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Global slowdown hits developing countries

Developing countries are now facing an economic slowdown with a deterioration in GDP growth, exports and lending conditions, as a result of the Eurozone crisis and the US slowdown.

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Workers in a garment factory in Bangladesh. A decline in exports may affect the livelihood of such workers in developing countries. (AFP)

By Martin Khor

Developing countries are increasingly being adversely affected by the economic recession in Europe and the slowdown in the United States.

The hope that major emerging economies like China, India and Brazil would continue to have robust growth, de-coupling from Western economies and becoming an alternative engine of global growth has been dashed by recent data showing that they are themselves weakening.

Just as during the 2008-2010 global crisis, a decline in exports caused by falling Western demand is the main way in which the developing countries are being hit.

The inflows of capital into developing countries have also slowed down, and a reversal to a new outflow situation may well take place. The lending conditions of banks in emerging economies have also deteriorated, according to a banking industry survey.

Recent reports confirm the slowdown in many major developing economies.

Slowdown in several Asian countries

In China, growth of the gross domestic product fell to 7.6% in the second quarter of this year, denoting a continuous deceleration from 10.4% in 2010, 9.2% in 2011 and 8.1% in first-quarter 2012.

China's export growth has been sinking rapidly. Exports in July were only 1% higher than a year ago, far below the 11.3% growth in June, indicating that China will not be able to rely on its export-led model for further growth in the near term. China's exports to EU countries fell 16% in July compared to June, showing the big impact of the Eurozone crisis.

China's import growth in July also fell to 4.7% from a year earlier, which indicates that other countries may not rely on China as an alternative locomotive to offset the slowdown in the West.

India's economy is also slowing. GDP growth fell to 5.3% in the first quarter of this year. The IMF has lowered its growth projection to 6.1% for 2012 overall. This compares to 6.5% growth last year and 8.4% in the preceeding two years. The Reserve Bank of India cut its growth forecast for this year to 6.5% from 7.3%. Some private economists have lower forecasts of around 5.5%.

India's industrial output fell for the third time in four months in June, according to a 10 August news report. Industrial output declined 1.8% in June mainly due to the poor performance in manufacturing whose output dropped 3.2% from a year earlier. Capital goods production fell 28% in June.

The country's external trade situation has also deteriorated. Exports fell 5.5% in June, compared to the strong growth during much of last year, according to a Reuter report. The rupee's level has fallen in the first half of this year, hitting a record low of 57.3 to the US dollar on 22 June. Foreign exchange losses have affected profits of some big local companies. The finance minister P. Chidambaram told Parliament that the rupee's fall was hurting the performance of Indian companies and fuelling inflation.

The Singapore economy contracted 1.1% in the second quarter over the previous quarter at an annualised rate, mainly due to manufacturing output falling by 6 per cent.

For Malaysia, the growth rate for 2012 is projected to be 4.2% by the Malaysian Institute for Economic Research. This is lower than last year's 5.1 per cent growth, which had also slowed to 4.7 per cent in the first quarter.

In Indonesia, the Central Bank said that growth was slowing and projected the rate to be 6.2 per cent for 2012, compared to 6.5% last year (and 6.3% in the first quarter).

Situation in some South American and African countries

In South America, two of the largest economies are also facing decelerating growth prospects.

In Brazil, the government on 20 July lowered its growth projection for 2012 to 3% (from the earlier 4.5% forecast). The IMF's latest growth estimate is even lower at 2.5%. Industrial production declined by 4.3 per cent in the 12 months to May. Some private economists have forecasted more pessimistic 1.5-2 per cent GDP growth rates. Growth was 2.7% in 2011 and 7.5% in 2010. The Brazilian currency, the real, has also been depreciating from its 2012 high of 1.69 per US dollar in late February.

Argentina had one of the fastest growing economies in the world. GDP growth was 8.9% in 2011, and the average annual growth was 7.6% in 2003-2010. But the economy contracted by 0.5% in the 12 months to May. Industrial production in June fell 4.4% on the year due mainly to a 31% decline in the auto sector.

