

NOTE

Affecting the 'Real Economy'

Martin Khor writes :

Uncertainties in the financial sector are having a negative effect on the real economy of production, growth and jobs. These finance-related uncertainties include gyrations in exchange rates, movements in capital flows, and speculation in the markets for currencies, oil and other commodities.

It is increasingly hard to assess the extent to which changes in prices of commodities and in exchange rates, or movements in capital flows, are caused by fundamentals or by speculation. In the week ending 7 September 2008, the US dollar rose against many currencies. This was despite the continuing economic gloom in the United States. Home foreclosures are at a record high and will get much worse.

The crisis at the two giant mortgage companies, *Fannie Mae* and *Freddie Mac*, is so intractable that the US government has decided to take over both of them.

Meanwhile, the big rise in the price of palm oil in the past few years and then its rapid fall in recent months is a sign of the big fluctuations in commodity prices. This may partly be explained by real factors, but could also be due to financial speculation in the commodity markets.

On 4 September, the UN Conference on Trade and Development (UNCTAD) released its Trade and Development Report (TDR) for 2008. The TDR is considered the United Nations' most important annual report on the global economy. Its message is that growth prospects worldwide are dimming, but not disastrously. Its main point is that the real economy is being hit by uncertainty and instability in international financial, currency and commodity markets.

It was also concerned about the direction of monetary policy in some major developed countries. These two factors have led to a gloomy outlook for the world economy and present considerable risks for the developing world.

The financial turbulence, the speculative forces affecting food and oil prices, and the apparent failure of foreign exchange markets to bring about changes in exchange rates that reflect shifts in the international competitiveness of countries suggest that there is an urgent need for redesigning the system of global economic governance, says UNCTAD. A financial system that every three or four years is subject to a severe crisis that not only hurts actors in financial markets but also has repercussions on the real sector must be deeply flawed. □□□