Japan’s natural calamity will impact the world economy. The impact of the earthquake and subsequent tsunami that afflicted Japan is yet to be fully evaluated. The Economic and Fiscal Policy minister Kaoru Yosano said that the damage to the world’s third largest economy will exceed the 20-trillion yen loss suffered in the aftermath of the Kobe earthquake. Indeed, the initial impact on growth will be negative due to damaged infrastructure, closure of major industrial plants, and severe disruptions in energy supply, but the economy should quickly bounce back, posting strong growth once reconstruction efforts start, as it did in the aftermath of the 1995 Kobe earthquake, when GDP grew more than 3% annualized in the first three quarters following the earthquake [see http://GEM or for external users: www.worldbank.org/gem]. Furthermore the earthquake hit at a time when economic fundamentals were strengthening sharply, as indicated by a string of recent data releases, following the contraction recorded last quarter.

The central bank poured a record 15 trillion yens today into the Japanese economy, as the Nikkei 225 Stock Average closed 6.2% down today, the biggest one-day drop since December 2008, while the benchmark 10-year government bond yields dropped 7 basis points to 1.2 percent as investors sought a haven. The Bank of Japan announced that it would promptly provide additional liquidity if needed, and said its board will meet each day this week to assess liquidity needs, but is limiting its bond purchases, signaling it may limit its role to ensuring financial stability.

Given the disruptions in activity at some of the country’s nuclear reactors, Japanese demand for energy from other fuel sources such as thermal coal, natural gas, and petroleum products will surge and may push oil prices higher. Nuclear power represents about 10% of energy consumption in the country, while energy imports represent more than 85% of Japan’s energy consumption. Conversely, the expected initial decline in industrial activity in Japan will likely reduce demand for metals such as iron ore, nickel, aluminum, copper, and zinc, and many commodities have already traded lower. Once reconstruction efforts start, demand for commodities, such as copper and zinc, will rise significantly putting upward pressure on prices of these commodities.
Credit risk for Europe’s troubled countries decline amid bailout expansion pact. The cost of protecting peripheral government debt against default rallied strongly today, after a sharp run-up last week, as European leaders agreed to expand the lending capacity of the region’s bailout fund. Policy makers of the 17 euro-zone nations agreed to boost the lending capacity of the European Financial Stability Facility (EFSF) to a full €500 billion ($694.9 billion) from slightly more than €300 billion and to lower borrowing costs on Greek’s bailout loans. The spread on five-year Greek credit-default swaps tumbled 94 basis points (bps) to 949 bps, while contracts on Portugal dropped 35 bps to 478 bps and Spanish narrowed by 25 bps to 232 bps, according to Data provider CMS. In contrast, the Irish CDS spreads widened 8 bps to 606 bps, bucking the regional trend, as EU official rejected Ireland’s bid for lowering interest rate on the country’s bailout loan.

Among emerging markets... In South Asia, India’s wholesale price index unexpectedly rose to 8.3% (y/y) in February from 8.2% (y/y) recorded in the previous month, showing that inflationary pressures were still building in the economy despite seven hikes to the benchmark interest rate by the Reserve Bank in the previous one year. As inflation is above the central bank’s target range of 7%, the Reserve Bank faces pressure to aggressively increase interest rates in the coming months, starting with the monetary policy meeting later this week.

Recent issues and other current analysis is also available on the Prospects blog

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