

CENTRAL BANK OF BARBADOS



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Publisher's Note

The *Economic Review* is published three times a year in June, September and December, by the Central Bank of Barbados. It is prepared by the Bank's Research Department and contains articles of research undertaken at the Bank. In addition, we welcome contributions of a non-technical and empirical nature on economic and policy issues in the Caribbean. Book reviews and surveys are also welcome. All submitted papers are reviewed by the Editorial Committee* and external referees.

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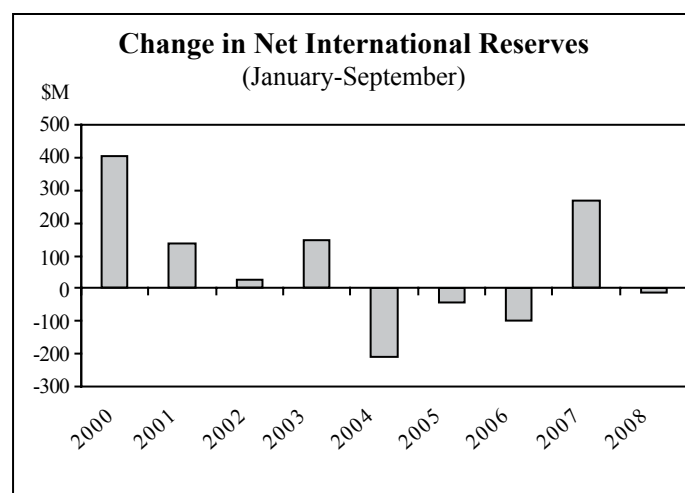
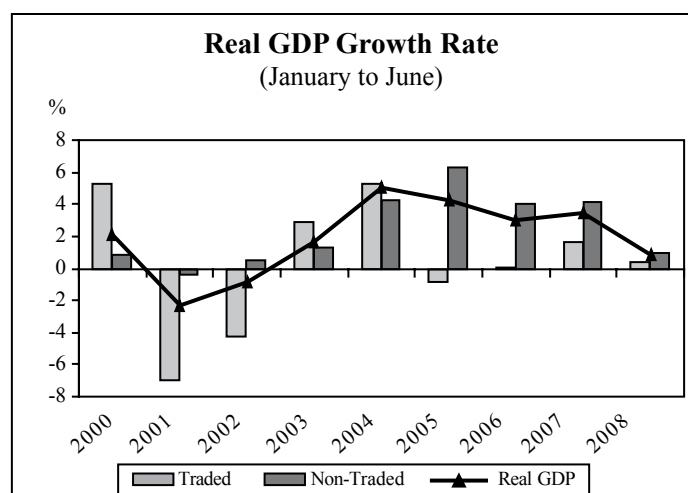
Review of Economy

The global economy continued to lose momentum during the first nine months of 2008, as turmoil in global financial markets, coupled with heightened inflation, significantly reduced aggregate demand. The ongoing sub-prime mortgage market crisis that began in the latter half of 2007 intensified immensely during the third quarter of 2008, evidenced by the failure of several large US-based financial firms. This distress in US financial markets quickly spread to other advanced economies, affecting a number of international banks and as a result, the developed world experienced a significant economic slowdown. However, moderate growth was maintained by emerging markets, on which the effects of the financial crisis were less severe.

Consequent on these developments, the Barbados economy expanded by approximately 0.9%, significantly below the average January-to-September growth rate of 3.4% in the preceding five years. The slowdown in the economy was concentrated mainly in the traded sectors, primarily tourism, while a decline in output of the bellwether construction industry contributed to an overall sluggish performance of the non-traded sectors. The moderation in tourism earnings, coupled with a surge in the value of fuel imports, led to a deterioration of the current account deficit, which was the largest since 2005. In the absence of sufficient

capital and financial inflows, the widened current account deficit was partly financed from the stock of foreign reserves, resulting in a slight contraction in the net international reserves (NIR). Excess liquidity in the financial system remained high, even amid signs of a reversal in the dual trends of mounting deposits and sluggish credit growth that had contributed to a build-up in liquidity in the corresponding period of 2007. As such, Government was able to finance the majority of its operations domestically.

After registering an average January-to-September expansion rate of 4.0% between 2003 and 2007, growth in the non-traded sectors slowed to an estimated 1.0% in the review period. The slowdown came as construction activity declined and the other non-traded sectors – wholesale and retail trade; electricity, gas and water; transportation, storage and communication; and business and other services – lost much of the momentum observed over the previous five years. Growth in the traded sectors was even more subdued, at about 0.3%, owing largely to the turmoil affecting tourism source markets and a fall-off in the production of some non-sugar agricultural goods. In the face of slowdowns in both traded and non-traded activity, the average unemployment rate for the period edged up from the record lows witnessed in 2007, while inflation trended upward, as rising costs of imported food and fuel filtered through to domestic prices.



Notwithstanding the moderation in traded-sector output, there was a slight improvement in export earnings, on account of growth in exports of selected food and beverage products and the value of fuel exports. However, the increase in domestic exports could not compensate for slower growth in tourism receipts and the inflated import bill and, as a result, the external current account deficit widened substantially. At the same time, the capital and financial account surplus narrowed relative to 2007, when there were substantial capital inflows to finance real estate and tourism-related activities. Together, these developments led to a \$13.8 million dip in the NIR, as sizeable net losses in the third quarter eroded the \$114.0 million that had been accumulated in the first half. This was in stark contrast to the \$270.4 million reserve expansion recorded in the first three quarters of 2007. Consequently, the liquid foreign assets of the monetary authorities contracted by the end of September 2008 and represented 17.7 weeks of imported good and services compared to 19.7 weeks at year-end 2007 and 18.5 weeks at the end of September 2007.

Following a robust expansion in 2007, the pace of overall domestic deposit growth slowed significantly, largely attributable to a fall-off in deposits in the third quarter of the year. Meanwhile, credit continued growing apace and, in effect, for the year to September the increase in credit to the non-financial private sector exceeded the rate of domestic deposit accumulation, a turnaround from the situation in the first half of the year. Consequently, liquidity conditions tightened somewhat in the third quarter, but remained noticeably higher than at the end of 2007. The fiscal deficit was estimated at \$362.5 million, approximately \$190.1 million above the deficit in 2007 marking the largest deficit in the space of nine months in at least a decade. The widening deficit was mainly attributable to hikes in both current and capital expenditure, which more than offset increased revenue collections. Higher outlays on goods and services, transfers and subsidies and domestic interest payments all served to boost current expenditure, while greater

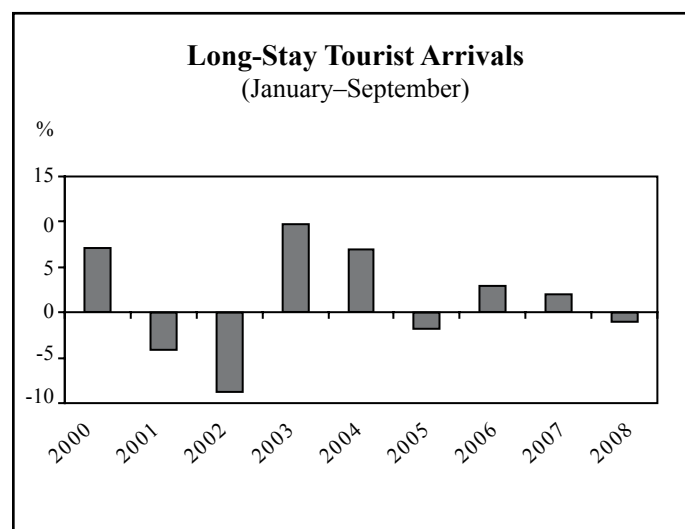
capital expenditure was fuelled by an increase in capital transfers to government institutions. Given the high levels of liquidity in the financial system, the government's fiscal deficit was financed primarily by domestic entities.

Production, Prices and Employment

Tourism

With deteriorating global economic conditions dampening demand in major source markets, tourism activity during the first nine months of 2008 declined marginally (0.1%) compared to growth of 2.8% in 2007, when the hosting of Cricket World Cup (CWC) matches had boosted second-quarter arrivals significantly. While the outturn for land-based tourism was relatively weak, cruise tourism remained robust, increasing for the second consecutive January-to-September period.

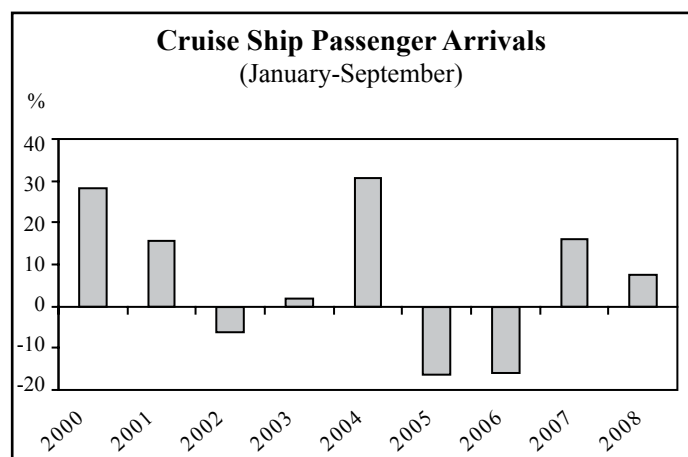
Data for the review period indicated that the number of long-stay visitors decreased by 1.2%, as a healthy first-quarter was offset by an average decline of 5.6 % between April and September. UK visitor arrivals, the largest category of long-stay arrivals since 1994, fell by 1.4%, marking the first decline in this market since 2005. The lower UK arrivals mainly reflected a



sluggish UK economy and a depreciating pound sterling. Additionally, visitors from non-traditional markets, which rose substantially due to CWC in 2007, declined by 31.9%, while higher airfares contributed to a 8.7% fall-off in arrivals from Trinidad and Tobago.

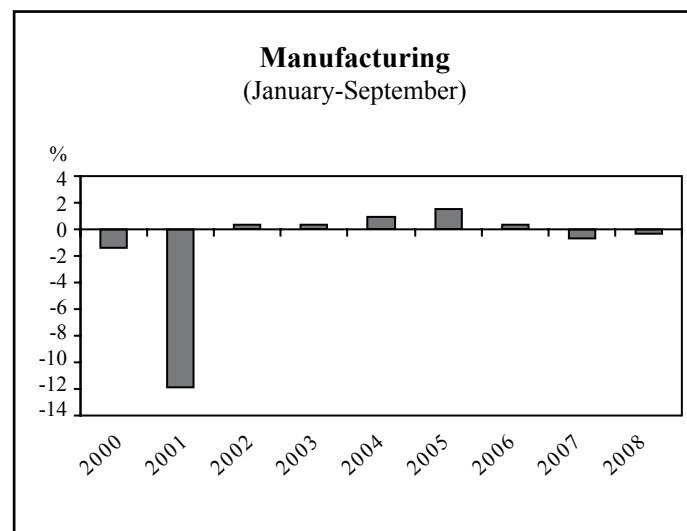
However, these reductions were partially offset by increased arrivals from other source markets including the US (up 1.5%). The overall outturn for the US market was mainly attributable to a 30.3% month-on-month hike in September, the result of increased promotional efforts by the Barbados Tourism Authority. Barbados also attracted more visitors from Canada (up 4.1%), Germany (up 9.5%) and the rest of other Europe (up 11.5%), helped in part by the appreciation of the Canadian dollar and the euro vis-à-vis the US dollar.

Following the recovery of cruise tourism in 2007 (which grew by 14.1%), cruise arrivals remained strong in 2008, expanding by 7.4%. The robust cruise performance resulted from the docking of higher-capacity vessels at the Bridgetown Port, which outweighed a contraction in cruise ship calls. The increase in ship capacity and reduction in ship calls represented the continuation of a trend exhibited since 2004, when energy prices began to rise significantly. Moreover, cruise vessels were used as temporary accommodation for visitors throughout CWC 2007, and the absence of this phenomenon in 2008 was also partially responsible for the decline in ship calls during the review period, particularly in the second quarter.



