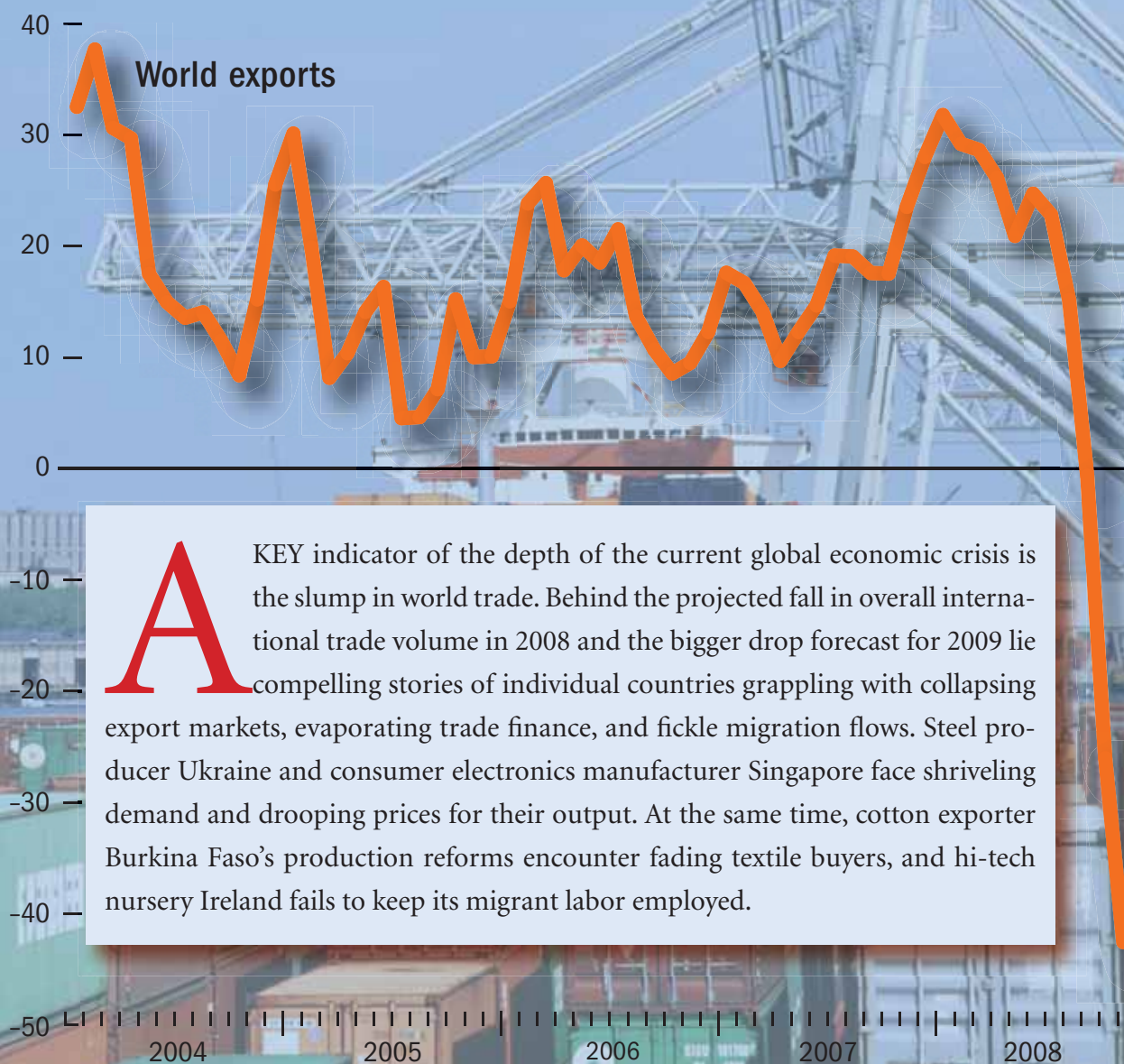


# Deep Impact

Four countries confront the harsh and disruptive effects of the global economic downturn

(merchandise export value, annualized three-month percent change)



**A** KEY indicator of the depth of the current global economic crisis is the slump in world trade. Behind the projected fall in overall international trade volume in 2008 and the bigger drop forecast for 2009 lie compelling stories of individual countries grappling with collapsing export markets, evaporating trade finance, and fickle migration flows. Steel producer Ukraine and consumer electronics manufacturer Singapore face shriveling demand and drooping prices for their output. At the same time, cotton exporter Burkina Faso's production reforms encounter fading textile buyers, and hi-tech nursery Ireland fails to keep its migrant labor employed.

