World Economic Situation and P

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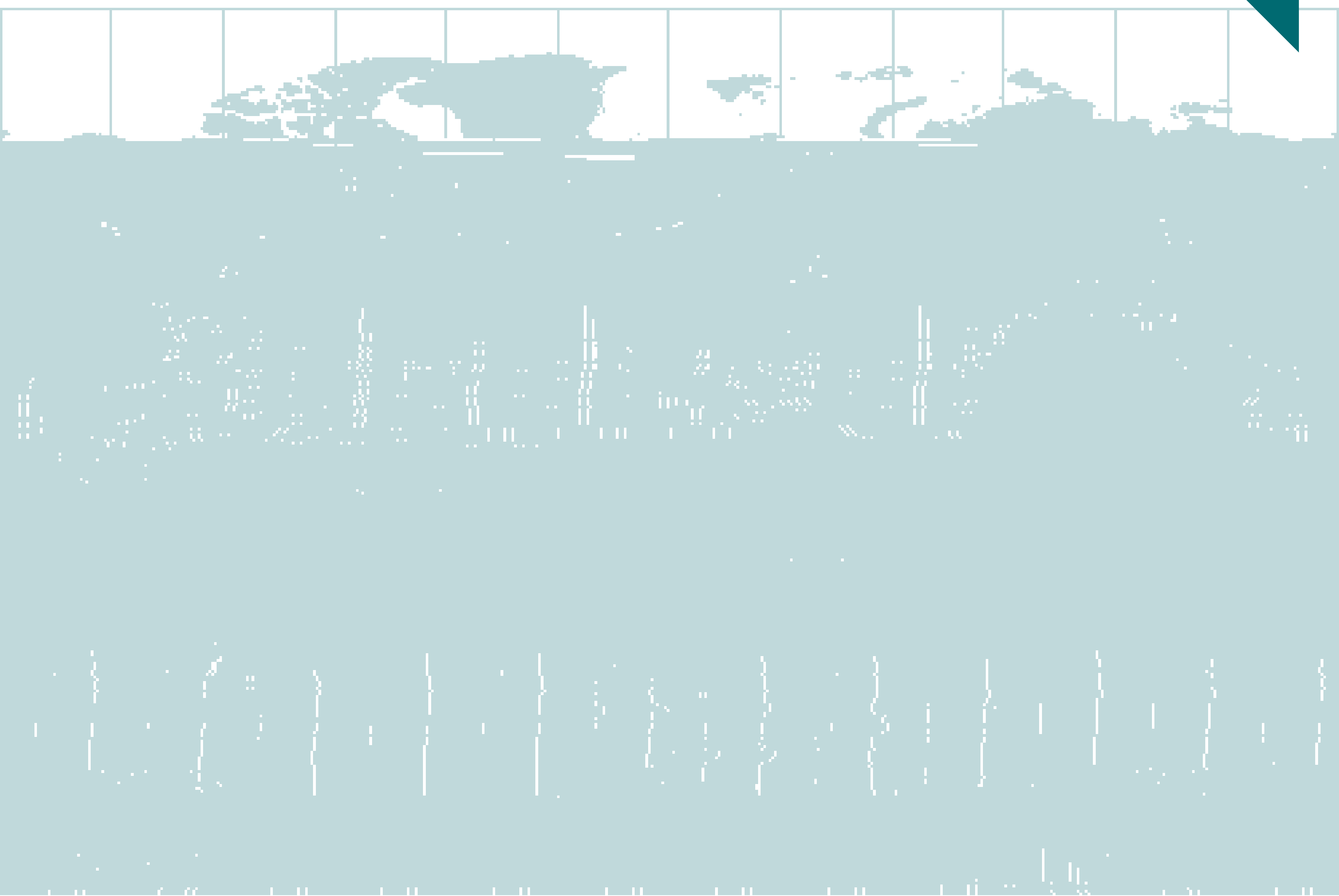