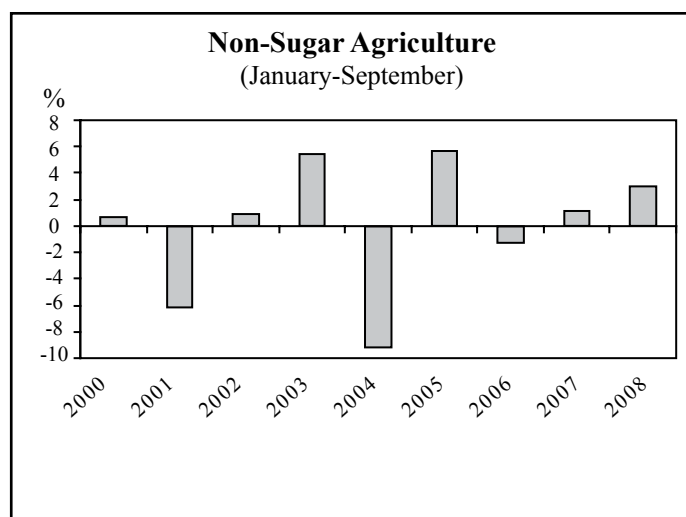
Manufacturing

Growth in manufacturing output continued to be flat during the review period reflecting mixed performances from the various manufacturing sub-sectors. Lower production was recorded in the garments (-33.8%), chemicals (-7.8%), wooden furniture (-4.9%) and other manufacturing industries (-2.1%), whilst the fall-off in construction activity contributed to an estimated decrease of 5.8% in the manufacture of other non-metallic mineral products. These reductions, however, were balanced by upturns in the predominantly export-oriented categories, namely beverages and tobacco (8.6%), electronics (3.6%) and food processing (1.8%).



Non-Sugar Agriculture and Fishing

Non-sugar agriculture and fishing activity grew by 3.2%, following growth of 1.5% in the similar period of 2007. This pick-up in activity resulted from a 37.4% spurt in fish-landings, owing mainly to a good flying fish season. Conversely, chicken production, which was adversely affected by the higher cost of feed, dipped by 0.2% whilst production in the dairy industry dropped by 5.0%, in stark contrast to an 18.9% increase a year earlier.



the first three quarters of 2008. This outturn followed an average increase of 5.8% in the comparable periods between 2004 and 2007. The industry further suffered from the end of the building boom in the commercial sector as well as a slowdown in private residential developments. The fall-off in construction value-added was captured in the downward movement of the sector's main performance indicators: employment in construction and quarrying (-10.8%) and domestic cement consumption (-7.0%).

In line with the decline in construction output, value-added for electricity, gas and water decreased by 0.7%. Conversely, mining and quarrying output grew by 6.4%, owing to the reactivation of onshore oil wells during the period.

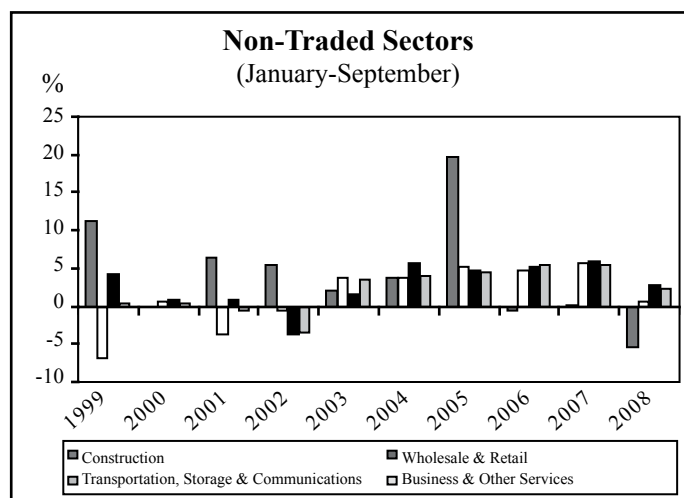
International Business and Financial Services (IBFS)

During the first three quarters of 2008, the number of new licences issued to International Business Companies (IBCs) amounted to 371, some 37 more than the previous year, while 75 societies with restricted liability were established, down from 126 in 2007. In addition, six Qualifying Insurance Companies, five Exempt Insurance Companies, three Management Companies, one offshore bank and one Holding Company were licensed during the period.

Non-traded Sectors

The main stimulus for the expansion in non-traded activity between January and September of 2008 was provided by the distribution and other services sectors, which nevertheless registered much smaller gains relative to 2007. Activity in transportation, storage and communications and business and other services grew by 2.8% and 2.4%, respectively, while the lacklustre performance of the traded sectors constrained growth in wholesale and retail trade to 0.7%.

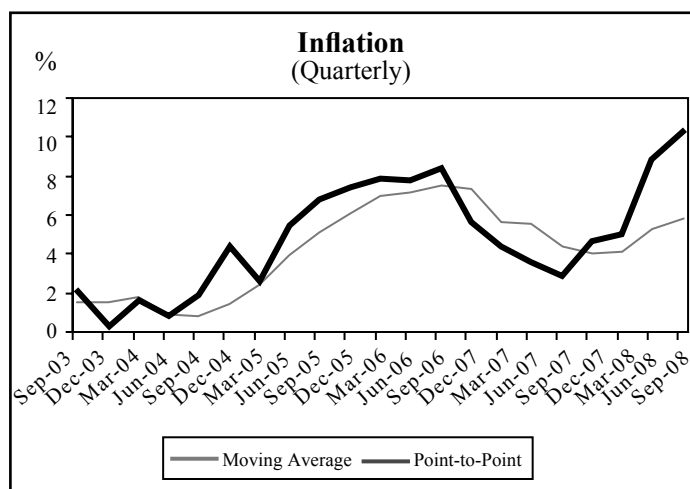
In contrast, construction activity, which had benefited from an intensified road rehabilitation programme and several tourism-related building projects in the lead-up to CWC 2007, contracted by approximately 3.4% during



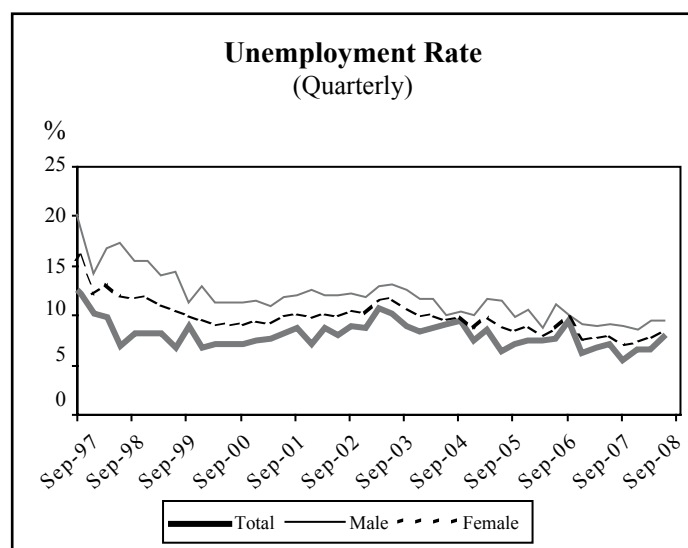
Prices and Employment

At the end of September 2008, inflation, as measured by a 12-month moving average, rose to 7.1% compared with the 4.4% recorded at the end of September 2007, while the point-to-point inflation rate was 11.2%, as compared to 2.9% in 2007, with price increases being recorded in all categories of the price index. The sharpest increases were observed in the prices of alcoholic beverages and tobacco (30.3%), food (17.1%), transportation (12.0%) and fuel and light (11.7%), which were driven in turn by soaring international food and

fuel prices and the reduction in government subsidies for gas and diesel in April.



The weakness in the domestic economy contributed to a slightly higher unemployment rate – 8.4% compared with 7.1% in 2007 – with the bulk of job losses occurring in wholesale and retail trade, manufacturing and construction and quarrying sectors. The rate of unemployment for males rose from 5.4% to 6.6%, while the rate for females moved from 8.9% to 10.2%.



Financial Sector

Data to September suggested that commercial banks' operations were not adversely impacted by the global financial crisis. Though slowing relative to 2007, the assets of commercial banks still grew, on the strength of loans and advances, which advanced by 7.0%. It should be noted, however, that the net foreign assets of commercial banks contracted by 7.6% by the end of September, mainly reflecting an 18.6% decline in foreign assets, which moved in tandem with the substantial outflows on the current account.

Credit

Lending by commercial banks increased during the period, with credit to the non-financial private sector rising by 7.1% (\$318.5 million), following growth of 4.9% (\$211.0 million) in 2007. Within the non-financial private sector, the main beneficiaries from additional commercial bank funding were individuals, where lending was up by \$138.2 million on top of the \$190.7 million increase registered a year earlier. Firms engaged in professional and other services, construction and other miscellaneous activities also augmented their borrowings, reporting an additional \$108.7 million, \$43.2 million and \$15.3 million, respectively. Moreover, lending to distribution entities advanced by \$12.8 million, mainly because of significant loans to two firms in excess of \$25.0 million in total. In contrast, credit flows to manufacturing, tourism and agricultural firms declined by \$12.2 million, \$10.6 million and \$9.3 million, respectively.

Statutory bodies and financial institutions also financed their activities through funds from the banking system. Loans to statutory bodies increased by \$33.1 million, with a large portion of this accounted for by the Transport Board, Barbados Port Inc and Barbados Agricultural Management Company. Meanwhile, credit to financial institutions advanced by \$31.8 million, on par with the expansion recorded in the comparable period of 2007 (\$34.8 million).

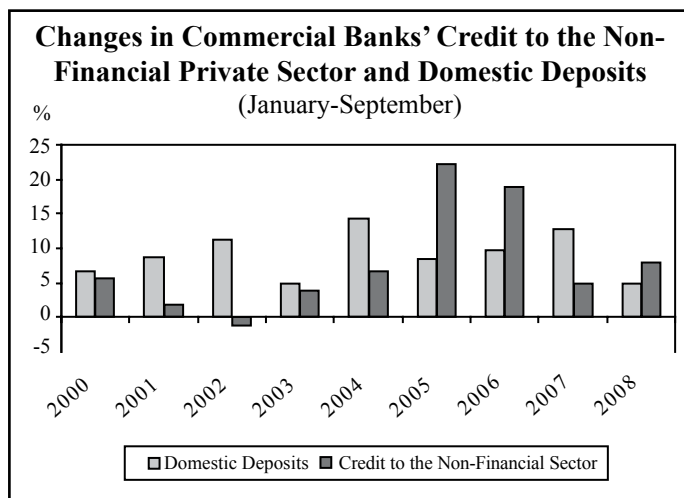
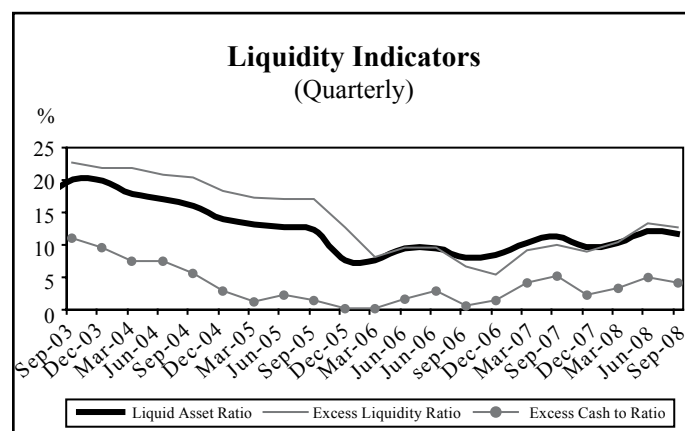
Deposits

Total deposit liabilities declined by 2.5% or \$227.4 million, in stark contrast to the 18.1% or \$1,328.3 million

build-up in 2007, when there were extraordinary capital inflows in relation to CWC-2007. Since there had been modest deposit accumulation during the first half of the year, the overall decline came on account of net withdrawals of \$237.4 million in the third quarter. This situation was the result of significant foreign outflows during that period, together with a \$529.5 million fall-off in non-resident deposits

Domestic deposits grew by 5.0% or \$367.6 million, substantially below the 13.8% or \$865.9 million expansion recorded in the previous year. Most categories of deposits expanded during the nine-month period: savings of private individuals advanced by \$225.8 million, financial institutions, \$79.7 million and statutory bodies, \$46.2 million. Conversely, deposits of business firms fell by \$111.9 million, with firms in the construction, distributive and manufacturing sectors registering declines of \$47.6 million, \$25.3 million and \$16.4 million, respectively.