Sources: Haver Analytics; and IMF staff estimates.

# Metal Fatigue

## Ukraine's steel earnings buckle with the world economy

David Hofman

WORLD steel prices are highly sensitive to global economic downturns. The earnings of major steel exporters such as Ukraine are therefore closely linked to trends in the world economy. As global car manufacturing and construction activity—and hence steel prices—have sunk in the deepening world slowdown, Ukraine's fortunes have been dragged down too, weighed down further by overdue policy decisions.

The economy of Ukraine, the world's eighth-largest steel producer, depends heavily on developments in its steel sector. Measured directly, the steel industry accounts for about 12 percent of Ukraine's national income, and for more than one-third of total exports of goods. Large as these numbers may already be, indirectly steel is even more important because many other economic activities depend on the steel sector. As a result, GDP growth in Ukraine tends to track developments in world steel prices (see chart).

Ukraine's strong link to metals prices previously helped boost the economy. A 2000–08 surge in steel prices—to levels far above their long-term downward trend—underpinned Ukraine's largely favorable export performance and impressive GDP growth: between 2001 and 2007, the Ukrainian economy grew by an average of 7½ percent a year in real terms. Export earnings and generous capital inflows fueled domestic credit growth, and equity and house prices soared. The external current account deficit rose strongly as imports jumped, and inflation began spiraling out of control. Meanwhile the government's policies, in particular the de facto exchange rate peg, failed to address the building imbalances.

### Sharp correction

Although steel prices clearly could not remain at the high levels of 2007 and 2008, few could have foreseen the dramatic speed with which steel prices came down in late 2008. Amid the global economic crisis, the commodity boom of recent years ended abruptly, and with global car sales slumping and a sharp contraction in construction activity, steel was particularly badly affected.

By early November 2008, steel prices had fallen more than 80 percent from their near-peak levels in August, bringing prices close to their long-term-trend levels. Even though the



A steel mill in Donetsk, Ukraine.

speed of the adjustment was exceptional, the sharp correction in steel prices itself was not without precedent. Indeed, steel prices have plummeted in every global recession since the early 1970s, each time bringing steel prices back to or beneath their long-term trend.

The collapse of steel prices has hit Ukraine hard. Led by a 50 percent fall in steel production, industrial production fell by about 25 percent between September and December 2008, and exports plunged. Overall economic performance slumped. Preliminary GDP figures show that real output contracted by about 9 percent in the fourth quarter in seasonally adjusted terms. All this was compounded by a simultaneous crunch in the availability of external financing, related to reduced risk appetite among international investors. This caused Ukrainian bond spreads to soar, and the local stock market lost about 75 percent over the year.

### Untenable currency regime

The combination of the large steel price shock and the loss of access to international capital markets made Ukraine's rigidly managed

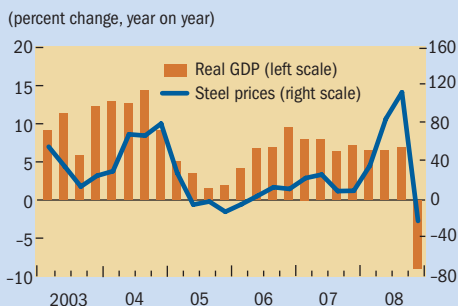
exchange rate regime untenable. Concerns about exchange rate volatility and the stability of the banking system then caused a run on deposits. This put the banking system—already vulnerable due to recent rapid credit growth, including in foreign currency to unhedged households—under heavy strain.

To deal with the negative effects of the steel price shock and of the squeeze in external financing, Ukraine's authorities are implementing a policy adjustment program that is supported by a \$16.4 billion IMF loan approved in November 2008. ■

*David Hofman is an Economist in the IMF's European Department.*

### Bolted together

The economy of Ukraine, the world's eighth-largest steel producer, depends heavily on developments in its steel sector.





