

## Global Economic Performance

### Overview and global prospects

The continuing rise in oil prices, underlying the economic developments of 2006, took a backseat to the turmoil in global financial markets that emerged out of the American subprime mortgage problem in mid-2007. With a sharp downturn in the United States and the spreading crisis in financial markets, global economic activity decelerated in the second half of 2007. Nonetheless, over the full year, the growth in world output edged down only marginally from 5.0 percent in 2006 to 4.9 percent<sup>1</sup>.

Commodity markets have continued to boom despite the recent slowing global activity. Strong demand from emerging economies, which has accounted for much of the increase in commodity consumption in recent years, has been a driving force in the price run-up, and biofuel-related demand has boosted prices of major food crops. At the same time, supply adjustments to higher prices have lagged, particularly for oil. Somewhat perversely, the strength in commodity prices also seems to have been at least partly due to financial factors, as commodities have increasingly emerged as an alternative asset class. As a result, headline inflation has increased around the world, particularly in the developing economies<sup>2</sup>.

The financial shock originating in the U.S. subprime market spread quickly and unpredictably to inflict extensive damage on markets and institutions at the core of the financial system<sup>3</sup>. The fallout has

curtailed liquidity in the interbank market, weakened capital adequacy at major banks, and prompted the repricing of risk across a broad range of instruments. Equity prices have also retreated as signs of economic weakness have intensified, and evidence is gathering of a broad credit squeeze. However, the trade spillovers from the slowdown in the advanced economies have been limited so far and are more visible in economies that trade heavily with the United States. The financial market stress also had an impact on foreign exchange markets and the U.S. dollar has depreciated further since mid-2007. This, in turn, has helped boost U.S. net exports.

Prospects are for a marked slowdown in 2008 that will linger on through most of 2009. The problems in the United States have spread to western Europe and are spilling over into the real economy worldwide. Global growth is now projected to slow to 3.7 percent in 2008 (Table 1-1). However, achieving this rate will require that most advanced economies experience only mild slowdowns and that many developing economies keep their rapid pace of growth largely on track.

### The United States

For the third straight year, the pace of economic activity in the U.S. economy slowed as real gross domestic product (GDP) grew by 2.2 percent in 2007 compared to 2.9 percent a year earlier and 3.1 percent the year before that. Real growth in the economy weakened sharply in the fourth quarter

1 All projections in this chapter come from the International Monetary Fund's *World Economic Outlook*, April 2008.

2 Headline inflation gauges the rate at which the cost of living is rising. That is, it measures the rate of change in the consumer price index (CPI).

3 *World Economic Outlook*, Executive Summary.