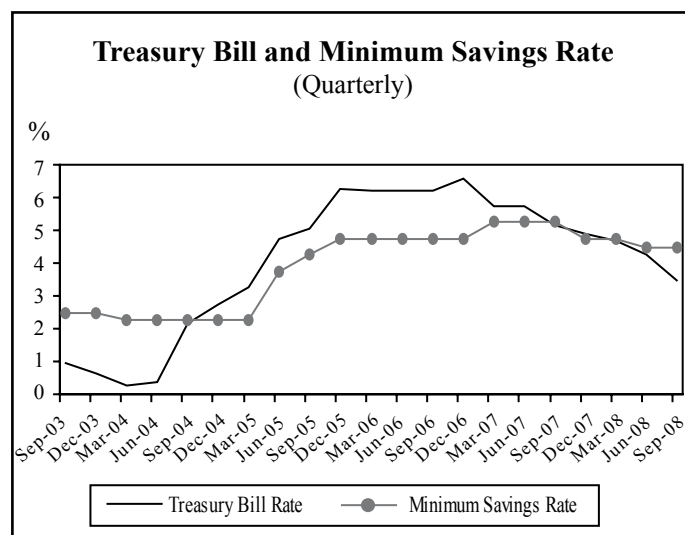
quarter, the liquid asset ratio fell marginally to 11.6% from 12.0% at the end of June 2008, but was still significantly higher than the 9.5% registered at the end of 2007.



Overall, commercial banks' excess cash reserves rose from \$159.5 million at the end of 2007 to \$323.6 million by the end of the third quarter, while holdings of excess securities increased by \$167.6 million to \$667.5 million over the similar period.

Liquidity and Interest Rates

The banking system continued to be characterised by high levels of liquidity, underpinned by greater excess holdings of both cash and securities during the first nine months of 2008. Quarterly analysis, however, revealed that much of the build-up in excess liquidity occurred during the first two quarters of the year, when credit growth lagged that of deposits. With the reversal of this trend in the third



Summary Accounts of the Banking System
(\$ Million)

	2006				2007				2008 ^p		
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
Net International Reserves	1,730.2	1,610.6	1,613.2	1,691.2	1,940.4	2,035.1	2,083.8	2,247.7	2,494.9	2,389.9	2,076.6
Monetary Authorities	1,282.5	1,167.4	1,136.4	1,194.1	1,333.0	1,454.3	1,464.6	1,548.0	1,664.1	1,662.0	1,534.2
Commercial Banks	447.7	443.2	476.8	497.1	607.4	580.8	619.2	699.7	830.8	727.9	542.5
Net Domestic Assets	3,527.1	3,801.2	3,984	4,085.9	3,987.6	4,202.3	4,272.2	4,340.7	4,220.8	4,372.2	4,557.5
Credit to Public Sector	164.5	331.0	387.6	337.1	161.2	274.1	388	452.1	273.1	415.1	534.7
Central Government (net)	392.6	603.4	631.8	433.1	391.2	508.9	683.8	533.6	499.2	715.7	823.3
Rest of Public Sector	-228.1	-272.4	-244.2	-95.9	-230.0	-234.8	-295.8	-81.5	-226.1	-300.6	-288.6
Credit to Rest of Financial System	344.1	261.9	339.7	343.2	454.3	359.5	379.8	482.1	423.1	435.1	441.7
Liabilities to Other Financial Institutions	-552.9	-561.1	-567.7	-631.9	-727.6	-722.4	-763.8	-925.4	-876.2	-884.5	-849.4
Credit to the Private Sector	3,890.5	4,015.3	4,098.7	4,292.9	4,311.4	4,416.1	4,503.9	4,513.5	4,626.5	4,706.1	4,832.0
Liabilities to the Private Sector	5,257.3	5,411.9	5,597.2	5,777.1	5,928.0	6,237.4	6,356.0	6,588.3	6,715.7	6,762.2	6,654.1
Demand Deposits	1,530.9	1,515.6	1,672.2	1,794.7	1,780.1	1,861.7	1,847.0	2,004.8	1,955.3	1,919.0	1,902.3
Time Deposits	556.0	625.3	584.6	552.7	672.7	784.3	812.3	763.9	869.3	868.2	733.8
Savings Deposits	2,733.5	2,839.2	2,907.2	2,964.7	3,016.9	3,121.3	3,238.5	3,327.6	3,417.1	3,510.1	3,557.3
Currency in Circulation	436.8	431.8	433.1	465.0	458.3	470.1	458.2	492.1	474.0	464.8	460.8
MEMO:											
Domestic Deposits	6,112.9	6,350.8	6,494.3	6,619.2	6,978.7	7,267.4	7,471.5	7,690.1	7,942.4	8,095.6	7,966.1
Liquid Assets	1,293.1	1,286.5	1,279.7	1,307.3	1,452.6	1,576.0	1,592.0	1,721.2	1,856.5	1,822.6	1,686.5
Loans & Advances	4,240.5	4,382.3	4,469.5	4,713.7	4,871.0	4,857.5	4,978.9	5,097.2	5,167.5	5,281.1	5,454.2

Source: The Central Bank of Barbados

P:Provisional

* Domestic Deposits includes the foreign currency deposits of Residents

This accumulation of surplus funds in the banking system resulted in intense competition for the available stock of Treasury bills. Consequently, the average discount rate on 3-month Treasury bills fell by 1.37 percentage points at the end of September to 3.48%. In the face of high excess liquidity and a slowdown in economic growth, the Central Bank of Barbados lowered the minimum deposit rate by 25 basis points to 4.50% per annum, effective April 2008, marking a cumulative decline of 75 basis points from November 2007. In response to the Central Bank's monetary policy intervention, commercial banks lowered their interest rates. At September 2008, the weighted average lending rate on all loans moved from 10.68% in December 2007 to 10.31%, while the weighted average rate on selected loans declined by 37 basis points to 9.46%. Furthermore, the weighted average deposit rate fell steadily to 4.45%, down from 4.80% at the end of 2007.

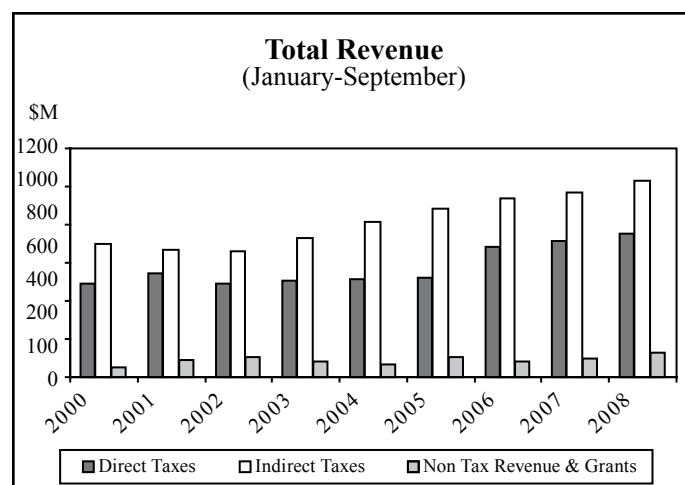
Government Securities

The value of Treasury bills outstanding at the end of September was \$697.0 million, about \$6.7 million above the total at the end of 2007. Of the amount outstanding, \$585.6 million, or 84.0%, was held by commercial banks and trust companies. There were two issues of Treasury notes and one of debentures during the period, bringing Government's total outstanding debentures to Treasury notes \$3,075.0 million. The National Insurance Scheme held \$1,461.4 million worth of debentures, while the deposit money banks and trust companies' portion totalled \$734.4 million. The remainder was distributed among insurance companies and other institutional holders. The nominal value of savings bonds at the end of the period totalled \$96.4 million.

Public Sector

Revenue

Total revenue was estimated at \$1,816.4 million, about 1.9% higher than the revenue earned in the similar period of 2007, reflecting increased indirect tax receipts. The intake of indirect taxes rose by 4.1%, significantly above the 2.6% increase in 2007, on the strength of higher

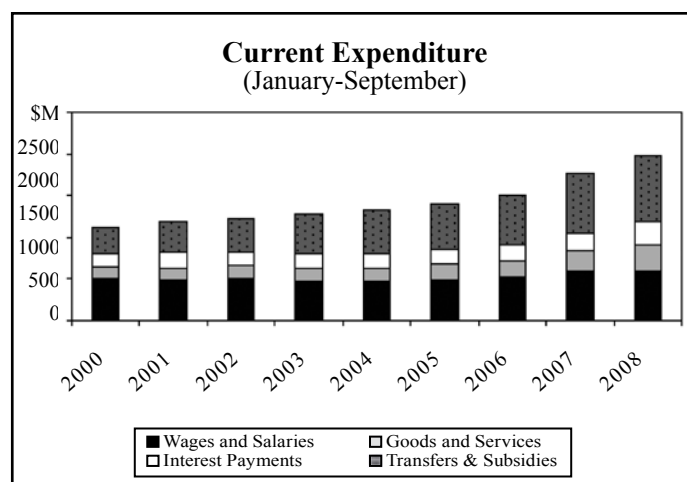


import duties and excise taxes (12.7% and 9.1%, respectively), primarily the result of the surge in the value of intermediate imports. On the other hand, VAT receipts remained virtually unchanged, in stark contrast to the average expansion rate of 10.6% between 2003 and 2007, owing largely to the sluggish performance of the domestic economy.

Conversely, direct taxes fell marginally (0.7%), largely due to a contraction in corporate tax receipts (4.4%) on account of a weak performance by the international business sector. There was also a fall-off in property tax collections (28.0%), partly due to the reduction in the property transfer tax rate from 7.5% to 2.5% in 2007. However, these declines were somewhat offset by increased personal tax receipts, which grew by (3.7%), despite the upward revision of the personal tax-free allowance in 2007.

Expenditure

Current expenditure rose by approximately 9.5% to \$1,928.9 million, compared with an increase of 16.8% in 2007. Transfers and subsidies advanced by 17.2%, reflecting increased grants to the University of the West Indies, the Barbados Agricultural Development and Management Corporation and the Transport Board, while foreign interest payments, which rose on account of prison-related debt payments, pushed interest expenditure up by 11.5%. At the same time, spending on goods and services



account of larger capital transfers to government institutions. Among the organisations benefiting from these outlays were Caves of Barbados, the Urban Development commission and the Rural Development Commission. In addition, work continued on the expansion of the ABC Highway, as well as the rehabilitation of a number of feeder roads.

