OECD ECONOMIC OUTLOOK, No. 84, PRELIMINARY EDITION

CHAPTER 3: DEVELOPMENTS IN SELECTED NON-MEMBER ECONOMIES

(Note by the Secretariat)

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CHAPTER 3
DEVELOPMENTS IN SELECTED NON-MEMBER ECONOMIES

BRAZIL

The expansion that gathered pace during 2007 was sustained in the first half of 2008, although activity appears to be slackening owing to a worsening of financial conditions. Domestic demand has been the main driver of growth. The trade surplus is shrinking, essentially due to buoyant demand for imports, and the current account has shifted into deficit. Dynamism in the labour market continued to deliver robust job creation. Inflation picked up considerably through mid-year.

Further monetary tightening is expected in the near term, despite a falling output gap in 2009, to quell the inflationary pressures arising from a sharp exchange rate depreciation. The primary budget surplus target is expected to be met, although the 2009 draft budget law calls for further increases in expenditure. Reversing the trend of increasing public spending is among Brazil’s main macroeconomic policy challenges.

**Growth remains strong but is losing steam**

GDP grew by 6.1% on a year-on-year basis in the second quarter, a pace of expansion little changed since end-2007. Domestic demand continued to outpace GDP growth, supported by vigorous private consumption and strong investment spending. Rising imports have

1. 12-month ahead, year-on-year percentage change.
Source: Central Bank of Brazil and IBGE.
narrowed the trade surplus. This is widening the current account deficit (coupled with record-high investment income payments), following five years of surpluses. Export performance has remained robust, buttressed by still vigorous external demand and price gains, and despite a strong, albeit declining, exchange rate. Job creation has been particularly robust in labour-intensive sectors, such as construction, supported by dynamic investment demand. Unemployment fell marginally during the first semester and remains at historically low levels. From the supply side, agriculture and manufacturing continue to lead the expansion. Recent indicators, such as sales, capacity utilisation and industrial production, nevertheless point to a deceleration in activity in the coming months.

### Brazil: Macroeconomic indicators

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<td>Primary fiscal balance (per cent of GDP)</td>
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<td>Current account balance (per cent of GDP)</td>
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<td>0.1</td>
<td>-1.7</td>
<td>-2.2</td>
<td>-2.4</td>
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Note: Real GDP growth and inflation are defined in percentage change from the previous period. Inflation refers to the end-year consumer price index (IPCA).

Source: Figures for 2006-07 are from national sources. Figures for 2008-10 are OECD projections.

### Monetary policy continues to be tightened

Inflation rose considerably in mid-year and remains well above the central target. Rising food and energy prices contributed, but strong demand growth has been the main source of inflationary pressures. The authorities responded with a cumulative 250-basis-point policy-rate hike since April to 13.75% in September, and left the rate unchanged in October. Wholesale-price inflation began to recede in August, reflecting global

### Brazil

1. Cumulated 12-month flows.

Source: IBGE and Central Bank of Brazil.
trends in commodity prices, but gathered pace again from October owing to a sharp depreciation of the real in September/October. The 6.5% ceiling of the end-year target range is unlikely to be breached, but the exchange rate depreciation will exert upward pressure on prices over the coming months.

Brazil: External indicators

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<tr>
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<td>$ billion</td>
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<td>203.5</td>
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<td>Goods imports</td>
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<td>176.6</td>
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<td>Services, net</td>
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<td>Invisibles, net</td>
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Percentage changes

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<td>Goods export volumes</td>
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<td>Goods import volumes</td>
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<td>2.5</td>
<td>-2.5</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

Source: Figures for 2006-07 are from national sources. Figures for 2008-10 are OECD projections.

External credit conditions have deteriorated

The economy has not been immune to the deteriorating global financial environment. External financial conditions tightened considerably in the third quarter, with a steep increase in sovereign risk premia. Domestic bank credit growth remains healthy but is losing steam. The central bank relaxed reserve requirements in September/October to alleviate pressure in the interbank market and took measures to tackle liquidity shortages in second and third-tier banks. Most recently, a temporary $30 billion swap facility was set up between the Brazilian and US central banks. The performance of domestic equity and corporate bond markets has suffered as the global appetite for risk has diminished.

Fiscal policy is on track...

Fiscal performance has been solid, with the consolidated primary budget surplus at about 4.4% of GDP on a 12-month cumulative basis in August. This outturn has been aided in part by cyclical revenue gains, which have more than compensated for the losses associated with the non-renewal of the bank debit tax (CPMF) at end-2007. A strong labour market is boosting formal employment, thus raising social security revenues and reducing the payment of social benefits. Capital outlays are on the rise, including disbursements under the federal investment package (PAC) launched in 2007. But federal payroll spending is trending up as a result of recent wide-ranging changes in career streams and hikes in compensation. The public debt-to-GDP ratio continues to fall, although ongoing monetary tightening is putting upward pressure on the interest bill.

… but expenditure is again being raised

The 2009 draft federal budget law, submitted to Congress in August, maintains the primary budget surplus target at 3.8% of GDP. An additional surplus of 0.5% of GDP, if it materialises, is expected to be earmarked to finance deposits in Brazil’s soon-to-be-created sovereign wealth fund. The draft budget is predicated on additional revenue gains and a proposed 12% increase in the minimum wage, well ahead of expected labour productivity growth, as well as further increases in civil service compensation and
outlays on social benefits. The primary budget surplus target is expected to be met, despite these increases in expenditure and the adverse impact of the deceleration of economic activity on revenue.

The government announced its intention to shift the current fiscal target from a primary surplus to an overall balance from 2010. A band would be defined around this balance to deal with uncertainty about fluctuations in the interest bill arising from changes in the monetary stance. Brazil’s still high, although declining, share of floating-rate securities in the government debt stock makes its debt dynamics particularly sensitive to monetary policy moves. The authorities also announced their intention to shift the public accounts gradually to full accruals from the current cash-flow basis, although the timeframe for implementation has not been announced.

Activity is expected to lose impetus in the first half of 2009, due to ongoing credit tightening, but to regain strength towards year-end and into 2010. Domestic demand will in all likelihood continue to drive growth. The current account deficit is set to widen on the back of solid, albeit weakening, import growth, while export growth weakens along with global demand. Moreover, the terms of trade are already deteriorating as a result of falling commodity prices. With the positive output gap gradually shrinking in 2009, and once the second-round effects on prices of a weaker exchange rate have begun to fade, inflation is poised to converge to the 4.5% central target over the forecast period. Further monetary tightening is projected in the coming months, possibly at a slower pace than in the recent past, but is unlikely after mid-2009, once disinflation has been secured.

A further deterioration of the global financial environment and global demand is the main source of risk to the Brazilian economy. A further sharp decline in commodity prices may raise concern among market participants about the resilience of Brazil’s external accounts, especially in an environment of heightened risk aversion. On the domestic front, disinflation may prove to be more gradual than envisaged as a result of a weaker real. In this case, the monetary tightening cycle may be longer than projected.
GDP growth has fallen, from a peak of nearly 12% to a pace in the high single digits. Export growth is weakening and, with slower capital formation, domestic demand is also projected to ease in 2009, before recovering in 2010. Disinflation is on course to continue, in part due to moderating commodity prices but also reflecting slower output growth.

The fiscal position is healthy and, even though the government has already introduced a package to stimulate demand, income tax cuts could also be considered. With headline inflation declining, monetary policy has scope to further offset the impact of the global downturn, following recent interest rate cuts. Lower inflation also provides an opportunity to re-align energy prices with underlying costs; major hikes in electricity prices are required to alleviate shortages and stimulate much-needed investment spending in the sector.