In Chile, the Central Bank forecasts an economic slowdown in the second half, according to a Reuters report of 7 August. The country had a $95 million trade deficit in July compared to a $1 billion surplus in June and a $230 million surplus in July 2011. One reason for this reversal is the fall in copper export earnings.

In South Africa, growth in the first quarter was 2.7% (over the previous quarter), which was down from the 3.2 per cent growth of fourth quarter 2011. Manufacturing production in June declined 2.4% from a month earlier, and was only 0.8% higher than a year earlier, according to a Bloomberg report of 8 August. According to the Reserve Bank, the manufacturing sector remains susceptible, through export decline, to the global economy's renewed weakness, particularly in the euro area.

A report by the London-based Overseas Development Institute has predicted that the fiscal austerity measures by European countries will affect African countries through export decline and declines in remittances, foreign investment and aid. It said that Mozambique, Kenya, Niger, Cape Verde and Cameroon are among the most vulnerable African countries to the eurozone crisis as they are highly dependent on trade with eurozone countries, while some are also linked through aid, strong financial linkages or pegging of their currencies to the euro.

Change in perception of South from leaders to victims of global economy

Growth of buildings in developing countries may slow down in face of the new global crisis.

The prevalent view about the prospects of developing economies has almost suddenly changed from their being the emerging leaders of the global economy to their also being victims of the Western slowdown.

In July, the new World Bank President Jim Yong Kim warned that the debt crisis in Europe would hurt most regions in the world. If a major European crisis develops, the developing countries' economic growth rate could be cut by 4 per cent or more, he predicted.

Even if the eurozone crisis is contained, it could still reduce growth in most of the world's regions by as much as 1.5 per cent.

Also in July, the IMF in its latest world economic outlook gave a downbeat picture of how developing countries are now being adversely affected by the European and US economic situation. It warned that the ability of governments worldwide to respond to the new slowdown has become limited. And while the withdrawal of capital from developing countries was not at critical levels, there could be problems for some if conditions deteriorate.

A paper by Yilmaz Akyuz, chief economist of the South Centre, shows that the theory of the "staggering rise of the South" had vastly exaggerated the developing countries' de-coupling from the economic fortunes or misfortunes of the developed countries. Much of the high growth in developing countries in the past decade has been due to the favourable external conditions generated by the Western countries.

The high consumption growth in the United States was a main basis for the high growth of manufactured exports from China and other East Asian countries, and these together also underlay the boom in commodity prices that lifted growth in Africa and South America. The boom in capital flows into major developing countries also helped to fuel their growth and covered the current deficits of several of them.

The global crisis in 2008-2009 slowed down the developing countries' export growth and reversed the capital flows, but the strong anti-recession actions (fiscal stimulus, low interest rates and expansion of liquidity) in developed countries resulted in the resumption of export growth and capital inflows in the developing countries.

However, with the developed countries ending their reflationary policies and instead switching to austerity budgets and with their low interest rates having little effect, the recessionary conditions in Europe are now impacting adversely on developing countries. With the positive conditions that supported the South's rise no longer in place and in fact turning negative, the developing countries' prospects have dimmed, prompting the need for a change in development strategy.

(See separate article by Yilmaz Akyuz in this issue of South Bulletin for a detailed analysis of the changed global situation, its effects on developing countries and their need for a new development strategy).

Lending conditions worsen in emerging economies

Meanwhile the Wall Street Journal of 19 July reported that lending conditions in emerging economies deteriorated in recent months due to the euro zone crisis.

According to a report of the Institute of International Finance, credit standards grew tighter in emerging-market banks around the world, while bad loans increased in the second quarter. The results suggest trouble ahead for emerging economies, with banks in Asia and Latin America showing deeper caution, which can lead to weaker lending.

The survey in June, covering 132 emerging-market banks, showed a worsening in overall lending conditions for the fourth straight quarter. Almost half of emerging-market banks said funding conditions in international markets tightened in the prior three months, while less than 9% said they eased. A third of emerging-market banks expected bad loans to rise in the third quarter, while only about 15% expected them to drop.

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