Financing

Government's fiscal position worsened considerably during the period, evidenced by an overall deficit of \$365.7 million, compared to \$172.3 million in 2007. With the high level of excess liquidity, Government relied on domestic lenders to finance its deficit. The National Insurance Scheme provided approximately \$178.1 million, \$189.9 million came from commercial banks, while Central Bank's net lending to Government was \$99.8 million. Net foreign financing outflows totalled \$51.2 million, as amortisation payments (\$76.0 million) exceeded project inflows (\$24.8 million).

soared (up 24.5%), as some items of capital expenditure were reclassified and shifted to this category. Despite the reclassification, capital expenditure grew by 35.3%, on

Government Financing (January – September) (\$ Million)

	2004	2005	2006	2007	2008 ^P
Domestic Financing	115.7	203.1	123.7	220.2	406.9
Central Bank	48.4	19.9	217.4	104.0	99.8
Commercial Banks	105.4	90.6	(145.4)	127.7	189.9
National Insurance Scheme	(3.5)	157.6	40.0	85.7	178.1
Other Private Non-Bank	111.1	140.7	87.4	158.4	128.9
Other	(145.7)	(205.8)	(107.1)	(254.9)	(179.7)
Divestment	-	-	31.4	-	-
Foreign Financing (net)	(16.3)	(62.2)	(41.3)	(47.8)	(51.2)
Project Funds	56.2	9.7	34.2	25.3	24.8
Amortisation	(72.4)	(71.9)	(75.5)	(73.1)	(76.9)
Total Financing	99.4	140.9	82.4	172.3	365.7

Source: The Central Bank of Barbados

P: Provisional

Government Operations

(January – September)

(\$ Million)

	2004	2005	2006	2007	2008 ^P
Total Current Revenue	1,395.8	1,520.7	1,712.2	1,783.2	1,816.4
Tax Revenue	1,330.5	1,409.4	1,625.6	1,682.9	1,717.6
<i>Direct Taxes</i>	518.4	526.6	684.5	717.1	711.8
Personal	240.1	206.5	234.0	249.6	258.9
Corporate	180.9	233.2	329.7	356.5	340.8
Property	56.8	50.7	71.3	47.7	34.3
Other	40.6	36.3	49.5	63.3	77.9
<i>Indirect Taxes</i>	812.0	882.8	941.1	965.7	1,005.3
Stamp	13.6	14.6	18.3	18.6	14.7
VAT	452.0	484.1	542.7	608.0	607.3
Excises	112.9	131.4	145.8	116.9	126.8
Import Duties	143.9	151.8	136.9	133.9	151.0
Other	89.7	100.9	97.3	88.3	105.3
Non Tax Revenue & Grants	65.4	111.3	86.6	100.3	98.8
Current Expenditure	1,327.3	1,405.6	1,507.0	1,760.9	1,928.9
Wages & Salaries	475.6	496.4	530.0	602.2	566.2
Goods & Services	157.9	186.1	180.2	232.7	289.8
Interest	167.5	176.5	197.6	217.9	243.0
External	70.8	65.1	68.1	63.9	77.8
Domestic	96.7	111.5	129.5	154.1	165.2
Transfers & Subsidies	526.3	546.6	599.2	708.0	830.0
Current Account Balance	68.5	115.1	205.2	22.3	-112.5
Capital Expenditure	166.2	185.7	216.0	166.0	224.5
Net Lending	1.7	70.2	71.6	28.7	28.7
Total Expenditure and Net Lending	1495.2	1661.5	1794.6	1955.5	2,182.1
Overall Balance	(99.4)	(140.8)	(82.4)	(172.3)	(365.7)

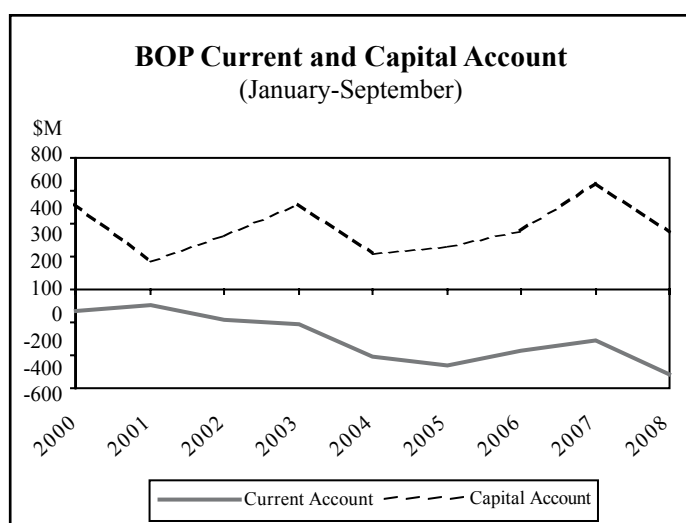
Source: The Central Bank of Barbados and Accountant General.

P: Provisional

Foreign Trade and Payments

Current Account

The current account deficit, which had been improving since 2005, deteriorated by approximately \$261.5 million during the first three quarters of 2008, as higher export earnings could not compensate for smaller gains in travel credits and the surge in the value of retained imports. Retained imports soared by 17.5%, about 11.8 percentage points higher than the increase posted a year earlier.



The rise in retained imports stemmed principally from a 37.7% hike in the value of intermediate goods, which in turn was due to a spike in the value of fuel imports. At the same time, consumer imports grew by 7.0%, buoyed by increased outlays on food and beverages, furniture and pharmaceuticals. Together, these expansions more than offset a fall-off in capital goods imports, the result of reductions

in the imports of machinery and transport equipment, mainly sound recorders and telecommunications equipment.

Merchandise exports advanced by approximately 9.9% (\$38.5 million), approximately four times the rate of expansion registered a year ago. This improvement was underpinned by the outturn for exports in the other manufacturers category (up \$11.6 million), and a hike in the value of fuel exports (up \$7.7 million).

In addition, exports of chemicals and food and beverages rose by \$7.5 million and \$10.6 million, respectively. Electronics exports also grew by \$2.6 million, a turnaround from the \$15.3 million decline in 2007. Export earnings from services was tempered by the moderation in the growth of travel credits (2.9% compared with 12.0% in 2007) associated with the fall-off in long-stay arrivals.

Capital and Financial Account

The capital account surplus for the first nine months of 2008 was \$342.6 million, down from \$565.9 million a year earlier, when there were substantial capital inflows to finance real estate and tourism related activities. In the absence of any such extraordinary inflows, private capital inflows were down, moving from \$920.1 million in the first three quarters of 2007 to \$409.4 million in 2008, on account of loan repayments and remittance of funds from the sale of real estate. At the same time, there were net public long-term outflows of \$59.7 million, as the project funds and other public sector inflows received during the period could not compensate for the increased amortisation payments. Collectively, these developments led to a decline in net long-term capital inflows, which, when coupled with net short-term outflows of \$67.5 million, resulted in the smaller capital account surplus.

Balance of Payments

(January – September)

(\$ Million)

	2004	2005	2006	2007	2008 ^P
Current Account Balance	(178.7)	(508.3)	(369.7)	(244.8)	(506.3)
Merchandise Trade	(1,367.5)	(1,544.5)	(1,414.3)	(1,509.2)	(1,804.8)
Total Exports (BOP Basis)	332.8	400.9	490.0	545.8	519.9
Domestic Exports	273.5	322.4	382.5	388.2	426.7
Sugar	44.9	45.4	44.6	46.3	45.0
Electronic Components	22.0	21.5	31.4	16.1	18.7
Chemicals	30.4	41.2	44.3	46.9	54.4
Food/Beverages	70.3	85.7	73.4	98.8	109.4
All Other	106.0	128.5	188.8	180.3	199.2
Total Imports (BOP basis)	1,793.0	2,071.9	2,331.8	2,224.5	2,520.0
Retained Imports	1,858.2	2120.0	2,049.7	2,167.1	2,545.6
Consumer Goods	727.3	851.1	749.7	811.3	868.4
Capital Goods	418.4	426.6	477.9	462.6	447.9
Intermediate Goods	705.2	834.7	811.7	883.0	1,216.1
Miscellaneous Goods	7.3	7.6	10.5	10.2	13.2
Services (net)	909.6	968.4	1,052.7	1,209.5	1,283.3
Travel Credits	1,205.3	1,371.7	1,619.0	1,813.2	1,865.7
Other	131.4	46.0	(67.6)	(105.1)	(50.5)
Investment Income (net)	(154.2)	(217.2)	(308.8)	(145.6)	(164.9)
Transfers (net)	233.3	285.0	300.7	200.5	180.1
Capital and Financial Account	221.1	268.1	368.0	565.9	342.6
Long term	(39.1)	24.4	634.9	844.7	349.7
Public	(72.4)	12.4	(17.8)	(75.4)	(59.7)
Private	33.3	12.0	652.6	920.1	409.4
Other	26.7	27.7	42.4	60.4	60.4
Short-term	255.1	218.7	(324.7)	(339.1)	(67.5)
Errors & Omissions	(21.2)	(106.8)	3.2	32.9	7.4
Balance for Official Financing	(206.1)	(304.2)	1.4	354.0	(171.1)
Reserve movements (CBB basis)	206.1	304.2	(1.4)	(354.0)	171.1
(-Increase/+Decrease)					
Change in NIR - (IMF basis)	210.7	41.0	103.4	(231.8)	13.9
(-Increase/+Decrease)					

Source: The Central Bank of Barbados

P: Provisional

Regional Economic Developments

During the first six months of 2008, economies across the region suffered from the negative spillover effects of a deteriorating global economic environment. The impact of the global slowdown was particularly severe on the tourism sectors of the regional economies, with most countries recording decreases in both long-stay and cruise arrivals. At the same time, unfavourable weather conditions, coupled with increased input costs resulted in a decline in agricultural output. Throughout the period, persistently high international commodity prices posed a major challenge for most economies, not only placing substantial pressure on some external current accounts, but also elevating inflation rates. In light of these strong inflationary pressures, some central banks aggressively tightened their monetary policy stance.

Provisional data for the first six months of 2008 indicated that stopover tourist arrivals in the Bahamas and Belize were down 1.3% and 0.9%, respectively, while cruise arrivals in these countries declined by 4.3% and 15.3%, respectively. Tourism activity was moderate in the OECS area, as several territories experienced contractions in their long-stay arrivals, ranging from 3.5% in Dominica to 13.1% in Anguilla. The only countries in the group to post growth were St. Kitts and Nevis, Antigua and Barbuda and St. Lucia, where stopover arrivals increased by 1.8%, 8.3% and 9.1%, respectively. Of particular note, the overall outturn for St. Lucia largely reflected additional chartered flights from Canada and additional airlift by a regional carrier out of Barbados. In Jamaica, stopover arrivals grew consistently over the period on account of increased airlift, an aggressive advertising campaign in Europe and the United States and the opening of a major hotel during the first quarter of the year.

Hampered by the inclement weather conditions and high costs of production, agricultural output fell significantly during the first six months of 2008 – particularly in Jamaica, the OECS and Trinidad and Tobago. Export agriculture in

Jamaica and OECS continued to reflect the adverse impacts of Hurricane Dean in 2007. With respect to Jamaica, there were no exports of banana and exports of coffee and sugar shrank by 7.6% and 6.9%, respectively, while in the OECS overall agriculture contracted on account of reduced banana production. In Trinidad and Tobago, agricultural output was tempered by rising costs, labour and raw material shortages, as well as the end of sugar production in 2007.

Construction activity, which was the main impetus for growth in the non-traded sectors in preparation for CWC-2007, turned in a mixed performance. Value-added increased in the OECS and Jamaica though slowing relative to 2007, while construction sector output in the Bahamas was comparatively flat, as a pick-up in private real estate activity was eclipsed by a reduction in foreign investment projects. Conversely, construction activity in Trinidad and Tobago continued to be robust, as work proceeded on a host of private and government projects.

External current account developments varied. Preliminary estimates suggest that higher payments for fuel and food imports led to a widening of the current account deficits in Guyana, Jamaica and the OECS. Conversely, the current account deficit in the Bahamas narrowed by approximately 42.0% during the second quarter, largely because a 32.8% fall-off in net non-oil imports cushioned a 38.1% increase in oil payments and the stagnation in tourism earnings. In Trinidad and Tobago, higher energy prices ensured favourable export earnings, resulting in a January-to-June current account surplus of TT\$17,008.8 million, compared with TT\$9,518.1 million in 2007. With respect to the capital and financial account, an improvement was registered in all countries, the exception being Trinidad and Tobago, where the deficit on the capital account widened significantly, owing largely to outflows for regional bonds and debt payments. However, the surplus on the current account was more than sufficient to offset the capital account deficit, leading to a TT\$12,828.1 million increase in the NIR.