_GDP growth continues to moderate_

Growth has moderated for seven quarters in a row. Reflecting the global downturn and increasing domestic costs, real exports have been losing momentum since mid-2007, which has resulted in a marked fall in the growth of imports used in export processing industries over recent months. The trade balance has been broadly stable for the past 18 months at around $200 billion at an annual rate.

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_Source: CEIC._
Domestic demand rebalances away from investment

Domestic demand growth has also softened since late 2007. Growth in real fixed investment continues to trend downwards, largely reflecting a slump in real estate investment driven at least partly by the tightening in monetary policy through to mid-2008. In a number of cities in China’s coastal manufacturing regions, residential property prices have fallen considerably. Nationally, real house prices have declined by 3.5% from their end-2007 peak. Industrial production has also slowed in 2008, reflecting inter alia the re-emergence of electricity shortages and restrictions imposed for the Olympics. Profit growth has fallen by half to 20% in 2008 compared to 2007. Although nominal wage growth has been strong, high inflation during the year to Spring 2008 has eroded the gains in purchasing power. On the other hand, buoyant real retail sales in recent months indicate ongoing resilience in consumption spending.

Source: CEIC.
Inflation is falling as food prices moderate

Even with increases in regulated energy prices, consumer price inflation declined rapidly from a peak of 8.7% in February 2008 to 4% by October. Disinflation has been driven by lower food prices. Non-food price inflation continues to increase gradually and is currently running at just over 2%. Upstream pricing pressures have also moderated but remain somewhat elevated, with producer prices up by 6.6% in October.

China: External indicators

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<th>2008</th>
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<td>Goods and services exports</td>
<td>1 061.7</td>
<td>1 342.2</td>
<td>1 620.9</td>
<td>1 772.7</td>
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<td>852.8</td>
<td>1 034.8</td>
<td>1 298.3</td>
<td>1 418.8</td>
<td>1 624.0</td>
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<td>Foreign balance</td>
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<td>307.4</td>
<td>322.5</td>
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<td>Net investment income and transfers</td>
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<td>76.1</td>
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<td>Current account balance</td>
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<td>371.8</td>
<td>398.6</td>
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<tr>
<td>Goods and services export volumes</td>
<td>23.8</td>
<td>19.9</td>
<td>9.4</td>
<td>5.7</td>
<td>10.7</td>
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<tr>
<td>Goods and services import volumes</td>
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<td>7.9</td>
<td>9.3</td>
<td>12.7</td>
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<td>Export performance¹</td>
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<td>13.3</td>
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<td>Terms of trade</td>
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<td>-1.2</td>
<td>-5.1</td>
<td>3.5</td>
<td>0.3</td>
</tr>
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</table>

¹. Ratio between export volume and export market of total goods and services.
Source: OECD Economic Outlook 84 database.

Monetary policy has changed focus from inflation to growth

Faced with heightened volatility in asset markets and extreme global uncertainty, the People’s Bank of China has signalled its intention to support growth. Accordingly, since mid-September it has cut the benchmark lending rate three times and the benchmark deposit rate twice, in 27 basis point steps. In addition, the lower bound on commercial bank lending rates has been cut from 90% to 70% of the benchmark lending rate for home loans. The People’s Bank has also cut the reserve requirements of the smaller banks -- which tend to serve small and medium-sized enterprises -- by 100 basis points and of the top-tier banks by 50 basis points. The interbank market remains insulated from the turmoil in global money markets and interest rates have been relatively stable. From end-July the appreciation of the renminbi vis-à-vis the US dollar has been brought to a halt. However, given the strengthening of the US dollar, the renminbi’s effective exchange rate has appreciated. Reflecting greater global risk aversion and flat net exports, foreign exchange reserve accumulation has slowed sharply. Growth in M2 and bank lending remains low, leading to the removal of credit quotas by the People’s Bank.

The fiscal position is sound

The Government accounts remain healthy, with a budget surplus and a low debt-to-GDP ratio. Partly as a result of windfall revenues from the special tax on crude oil production, government revenues were buoyant over the first half of 2008, growing three percentage points faster than expenditure. They have slowed somewhat since, however, in line with moderating economic growth. Overall, it would seem that the fiscal surplus is running at around the same level so far in 2008 as in 2007. Against this backdrop of a strong fiscal position, the government has announced a stimulus package designed to support growth. A number of infrastructure
projects have been approved and brought forward and social spending increased. In an effort to stimulate investment the government has also moved to cut the cost of capital by making the value-added tax on investment goods fully deductible. The export tax rebate on selected goods has also been increased and the State Council has established a fund to finance low-cost housing.

Looking forward, growth is likely to moderate further, and the annualised quarter-on-quarter growth rate is projected to fall below 8% in the near term. Global uncertainties and the correction in the domestic housing market will restrain investment spending, keeping domestic demand soft into the first half of 2009 before it recovers gradually into 2010. Export growth is projected to remain subdued in 2009 and then to pick up in 2010. China’s export market share is likely to expand at a slower pace than in the past as unit labour costs are rising markedly. Import growth is projected to gather pace as domestic demand increases, leading to some decline in the current account surplus as a share of GDP in 2010, despite the improvement in the terms-of-trade. Lower commodity prices coupled with a spell of subpar growth should ensure that inflation continues to ease during 2009 and then stabilises in 2010.

The rebalancing of growth away from net exports towards domestic demand, with an emphasis on stimulating investment spending, is set to continue. This transition entails stresses in some sectors of the economy, particularly the export-oriented ones. A risk to growth is that exports prove to be more sensitive to falling foreign demand than assumed in the projections or that exporters do not cut prices. Also, if consumption were to react more than expected to the erosion in wealth, the slowdown in growth could be larger than projected. On the other hand, although the exact stimulus flowing from the November 10 package is uncertain, and has not been included in the baseline projections, it is clear that the package represents a major upside factor for the development of the economy over the next two years. Capital formation is likely to be boosted both in the government sector, through accelerated outlays on infrastructure, and in the company sector, through the change in the value-added tax regime. This latter reform will significantly lower the user cost of capital for firms, so stimulating their investment.
INDIA

Growth has continued to slacken to under 8% by the second quarter of 2008. Inflation is high, driven by commodity prices, but the peak appears to have passed. The current account deficit has risen substantially and there is downward pressure on the exchange rate. The economy is projected to slow further over the next year and to recover in tandem with the world economy in 2010.

Unchecked fiscal spending during the expansion has left the Indian authorities with little room for manoeuvre in the ongoing slowdown. At the same time, foreign institutions have become more reluctant to invest in India. A period of fiscal retrenchment seems desirable, focussed on making government subsidies available only to those in real need.

The economy continues to slow

From a peak growth rate of 11% during 2006, the economy slowed markedly, to 7.9% by the second quarter of 2008. Private consumption and investment have both lost momentum, and the drag from foreign trade has become more pronounced. Government consumption, however, has picked up. The slowdown continued in the third quarter of 2008, with industrial production up only 4.5% in July-August over a year earlier.

The external deficit has widened

Since mid-2007, the nominal value of imports of goods and services has increasingly outpaced exports, notably due to previously rising oil prices and slowing software sales. Accordingly, the current account deficit widened to 2% of GDP in the first half of 2008, against only 0.5% a year earlier.