* The present document updates *World Economic Situation and Prospects 2010* (United Nations publication, Sales No. E.10.II.C.2), released in January 2010.

http://www.un.org/esa/policy/wess/wesp.html

World Economic Situation and Prospects 2010

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Global macroeconomic trends

Having fallen into the most severe recession since World War Two, the world economy is on the way to recovery. Following a contraction of 2.0 per cent in 2009, world gross product (WGP) is expected to grow by 3.0 per cent in 2010 and 3.1 per cent in 2011, (table 1). e pace of the recovery remains subdued, however. It is far from su cient to recuperate the job losses and close the output gap created by the deep recession. e baseline forecast assumes that the multi-year policy stimulus measures put in place in the major economies will be implemented as envisaged, implying that in most countries government stimulus will continue at least during 2010, and that private sector confidence will pick up gradually.

Buttressed by unprecedented government support worldwide, global financial markets have progressively stabilized. By mid-2010, systemic risks in the world financial system have abated notably, while risk premia in most credit market segments have dropped to pre-crisis levels. Also, major equity markets have recovered on average about half of the losses incurred during the crisis, while banks and other financial institutions have managed to rebuild their capital. Capital inflows are gradually returning to many developing economies, and prices of primary commodities have rebounded after steep declines from the start of the crisis to the second quarter of 2009.

e recovery in the real economy has also gained more traction. Propelled by fiscal stimulus packages and expansionary monetary policies, most economies registered positive growth in late 2009 and early 2010. e increase in policy-engendered public spending and the turn-around in inventories, which were curtailed precipitously during the crisis, have been major factors in the growth recovery. Meanwhile, household consumption and business investment are showing tentative signs of revival and international trade and global industrial production, which both collapsed during the crisis, have been rebounding steadily, although they are still below their pre-crisis peaks.

Yet, important weaknesses remain in the world economy. Despite the huge amount of liquidity that was injected into the financial system, credit flows to non-financial sectors in many economies, particularly the major developed economies, remain subdued. While the rebound in equity prices has mitigated the losses of many financial institutions, the process of establishing sounder balance sheets through write downs of troubled assets and de-leveraging is still on-going. At the same time, public finances of many developed countries have deteriorated rapidly due to the impact of the crisis and the policy responses. In some, suchri68( )]TJ-0.012 Tc T*[s)-226(h)6(s)5(F(b)19()-4(i)o)-27t6(m)-9(auc)-87(t)-72(e)-80()41

labour markets and social conditions is still being felt more broadly. e reduction in employment and income opportunities has led to a considerable slowdown in progress towards to remain muted in developed and in many developing economies. Yet, the recent rise in commodity prices may contribute to higher inflation, especially in developing countries with rates of growth close to pre-crisis levels.

The risk of a protracted period of mediocre growth for the world economy remains high in the aftermath of the global financial crisis. This poses new policy challenges. In the near term, policy support remains essential for solidifying and broadening the global recovery. One key area is to strengthen support for boosting employment. A robust recovery in jobs is crucial to a recovery in effective demand, which in turn will help reduce budget deficits. An increasing number of countries have stepped up efforts to stimulate job creation, such as through subsidies to firms that hire new workers and enhanced re-employment programmes for the unemployed. However, more needs to be done to link aggregate demand management and labour market policies so as to ensure a much more job-intensive recovery.

During the financial crisis international policy cooperation among major economies, particularly in the Group of 20, played an important role in restoring confidence and averting a much deeper crisis. As the financial crisis ebbs, however, the cooperative spirit is fading. Given their diverse pace of recovery and their idiosyncratic challenges, individual countries have different policy priorities: some will be able to unwind stimulus policies earlier, while others may have to consolidate their public debt more urgently. These country-specific policy adjustments, however, require more international coordination to strengthen policy synergies at the global level and to mitigate negative policy spill-overs to the world economy. Meanwhile, the unfinished agenda in reforming national and international financial systems requires further broad international policy cooperation.