# Reboot Required

## Dwindling demand in major export markets freezes Singapore's electronics industry

Roberto Guimaraes and Alessandro Zanello

WESTERN markets that for years eagerly sought consumer electronics made in Singapore have fallen off a cliff in the past 12 months. European and American gadgeteers who had repeatedly rushed to stores for new-generation computers, smartphones, and digital cameras now stay at home, out of credit and confidence. The global downturn has hit Singapore head on: the economy, which experienced rapid growth of almost 8 percent in 2007 managed only 1½ percent last year.

This high sensitivity to global events reflects Singapore's industrial structure and areas of specialization. One-third of the economy—revolving around manufacturing, especially of information technology products, trading services, and some financial activities particularly vulnerable to shifts in investor confidence—is directly affected by advanced economies' growth.

Another third of economic activity is influenced mostly by regional developments. Both sectors are being hit significantly (see chart), and the shock waves of falling external demand are having an impact on more domestically oriented industries such as construction and utilities.

### Commitment to openness

Singapore's engagement with the international trade and financial systems is exceptional by many metrics, so a large impact is to be expected when the world economy wobbles. Exports account for 230 percent of GDP, and the city-state is a vibrant financial hub in Asia. More than 100 foreign banks, with assets equivalent to nearly six times GDP, use Singapore as a base for regional operations; three domestic banks are also major providers of liquidity to regional firms and multinationals.

But deep economic and financial integration carries with it exposure to global financial shocks and the business cycle of trading partners. For example, a recent IMF study shows that a slowdown in the United States translates into almost a one-for-one decline in the pace of activity in Singapore.

### One-two punch

In fact, the current crisis packs a one-two punch for reeling Singapore. Contagion is occurring through both the trade and the financial channels.



A digital video disc player assembly line in Singapore.

**Trade.** Exports shrunk by 25 percent in the fourth quarter of 2008 compared with the same period in the previous year, after also contracting in the previous two quarters. The export slump has been broad based. The contraction in electronics exports (which account for one-third of total exports) started in early 2007 and has now become the longest on record. Worse still, the export fall has deepened since early 2008. Meanwhile, shipments of petrochemical and pharmaceutical products that had held up through 2007 have taken a dive. Exports to the United States and the European Union have been particularly affected so far, but exports to Asia, which absorbs more than one-half of Singapore's total exports, have also started to feel strong headwinds.

**Finance.** The global financial turmoil has also affected equity prices and credit. Singapore's stock index fell 50 percent in 2008 and volatility spiked. Interbank lending in U.S. dollars has slowed considerably as global liquidity tightened—and only timid signs of recovery are in sight. With higher bank funding costs, there have

been reports of cutbacks on trade financing that could bring wider disruptions in trade activity by putting firms under additional stress.

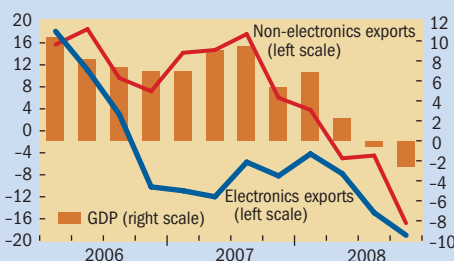
On the upside, the authorities are taking decisive action to cushion the impact of the global crisis. The central bank has eased the stance of monetary policy and introduced deposit guarantees to shore up confidence in the banking system. On the fiscal front, the 2009 budget is appropriately expansionary and includes a range of tax and spending measures to help businesses and households, including tax rebates, infrastructure spending, and loan guarantees. ■

*Roberto Guimaraes is an Economist and Alessandro Zanello is Assistant Director in the IMF's Asia and Pacific Department.*

### Network down

Singapore's information technology-based electronics exports have crashed and taken the city-state's economy with them.

(percent change, year on year)



Sources: CEIC Data; and IMF staff calculations.

