

key risk is a disorderly de-leveraging of large intra-European cross-border bank exposures. Such an event could make it impossible for many emerging economies to roll over large amounts of short-term debt and could potentially have a similar effect on some advanced economies that have seen a significant widening of sovereign risk premiums. The result could be a financial and real sector collapse in most emerging and a few advanced economies, with major feedback effects on the other economies. However, there are also some upside risks: if EU countries manage to put in place a forceful, comprehensive, and coordinated response to the financial sector travails, confidence and risk taking might recover faster than expected.

United Kingdom

Real growth in the U.K. fell from 3.0 percent in 2007 to 0.7 percent in 2008 as spending by British consumers decelerated by 1.4 percent in 2008, after increasing 3.0 percent in 2007. Spending slowed for both goods and services. Spending on non-durable goods turned down, while spending slowed for durables and semi-durable goods. Domestic investment fell 3.1 percent after having increased 6.8 percent in 2007, reflecting a downturn in dwellings. Exports of goods and services edged forward in 2008, up 0.1 percent. Imports of goods fell 2.0 percent while imports of services advanced 3.6 percent. Government spending accelerated in 2008, rising 3.4 percent compared to 1.5 percent a year earlier.

The U.K. posted quarterly declines in real output over the last three quarters of 2008, at an accelerating rate of contraction. Real GDP fell at an annual rate of 6.1 percent during the fourth quarter. Looking forward, the recession is expected to be quite severe in the U.K., which is being hit hard by the end of the boom in real estate and the contraction in financial activity. As a consequence, real GDP in the U.K. is forecast to drop by 4.1 percent in 2009 and by 0.4 percent in 2010.

Emerging Economies

Emerging Asia

The impact of the global crisis on economies in Asia has been surprisingly heavy. There were many reasons to expect Asia to be relatively shielded from the crisis: the region was not heavily exposed to U.S. securitized assets, and improved macroeconomic fundamentals and (with a few exceptions) relatively sound bank and corporate balance sheets were expected to provide buffers. Nevertheless, since September 2008, the crisis has spread quickly to Asia and has dramatically affected its economies.

The impact on the real economy through the trade channel has been severe and similar across Asia. The drop in global demand has been particularly focused on automobiles, electronics, and other consumer durable goods that are an integral part of the production structure across east Asia. As a result, exports and industrial production have plummeted.

Spillovers from the global financial crisis to domestic financial markets across Asia have also been substantial. Equity and bond prices have plummeted. Real estate markets have remained under pressure in a number of economies (for example, Singapore and China). Currencies have depreciated in most of the region's emerging economies, although the Chinese renminbi has remained broadly unchanged relative to the U.S. dollar. Portfolio and other flows have dwindled, implying tighter domestic credit conditions. As a result, many banks and firms have begun to experience serious stress.

Growth projections for Asia have been marked down to varying degrees, in line with weaker global demand and tight external financial conditions. The exact channels of transmission of the external shocks and the severity of their impact vary considerably across economies. Despite these impacts, emerging Asia is expected to continue to grow, led by China and India. A modest recovery is projected in 2010, underpinned by a pickup in global growth and a boost from expansionary fiscal and monetary policies.