The higher costs for imported food and fuel filtered through to domestic prices within the region, pushing up inflation rates. At the end of June, the point-to-point rate of inflation stood at 11.2% in the ECCU, with individual country rates ranging from 6.8% in St. Kitts to 13.1% in St. Vincent. In the case of Jamaica, headline inflation reached 11.6% in June 2008, 6.5 percentage points above the outturn for the comparable period in 2007. The most significant contributors were food and non-alcoholic beverages, housing, water, electricity, gas and other fuels and transport, which expanded by 2.2%, 2.7% and 2.9% respectively. Likewise, headline inflation in Trinidad and Tobago rose to 11.3%, from 7.3% a year ago and marked the country's highest recorded year-on-year rate since April 1994, when inflation reached 12.0%. Rising food prices – in particular bread and cereals (43.0%), fish (26.6%), fruit (37.8%) and oils and fats (23.9%) – were the main drivers of inflation in Trinidad and Tobago. Of the countries under review, inflation was least problematic for The Bahamas. The 12-month moving average rate of inflation at the end of June was 3.3% only 0.9 percentage points above the figure in 2007. The main contributors to the higher prices were furniture and household operations (7.2%), medical care (4.8%) and food and beverages (4.2%).

In an effort to subdue the strong inflationary pressures, some regional central banks tightened their monetary policy stance during the review period. After raising its open market operations (OMO) rate by 100 basis points in January 2008 and then by an additional 85 basis points one month later, the Bank of Jamaica increased rates by 50 basis points across the entire spectrum of OMO instruments, effective June 2008. Similarly, the Central Bank of Trinidad raised its repo-rate by 25 basis points to 8.25% as at February 2008 and increased the reserve requirements on commercial banks from 11.0% to 13.0%. Accordingly, prime lending rates rose to 12.75%, compared with 11.75% in the corresponding period last year.

International Economic Developments

Global growth weakened during the first nine months of 2008, as turbulent financial markets and strong inflationary pressures curtailed demand. Many policymakers seeking to intervene were therefore faced with a difficult task given the prospect of stagflation. However, inflationary pressures began to level off in the third quarter, as the worsening financial crisis led to a further slowdown in global demand, which had a somewhat stabilising effect on commodity prices.

Economic conditions in US have been deteriorating significantly, as the ongoing sub-prime market crisis rattled both consumer and investor confidence. This, coupled with increased inflation on account of higher fuel prices, served to temper domestic demand and by extension, real economic activity in the US.

In an attempt to spur output growth during the first half of the year, both the US Federal Reserve Board (Fed) and the government intervened. The Fed aggressively cut its interest rate from 4.25% at the beginning of the year to 2.0% by the end of June. In support of this measure, the government implemented a \$168-billion economic stimulus package in May, which involved lump sum payments to more than 130 million households. The tax cut enhanced personal consumption expenditure, whilst a depreciating dollar boosted domestic exports, and together, these developments resulted in higher than expected growth for the first half of the year. However, consumption fell in real terms during July and remained virtually flat in August, suggesting that the effects of the tax cuts were relatively short-lived. In addition, conditions in the US labour market pointed to a further weakening of the US economy, with the unemployment rate increasing from 5.7% in 2007 to 6.1%.

With inflation reaching the highest level since January 1991, the scope for further stimulus narrowed significantly. Faced with the prospect of stagflation, US policymakers refrained from any additional monetary and/or fiscal stimuli during third quarter of the year.

Economic Indicators: Industrial Countries

Countries	Real Output (% Growth)		Unemployment (% Rate)		Inflation (% Rate)	
	2007 Q1-Q3	2008 Q1-Q3	2007 Q1-Q3	2008 Q1-Q3	2007 Sept.	2008 Sept.
United States	1.9	1.8	4.7	6.1	2.8	4.9
Canada	2.9	4.5	5.9	7.2	1.9	3.4
Euro Zone	2.8	1.4	7.3	4.0	1.6	3.6
United Kingdom	3.1	1.4	2.6	5.3	2.4	5.2
Japan	2.2	0.5	4.0	4.0	-0.2	2.1

Source: Various Central Banks and National Statistical Offices

However, in mid-September, the full extent of the fall-out from the sub-prime crisis became evident, as there was a cascading series of bankruptcies, mergers or conservatorship in major US financial institutions – including Fannie Mae, Lehman Brothers and Freddie Mac, leading to a sudden fall-off in liquidity for the provision of credit. Confidence in the banking system was further shaken, sending overnight LIBOR rates to multi-year highs. As such, economic growth for the third quarter was just 0.8%, resulting in an overall rate of growth of 1.8% for the first nine months of 2008, down from 1.9% in the corresponding period of 2007.

The other advanced economies also grappled with the twin problems of waning economic growth and heightened inflation. Economic growth in Canada slowed to 1.1% in the first half of 2008 from 2.5% in 2007. Similarly, growth in the UK and the Euro zone was only 2.0% and 1.7% respectively, compared with 3.1% and 2.9% in 2007.

However, there were some grounds for optimism, as international commodity prices fell by 20.0% between August and September and consequently, inflationary pressures in the advanced economies showed signs of abating. Specifically, inflation in the US and the Euro zone dipped to 4.9% and 3.6% in September, down from the July peaks of 5.6% and 4.0% respectively, which in turn broadened the scope for policy intervention during the remainder of the year.

With respect to the emerging markets and developing economies, inflation was the main challenge for policymakers

through much of the review period, with most central banks gradually pushing up policy rates to stave off inflationary pressures. However, during the third quarter of 2008, inflationary pressures in some countries eased, reflecting in large measure the moderation in food and energy prices. For instance, in China, the point-to-point rate of inflation was 4.9% at the end of August, down from July's 6.3% and marked the country's lowest rate since June 2007. Likewise, Brazil's consumer prices rose at their slowest pace in eleven months (6.2%), assisted by a fall in food and beverage costs.

While the effects of the financial crisis were not totally absent from key emerging and developing economies, the impact was less severe on real output with most countries managing to maintain moderate rates of growth during the review period. This was largely attributable to growth in domestic demand and increasing regional demand for exports, which mitigated the effects of reduced demand from the industrial economies. However, financial markets in these economies mirrored the ongoing turmoil in the more advanced economies' markets, as international capital began to flow out, causing stock prices, bond yields and currency values to slide virtually across the board throughout most of the review period, but particularly in September.

Commodity Prices

The moderation in global demand had a somewhat stabilising effect on commodity prices, which fell by 20.0% between August and September 2008. Nevertheless, commodity prices at the end of the period remained noticeable higher than in 2007. The international price of oil declined from US\$131.5 a barrel at the end of June 2008 to US\$99.6 a barrel at the end of September 2007. However, oil prices were still 11.4% above the figure recorded at the end of December 2007 and 35.5% greater than oil prices at the end of September 2007. Food prices also increased during the period, driven by growth in the prices of bananas and wheat, which advanced by 21.0% and 118.8% respectively. In contrast, the price of wheat, which had been sliding since the first quarter of the year, was down 9.5%, reflecting favourable weather conditions and increased production by all exporting regions.

Commodity Prices

Commodities	Sept-07	Dec-07	Sept-08	% Change on Sept-07	% Change on December-07
Non-Fuel (Index of Market Prices)	141.5	142.8	149.3	5.5	4.6
Food (Index of Market Prices)	135.1	145.1	154.3	14.2	6.3
Sugar (US ¢ / lb)	9.9	10.5	14.0	41.4	33.3
Bananas (US \$ / metric ton)	666.4	648.5	806.6	21.0	24.4
Rice (US \$ / metric ton)	330.0	378.0	722.0	118.8	91.0
Wheat (US \$ / metric ton)	326.5	368.6	295.6	-9.5	-19.8
Soybeans (US \$ / metric ton)	347.6	423.1	437.8	25.9	3.5
Metals (Index of Market Prices)	174.8	162.6	164.1	-6.1	0.9
Aluminium (US \$ / metric ton)	2,395.0	2,382.8	2,524.2	5.4	5.9
Iron Ore (US ¢ / metric ton unit)	84.7	84.7	140.6	66.0	66.0
Copper (US \$ / metric ton)	7,671.4	6,630.7	6,975.1	-9.1	5.2
Silver (US ¢ / troy ounce)	1,144.0	1,424.0	1,219.0	6.6	-14.4
Gold (US \$ / troy ounce)	598.3	780.0	829.9	38.7	6.4
Petroleum (US \$ /barrel)*	73.5	89.4	99.6	35.5	11.4%

*Simple average of three spot prices; Dated Brent, West Texas Intermediate, and Dubai Fateh

**Regional Stock Exchanges*****Barbados Stock Exchange***

During the third quarter of 2008, the Barbados Stock Exchange (BSE) recorded a moderate decrease in the performance of the companies listed on the BSE. The Composite Index was recorded at 1,037.28, representing a decrease of 3.73%. In addition, the market capitalization for the Composite Index recorded a decline of 3.86% for the period under review.

During the review period, the local index decreased from 4,318.55 to 4,090.83 representing a 5.27% decline for the quarter. This movement resulted from five local companies advancing, and eleven declining and five remained firm, while three companies did not trade. Cable and Wireless Barbados reflected the greatest change in share price, climbing from \$4.29 as at June 30, 2008 to \$5.60 at end September 2008, representing an impressive increase of 30.54%. The other companies that recorded increases in the third quarter were Grace Kennedy Limited with 1.85% and Cave Shepherd with 1.29%. Sagicor Financial Corporation, the best performing company for the second quarter, suffered the largest decline in share price of 18.11%. FirstCaribbean International Bank followed with a 6.84% decline and Insurance Corporation of Barbados with 6.53%. The market capitalization for local companies reported a marginal increase for the third quarter of 5.23%, represented by movement from BDS \$11.78 billion to BDS \$11.12 billion, over the period.

The cross-listed index recorded an increase of 0.29%, moving from 2,142.23 to 2,148.39, partly as a result of the share price increase of one of the companies listed, namely GraceKennedy. The market capitalization for cross-listed companies moved from BDS \$4.32 billion to BDS \$4.31 billion resulting in 0.17 % decrease for the period under review - in contrast to the decline of 42.6% for the previous quarter.

Over the third quarter of 2008, the shares of FirstCaribbean International Bank was the most liquid security, accounting for approximately 28.21% (1.35 million shares) of the shares traded in the regular market for the period. Ansa Mcal (Barbados) Limited was the value

leader for the period, with its total value of shares traded equaling BDS\$7.51 million, followed by Neal & Massy Holdings Limited and FirstCaribbean International Bank, with BDS\$5.3 million and BDS\$5.1 million shares traded, respectively.

Barbados Stock Exchange Volume Leaders
(July - September)

Institution	Volume Traded (Millions)
FirstCaribbean International Bank	1.352
Banks Holdings Limited	0.539
Cable & Wireless Barbados Limited	0.484
Ansa Mcal Barbados Limited	0.464
Sagicor Financial Corporation	0.374

Source: Securities Exchange of Barbados

Mutual Fund Performance

For the third quarter of 2008, local mutual funds reported a notable improvement in performance. Four funds recorded growth, while six declined and one remained unchanged. This represents a moderate decline in the performance of mutual funds compared to the previous quarter, when growth was recorded for eight of the funds registered. BNB Income Fund recorded the highest quarterly increase of 1.96%, up from the increase of 1.64% that was recorded at the end of the last quarter. Roybar Investment Corporation followed closely behind with 1.65%; less than the growth of 2.91% that was reported for the previous quarter. Bringing up the rear for the top three performing funds for the third quarter was Fortress High Interest Fund – DIST, recording an increase of 1.30%. This was a noteworthy improvement compared to the last quarter, when Fortress High Interest Fund – DIST was one of the two funds that recorded a decline for the second quarter of 2008.

BNB Capital Growth Fund, the best performing mutual fund for the previous quarter, recorded the highest quarterly decline of 6.52% for the review period. Similarly, Fortress Caribbean Growth Fund recorded the second

highest quarterly decline of 5.05% for the July to September period, down from an increase of 7.21% as at end-June 2008. These quarterly performances were influenced in part by the exposure of these funds to the financial downturn in international markets.