Source: Centre for Monitoring the Indian Economy.
India: Macroeconomic indicators

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<thead>
<tr>
<th></th>
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<th>2007</th>
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<td>Real GDP growth</td>
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<td>Inflation(^1)</td>
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<td>Wholesale price index (WPI)(^3)</td>
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<td>Fiscal balance (per cent of GDP(^6))</td>
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Note: Data refer to fiscal years starting in April.
1. Percentage change in GDP deflator from previous period.
2. Consumer price index for industrial workers.
3. All commodities.
4. Mumbai three month offered rate.
5. 10 year government bond.
6. Gross fiscal balance for central and state governments, includes net lending and transfers to oil, food and fertiliser companies and recurrent Pay Commission awards, but not backpay nor debt write-offs for small farmers.

Source: CMIE and OECD projections.

But inflation is beginning to ease

Inflation, as measured by the 12-month rate of change in the wholesale price index, has run at a double-digit pace since June 2008. However, and notwithstanding the serious problems plaguing this index (as well as the various consumer price indices), the inflation peak seems to have passed. Indeed, the quarterly rate of inflation has eased considerably in recent months, despite substantial effective exchange rate depreciation. This largely reflects the very sharp deceleration in the prices of metals and petroleum. Going forward, all indicators of inflation are expected to ease, in a context of lower commodity prices and slower growth.

Equity prices and the exchange rate have weakened

Wholesale price inflation has eased

1. Primary products include agricultural, food and energy products, metals and cement.

Source: Centre for Monitoring the Indian Economy.
Capital outflows are causing stress

Pressure on the exchange rate has stemmed from a marked re-assessment of the Indian stock market by foreign investors, leading to a negative swing in portfolio investment of 6% of GDP in the year to second quarter of 2008. The Reserve Bank increased rupee purchases and hiked interest rates, but the exchange rate slide continued in the third quarter. Despite controls on short-term capital flows, volatility in domestic interest rates shot up from mid-year onwards. With the intensification of the global financial crisis in September, the stock market continued to weaken and by end-October equity prices were 53% below their January 2008 peak. To mitigate the impact of slower world growth, the Reserve Bank reduced the cash reserve ratio for banks by 350 basis points, to 5.5%, thereby injecting liquidity equivalent to 4% of GDP into the banking system, and lowered its repo rate by 150 basis points, to 7.5%.

### India: External indicators

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<td>Net investment income</td>
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<td>Transfers</td>
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<td>Current account balance</td>
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<td>-25.0</td>
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Percentage changes

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</tr>
<tr>
<td>Goods and services import volumes</td>
<td>24.5</td>
<td>7.7</td>
<td>6.0</td>
<td>6.5</td>
<td>8.0</td>
</tr>
<tr>
<td>Terms of trade</td>
<td>5.2</td>
<td>-0.6</td>
<td>-4.2</td>
<td>4.5</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Note: Data refer to fiscal years starting in April.
Source: National sources and OECD projections.

Fiscal consolidation appears to have been abandoned

Fiscal consolidation efforts have been greatly relaxed. The on-budget fiscal data show impressive deficit reductions at both the central and state levels since the introduction of the Fiscal Responsibility and Budget Management Act (FRBMA) in 2004 and its subsequent generalisation in the states. So far this fiscal year, however, total central government receipts have fallen while expenditure grew slightly. In addition, off-budget spending and unfunded commitments have risen. Pay increases for public sector employees, as set by the Pay Commission, and the waiver of loans for small farmers introduced in the previous budget look set to add an additional 1% of GDP to the central government fiscal deficit in 2008 and more to the deficits of state governments. Moreover, while the Government has so far only committed to reimburse the banks one third of the cost of the latter initiative, the projections assume that the government will shoulder all of the cost during the projection period (1.4% of GDP). In addition, off-budget outlays on food, fertilizer and oil subsidies could amount to an additional 3% of GDP in the current fiscal year, or even
more according to official estimates. All in all, it would seem that the constraints imposed by the FRBMA have led to soaring off-budget expenditure, bringing the consolidated fiscal deficit (including off-budget items) to 10% of GDP in fiscal year 2009.

**Growth is to be more subdued this year and next**

The projections for the Indian economy are predicated on a gradual return to normal conditions in global financial markets beginning in late 2009 and on a constant nominal exchange rate. Even in these circumstances, pressure on the currency may limit the room for further cuts in interest rates, so that the real rates facing consumers and firms will rise markedly, weighing on domestic demand. Moreover, the recent fall in the exchange rate may only be sufficient to offset the slowing of world trade. With lower commodity prices and subpar growth, inflationary pressures should ease. Falling oil prices will not directly affect the price level, due the subsidisation and regulation of energy prices. However, they will reduce the toll on public spending. Overall, growth is projected to drop to around 7% in 2008 and 2009 before recovering to over 8% in 2010 as world growth picks up.

**High fiscal deficits might deter foreign investment**

The Indian economy faces the risk of a loss of confidence on the part of international investors. This is linked to a global flight towards the safest assets, but also to the serious loss of fiscal discipline that has led some credit agencies to downgrade India’s sovereign debt. As debt issuance increases, the risk premium on Indian paper could rise, further depressing stock market prices. This could trigger additional withdrawals of foreign equity and put further downward pressure on the exchange rate. In turn, non-resident Indians may delay transfer payments, which are an essential source of finance for the current account. On the upside, however, the likely decline in inflation could help restore confidence more rapidly than envisaged, which would support demand and activity.
RUSSIAN FEDERATION

The fallout from the global financial crisis will sharply reduce real GDP growth in Russia through 2009, with a pick-up expected in 2010. With a reversal in the substantial rise in oil and metal prices, the pattern of terms of trade gains fuelling rapid growth in domestic demand has come to an end. Inflation has risen strongly, but may now have peaked and should decline in 2009-10. Fiscal and current account balances are expected to worsen sharply.

Policy challenges will multiply in a new environment of more binding fiscal constraints. At a minimum, less economically efficient forms of stimulus, like reducing the rate of value-added tax, should be resisted. As to monetary policy, countering the effects of short-term speculative capital outflows on the exchange rate is justifiable, but reserves should not be run down to postpone adjustments warranted by fundamentals. The authorities have responded decisively to threats to banking system stability, but further action, including improved coordination with foreign regulators given the global scale of the problem, may be needed.

Growth has been strong, but is decelerating

GDP growth remained rapid at 8% year-on-year in the first half of 2008, supported by further terms of trade gains. Private consumption continued to expand at double-digit rates, in line with strong, albeit decelerating, growth in real wages and consumer credit. Investment growth showed some signs of a slowdown but remained high. On the supply side, construction and market services continued to expand, but growth in construction has been falling since January and many projects have recently been put on hold due to financing constraints. Manufacturing activity has

The falling oil price has been the main factor in the stock market decline

The exchange rate is still managed, but within wider bands

Source: Datastream and OECD estimates.
slowed down somewhat, while resource extraction has continued to stagnate. A range of official and survey data beyond the second quarter, together with the financial crisis that struck in September, suggest a marked slowdown in the second half of 2008.

**Russian Federation: Macroeconomic indicators**

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>7.4</td>
<td>8.1</td>
<td>6.5</td>
<td>2.3</td>
<td>5.6</td>
</tr>
<tr>
<td>Inflation (^1)</td>
<td>9.0</td>
<td>11.9</td>
<td>13.6</td>
<td>7.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Fiscal balance (per cent of GDP) (^2)</td>
<td>8.4</td>
<td>6.1</td>
<td>5.5</td>
<td>-1.8</td>
<td>-1.2</td>
</tr>
<tr>
<td>Current account balance (per cent of GDP)</td>
<td>9.5</td>
<td>5.9</td>
<td>6.5</td>
<td>0.5</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

1. End-of-period.
2. Consolidated budget.

*Source: Data for 2006-07 are from national sources. Data for 2008-10 are OECD estimates and projections.*

**Inflation remains high but inflationary pressures have eased**

Inflation has risen to about 15% and will finish the year well above the authorities’ (upwardly-revised) objective of 11.8% for 2008. Beyond rising food and energy prices, this surge reflected strong domestic demand and the policy of the Central Bank of Russia (CBR) to target the nominal exchange rate (versus a basket of the US dollar and the euro) in the face of large balance of payments inflows, which resulted in very rapid money supply growth. Food and energy prices have recently begun to weaken, while money supply growth has been slowed by the fall in commodity prices and a reversal of net capital inflows.

