in helping to boost demand to support global recovery, but they will need access to financing for years to come.*

***Key words:*** *global economy, crisis, price, unemployment, development*

***JEL classification:*** *F59*

After the global recession, economic growth has turned positive, as a wide range of policy interventions has supported demand and reduced uncertainty and systemic risk in financial markets. The global economy is in the early stages of a recovery following the sharpest contraction since the Great Depression but progress is uneven. Some regions are already seeing a revival but others continue to struggle. The same is true for the world economy where many areas in the financial sector are enjoying resurgence, although problems remain throughout much of the real sector.

The world economy has begun to grow again but the recovery will be uneven. After unprecedented intervention by central banks and governments, the global economy began to strengthen in the second half of 2009. The problems persist in some parts of Eastern and Central Europe. Economists from the IMF project that global real GDP fell by 1.1% in 2009 but predict gains of 3.1% in 2010. In advanced countries, modest growth of 1.3% is expected after a contraction of 3.4% in 2009. The outlook is brighter for emerging economies and other developing countries where growth is forecast at 5.1% in 2010, up from 1.7% in 2009.

Commodity markets have made an unusually quick recovery that will be sustained over the medium term. The drop in commodity prices in the second half of 2008 was faster and steeper than in other recessions while their recovery is equally remarkable. Commodity prices will be increasingly dependent on economic conditions in developing countries. With a buoyant recovery already underway in Asia, commodity demand is strengthening ahead of the recovery in the industrialised world. A second factor is China's unbridled ambition to extend its influence over commodity markets throughout the world. Thus, in the medium term, commodity prices in real terms are likely to remain above historical trends. Metal prices, for example, rose by nearly 60% in the second half of 2009. Led by copper, gold, lead and nickel, mineral prices should see further gains in 2010. The outlook for oil prices is more circumspect owing to excess capacity of oil exporters and the erratic pace of the global recovery. Oil prices, however, will be firmer in 2010.

Gross domestic product is likely to grow faster in the US than in Japan and the three largest euro area countries – Germany, France and Italy - but will remain generally fragile as inventory destocking by businesses and the ending of some fiscal stimulus measures weighs on activity. OCDE show that US GDP is expected to rise by 2.4% and 2.3% in first and second quarters this year. The combined GDP of the three largest countries in the euro area is projected to grow at 1.9% in the second quarter after 0.9% in the first three months of the year. In Japan, GDP growth is forecast at 2.3% in the second quarter of 2010 after 1.1% in the first. Fourth quarter 2009 GDP grew by 5.6% in the US; by 0.4% in the three largest countries of the euro area and by 3,8% in Japan.

The unemployment will continue to rise in many industrialised countries. In the USA the jobless rate has risen faster than in most large industrialised countries and more rapidly than in any other recent recession. In Japan and some European countries, companies generally prefer to reduce the number of hours worked or resort to part-time employment before cutting their work forces, which has helped to contain the rise in unemployment. However, unemployment will be most acute in countries that have seen significant property-market bubbles and rapid expansion of the construction industry. In Ireland, for example, unemployment will be 15.9% in 2010 and will surpass 20% in Spain.

Emerging economies in Europe and the former Soviet Union will probably suffer the largest job losses during 2010. Capital inflows to these countries will be especially slow to recover while large foreign currency debts can lead to exchange rate depreciation, which could stifle exporters' aspirations.

Than after other recent recessions, the recovery will be slower and weaker. Policy makers have been hoping for a V-shaped recovery but that seems increasingly unlikely. Credit booms, housing bubbles, job uncertainty and burgeoning current account deficits all weigh heavily on consumer decisions. Real consumer spending in industrialised countries is expected to rise by 0.7% in 2010 and in some eurozone countries it could contract.

OECD Chief Economist Pier Carlo Padoan said: “Although we are seeing some encouraging signs of stronger activity, the fragility of the recovery, a frail labour market and possible headwinds coming from financial markets underscore the need for caution in the removal of policy support”, on the Interim Economic Assessment for G7. Inflation should not pose a serious threat to the recovery. In advanced countries, price increases will be subdued until the recovery eventually reduces output gaps. Consumer prices in advanced countries are expected to rise by 1.1% in 2010, faster than in 2009 (only 0.1%) but far below historical trends. In developing countries, consumer prices will rise by 4.9% in 2010 compared with 5.5% in 2009. The overall decline can be attributed to factors including the drop in oil prices following the spike in 2008 and the lingering effects of the recession.