## In a Spin

### Plunging prices leave Burkina Faso's cotton companies in a difficult situation

Isabell Adenauer, Norbert Funke, and Charles Amo Yartey

AS the global economic crisis cut demand for textiles and depressed cotton prices, Burkina Faso's cotton farmers at first were insulated from the worst effects of the commodity price shock. A new producer price mechanism helped put cotton sector finances on a sounder footing. But as the crisis escalates, cotton companies face a choice between selling or stocking during an extended slide in the world cotton price.

Cotton accounts for about 60 percent of exports in Burkina Faso, sub-Saharan Africa's biggest cotton producer. The cotton sector provides about 700,000 jobs, employing about 17 percent of the population, and many more people benefit indirectly. In several rural areas, where poverty is high, the sale of cotton seed is the main or even only source of cash revenue. The expansion of cotton growing has stimulated production of cereals, mainly because fertilizer financed with cotton credit can also be used for other crops. As a result, poverty has been reduced by one-quarter in cotton-growing areas.

#### Cotton sector reforms

Although the past few years have been difficult for Burkina Faso's cotton production, the sector was about to recover when the global economic crisis started. Ginning companies, which separate the cotton fiber from seeds and stalks, sell at world prices and incurred sizable financial losses during 2005–07, partly because of an inflexible pricing mechanism that prevented the pass-through of lower cotton prices to producers. In 2007, Burkina Faso's cotton production declined by more than 40 percent because of late rainfall and low international cotton prices.

Several institutional and policy reforms followed.

- A market-based producer price mechanism was established. It sets producer prices, based on a five-year centered average of world prices, at the beginning of each growing season.
- A smoothing fund was created to support the price mechanism for producers and compensate ginning companies should world market prices fall below producer prices.
- Big ginning company losses required a recapitalization of the largest, SOFITEX, in 2007, which increased government ownership of the company from 35 percent to more than 60 percent.

#### The crisis and cotton

The global economic crisis affects the four main stakeholders in the cotton sector in different ways.



The cotton harvest in Boromo, Burkina Faso.

**Producers.** The new producer price mechanism gave farmers certainty about sale prices at the beginning of the 2008 season, isolating them from the price decline later in the year. Cotton production in 2008 was thus not affected by the plunge—down about 40 percent from the March peak—in cotton prices during the year (see chart). In fact, cotton production exceeded expectations, reaching more than 500,000 tons because of good weather conditions. But producers will be affected directly if crisis-related demand continues to depress cotton prices in coming years.

**Ginning companies.** They protected part of their income by selling about one-third of their production forward when the average cotton price was still relatively high. For their unhedged production, the companies now face a difficult choice: sell at current spot prices or stock ginned cotton in the hope that international prices recover. However, postponing sales carries the risk that prices may decline further. Moreover, sales contracts are needed to finance the rest of the current season, because banks take them as guarantees.

**Banking sector.** Local and international banks provide financing for the cotton sector, and local banks have important exposure to the crop. A reduction in credit or higher borrowing costs would jeopardize the equilibrium of the sector.

**Government.** Although the government plans to gradually withdraw from the cotton sector, it is having difficulty identifying a strategic partner for SOFITEX. If cotton prices continue to decline, a drying up of the smoothing fund could eventually lead to calls for government support.

Although the cotton sector in Burkina Faso has so far managed to weather the global storm, its fortunes depend on the outcome of the current season, international cotton prices, and financing conditions. That is why reforming the sector to improve productivity is more important than ever. Burkina Faso is currently experimenting with genetically modified cotton, which promises a productivity gain of about 30 percent. It may also explore the scope for more cooperation with cotton producers in other West African countries. ■

Isabell Adenauer, Norbert Funke, and Charles Amo Yartey are, respectively, Resident Representative, Mission Chief, and Economist for Burkina Faso in the IMF's African Department.

#### Bobbin lower

The global economic crisis cut worldwide demand for textiles and depressed cotton prices during 2008.

(international cotton prices, U.S. cents per pound)



Sources: DataStream; and IMF staff estimates.

# High Mobility

## Newly unemployed migrants to Ireland may stay put in recession

Siobhán McPhee

**R**APID economic growth in the early 1990s transformed Ireland from a land of emigration and few opportunities to one with a high demand for labor. It became a ready destination for foreign workers. Now, the global recession has hit hard in Ireland—harder at the foreign workers than at Irish nationals. But it is unclear whether this reversal in fortune will result in a mass exodus of non-Irish nationals. So far many of them appear to be staying—in part because of generous social benefits and in part because there are few, if any, alternative destinations where they can find jobs.