**Russian Federation**

**A shift to net private capital outflows is bringing down money supply growth**

**Several indicators are signalling a slowdown**

*Source: OECD calculations based on Central Bank of Russia, Russian Federal Service for State Statistics and Institute for the Economy in Transition.*
Monetary policy has been undergoing significant changes, a result of both long-term planning by the CBR and shifts in the balance of payments. Under the quasi-fixed-exchange-rate regime in place for the past several years, central bank interventions in the foreign exchange market were the dominant factor in the growth of monetary aggregates. Large current account surpluses driven by high oil prices, combined with a shift over the years from net private capital outflows to inflows, yielded very rapid money supply growth; real interest rates have been negative for many years. In May 2008 the CBR widened its foreign exchange market intervention bands to permit more day-to-day volatility, flagging this change as a step in the direction of a long-term shift to inflation targeting.

### Russian Federation: External indicators

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods and services exports</td>
<td>335</td>
<td>394</td>
<td>520</td>
<td>410</td>
<td>435</td>
</tr>
<tr>
<td>Goods and services imports</td>
<td>209</td>
<td>283</td>
<td>350</td>
<td>350</td>
<td>400</td>
</tr>
<tr>
<td>Foreign balance</td>
<td>126</td>
<td>111</td>
<td>170</td>
<td>60</td>
<td>35</td>
</tr>
<tr>
<td>Invisibles, net</td>
<td>-31</td>
<td>-35</td>
<td>-54</td>
<td>-52</td>
<td>-50</td>
</tr>
<tr>
<td>Current account balance</td>
<td>94</td>
<td>76</td>
<td>116</td>
<td>8</td>
<td>-15</td>
</tr>
</tbody>
</table>

Percentage changes:

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goods and services export volumes</td>
<td>7.3</td>
<td>6.4</td>
<td>6.0</td>
<td>2.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Goods and services import volumes</td>
<td>21.9</td>
<td>27.3</td>
<td>23.0</td>
<td>8.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Terms of trade</td>
<td>11.4</td>
<td>4.2</td>
<td>23.7</td>
<td>-16.5</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Source: National sources and OECD projections.

The financial system has been shaken by the effects of the international financial crisis and related external factors. By late-October the Russia stock market index had fallen by more than 75% from its peak in May 2008, with disorderly price declines triggering market closures on several occasions, as investors withdrew from emerging market assets generally and concern about Russia-specific factors, including the falling oil price, grew. A cycle of margin calls and forced equity sales sparked a liquidity crisis in a range of small and medium-sized banks. The government and the CBR responded with relaxed reserve requirements, stepped-up overnight repos, the placing of large government deposits normally held at the central bank, and more generous deposit insurance.

Growth in public spending slowed in the first half of 2008, while surging oil prices brought further revenue windfalls. The central government surplus ran at 8.8% of GDP through August, compared with the 2008 budget target of 4.6%. Assets in the two funds created in February 2008 from the previous Stabilisation Fund reached $190 billion at end-September. In October, the government amended the rules regarding management of the National Welfare Fund’s resources to permit it to invest in domestic assets. The decision to cut the value-added tax rate has been postponed, but pressures are growing for the budget to do more to support activity. Even with unchanged expenditures, the budget is likely to move into deficit in 2009 as a result of weaker oil and gas revenues.
Growth is projected to slow markedly in 2009 before picking up in 2010. With terms of trade gains projected to reverse and given a negative environment in international capital markets and the worsening outlook for other major economies (itself a factor in the weakness of commodities prices), growth of domestic demand will slow. Real GDP growth should decline sharply in 2009 before recovering somewhat in 2010. Household consumption will continue to expand, albeit at a slower pace, while investment growth will be hard-hit by the tighter credit conditions and the less favourable outlook for demand. Although inflation remains an important challenge, the recent falls in energy and food prices and the slowdown in money supply and economic growth should ease pressures. The current account is set to swing sharply, probably moving into deficit for the first time since 1997.

The global crisis carries risks including the risk of overreacting. The deterioration in the external climate carries substantial risks for Russia, less through financial channels -- given still underdeveloped intermediation -- than via further falls in the price of oil and other export commodities. The vigorous action already taken to protect banking, corporate and financial markets from the effects of global financial turmoil should limit spill-over to real economic activity, though further action may be necessary. At the same time, the scale of the response (announced liquidity support measures are around 14% of GDP) suggests that vigilance will be needed to prevent accommodating misallocation of resources which could rekindle a renewed upsurge in inflation when credit growth resumes. Renewing efforts to step up long-needed structural reforms would strengthen trend growth and bolster confidence.
CHILE

After several years of robust expansion, activity is projected to moderate and inflation to recede. The slowing world economy, tighter financial conditions and lower investments in mining and energy will all slow growth. Inflation will decline gradually as second-round wage increases from high commodity prices wear off and expectations are re-anchored to the central bank’s target. Past current account surpluses have disappeared as copper prices have retreated from high levels.

To ensure an orderly decline in inflation, policies should remain prudent. Depending on world macroeconomic and financial developments, a gradual loosening of the monetary policy stance may be warranted unless the recent depreciation of the peso revives inflationary pressures. The fiscal rule provides an appropriate mild countercyclical cushion to activity.

Growth is now moderating but inflation is high

Activity was robust and broad-based during the first half of 2008. Consumer spending, especially of durable goods, was sustained by rapid employment gains, while investments in mining and energy were boosted by high commodity prices. However, the economic environment has recently weakened significantly. Lower copper prices and strikes in the copper mines have slowed export growth and the current account has swung into deficit. Together with the central bank’s interventions in foreign exchange markets from April to September to accumulate reserves, this contributed to a sharp depreciation of the currency. Economic prospects dimmed further in October as the turmoil in world financial markets intensified. Both headline and core inflation have risen since April as

1. Central Bank of Chile Survey.

Source: OECD Economic Outlook 84 database; Central Bank of Chile.
second-round effects propagated the initial impact of spikes in world food and energy prices. Employment has been growing at close to 3% year-on-year so far in 2008, and the resulting tight labour market conditions have contributed to strong nominal wage growth. Inflation expectations are well above the central bank’s target of 2-4% but have receded recently during the turmoil on world financial markets. The financial sector is well capitalised but has been affected by US dollar liquidity restrictions.

Chile: Macroeconomic indicators

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>4.3</td>
<td>5.1</td>
<td>3.9</td>
<td>2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>Inflation¹</td>
<td>3.4</td>
<td>4.4</td>
<td>8.0</td>
<td>5.6</td>
<td>3.8</td>
</tr>
<tr>
<td>Fiscal balance²</td>
<td>7.7</td>
<td>8.8</td>
<td>7.0</td>
<td>1.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Structural fiscal balance²</td>
<td>1.0</td>
<td>1.0</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Current account balance²</td>
<td>5.0</td>
<td>4.0</td>
<td>-1.6</td>
<td>-2.9</td>
<td>-2.6</td>
</tr>
</tbody>
</table>

1. Inflation refers to average consumer price index.
2. In percent of GDP.
Source: National sources and OECD projections.