The efforts to alleviate poverty have been set back in developing countries. Sub-Saharan Africa will be hardest hit because per capita GDP contracted in 2009 for the first time in a decade. Donor support is critical but could falter as advanced countries struggle with their own budgetary issues.

Policy support to combat the recession will continue in 2010 but at a diminished level. Most governments can not afford to provide additional assistance once current stimulus programmes have run their course. In advanced economies, further action is deterred by the huge debt which has accumulated and the need to build public savings in preparation for population ageing. The tax breaks and transfer payments that were at the forefront of most stimulus schemes typically have only a modest impact on economic activity. Measures that have only recently begun to be implemented – for example, new government spending programmes for infrastructure – will have a greater impact but they occur with a lag and the results will become apparent in 2010 or later.

"In the USA economists expect real GDP grow by 1.5% in 2010 with a higher projection by the OECD of 2.5%. Canadian economists have predicted growth of 2.7% in 2010 while the IMF expects a weaker recovery of 2.1% growth."[1]

In USA the unemployment in the USA topped 10% in late 2009 and will continue to edge upward through mid-2010. In Canada, unemployment is expected to reach 9.2% in 2010 – a ten-year high. The jump in jobless rates is mainly due to the recession's impact on labour-intensive sectors such as construction and finance. The unemployment rate in America will probably not return to pre-recession levels before 2014.

The general government budget deficit, in the USA, is expected to reach around 10% of GDP in 2010. Analysts generally agree that in this slower-growth, high-debt-accumulation scenario, the country's potential rate of economic expansion will be lower. By 2014, potential output in the USA will be about 6% lower than if the recession (and subsequent stimulus spending) had not occurred.

In 2009, the combined GDP of Latin America countries contracted by 2.9% although conditions in the region's larger economies began to stabilise in the second half of the year. A recovery is expected in 2010 with growth of almost 3%. Commodity-exporting countries such as Brazil, Chile, Colombia, Mexico and Peru should perform better than the region as a whole, while commodity importers face slower recoveries. A drop in remittances and tourist receipts will limit gains in most of Central America and the Caribbean. Mexico's involvement in the North American Free Trade Association (NAFTA) means that its prospects are closely linked with recovery in the American industrial sector.

Returns on investment in most industrialised countries will remain low for some time, prompting investors who seek higher but reasonably safe yields to Latin America. The rise in commodity prices will reinforce this trend. Large inflows of foreign capital may also result in currency appreciation, which could create its own set of problems.

The combined GDP of the EU fell by 4.2% in 2009. Modest growth of around 0.5% is forecast for 2010 though in a few countries – notably Ireland, Greece and Spain – the recession will continue. The European Commission estimates that the cumulative loss in output since the recession began in mid-2008 amounts to at least 5% – the deepest and most broad-based recession in the EU's history.

Europe's recovery depends on temporary factors such as inventory adjustment and the effects of stimulus packages that will dissipate over the medium term. There are other reasons why this recovery will be more leisurely than in previous recessions. First, any rebound in trade will be constrained by a rebalancing of world demand. Second, if the upturn in exports is neither strong nor prompt, the spillover effects for domestic employment and private consumption will also be weakened. Finally, the need for households to scale back their indebtedness – as well as the prolonged rise in unemployment – will further slow the recovery in consumer spending.

Officials will have to rein in public spending once the region's economies are on the way to recovery. The European Commission forecasts that without tighter spending controls the EU's public debt could reach 100% of GDP by 2014. As recently as 2007, this was equivalent to only 66% of regional GDP.

Real GDP of Central and Eastern Europe fell by 5.0% in 2009 and the IMF predicts growth of 1.8% in 2010. Such an outcome would be well below historical trends, though for most countries the recession will have ended. The Baltic States are a notable exception. In Latvia and Lithuania, real GDP will fall by 4.0% in 2010 while Estonia will see a decline of 2.6%.

[1] Global Economic Prospects 2010 – Global Growth

The support from fiscal and monetary policy for domestic demand, as well as improving global demand is likely to support growth in the region. However, ongoing balance-sheet problems of Euro Area banks are likely to remain a drag on financing conditions. So far, commercial banks have made little use of the governments' rescue packages, and governments have yet to amend rescue plans. As a result lending restrictions are likely to remain a drag for capital expenditure. According to the latest ECB *Financial Stability Review* (2009) only two-thirds of potential losses in major European banks have been provisioned or written off so far, with some 187 billion euros of potential losses still remaining.

