International financial markets

Agencies downgrade credit ratings for Ecuador and Venezuela. Standard & Poor’s Rating Services and Fitch Ratings both slashed Ecuador’s sovereign ratings to “in default”, after the country failed to make a coupon payment on its foreign debt at the end of the grace period yesterday (December 15). However, both agencies continued to differentiate ratings at the level of individual bonds. S&P downgraded its long-and short-term sovereign credit ratings on the Republic of Ecuador to ‘SD’ (selective default) from ‘CCC-’ and ‘C’, respectively, while Fitch cut Ecuador’s long-term foreign currency Issuer Default Rating (IDR) to ‘RD’ from ‘CCC.’ These rating actions follow the government’s unwillingness to pay the scheduled $30.6 million interest due on the $510 million in outstanding global bonds due 2012. Meanwhile, the Ecuadorian government reportedly plans to keep up payments on the rest of its external debt (excluding the 2030 global bonds which are also regarded as “illegitimate”) which includes loans from multilateral banks and other countries.

Fitch also lowered its rating on the Bolivarian Republic of Venezuela, citing the “increased risk of financial and economic crisis” as a result of a questionable macroeconomic policy framework. The agency downgraded Venezuela’s foreign and local currency ratings one level to ‘BB-’ (four levels below investment grade) from ‘B++’, with a stable outlook. Fitch said in a statement that “the economy’s dependence on oil revenues, high inflation and overvalued fixed exchanged rate increase the challenges for authorities to adjust to a low oil price environment.” However, the agency also said that the country’s relatively low debt burden and manageable debt maturity profile combined with about $18 billion in liquid external assets as well as $8 billion in international reserves provide a near-term cushion and support Venezuela’s current rating.

Markets await Fed rate decision and additional liquidity-boosting steps. Expectations are high for a 50 basis point reduction in the Fed Funds target rate today from its current 1% level to an all-time low 0.50%. This is likely to exhaust the central bank’s ability to lower rates further, and meanwhile in the opinion of many economists, the move to a 0.50% funds rate is unlikely to have much effect
in stimulating a revival in bank lending, “only pushing on that string a bit more.” Hence, the Fed is contemplating other steps that it might take to help channel liquidity to segments of the economy currently thirsty for credit, by enlarging its current holding of public and private assets—e.g. buying up more Treasury securities to generate broader liquidity, or purchasing private securities backed by revolving debt (credit cards), or auto-, consumer and small business loans.

A debate appears to be underway within the FOMC, with several members in favor of “...shifting from a policy aimed at reducing credit spreads in the market to one of improving the flow of funds in financial markets,” according to Mark Gertler of NYU. Others, including Jeffrey Lacker, President of the Atlanta Fed, stated “My reading of current conditions is that bank lending is more constrained now by the supply of creditworthy borrowers than by the supply of bank capital”. We’ll know some near-term answer to these questions at 2:15 EST today.

U.S. inflation falls 1.7% in November, most ever, on lower energy costs. A dramatic falloff in headline consumer price inflation in November (1.7% (m/m)—the most since the U.S. government began been keeping records in 1947) has its roots in deepening recession (in the United States and globally), which has cut demand pressure on crude oil, other fuels and commodities. Energy costs fell by a whopping 17% during November, the most since 1957, with gasoline prices off 29.5%, fuel oil down 14.6% and natural gas (linked to oil through contracts) declining 5.2%. At a seasonally adjusted annualized pace (or saar), headline inflation dropped from 6.7% during the third quarter of 2008 to a decline of 4.1% in the three months through November—and is likely over the next months to fully offset the run-up in inflation seen in the second and third quarters of the year [see http://GEM]. “We had a bubble in oil, the bubble has burst”, According to David Wyss of Standard and Poor’s in New York. “One thing recessions are really good at is bringing down inflation.”

Core prices, which exclude food and fuel, were unchanged in November, somewhat of a surprise given the massive falloff in energy costs over the past five months, and its potential for favorable effects on a broader array of goods. Overall inflation has eased from a recent peak of 5.2% on a year-on-year measure to 3.2% currently, while core prices are pacing at a modest 2.2% pace.

U.S. housing starts and permits off precipitously in November. Continuing the downtrend of the past three years, housing starts and permits plummeted in November, the former by 18.9% (m/m) the steepest since data has been collected by the Commerce Department staring in 1959. Permits, the initiating step for breaking ground on a new home fell 12.3% in the month. Both figures suggest that the direct fallout on economic activity related to the plunge in homebuilding will continue through the fourth quarter and well into 2009.

At the same time, one can draw some “hope” from the data, that inventories of new homes are at least being constrained, in a broader sense, providing some offset to the flow of properties coming to market through foreclosures. A necessary condition for tightening of the market for new homes is reduction in supply, and with home starts standing a record 40% below year-earlier levels in November, there is “progress” being made.
Among emerging markets... in South Asia, Sri Lanka’s economic growth slowed to 6.3% in the third quarter (y/y) down from 7% in the previous quarter on lower global demand for tea, rubber and textiles.

In the CIS, Russia’s industrial output contracted 8.7% in November the largest decline since 1998, after remaining relatively flat in October, as global recession affects demand for steel, pipes, and fertilizers. Industrial output has now advanced by 3.7% in the year through November (y/y). Growth in services, which account for 60% of the economy, slowed to 5.5% from 6.9%, while gains in industry eased to 5.6% from 6.9%.

In Latin America, Brazil’s retail sales expanded 10.1% in October year-on-year, as computer sales surged 44%, a sign that consumer spending remains strong.

In Sub-Saharan Africa, Nigeria’s consumer price inflation inched up to 14.8% in November, from 14.7% the previous month, as food prices increased, according to the Nigerian Bureau of Statistics. Mozambique’s government revised down GDP growth to 6.5% in 2008 from 8% earlier, and expects economic growth in 2009 to increase to 6.7%.

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