The central bank has tightened the stance of monetary policy

The combination of high inflation, slowing growth, pressures on the currency and a stressed financial sector make for difficult macroeconomic policy choices. While much of the acceleration in inflation reflects the pass-through of world food and energy price increases, strong aggregate demand is likely to have contributed to the propagation of price pressures throughout the economy. To deal with these pressures, the central bank increased its policy rate to 8.25% in four successive 50 basis points increases from June to September. In October, however, in the wake of the worsening financial turmoil, slowing activity and falling commodity prices, the central bank interrupted the monetary policy tightening. A gradual loosening may be appropriate to support activity, unless the recent depreciation of the currency revives inflationary pressures. Fiscal policy has been expansionary and, going forward, the implementation of the fiscal rule will result again in a mildly countercyclical stance in 2009, with government spending rising by 5.7% in real terms.

Growth is projected to slow

Growth is projected to moderate from recent peaks as world activity decelerates, tighter monetary policy bites into demand, and investment activity wears off. The economy should rebound in 2010 as Chile’s export markets start to recover and global financial market turmoil subsides. Weakening activity, in combination with lower world commodity prices, is expected to bring consumer price inflation near the central bank’s target, with a gradual decline from some 8% at end 2008 towards 3% by end 2010.

Downside risk to growth, upside risk to inflation

The growth projection is subject to significant downside risks, as the terms of trade deterioration and world slump may be worse than anticipated. Inflation may revert to the target more slowly than projected if the recent depreciation of the currency is passed through to domestic prices and upcoming public and private sector wage negotiations result in real wage increases in excess of productivity growth.
ESTONIA

Real GDP will continue to decline through to the end of 2008, reflecting mostly a sharp drop in domestic demand. Growth is projected to gradually pick up by the end of 2009 and into 2010, driven by stronger exports. Currently high inflationary pressures are expected to weaken in 2009, but the past real exchange rate appreciation will make the desired export driven recovery challenging.

The currency board and the government’s commitment to the balanced budget rule limit macroeconomic policy options to support the recovery. Labour market flexibility, in particular more rapid wage adjustment and higher regional mobility, would be desirable in this context.

A loan financed boom is ending in a bust

Strong domestic demand, in particular household consumption and investment in real estate, have driven the exceptionally rapid economic growth of recent years. Private consumption and investment were financed by borrowing from foreign banks at low or even negative real interest rates, while strong labour shortages led to high wage increases. Growth peaked in mid-2007 as international financial market problems began and lending conditions tightened. Real GDP declined in the first half of 2008 by almost 2%. The output decline has been fastest in the real estate and construction sectors, and has been accompanied by house price decreases. However, inflation has remained high due to the lagged response in the labour market.

Estonia

Demand and output are now falling

The current account has been increasingly financed by external credit

Note: In the decomposition of the current account deficit, negative numbers indicate an increase in reserves. The financial account balance is decomposed into equities (net direct investment plus net equities in portfolio investment) and debt. Net errors and omissions have been added to the capital account balance.

Source: Bank of Estonia; OECD Economic Outlook 84 database.
Wage increases have exceeded labour productivity growth

Wages rose by about 20% in 2007 and continued to increase in the first half of 2008 by around 15%. The hike in wages led to a widening gap between real wages and labour productivity and fuelled a strong real exchange rate appreciation, which has weakened competitiveness. These developments will make moving towards an export driven economy more challenging.

Estonia: Demand, output and prices

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current prices EEK billion</td>
<td>Percentage changes, volume (2000 prices)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private consumption</td>
<td>96.6</td>
<td>12.7</td>
<td>7.9</td>
<td>-1.5</td>
<td>-1.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Government consumption</td>
<td>30.0</td>
<td>1.8</td>
<td>3.9</td>
<td>3.6</td>
<td>-0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>53.3</td>
<td>19.5</td>
<td>4.9</td>
<td>-1.4</td>
<td>-6.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Final domestic demand</td>
<td>179.8</td>
<td>12.9</td>
<td>6.3</td>
<td>-0.7</td>
<td>-2.7</td>
<td>2.0</td>
</tr>
<tr>
<td>Stockbuilding(^1)</td>
<td>4.7</td>
<td>1.4</td>
<td>1.8</td>
<td>-3.7</td>
<td>0.9</td>
<td>0.0</td>
</tr>
<tr>
<td>Total domestic demand</td>
<td>184.5</td>
<td>13.9</td>
<td>7.5</td>
<td>-3.9</td>
<td>-1.8</td>
<td>2.0</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>138.9</td>
<td>11.6</td>
<td>0.0</td>
<td>-3.2</td>
<td>0.6</td>
<td>4.7</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>149.8</td>
<td>20.4</td>
<td>4.2</td>
<td>-6.4</td>
<td>-1.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Net exports(^1)</td>
<td>-11.0</td>
<td>-8.3</td>
<td>-3.9</td>
<td>3.1</td>
<td>1.2</td>
<td>0.9</td>
</tr>
<tr>
<td>GDP at market prices</td>
<td>173.5</td>
<td>10.4</td>
<td>6.3</td>
<td>-1.9</td>
<td>-2.0</td>
<td>2.9</td>
</tr>
<tr>
<td>GDP deflator</td>
<td></td>
<td>7.0</td>
<td>9.6</td>
<td>10.0</td>
<td>6.8</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Memorandum items

|                      | 2005  | 2006  | 2007  | 2008  | 2009  | 2010  |
| Harmonised index of consumer prices |       | 4.4   | 6.7   | 10.7  | 5.1   | 3.2   |
| Private consumption deflator         |       | 4.1   | 7.8   | 10.0  | 5.9   | 4.2   |
| General government financial balance\(^2\) |       | 2.9   | 2.7   | -0.7  | -2.4  | -1.4  |

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods (http://www.oecd.org/eco/sources-and-methods).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

Source: OECD Economic Outlook 84 database.

Fiscal policy is pro-cyclical

The commitment to the balanced budget rule makes fiscal policy pro-cyclical and limits policy adjustment to mitigate the effects of the downturn. The planned cut in the income tax rate from 21 to 20% in 2009 has been postponed and the lower reduced-rate of value added tax has been increased from 5 to 9%. On the spending-side, the government envisages staff and wage cuts as well as partial reversals of many recently introduced expenditure increases.

Labour market reform raises flexibility but risks reducing work incentives

The new labour law, currently under consideration in parliament, proposes some measures that will raise labour market flexibility, in particular shortening the notice period for layoffs and cutting severance payments. The law, in combination with business-friendly product market regulations, would facilitate economic recovery. However, the simultaneously expanded unemployment insurance will have to be well managed. Increasing replacement rates risks a reduction in incentives to search for and take a job.
The sharp fall in growth will continue

The economy is estimated to have entered a recession in 2008, with GDP falling by 1.9%. This fall is driven mainly by a drop in domestic demand, particularly private consumption and real estate investment. By end-2009, real GDP growth is expected to turn positive again, mainly reflecting stronger exports as the world economy reverses. Currently strong inflation is expected to ease in 2009 and fall further in 2010 to close to 3% as the impact of the tax hikes fades, and falls in food and energy prices are passed through.

The still high current account deficit creates risks for the recovery

While the current account deficit has narrowed, the risk of an accelerated reversal of capital flows remains. Weaker than expected economic growth in Estonia’s main trade partners is a downside risk to the export driven growth recovery.
INDONESIA

Strong domestic demand continued to underpin growth in the first half of 2008. Investment was particularly robust. Imports are growing faster than exports, but the trade and current accounts are still in healthy surpluses. Inflation rose substantially following a hike in regulated domestic fuel prices in May.