Mutual Fund Performance
(Net Asset Values)

Mutual Funds	Sep. 30 '08 (Bds \$)	June 30 '08 (Bds \$)
Roybar Investment Corp.	4.32	4.25
Fortress Caribbean Growth Fund	5.08	5.35
Fortress High Interest Fund - ACC	1.48	1.46
Fortress High Interest Fund - DIST	1.03	1.02
BNB Income Fund	1.26	1.24
BNB Capital Growth Fund	1.36	1.46
BNB Property Fund	1.70	1.71
CLICO Balanced Fund Inc.	1.26	1.31
Sagicor Global Balanced Fund	2.23	2.24
Sagicor Select Growth Fund	1.15	1.18
Sagicor Preferred Income Fund	1.03	1.03

Source: Barbados Stock Exchange

Jamaica Stock Exchange (JSE)

During the third quarter of 2008, there was an increase in trading volume on the JSE, as market volume amounted to 569,142,260 units at a value of JMD\$4,992 million. For the third consecutive quarter, Cable & Wireless Jamaica Limited was the volume leader, with 156.3 million units traded during the quarter (27.46% of the market), followed by Supreme Ventures Limited with approximately 133 million units (23.36%). Jamaica Broilers Limited – the third largest volume leader for the second quarter of 2008 – remained in this position for the quarter under review, with 58,202,796 units (10.23%) traded.

During the quarter, seven companies advanced, thirty declined and four remained unchanged. Among the major companies advancing was Montego Freeport, which registered the best performance of a 45.24% increase in share price. Palace Amusement followed with a 22.00% increase and Seprod by 19.63%. Ciboney Group continued to be the major declining company for yet another quarter, down by

33.33% as at end-September 2008. These price movements for the quarter contributed to the overall decline in the JSE Index for the review period, with the index recording a movement from 110,268.26 at the beginning of the quarter, to 101,287.55 as at September 30, 2008 - down by 8.14%.

Trinidad and Tobago Stock Exchange (TTSE)

During the third quarter of 2008, the TTSE Index decreased by 7.35%, moving from 1,150.24 points at end-June 2008 to close at 1,065.62 points. This performance was influenced by the decline of nineteen companies during the quarter, while nine companies advanced and only four traded firm. National Flour Mills Limited was the major declining company, registering a contraction of 28.95%.

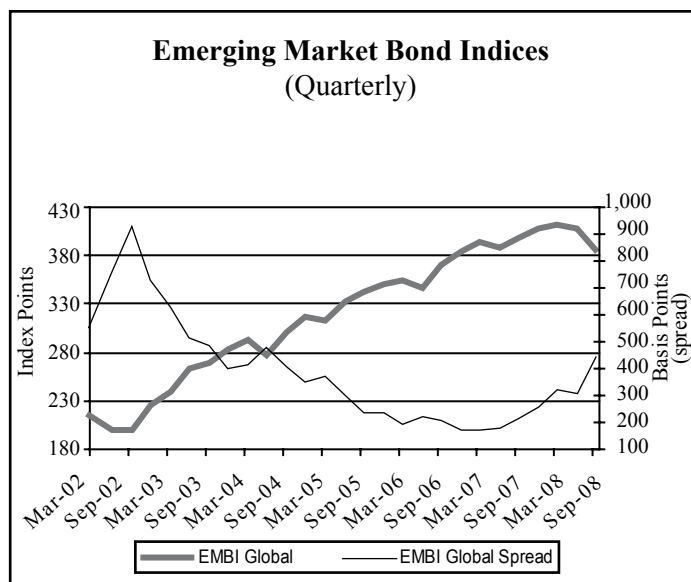
For the second time this year, Readymix (West Indies) Trinidad Limited headed the list of advancers for the quarter, with a share price increase of 79.34%. Point Lisas Industrial Port Dev Corp Ltd followed with 33.89% and L J Williams B took third place with 25.83%. Trinidad Cement Limited was the top volume leader with 6.9 million shares traded (22.18% of the market), followed by Sagicor Financial Corporation with 4.5 million shares (14.39%) and Guardian Holdings Limited with 2.1 million shares traded (6.80% of the market).

Emerging Markets

From mid-September emerging markets experienced a systemic sudden stop, where global deleveraging pressures and heightened risk aversion led to a sell-off of emerging market assets. International capital started to flow outward, causing bond yields, stock prices and currency values to tumble virtually across the board.

Bond Markets

Reflecting the general turmoil in financial markets, the emerging market global bond index (EMBI) fell sharply during the third quarter, amid a generalized spike in risk spreads and an issuance drought.



Equity Markets

Emerging market stock indices mirrored the market turmoil in advanced economies, with all of the major indices recording significant fall-offs during the quarter.

Emerging Market Equity Indices

(Quarterly)

Country/Region	Index	Jun-08	Sep-08	% Ch
Argentina	Merval	1,287.02	1,094.78	-14.9
Brazil	Bovespa	65,017.58	49,541.27	-23.8
Chile	IPSA	2,999.90	2,753.31	-8.2
Mexico	IPC	29,395.49	24,888.90	-15.3
Venezuela	Caracas	37,259.15	37,969.01	1.9
Latin America	MXLA Index	4,751.47	3,186.40	-32.9
China	Shanghai	2,736.10	2,293.78	-16.2
Hong Kong	Hang Seng	22,102.01	18,016.21	-18.5
India	Mumbai	13,461.60	12,860.43	-4.5
Indonesia	Jakarta	2,349.11	1,832.51	-22.0
Malaysia	Kuala Lumpur	1,186.57	1,018.68	-14.1
Philippines	PSE	2,459.98	2,569.65	4.5
Singapore	Straits Times	2,947.54	2,358.91	-20.0
South Korea	Seoul	1,674.92	1,448.06	-13.5
Thailand	SET	768.59	596.54	-22.4
Taiwan	Weighted	7,523.54	5,719.28	-24.0
Asia	MXMS Index	396.65	301.32	-24.0

Source: Bloomberg Service

Most Asian stocks were down on concern that slowing demand in the US and Europe would reduce exports. Similar concerns weighed on stocks in some Latin markets, for example Mexico, which remains heavily dependent on the US for export receipts and remittances, while stock markets in commodity exporters like Chile were adversely affected by falling commodity prices. Even equity markets in less export-dependent economies like Brazil were still impacted as a result of tightening domestic and global credit conditions.

Emerging Market Currencies

Country/Region	Currency	Jun-08	Sep-08	% Change
Argentina	Peso	3.03	3.13	-3.6
Brazil	Real	1.60	1.90	-18.8
Chile	Peso	527.89	552.11	-4.6
Mexico	Peso	10.31	10.94	-6.1
Venezuela	Bolivar	2,147.30	2,147.30	0.0
China	Yuan	6.85	6.85	0.1
Hong Kong	Dollar	7.80	7.77	0.4
India	Rupee	43.04	46.96	-9.1
Indonesia	Rupiah	9,228.00	9,506.00	-3.0
Malaysia	Ringitt	3.27	3.44	-5.2
Philippines	Peso	44.96	47.05	-4.7
Singapore	Dollar	1.36	1.44	-5.6
South Korea	Won	1,046.05	1,206.85	-15.4
Thailand	Baht	33.44	33.86	-1.3
Taiwan	Dollar	30.35	32.21	-6.1

Source: Bloomberg Service

Currency Markets

Most emerging markets with floating exchange rates experienced significant currency depreciations during the quarter under review. Among Asian currencies, South Korea's won recorded the sharpest depreciation amid significant capital outflows and a shortage of US dollar liquidity toward the end of September, while the Brazilian real saw its value fall most among Latin Stocks on rising investor risk aversion.



The Impact of the Global Financial Crisis and Economic Slowdown on International Trade

With the ongoing global financial crisis and economic slowdown, international trade is once again placed in a vulnerable position and is likely to incur an even greater falloff than what was experienced during 2001, the year of the September 11th terrorist attack. Since international trade provides opportunities for job creation, foreign currency accumulation and economic growth, the present crisis has adverse implications for the world economy.

This article examines how the present economic turmoil is affecting international trade, focusing on three key aspects: the impact of tightening financing conditions on the availability of trade finance facilities, the issue of contracting export demand due to the slowing global economy and, finally, the potential for some protectionist backlash in light of deteriorating economic conditions.

Trade Finance

Trade finance is the funding and management of international trade transactions. There are various financial tools and packages of trade finance.

However, the three most popular tools are: (1) trade-financing instruments, (2) export credit insurance and (3) export credit guarantees. Trade-financing instruments encompass: (a) documentary credit, (b) factoring, (c) pre-shipping financing, (d) post-shipping financing, (e) buyer's credit and (f) supplier's credit.¹

Due to the worldwide credit squeeze stemming from the U.S. sub--prime mortgage meltdown, trade finance, like any other form of credit, has been severely affected. In a November 12, 2008 report by Pascal Lamy, the Director-General of the World Trade Organisation (WTO), it was stated that the market for trade finance has dwindled since

September 2008. He further affirmed that the main impact of deteriorating trade finance is felt most by traders and banks of emerging market economies.

Some trade finance practitioners even posit that the situation is likely to worsen as time progresses. Current market estimates put the liquidity gap in trade at roughly US \$25 billion.

However, in response to the upcoming challenges, the World Bank indicated that it intends to expand its Global Trade Finance Programme from US \$1.5 billion to US \$3.0 billion.

Reduced Demand for Imports

Apart from trade finance, real Gross Domestic Product (GDP) growth is slowing worldwide; as a result, global demand for imports is on a downward trend. For example, Japanese exports of goods and services to the U.S. declined by an estimated 21% from August 2007 to August 2008. This contributed to Japan's trade balance slumping into a deficit during that same period, the first since November 1982. Further evidence of dampening import demand comes from the U.S., as its trade deficit in goods and services decreased to \$56.5 billion in September from \$59.1 billion in August, since imports decreased at a faster rate than that of exports. Even Germany, one of the world's largest exporters of goods, saw its largest annual reduction in exports in five years during August 2008. On the other hand, China's trade surplus rose by 20% in October 2008 from its September high of \$2,936 billion. Nonetheless, there remain signs of decelerating external demand for Chinese goods.

On the other hand, the slowing global economy has brought some relief to consumers in term of prices. Since August 2008 the price of oil, food and non-food commodities decreased as flagging economic conditions curbed consumer demand. However, oil-exporting countries like Algeria, Angola, Nigeria, Iran, Iraq and Trinidad and Tobago have suffered some losses as a result of the lower oil prices,

¹ See Box 1

Box 1: Breakdown of Trade Finance Facilities

■ Trade Financing Instruments

- **Documentary credit** describes the situation where the importer's bank pays the exporter only after certain documents are presented. The documents usually required are: shipping documents, insurance documents and relevant invoices.
- **Factoring** occurs when a business sells its accounts receivable to a financial institution that specializes in debt collection (the factoring house) at a discount. The factoring house assumes all the rights and risks associated with the receivables, and receives the payments made by the debtors for the invoice value. Generally, this type of trade-financing instrument is very useful in mitigating the risk of cash flow problems.
- **Pre-shipping financing** provides exporters with the necessary funding to prepare their goods for shipping. This funding may be used to support pre-export activities such as: raw material cost, payment of wages, packaging and overheads. Various lending institutions provide this facility; it is usually short-term and takes the form an overdraft or cash credit.
- **Post-shipping finance** guarantees the exporter sufficient cash until the importer receives the merchandise and the exporter obtains payment. Like pre-shipping finance, post-shipping finance is also short-term.
- **Buyer's credit** is a loan extended to the buyer (importer) on behalf of the seller (exporter). This financial arrangement allows the importer to make payments due to the exporter in accordance with the terms and conditions stipulated in the contract. Supplier's credit is financial agreement whereby the exporter extends credit to the importer to finance their purchases.

- **Export credit insurance** covers the commercial and political risks associated with cross border trading. Factors such as: importer delinquency, the non-acceptance of goods by the importers' country from exporters and failure of foreign banks to honour documentary credit all account for commercial risk. Political risk involves situations such as riots, war and currency devaluation. However, export credit insurance does not actually require the provision of credit.

- **Export credit guarantees** facilitate the exporters' access to funds through the protection of export-financing banks. This way an exporter can obtain pre-shipment and post-shipment financing from lending institutions with minimum hassle.

which translates to a decrease in economic growth and lower tax government revenues. For instance, the energy sector contributed approximately 45% of Trinidad and Tobago's GDP, 78% of its foreign exchange earnings and 64.4 % of

government revenue in 2007.