### The Celtic Tiger

In the early 1990s, labor shortages first appeared in high-skill sectors, such as information technology. Many Irish people who had emigrated in the 1980s returned from the United Kingdom and the United States to meet some of this demand. But as the so-called Celtic Tiger continued to grow, other sectors began to experience labor shortages that were filled by foreign workers. Among these sectors was hospitality—restaurants, hotels, and entertainment. Shortages were especially acute in nursing, prompting the Irish government to actively recruit nurses in the Philippines and Sri Lanka.

Non-Irish workers in Ireland represented 16 percent of the population in July–September 2008, according to the Quarterly National Household Survey (QNHS). After 2004, when eight Eastern European countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia) joined the European Union (EU), the majority of migrant workers to Ireland came from these countries—especially from Poland.

But the global economic recession has dramatically set back the Celtic Tiger. Unemployment has risen sharply, from 4.8 percent in the third quarter of 2007 to 7 percent in the same period of 2008, according to the QNHS. Irish immigrant workers have felt the impact of declining production more than have Irish nationals. Similarly, more immigrants have signed on to the live register—where job-related claims are filed with county welfare offices—than have Irish nationals. The unemployment rate among non-Irish workers was 9 percent, compared with 6.1 percent among nationals. The number of non-nationals signing on to the live register increased by 100 percent between October 2007 and October 2008, compared with a 52 percent rise among nationals.



An English class in Lublin, Poland.

Higher unemployment among migrants comes as no great surprise. The vast majority of the Eastern European migrants to Ireland were lured by the construction and financial sectors—both of which experienced heavy job losses in 2008. But the employment situation is different in some other sectors. Hospitality, a major employer of migrants, is not hiring, but hospitality employers are not cutting staff either. Moreover, job losses are occurring in some high-skill sectors—particularly in those related to the construction industry, such as engineering and architecture. Some Irish nationals are again emigrating, seeking work in Australia, New Zealand, and even the oil-rich countries of the Middle East, according to recent reports.

### Migrants may stay

But the reality is that Irish emigration never ceased, even when some highly skilled workers were returning and increasing numbers of foreign workers were settling in Ireland (see chart). And this recent increase in emigration of high-skilled Irish nationals may not be accompanied by large numbers of migrant departures. If the recession in major European countries during the late 1970s and 1980s is a guide, Ireland would not experience an exodus of migrant workers. But times are different and migrant workers lead highly mobile lives. Workers could choose to go where jobs are more readily available or they could choose to return home. But they may just stay put.

Ireland's relatively liberal social welfare system could dissuade many migrants from leaving. Migrants from other EU countries qualify for social welfare benefits after working and paying taxes in Ireland for two years. Non-EU migrants must

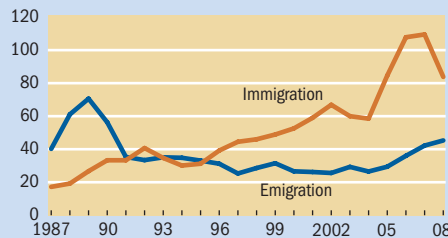
have been living in the country for five years and working for the entirety of this period to qualify. Immigration peaked in 2006. As a result, many, perhaps most, immigrant workers qualify for benefits. Because the entire EU is in a recession, as are most major economies around the world, jobs elsewhere might not be readily available and rather than risk a move in search of work, many migrants may choose to stay in Ireland and ride out the storm. Although Ireland's rate of emigration in 2009 may once again be close to that of the 1980s, as the Training and Employment Authority predicts, Ireland has become an immigration country. ■

*Siobhán McPhee is a doctoral candidate in Public Policy in the School of Geography, Planning and Environmental Policy at University College, Dublin.*

### Heading to the Emerald Isle

Ireland's once booming economy attracted workers from abroad. But, in the current economic crisis, emigration is up and immigration is slowing.

(thousands of persons)



Source: Irish Central Statistics Office.  
Note: Data preliminary for 2007 and 2008.