Monetary policy is being tightened and measures to tackle worsening credit conditions are being taken. Outlays on fuel-price subsidies are being contained but the budget will continue to be vulnerable to fluctuations in international energy costs in the absence of a formal mechanism for adjusting domestic fuel prices.

Activity remains vigorous but is decelerating

Real GDP grew by 6.4% on a year-on-year basis in the second quarter, a mild deceleration from the first quarter. Domestic demand continued to be the main driver, although private consumption lost some impetus in the second quarter because of rising fuel and food prices. Investment growth was particularly solid. Export performance has been strong reflecting still-supportive external demand, but buoyant import growth is narrowing the sizeable, current account surplus.

Source: OECD Main Economic Indicators and Statistics Indonesia (BPS).
Monetary tightening was halted in October

Inflation spiked during June-August following a policy-induced upward adjustment in domestic fuel prices by nearly 30% at the end of May. Bank Indonesia responded to the ensuing inflationary pressures, a concomitant deterioration in expectations and rising food prices by hiking the policy rate by a total of 100 basis points, to 9.5% in October. Inflation is showing signs of moderation, as the effects of the fuel-price hike wear off, but remains well above the end-year target range of 4-6%. Credit conditions have deteriorated on the heels of the worsening global financial environment. Bank reserve requirements have been lowered and additional liquidity-boosting measures have been taken. The central bank is continuing to intervene in the foreign-exchange market to tame excessive exchange-rate volatility. In line with growing global risk aversion, the rupiah has depreciated since mid-year, especially in October, and the domestic yield curve has steepened.

<table>
<thead>
<tr>
<th>Indonesia: Macroeconomic indicators</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>5.5</td>
<td>6.3</td>
<td>6.2</td>
<td>5.4</td>
<td>6.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>6.6</td>
<td>6.6</td>
<td>12.0</td>
<td>7.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Fiscal balance (per cent of GDP)</td>
<td>-1.0</td>
<td>-1.2</td>
<td>-1.3</td>
<td>-1.5</td>
<td>-1.5</td>
</tr>
<tr>
<td>Current account balance ($ billion)</td>
<td>10.8</td>
<td>10.4</td>
<td>4.0</td>
<td>3.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Current account balance (per cent of GDP)</td>
<td>3.0</td>
<td>2.4</td>
<td>0.8</td>
<td>0.5</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Note: Real GDP growth and inflation are defined in percentage change from the previous period. Inflation refers to the end-year consumer price index.
Source: Figures for 2006-07 are from national sources. Figures for 2008-10 are OECD projections.

The domestic fuel price hike relieved budgetary pressures

Budget revisions following the May fuel-price hike point to a deficit of 1.3% of GDP in 2008, marginally higher than in 2007. Despite the price adjustment, energy subsidies still account for a large share of total central government expenditure. The public debt is likely to fall to within the 30-35% of GDP target range for 2009. Legislation was approved in September reducing marginal personal income tax rates from 2009; the top personal tax rate will fall by 5 percentage points to 30%. A flat corporate tax rate of 28% will be introduced in 2009, with a further reduction to 25% in 2010. Small and medium-sized enterprises will be granted additional tax relief. The law provides incentives for firms to list in the stock exchange by reducing their corporate tax rate by 5 percentage points. The tax rate on dividend income will also be lowered. The package is foreseen to cost about 0.7% of GDP in 2009.

Growth may regain strength towards end-2009

Activity is expected to lose steam in the coming months and then regain momentum from the second half of 2009. Domestic demand, especially private consumption, is set to remain the main driver of growth. Exports are also likely to continue to perform reasonably well, despite the slowdown in global demand and falling commodity prices. A moderation in demand for imports in line with slackening activity should sustain the trade surplus. Inflation is set to move toward the target range in 2009-10 as monetary policy continues to be tightened and commodity prices remain
contained. Fiscal policy is expected to remain on track, with low international fuel prices providing relief to the budget. Nevertheless, in the absence of an automatic adjustment mechanism for domestic fuel prices, fiscal policy will remain vulnerable to movements in global energy prices.

The main risks stem from external sources

A slower-than-expected recovery in global demand, coupled with a faster-than-anticipated fall in commodity prices, would take a toll on export growth. At the same time, heightened volatility in international financial markets would pose challenges for the conduct of monetary policy and for budget financing. On the domestic front, meeting the inflation target may take longer than expected, causing the current monetary tightening cycle to be more protracted.
Global financial turmoil is deepening the slowdown, with the pace of economic activity not expected to pick up substantially before the latter part of 2009. The central bank has already cut its policy rate in reaction to the crisis in financial markets.

Monetary policy should remain biased towards easing in the near term. Further ahead, assuming a relatively trouble-free recovery from the financial crisis, the policy stance should tighten. Consideration of an increase in the fiscal spending ceiling should be put on hold in light of the increased economic uncertainty.

A slowdown in economic activity is already underway

A rapid pace of export-led growth in recent years (over 5% on average each year from 2004 to 2007) has for some time generated expectations of a slowdown as output had almost certainly risen above potential levels. Real GDP growth eased in the spring of this year, in part because first-quarter growth had been boosted by extra vehicle sales prompted by tax and regulatory changes. There are signs of a substantial slackening in activity for the balance of the year: the Bank of Israel’s State-of-the-Economy index, credit-card purchases and consumer confidence all point to weakening demand and output.

1. For technical reasons, these figures use Israel’s official statistics, which include data relating to the Golan Heights, East Jerusalem and Israeli settlements in the West Bank.

2. The State of the Economy index is calculated by the Bank of Israel each month and comprises six indicators covering: industrial production, employment, revenues in service sectors, goods imports and exports, and services exports.

Source: Central Bureau of Statistics and Bank of Israel.
Thus far, domestic banking has stood up well

Recent events in global financial markets are probably already deepening the slowdown. So far, the Israeli banking sector has not encountered serious difficulties, but the economy is inevitably exposed to global developments. In the initial weeks following the acceleration of the global financial crisis in mid-September Israeli equity prices fell sharply, and wealth effects will probably affect consumption. Tightening credit conditions and further weakening of external demand are also likely channels through which the crisis will affect the real economy.

Israel: Demand, output and prices

<table>
<thead>
<tr>
<th>Year</th>
<th>Current prices ILS billion</th>
<th>Percentage changes, volume (2005 prices)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>Private consumption</td>
<td>333.5</td>
</tr>
<tr>
<td></td>
<td>Government consumption</td>
<td>153.5</td>
</tr>
<tr>
<td></td>
<td>Gross fixed capital formation</td>
<td>97.8</td>
</tr>
<tr>
<td></td>
<td>Final domestic demand</td>
<td>584.9</td>
</tr>
<tr>
<td></td>
<td>Stockbuilding*</td>
<td>14.7</td>
</tr>
<tr>
<td></td>
<td>Total domestic demand</td>
<td>599.6</td>
</tr>
<tr>
<td></td>
<td>Exports of goods and services</td>
<td>256.6</td>
</tr>
<tr>
<td></td>
<td>Imports of goods and services</td>
<td>258.5</td>
</tr>
<tr>
<td></td>
<td>Net exports</td>
<td>-1.8</td>
</tr>
<tr>
<td></td>
<td>GDP at market prices</td>
<td>597.8</td>
</tr>
<tr>
<td></td>
<td>GDP deflator</td>
<td>-1.9</td>
</tr>
</tbody>
</table>

* Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

<table>
<thead>
<tr>
<th>Memorandum items</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation (CPI), Average increase</td>
<td>2.1</td>
<td>0.5</td>
<td>4.8</td>
<td>3.0</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Inflation (CPI), December-to-December increase</td>
<td>-0.1</td>
<td>3.4</td>
<td>5.0</td>
<td>1.5</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Private consumption deflator</td>
<td>1.8</td>
<td>0.6</td>
<td>5.6</td>
<td>3.0</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>General government financial balance*</td>
<td>-0.9</td>
<td>-0.4</td>
<td>-1.5</td>
<td>-1.9</td>
<td>-1.3</td>
<td></td>
</tr>
<tr>
<td>Current account balance*</td>
<td>6.1</td>
<td>3.0</td>
<td>2.6</td>
<td>3.0</td>
<td>3.1</td>
<td></td>
</tr>
</tbody>
</table>

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods (http://www.oecd.org/eco/sources-and-methods).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

Source: OECD Economic Outlook 84 database and Israel’s official statistics, which include data relating to the Golan Heights, East Jerusalem and Israeli settlements in the West Bank.