"The German economy grew at an annualized pace of 2.9 percent in the third quarter of 2009, with growth largely driven by corporate investment and construction, while private consumption waned. Looking forward, the strong recovery in foreign orders for manufactured goods suggests that net exports will come to support growth. In addition, increasing public capital expenditures will support activity in the second half of 2009 and most of 2010. However, rising unemployment will be a drag on private consumption."[2]

The output in the third quarter benefited from a rise in exports even as private spending remained stagnant and fixed investment continued to fall, in France. This country was suffered less than other rich nations, because it was neither a large supplier of international credit nor reliant on borrowing, and when private demand suddenly plunged, the French government stepped in. Although the recession in the United Kingdom has been deeper than most initially expected, positive GDP growth is expected to resume in the fourth quarter, thereby ending six consecutive quarters of falling GDP.

While overall developing- country growth remained positive, the deederation and dislocation that it has caused has been brutal. Unemployment is rising, an additional 90 million people are expected to remain in poverty (less than $1 a day) by the end of 2010 as a result of the slower growth, and as many as 30-50 thousand additional children are expected to have died of malnutrition in 2009. Investors are taking a more cautious approach to their involvement in the region, paying closer attention to domestic conditions and the efficacy of public policies. Their fear is that one or more countries may encounter another bout of financial volatility. Some countries have large amounts of foreign currency debt, which can prove extremely costly if exchange rates depreciate.

Russia's economy has suffered from its dependence on commodity markets. Real GDP shrank by 7.5% in 2009 while investment fell by nearly 14%. The IMF forecasts growth of 1.5% in 2010 but the outlook is improving amid rising oil prices, leading the OECD to predict growth of 4.9% for 2010. More investment is required to modernise antiquated industries and boost capacity. Moscow also hopes to spend US$1,000 billion during the next decade to improve infrastructure.

In Asia, the IMF predicts growth of 7.3% in 2010. Japan should growth of 1.7% in 2010 after a decline of more than 5% the previous year. Australia and New Zealand should manage growth of around 2%.[3]

Policy makers are counting on China and India to be the driving forces behind the region's revival and the global recovery. The IMF expects China's economy to grow by 9.0% in 2010 and India by 6.4%. The OECD is more optimistic, predicting growth of 10.2% in China and 7.3% for India. Consumer spending in China presently amounts to about a quarter of that in the USA and Europe, meaning that there are ample opportunities to rebalance global demand. However, rebalancing global demand will need to involve a host of emerging economies and will entail fundamental changes in patterns of spending and saving.

[2] Global Economic Prospects 2010 – Global Growth
[3] Global Economic Prospects 2010 – Global Growth

Although Asia is recovering, the effects of the recession could last for several years owing to lower rates of growth in productivity and investment. Governments will come under renewed pressure to change their growth strategy by reducing reliance on exports while boosting domestic and regional demand.

The economies of the Middle East and North Africa region werw adversely affected by the crisis to varying degrees. At the onset of crisis, equity markets among the high- income Gulf Cooperation Council (GCC) economies and several bourses in the developing region plummeted—by more than the average for emerging markets. Recovery in these markets has been hesitant, given uncertainties surrounding financial conditions in Dubai and the United Arab Emirates that have played a major role in funneling FDI into developing region. The IMF predicts growth of 4.1% in 2010 that among oil exporters in the Middle East and North Africa. The prognosis for oil importers in sub-Saharan Africa is not so bright although these countries can look forward to growth of 3.3% in 2010.

Great uncertainty continues to surround future prospects. Even the weak recovery outlined above is not certain. If the private sector continues to save in order to restore balance sheets, a double-dip, characterized by a further slowing of growth in 2011 is entirely possible especially as the growth impact of fiscal stimulus wanes. A stronger recovery is also possible, if the massive traditional and untraditional monetary stimulus that has been put into place in high-income countries begins to gain traction.

Given the slow growth and associated realside adjustments that are expected over the medium term, government policies should focus on productivity-enhancing growth strategies. For low-income countries, these strategies may involve simultaneously addressing underlying structural problems such as the quality of institutions, regulatory reform, and openness—all critical factors in promoting faster productivity growth. To the extent that these measures succeed in generating additional output and government revenues, associated expenditures will be more sustainable than more traditional expenditure-oriented ones. Countries with sufficient fiscal space may seek to target measures to reduce (infrastructure) bottlenecks. Invested wisely in human and physical capital, such steps can position a country to take better advantage of the global recovery when it comes, by more effectively exploiting existing comparative advantages and helping to generate new ones.

## REFERENCES


1. ***Global Economic Prospects 2009- Prospects for the Global Economy;
2. *** Global Economic Prospects 2010- Crisis, Financial and Growth;
3. http://www.imf.org/external
4. web.worldbank.org