The tourism industry, too, is suffering as a result of the global economic crisis. In general, vacationers are doing one of three things: vacationing at home, vacationing in

destinations close to their homes or simply spending less time in distant tourist destinations. The ailing tourism industry can lead to problems of slow foreign currency inflows via reduced travel credits, and lower than usual economic growth. Therefore, this current crisis has negative implications for tourism-dependent countries.

In the Caribbean, the first nine months of 2008 were characterised by low tourism output owing to the tough global economic conditions. Stemming from the slow tourist arrivals, the hotel industry in the Caribbean continues to experience tremendous pressure. This is evidenced by the dismissal of over 1,000 Bahamian hotel workers due to low occupancy. However, to date, most Caribbean tourist-dependent countries are focusing on exploiting niche markets in tourism and further developing other foreign exchange earning sectors in an effort to buffer the adverse impact of the deteriorating economic environment.

Protectionism

The possibility of increased protectionism is a looming fear among trade experts and government ministers. In earlier times when a country was confronted with economic crises, the initial response was to create import barriers and promote exports.

For example, many economists argue that the perilous times created by the Great Depression were further worsened due to leading industrialized nations choosing to adopt protectionist policies in the wake of the crisis. The Smoot-Hawley Tariff Act of June 17, 1930 was the act that most reflected these protectionist sentiments. The act placed heavy tariffs on over 20,000 goods imported by US residents. This policy severely altered US imports and exports as many of its trading partners countered by adopting the same approach.

The main reasons that had inspired governments to pursue such a course include: (1) increasing the demand for domestically produced goods; , hence retaining foreign reserves, (2) preservation of employment for locals, and (3) revenue generation via the funds earned from tariffs. However, the three stated rationales are often short-lived, since in the end, import barriers only lead to deeper economic

distress.

Protectionist policies are generally harmful since they create unemployment and stifle productivity by constraining the importation of resources. Protectionism restricts imports by placing heavy tariffs on certain items. Such policies confine the customer base of trading countries solely to its national boundaries and as a result workers are made redundant due to the slowdown of production in the economy. In any case, most countries to some degree are import-dependent due to lack of resources such as natural endowments, technology, finance and land capacity. This means that importation is essential to the day-to-day operations of the world economy. Therefore, the adoption of protectionist policies is counter-productive.

In light of these arguments opposing protectionism, Lamy in his address also warned members of the WTO against the pursuit of protectionist policies in response to the present economic climate. To strengthen his appeal, he used the Great Depression as an example of the dangers associated with trade barriers.

However, to date there have been few signs of actual protectionist measures being implemented. Indeed, leaders of Asia-Pacific nations expressed their enthusiasm about trade liberalisation when they met on November 22, 2008 for their annual summit, to sign off on a final declaration backing free trade. During the summit, the leaders indicated their commitment to overcoming the current economic conditions. They also agreed to shun protectionist policies and to trade freely even though the world economy is flagging.

However, there is a general recognition of the possibility that the events of the 1930s could very well reoccur in the twenty-first century given the present climate.

Conclusion

In summary, the current economic crisis is posing a tremendous challenge to international trade. In particular, trade-financing facilities are at high risk due to the shortage of liquidity globally. In response, the World Bank has announced its plans to double the amount of funds presently allocated to the Global Trade Finance Programme in an effort to mitigate

the risk, as well as stimulate world trade.

Indeed, demand for imported goods and services is falling as result of the global economic turmoil. The dampened demand for imports has led to balance of payments problems for a number of countries. In respect of services exports, the tourism industry continues to contract internationally, as vacationers limit their spending and stay close to home.

The fall-off in trade could be further exacerbated by a potential upsurge of protectionist sentiment. While

the dangers associated with protectionism seem to be foremost in the minds of trade commentators and policy makers at present, as the current crisis progresses and conditions tighten further, it is possible that policy makers will become less interested in trade liberalisation, which could have deleterious effects on the world economy.

Generally, small open economies are the most susceptible to the adverse consequences stemming from the impact of crises on international trade. Therefore, policy makers must put proactive measures in place in order to counteract the negative impact of declining international trade.



The Age Of Turbulence: Adventures In A New World

By Alan Greenspan
A Review by Kester Guy*

Introduction

This review delineates some key aspects of the book, **The Age of Turbulence Adventures in a New World**, in which Alan Greenspan traced the development of the “new world.” Specifically, he articulated some of his experiences and proposed a conceptual framework for understanding the new global economy. In doing so, he explored some critical elements of this emerging global environment: the principles that govern it; the vast energy infrastructure that powers it; the global financial imbalances and drastic shifts in world demographics that threaten it; and the chronic concern over justice and the distribution of its rewards. Greenspan conveyed his perceptions through the context of his own experiences and with a sense of responsibility to the historical record, so that readers could better appreciate his views.

The review continues with an outline of Greenspan’s autobiography. An overview of some turbulent experience in the United States is then presented and some of the developments in the new global economy are summarised.

Greenspan’s Biography

The early chapters of this book highlighted some phases of the author’s life, which helped shape the views he presented. Alan Greenspan was born in 1926 and was brought up by his mother in a lower middle class neighbourhood in Manhattan. As a boy, Greenspan visited his father monthly, but according to him, those visits were not sufficient to mend the “gaping hole” in his life. At age nine, his father wrote and dedicated the book, “Recovery Ahead” to him. This was during the Great Depression and the book predicted that the glory of the US economy would be restored.

Perhaps this was a defining moment for Greenspan as the book was inscribed: “To my son Alan: May this my initial effort with constant thought of you branch out into an endless chain of similar efforts so that at your maturity

you may look back and endeavour to interpret the reasoning behind these logical forecasts and begin a like work of your own. Your dad.”

As a youngster, Greenspan was an avid baseball fan and player. He was also skilled at Morse code and photography. However, none of these hobbies could compare to his fervent passion for music. At age twelve he started playing the clarinet and practised with total dedication daily. Soon after he learned several other instruments and was playing with a band at various shows. Upon graduation, Greenspan’s heart was set on joining the US army where he had hoped to be a part of the band. However, his dream was shattered when he was declared medically unfit to serve. Despite this, he continued with his music career, touring various parts of the US. Greenspan eventually enrolled in the School of Commerce, Accounts and Finance at New York University in 1945 and upon graduation he accepted a scholarship to pursue a master’s degree. By 1952, Greenspan was pursuing his Ph.D. in economics while he worked at the National Industrial Conference Board. Later that year he got married, however, within two years his life swivelled: he separated from his wife, dropped out from graduate school and quit his job to start a consultancy business.¹

Greenspan continued in technical research and had several articles published in various journals. His business also expanded and his name became well known among businessmen, policymakers and other economic technocrats. Greenspan’s involvement in public life started in 1967 when he was invited to serve as a policy advisor in the Richard Nixon campaign for president. While in public life Greenspan functioned in various capacities including: Economic and Domestic Policy Advisor, chairman of the Council of Economic Advisors², and Federal Budget Director. Greenspan also worked on several task forces and commissions, and served on the board of directors for numerous private companies. In 1987 he was appointed chairman of the Federal Reserves where he served until 2006.

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¹ Greenspan returned to graduate school during the 1970s and completed his Ph.D. He also remarried in April 1997.

² The Council of Economic Advisors is essentially a small consulting firm with a single client: the president of the United States.

Managing the Turbulence

This section outlines some of the policy actions taken and the results observed during times of economic instability in the United States. The source of the turbulence was sometimes generated from domestic activity; however, exogenous shocks also required policy makers' initiatives in steering the economy from undesirable outcomes. Principles outlined in Greenspan's account are still very useful today, as many countries have adopted similar policies to help stave off the adverse effects of the current global financial crisis.

The Inflation Spiral of 1970 – 1975

Greenspan reported that the US economy was growing sluggishly after the Cuban missile crisis in 1962, and the fiscal authority instituted a \$10 billion tax cut to stimulate economic growth. Though this action yielded positive results, the excessive spending on social programmes and the underestimation of the Vietnam War led to a build-up in fiscal deficits. This forced the government to abandon its policy and introduce a 10 percent surcharge on federal income tax. The new tax had a slowing effect on the economy and by 1970 the economy had plunged into a recession. Unemployment reached 6 percent and the inflation rate was growing at an annual rate of about 5.7 percent. The Fed cut interest rates and pumped money into the economy, but while output improved, inflation continued upwards. Public pressure on the political administration led to the adoption of wage and price controls to ease the inflation spiral, but such a policy created its own problems as there were breakdowns in market activity for certain goods within a few months. This result did not surprise Greenspan as he explained that a free-market would eventually undermine any attempt to control prices. President Nixon later acknowledged the inappropriateness of this policy and introduced measures to incrementally revoke it.

The Arab oil embargo of October 1973 significantly contributed to the increasing inflation and unemployment rates, and eroded the confidence of the general public.

The consumer price index rose sharply resulting in a shocking 11 percent inflation rate in 1974. The stock market was in a steep decline and the economy was at the brink of the worst recession since the 1930's. President Ford's new administration³, implemented policies aimed at easing the energy crisis, restraining federal budget growth, and jolted the economy with a one-time income tax rebate to boost families' incomes. Despite public pressures for greater intervention, President Ford heeded Greenspan's caution against panicky spending – noting that it can exacerbate the inflation spiral. In mid-1975 the economy showed signs of a recovery: GDP growth increased rapidly and by October of the same year the economy was expanding at the highest rate in twenty-five years, while inflation and unemployment eased.

The Stock Market Crash of 1987

Another era of severe turbulence, sometimes referred to as 'Black Monday', occurred in October 1987 with the collapse in stock market activity. The economy was thriving and although the Dow Jones Industrial Average (DJIA) had run up by more than 40 percent there were sign of instability building up: the national debt had grown from just over \$700 billion in 1980 to more than \$2 trillion at the end of the fiscal year 1988; the inflation rate had jumped to 3.6 percent from 1.9 percent; and there were concerns about the loss of competitiveness. The Fed increased the discount rate by 50 basis points to 6 percent in order to subdue inflationary pressures and hoped that their action would slow stock market index. The market initially responded in line with the Fed's policy action but fear and panic on Wall Street led to a significant falloff in the DJIA Jones average. On Friday October 16, the Dow fell 108 points and by the end of trade the following Monday it had plunged by 508 points – a 22.5 percent drop – the largest one-day loss in history.

The Fed tackled the crisis on two fronts. The first challenge was to persuade giant trading firms and investment banks not to pull back from doing business and the second was to persuade commercial banks to continue providing credit

³ President Nixon resigned from office in August 1974, and vice president Gerald Ford took over.

to customers and to support other financial companies at reasonable interest rates. In addition, the Fed indicated that it would provide liquidity support to the financial system. From the political side, Congress agreed to cut the deficit, since that was one of the long-term economic risks that unsettled Wall Street. Gradually, prices in the various markets stabilised, and by the start of November the markets appeared to have been settled. The economy held firm, growing at a 2 percent annual rate in the first quarter of 1988 and at an accelerated 5 percent rate in the second quarter. By early 1988 the Dow had stabilized at around 2 000 points, where it had been at the beginning of 1987, and trades resumed along a more sustainable path.

The Technology Boom

The “dot-com” boom (1995 – 2000) provided a high-tech fast-paced environment that transformed business operations. The new technologies gave businesses the capacity to gather and disseminate real-time information, and allowed consumers to track transactions through an online system. Indeed, the boom period had a sustained positive impact on the economy: productivity increased, economic growth picked up, unemployment fell and federal budget deficits were turned into surpluses. Stock market activity also received a boost as both the DJIA and NASDAQ averaged record growth of 30 and 40 percent, respectively within the first year. Total market capitalization grew rapidly to \$9.5 trillion and represented about 120 percent of GDP – significantly higher than the 60 percent ratio in 1990.