The central bank has cut its policy rate in reaction to the financial crisis

Inflation has been above the central bank’s target range (1 to 3% consumer price index growth) since late-2007, largely due to hikes in world food and commodity prices. Until recently, monetary policy was being tightened in response. Inflationary pressures are now abating with the most recent month-on-month figures showing small increases or falls in key components of the consumer price index, and indicators of inflationary expectations are favourable. This has given the Bank leeway to react to the crisis in financial markets; the policy rate was cut by 50 basis points, effective in October and by 25 points and then 50 points in November, bringing the rate to 3.0%. The first reduction prompted a temporary stock-market rally but also further depreciation of the currency. Against the dollar, the shekel has been trading some 5-10% below mid-year levels. Since March this year, the central bank has been implicitly favouring...
depreciation through a programme of announced foreign currency purchases that are primarily aimed at increasing reserves, which had for some time been seen as below optimal levels.

**Weak tax revenues are pushing the government balance back into deficit**

Robust growth in recent years, combined with spending and deficit ceilings, yielded a large fiscal improvement despite a series of tax cuts. Indeed, last year’s outturn saw a small surplus, and general-government debt has fallen from 100% of GDP in 2004 to 80%. This year, however, growth in tax receipts has dropped significantly, and a return to deficit is expected. Weaker GDP growth and completion of the schedule of tax cuts imply that revenue increases will also be low in 2009 and 2010.

**Real GDP growth is projected to drop significantly in 2009**

Despite recent weakness, growth is not expected to fall by much for 2008 as a whole but is projected to drop to around 2% in 2009. Output is not likely to pick up significantly until the second half of next year. Although, export growth will dip, the current account surplus will increase slightly, thanks to improved terms of trade. A fiscal deficit of 1.5% of GDP is projected for 2008, and this is expected to widen in 2009 before narrowing again in 2010 as activity recovers. Inflation is expected to fall back into the central bank’s target range around mid-2009.

**The greatest domestic risk is an increase in public spending ceiling**

The impact of the global credit crunch on the economy could be more pronounced than projected. Another risk relates to the increase in the ceiling on government expenditure growth, which has been widely discussed. Under robust growth prospects, a modest increase could be warranted. However, debt reduction needs to remain a priority and given the current economic climate such proposals should be put to one side. In any case, significant changes in policy will no doubt have to await the outcome of the February general elections.
ECO/CPE(2008)18/EO84/3

SLOVENIA

Economic activity is likely to slow significantly in 2009, driven in particular by a sharp deceleration in investment in construction. The following year, economic growth should return toward trend as both investment and private consumption recover. Headline inflation is expected to subside due to falling commodity prices, although planned public wage increases will exert upward pressure on core inflation.

With European Central Bank monetary policy likely to remain accommodating for Slovenia during the projection period, the fiscal policy stance should remain at least neutral to avoid adding to inflationary pressures. Competition in product markets needs to be nurtured to help reduce prices and improve productivity.

*Growth is tilting to the downside*

After having the strongest growth performance in the euro area in 2007 (6.8%), activity started to decelerate over the course of 2008. On the business side, construction spending has decreased while manufactures’ order books reveal that deteriorating international conditions damped exports. More broadly, business sentiment has been falling since the peak in mid-2007. Private consumption is being dragged down by the negative effects of higher inflation on real incomes and, with consumer confidence plummeting, there is little prospect of a revival in the short-term. Reflecting past strong growth, the registered unemployment rate has reached its lowest level in a decade.

**Slovenia**

**Growth is slowing down¹**

<table>
<thead>
<tr>
<th>Year</th>
<th>Consumption</th>
<th>Investment</th>
<th>Net exports</th>
<th>GDP growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>4.0%</td>
<td>6.0%</td>
<td>2.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>2005</td>
<td>2.0%</td>
<td>4.0%</td>
<td>0.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>2006</td>
<td>0.0%</td>
<td>2.0%</td>
<td>-2.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>2007</td>
<td>-2.0%</td>
<td>0.0%</td>
<td>-4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>2008</td>
<td>-4.0%</td>
<td>-2.0%</td>
<td>-6.0%</td>
<td>2.0%</td>
</tr>
</tbody>
</table>

**Monetary policy has become accommodating²**

<table>
<thead>
<tr>
<th>Year</th>
<th>Headline</th>
<th>Core</th>
<th>Euro area base rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>8.0%</td>
<td>-2.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>2006</td>
<td>6.0%</td>
<td>-2.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>2007</td>
<td>4.0%</td>
<td>-2.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>2008</td>
<td>2.0%</td>
<td>-2.0%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

1. Contribution to GDP growth for all series except GDP itself. GDP growth can deviate from the sum of the components shown because stock building is excluded.
2. Inflation is measured by the year-on-year change in the harmonised consumer price index. Core inflation excludes food and energy.

Source: Eurostat and OECD Economic Outlook 84 database.
Public wage policy will affect the pace of disinflation

Headline inflation increased during 2008 to 7% in June, the highest in the euro area. However, it has started to decline as energy and food prices have fallen. However, core inflation remains high and is likely to recede only gradually because the government has started implementing a catch-up policy for public sector wages, which may in turn fuel higher wage demands in the private sector. Wage growth is likely to exceed productivity growth in the coming years, eroding competitiveness.

Slovenia: Demand, output and prices

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current prices € billion</td>
<td>15.6</td>
<td>2.9</td>
<td>5.0</td>
<td>3.3</td>
<td>3.0</td>
<td>3.2</td>
</tr>
<tr>
<td>Percentage changes, volume (1995 prices)</td>
<td>5.5</td>
<td>4.1</td>
<td>2.5</td>
<td>2.8</td>
<td>2.3</td>
<td>2.0</td>
</tr>
<tr>
<td>Private consumption</td>
<td>7.3</td>
<td>10.4</td>
<td>11.9</td>
<td>8.4</td>
<td>1.6</td>
<td>3.7</td>
</tr>
<tr>
<td>Government consumption</td>
<td>28.3</td>
<td>5.0</td>
<td>6.4</td>
<td>4.6</td>
<td>2.5</td>
<td>3.1</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>0.5</td>
<td>0.8</td>
<td>1.8</td>
<td>0.5</td>
<td>-0.8</td>
<td>0.0</td>
</tr>
<tr>
<td>Stockbuilding¹</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total domestic demand</td>
<td>28.8</td>
<td>5.7</td>
<td>6.9</td>
<td>4.9</td>
<td>1.6</td>
<td>3.0</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>17.9</td>
<td>12.5</td>
<td>13.8</td>
<td>6.3</td>
<td>3.6</td>
<td>6.1</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>18.0</td>
<td>12.2</td>
<td>15.7</td>
<td>6.8</td>
<td>3.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Net exports¹</td>
<td>-0.1</td>
<td>0.2</td>
<td>-1.3</td>
<td>-0.5</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>GDP at market prices</td>
<td>28.7</td>
<td>5.9</td>
<td>6.8</td>
<td>4.8</td>
<td>2.1</td>
<td>3.5</td>
</tr>
<tr>
<td>GDP deflator</td>
<td></td>
<td>2.0</td>
<td>4.1</td>
<td>4.0</td>
<td>3.4</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Memorandum items

<p>| | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer price index</td>
<td></td>
<td>2.5</td>
<td>3.8</td>
<td>4.9</td>
<td>3.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Private consumption deflator</td>
<td>2.4</td>
<td>4.1</td>
<td>5.2</td>
<td>2.9</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>General government financial balance²</td>
<td>-1.2</td>
<td>-0.1</td>
<td>0.3</td>
<td>-0.7</td>
<td>-0.4</td>
<td></td>
</tr>
</tbody>
</table>

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods (http://www.oecd.org/eco/sources-and-methods).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

Source: OECD Economic Outlook 84 database.

Accommodating monetary policy requires an appropriate fiscal stance

European Central Bank monetary policy is likely to remain accommodative for Slovenia during the projection period. In this context, the authorities’ restrictive fiscal stance, as laid out in their Stability Programme, seems appropriate in view of inflationary pressures. However, with the planned phasing out of the payroll tax (cumulated loss of revenue of about 2% of GDP by 2010), the policy of public sector salary catch-ups and possible reversal of the strong revenue growth experienced in recent years, the actual fiscal position is likely to deteriorate. Hence, renewed efforts to control expenditures may be necessary to maintain the targeted improvement in the structural fiscal balance.

Disinflation and railway projects will bring the economy back to trend

In 2009, GDP growth is projected to be subdued, though still positive, owing to weak private consumption, the decrease in road construction investment and the global downturn. The following year, growth should return to trend as lower inflation should help increase real incomes and allow private consumption growth to return to trend by the
end of 2010. Investment will be boosted by new railway projects, and exporters should benefit from the recovery in international trade. The current account deficit widened to about 6% of GDP in 2008, but should narrow progressively.

**Second-round effect on wages poses a risk**

The main risk to the projections is the upward price pressures emerging from potential spill-over of strong public sector wage increases to higher wage demands in the private sector. On the other hand, inflationary pressures may be less pronounced if recent measures to reduce the tax wedge significantly increase labour supply.
SOUTH AFRICA

This year’s economic slowdown is projected to continue, reflecting weaker consumption growth and worsening terms of trade. Real GDP growth is expected to fall to about 3% in 2009 before rebounding to above 4% in 2010, with the FIFA World Cup providing a fillip to activity. Inflation is expected to turn down, returning to the central bank’s target range in 2010, as a result of the monetary tightening over the past two years and falling food and energy prices. Current account deficits will remain large with lower export prices broadly offsetting weaker import volume growth.

The projected move back into budget deficits is not worrisome, but fiscal policy should more than claw back the cyclical easing over the medium term, in order to get to cyclically adjusted balance. Monetary policy should continue to focus on price stability, but with food and energy prices falling, some easing may be possible earlier than previously envisaged. Prospects for long-term growth and meeting official employment targets would be improved by strengthening product market competition, with lighter regulation and less costly compliance being high priorities.

**Growth has slowed**

Having averaged 5% a year between 2004 and 2007, real GDP growth slowed to 4.2% in the first half of 2008. This was a function mostly of electricity supply disruptions in the first quarter, but also reflected weaker growth of domestic demand, especially private consumption. Substantial terms of trade gains and favourable domestic and international credit conditions in recent years have fuelled aggregate demand, resulting in

![Graph showing the credit crunch has hit asset prices hard](image)

![Graph showing the long rise in food prices, one driver of high inflation, has turned](image)

1. JP Morgan EMBI+ stripped spread.

*Source: OECD calculations based on Statistics South Africa, South Africa Reserve Bank and Datastream.*
in very large current account deficits. This process has reversed course, however, with a progressive tightening of monetary policy, rising spreads on emerging market assets this year and a sharp weakening in the prices of South Africa’s key export commodities since the second quarter.

South Africa: Macroeconomic indicators

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>5.4</td>
<td>5.1</td>
<td>3.3</td>
<td>3.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Inflation</td>
<td>4.6</td>
<td>6.5</td>
<td>11.4</td>
<td>6.9</td>
<td>5.7</td>
</tr>
<tr>
<td>Fiscal balance (per cent of GDP)</td>
<td>0.2</td>
<td>1.3</td>
<td>0.1</td>
<td>-1.6</td>
<td>-1.1</td>
</tr>
<tr>
<td>Unemployment (per cent)</td>
<td>23.1</td>
<td>23.6</td>
<td>23.3</td>
<td>23.1</td>
<td>22.5</td>
</tr>
<tr>
<td>Current account balance (per cent of GDP)</td>
<td>-6.5</td>
<td>-7.3</td>
<td>-7.7</td>
<td>-6.5</td>
<td>-5.8</td>
</tr>
</tbody>
</table>

Source: National sources and OECD projections.

Inflation remains high, however

Inflation trended upwards from early 2006 through late-2008, and has exceeded the upper end of the central bank’s target range of 3-6% since April 2007. It reached 13.6% in August 2008 before subsiding somewhat in September. Food and energy accounted for more than half the increase from the low point, and the big upward step in electricity tariffs in mid-year to address serious shortages provided another impetus. However, there have also been signs of second-round effects, as medium-term inflation expectations have risen to around 7%, and wage demands have picked up.

Global economic turmoil has hit export prices

The downturn in the terms of trade is a threat to domestic demand growth. Rising commodity prices had fuelled investment, government spending (via buoyant tax revenues, easing the public finance constraint), and consumption (via strong real wage gains), while attracting foreign capital inflows, which have further fed demand. This sequence is now reversing.

Political uncertainty has increased

Events surrounding the unexpected forced resignation of President Thabo Mbeki aggravated divisions within the ruling African National Congress (ANC), signaling political uncertainty ahead of the 2009 presidential elections, at a time when appetite for emerging market assets has ebbed with an increase in risk aversion.

Growth will be slower but still solid

A slowdown in domestic demand driven by tighter credit conditions both domestically and abroad, as well as a deterioration in the terms of trade, should see real GDP growth decline to 3.3% in 2008 and somewhat further in 2009. The main support to growth will be investment, particularly public infrastructure spending on the 2010 World Cup and expanding electricity supply. Growth should rebound to around potential in 2010 as financial turmoil fades and global economic activity recovers.

The target measure of inflation will fall substantially in 2009

The easing of fuel and food prices suggests that year-on-year inflation will continue to fall in coming months, notwithstanding the recent weakness of the rand. The further slowdown in economic growth in 2009 should reinforce the downtrend, and a rebasing and reweighting of the
consumer price index will bring a step decrease in the target inflation measure in the first quarter of 2009. Nonetheless, inflation is not expected to return to the central bank’s target zone until 2010.

South Africa’s large current account deficits have been a locus of macroeconomic vulnerability for several years. Now, with sentiment towards emerging market assets having worsened and international lending flows shrinking, the risk that the private capital inflows needed to finance those deficits will dry up has become more acute. A scenario with a forced contraction of imports and much weaker growth, while still less likely than the central scenario, has become a more immediate possibility.