Federal Reserves officials became increasingly concerned over the aggressive growth in stock prices: fearing that the development of a stock bubble might trigger an inflation spiral, and that a collapsing market would adversely impact the real sector.⁴ As Fed Chairman, Greenspan raised some of his concerns during a speech and suggested that the market was expanding too rapidly. His remarks initially caused a sell-off, mainly on the suspicion that the Fed was about to raise rates, but the market quickly rebounded and

after a few days had regained all its losses. By February 1997, the DJIA had soared to approximately 7 000 points, which prompted the Fed to increase short-term rates (from 5.25 to 5.50 percent) in order to restrain the market. The DJIA fell marginally a few weeks after but soon regained its momentum and continued its upward path – by mid-June of the same year, it was nearing 7 800 points.

The economy continued to show a strong performance and there was a build up in budget surpluses from tax receipts. In May 1997, a senior official of the New York Fed reported that estimates of the Treasury’s receipts were \$50 billion ahead of projections. Even though the economy was doing well, Greenspan argued that the economic performance was not sufficient to explain the surge in tax receipts. He however suspected that the stock-market effect might be largely responsible for the surge, and encouraged the Fed staff to accelerate its work on estimating the boost to household taxable income from stock-option grants and realized capital gains.⁵

The boom continued over three years and the Fed incrementally tightened interest rates to safeguard the economy against possible overheating and to squeeze excess liquidity from the financial system. By mid-2000 the Fed funds rate was 6.5 percent. This in effect gave the Fed the flexibility needed to provide liquidity that would limit economic damage in the event of a crash. However, the increases in rates did not appear to deter stock market prices as they peaked in March 2000 and remained relatively stable throughout the remainder of 2000. Amidst these developments, Greenspan was intrigued by the multibillion-dollar competition between several telecommunications companies. They were racing to expand the Internet by laying thousands of miles of fibre-optic cable. While demand for bandwidth was increasing exponentially, each competitor was laying enough cable to accommodate 100 percent of the projected overall demand. Greenspan anticipated that the market would fall by 30 to 40 percent since most of the competitors were likely to experience a decline in the value of their stocks, and billions

⁴ Greenspan noted Japan as an example where the stock market and real estate crash in 1990 crippled the economy over a sustained period.

⁵ The budget surplus grew from \$ 70 billion in 1998 to \$ 124 billion in 1999 and to \$ 237 billion in 2000.

of dollars of their shareholders' capital would be lost. At the onset of the second quarter of 2001 the stock market bubble began to contract. By the end of the year the NASDAQ index had lost a stunning 50 percent of its value, while the S&P 500 and the DJIA had declined by 14% and 3%, respectively. Although the total losses were small in comparison with the estimated wealth that the bull market had created, the Wall Street outlook remained gloomy and placed a damper on public confidence.

The build-up in budget surpluses resulted in tax cuts and tax rebates in June 2001. In the months that followed, federal revenues had plunged and the surpluses appeared to have been wiped away. According to Greenspan, this revenue shortfall was a reflection of the stock market fallout – a decline far worse than the experts had forecasted. Just as the bull market had generated the surplus, the post-dot-com bear market had taken it away.

Contagion: The Impact of the Russian Debt Crisis

As the Russian debt crisis of 1998 unfolded, the IMF stood ready with financial aid but Russian authorities made it clear that they had no intention of accepting the economic reform and fiscal management conditions imposed by the IMF. This defiance prompted a withdrawal of the IMF package. With depleting foreign exchange reserves, the Russian central bank was forced to abandon its defence of the Ruble and defaulted on its debt obligations.

The precipitating factor was the drop in the price of oil, which declined to a twenty-five year low of US\$ 11 a barrel. Since oil was a major Russian export, it meant that Russia could no longer afford to pay the interest on its debts.

Russia's default had a significantly adverse impact on the US stock markets. In the last four trading days of August alone, the DJIA lost more than 1,000 points, or 12 percent of its value. The bond market reacted even more strongly, as investors fled to the safety of the US Treasury market.

Banks also pulled back from new lending and raised interest rates on commercial loans. Behind these expression of uncertainty was the growing fear that several years of economic boom was coming to an end. Greenspan, in a speech, indicated that the imbalances caused by the technology revolution and rapidly globalizing markets were beginning to strain the world's financial system and threatening US economic stability. He indicated that the Russian crisis had the potential to destabilise the international financial system and looked for a solution from a globally co-ordinated perspective. To this end, central bankers and finance ministers of G7 nations agreed on a policy to urgently increase liquidity and ease interest rates throughout the developed world. Gradually, the policy effectiveness increased and markets around the world stabilised.

Comment

Many of the issues discussed previously are now being reflected in the current day crisis. As the US economy gained momentum during the period 2004-2006⁶, the Fed incrementally raised interest rates to reverse the threat of rising inflation. During that period the fed funds target rate rose from 1% to 5.25%. At the same time, the US housing market began to falter with prices falling and a rising number of homeowners, particularly subprime borrowers, defaulting on their mortgages. The events that followed led to, inter alia, the collapse of several investment funds, billions of dollars in write-downs, liquidity freezes on the interbank market, major fall-offs in stock market activity, investor panic, bankruptcy of several investment firms and widespread contagion into other sectors and economies.

To mitigate the effects of the financial fallout, both the monetary and fiscal authorities adopted several policy measures. Currently, these measures are quite similar to those outlined in the previous eras and involve massive rate cuts and liquidity support by monetary authorities as well as significant fiscal injections to boost economic activity in various sectors. Multilateral institutions such as the IMF, have already

⁶ Following the devastating events of September 11, 2001, the already fragile US economy was plunged further into a decline. In response, the Fed cut rates in stages (so that in December the target Fed Funds rate was 1.25%) to ease the rapidly deteriorating economic conditions. Although there was a slight pick up in 2002, economic activity generally remained sluggish into the first half of 2003.

provided financing to many countries and stand prepared to offer further assistance if required. Notwithstanding these interventions, economic conditions appear to be worsening, but policymakers are swiftly coordinating efforts to provide additional stimuli to ease the current situation.

The historical account of turbulence in this book is quite relevant and timely as it provides the details of some policy interventions and corresponding outcomes. Indeed, finding the optimal balance is perhaps the greatest challenge in managing an economy and policy makers must therefore be extremely careful when correcting for short-term misalignments. In the current context, serious consideration should at least be given to the future impact of present-day intervention.

Liberalisation: The Great Pillar of Market Capitalism

A number of global forces have gradually altered the world. New technologies facilitated low-cost communications as well as greatly enhanced mankind's ability to direct scarce savings into productive capital investments. The post-war liberalization of trade also helped to open up new low-cost sources of supply and other products that facilitate the forward thrust toward global market capitalism. The embrace of free-market capitalism in the years that followed helped to bring inflation to low levels and global interest rates to single digits.

The fall of the Berlin Wall in 1989 was a defining moment for many of the world's economies. Central planning was exposed as an unredeemable failure and market capitalism began quietly to displace those policies in much of the world. Not only did the economies of the former Soviet bloc embrace the ways of market capitalism, but so did most of the so-called "third world countries" – countries that had been neutral in the cold war but had practiced central planning or had been so heavily regulated that it amounted to the same thing. Communist China, which had edged toward market capitalism as early as 1978, accelerated the movement of

its vast, tightly regulated workforce toward the Free Trade Zones of the Pearl River Delta. China's shift to protect the property rights of foreigners was substantial enough to induce a veritable explosion in foreign direct investment into China.⁷ The investment, along with the abundance of low-cost labour, resulted in a potent combination that exerted downward pressure on wages and prices throughout the developed world. Smaller Asian countries, especially South Korea, Hong Kong, Singapore, and Taiwan, had led the way by adopting developed-country technologies to improve their standard of living through exports.

The rate of economic growth of these and many other developing nations far outstripped the rate of growth elsewhere. The result has been a shift of a significant share of the world's GDP to the developing world. The shift of shares of world GDP since 2001 from low-saving developed countries to higher-saving developing countries has increased world saving to such an extent that the aggregate growth of savings worldwide has greatly exceeded planned investments. The apparent excess in savings, combined with world-wide technology-driven increases in productivity, and the shift of workforces from centrally planned economies to competitive markets, have helped suppress both interest and inflation rates for all developed and many developing nations.

Market capitalism, the engine that underpins most of the world economy, has had a sweeping and positive impact on world development. The reinstatement of open markets and free trade during the past quarter century has elevated many hundreds of millions of the world population from poverty. Admittedly, many others around the globe are still in need, but large segments of the developing world's population have come to experience a measure of affluence.

Lessons

This section summarises what Greenspan sees as some important principles that can be useful in understanding

⁷ FDI in China grew from \$57 million in 1980, to \$4 billion in 1991, and then accelerated at a 21 percent annual rate, reaching \$70 billion in 2006.

and managing certain economic behaviours. According to Greenspan, some fundamental characteristics associated with global growth include:

1. The extent of competition domestically, and especially for developing nations, the extent of a country's openness to trade and its integration with the rest of the world;
2. The quality of a country's institutions that make an economy work;
3. The success of its policymakers in implementing the measures necessary for macroeconomic stability.

While these conditions are essential to prosperity, Greenspan stressed the need for state-enforced property rights and argued that if property rights are not properly enforced then open trade and the benefits of competition and comparative advantage would be seriously impeded.

Another important determinant of economic success is the extent of an economy's flexibility and resilience to shocks. Greenspan referenced the "bounce-back" of the US economy following 9/11 as a testament of economic flexibility, suggesting that flexibility and the extent of property rights are closely related. He emphasized that flexibility is obtained only if the competitive marketplace is free to adjust and allocate property as it sees fit. Therefore, he argues against restrictions on pricing, borrowing, affiliations, and market practices as these generally tended to hinder growth.

Greenspan also outlined that the super-abundance of natural resources – oil, gas, copper, iron ore, – does not automatically translate into the advance of a nation's production and wealth. Many studies have concluded that standard of living in resource-rich countries, particularly in developing countries, were markedly worse than that of other countries and their social indicators tend to be below average. He also noted that societies which aggressively pursue high levels of development tend to borrow against future incomes. Historically, these countries tend to run large government deficits that are financed by fiat money and the ensuing inflation eventually pushes these economies into recession

– as was experienced by some Latin American countries.

In the case of stock market activity, Greenspan underscored three very important points: firstly, there is no way to know for certain when a market is overvalued or undervalued; it does not make sense to fight market forces, therefore direct action against the market may not be useful; and finally, anything said about the market situation may spawn unintended results and hurt the credibility of the monetary authority. As a result he suggested that the monetary authority should focus on its central goal of stabilizing product and service prices to gain the flexibility needed in response to market failures.

Conclusion

According to Greenspan, the story of the past quarter of a century can be summed up as the rediscovery of market capitalism. After being forced into retreat by its failures of the 1930s and the subsequent expansion of state intervention through the 1960s, market capitalism slowly re-emerged as a potent force, and now almost pervades the entire world. The spreading of a commercial rule of law and especially the protection of the rights to property has fostered a worldwide entrepreneurial awareness. This in turn, like the "invisible hand," has led to the creation of institutions that now anonymously guide an ever-increasing share of human activity.

Looking ahead, Greenspan expects that the US economy would continue to grow mainly because of the advance in technology. However, his projections are based on the existence of certain preconditions including: continued adherence to the principle of globalized free markets; the fixing of the dysfunctional elementary and secondary school systems; that the consequences of global warming would be slow enough so as not to significantly affect US economic activity; and finally, that terrorist attacks would be kept in check. Based on historical record and experience, Greenspan asserts that US in 2030 is likely to be characterized by:

1. A real GDP three-fourths higher than that of 2006
2. The increased prominence of intellectual property

rights legislation and litigation

3. A Federal Reserve System that will be confronted with the challenge of inflation pressures and populist politics that have been relatively quiet in recent years.

However, if the Fed is unable to confine the inflationary forces, then the economy could be faced with:

- a. A core inflation rate markedly above the 2.2 percent of 2006
- b. A ten-year treasury note flirting with a double-digit yield sometime before 2030, compared with under 5 percent in 2006
- c. Risk spreads and equity premiums significantly larger than in 2006
- d. Therefore, yields on stocks would be greater than in 2006 (the result of a projected quarter century of subdued asset price increases through 2030), and, consonant with that, lower ratios of real estate capitalization.



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