Regional Outlook

Reserve has phased out some of its liquidity facilities and stopped purchasing of long-term assets. Policy interest rates are expected to be maintained at a very low level until the end of 2010, but modest increases may be expected in 2011.

Japan's economy contracted by more than 5 per cent in 2009; its worst performance since the oil shock in the early 1970s. While a collapse in exports was the major cause of the recession, macroeconomic stimulus measures and a rebound in exports have turned the economy around. Despite a slight decline in the unemployment rate, employment and income conditions remain inauspicious while persistent deflationary pressures continue to form a major obstacle to a more robust recovery. Growth is expected to remain lacklustre throughout 2010-2011, averaging 1.3 per cent over the two-year period. Being highly dependent on exports, the economy remains susceptible to any relapse in the recovery of its major trade partners, while high unemployment and low consumer confidence will curb household spending and concerns about public debt may constrain continuation of the fiscal stimulus.

Most of *Western Europe* exited recession by the third quarter of 2009. Nonetheless, in the Euro area the collapse in activity earlier in the year resulted in a decline in GDP by 4.0 per cent for 2009 as a whole. So far, the rebound has been driven by net exports, the end of inventory de-stocking and substantial fiscal support, through both automatic stabilisers and fiscal stimulus. Going forward, activity is expected to be driven by net exports with domestic demand, particularly investment, starting to contribute more in 2011. Nonetheless, domestic demand growth will remain subdued being held back by continuing balance sheet adjustments and tight financing conditions. Investment may pick up with increasing foreign orders but no sooner than after capacity utilization has su ciently rebounded from its record lows of mid-2009. Consumption expenditure is constrained by high rates of unemployment and meagre wage growth. As a result, overall output growth in the Euro area is forecast to remain subdued at 0.9 per cent in 2010 and 1.5 per cent in 2011. With such a meagre rebound in activity, unemployment is expected to remain elevated through 2011, though without significantly increasing from current levels.

Fiscal positions have moved sharply into deficit since the onset of the recession. Macroeconomic policy in most European countries is expected to shift from stimulus to consolidation in 2011, but the fiscal crisis in Greece is forcing immediate fiscal consolidation in those countries with perceived unsustainable budget positions. In Greece, with an estimated deficit of 13.6 per cent of GDP in 2009 and a public debt of 115 per cent of GDP, the government became caught in a solvency crisis requiring external assistance from the IMF in concert with the European Union, but not before causing contagion e ects in other countries. Heightened scrutiny by financial markets and downgrades by ratings agencies have led to a sharp rise in sovereign bond spreads for Portugal, Ireland, and Spain, which have already strongly tightened fiscal policy.

In most of the *new EU member states* economic activity stabilized in the last quarter of the 2009. However, the overall decline in output was dramatic, especially in the Baltic States, which su ered double-digit contractions of GDP. With the possible exception of these countries, positive output growth is expected in most of the EU member states in 2010. However, the recovery will be anaemic with GDP growth reaching 1.7 per cent in 2010, compared to a 3.5 per cent contraction in 2009. While several of the new EU countries have registered noticeable rebounds in industrial production in the first months of 2010, growth is also being constrained by low private spending and the reluctance of businesses to invest and banks to lend. us, an export-led recovery is the only realistic option, particularly as focus on fiscal consolidation will restrict stimulus options. However, monetary policies will remain accommodative as inflationary pressures are subdued. Meanwhile, unemployment has reached alarming levels in the Baltic States and continues to rise among the new EU member, especially for the low skill-workers. Although the worst of the increase may be over, it will take years of economic expansion for labour markets to recover. Moreover, the risk of a double-dip recession caused by, for instance, a premature withdrawal of monetary stimulus or too zealous e orts to achieve fiscal consolidation can still not be discounted. Growth is expected to strengthen to 3.2 per cent in 2011, assuming export demand and bank lending to the real sector will continue to pick up.

Economies in transition

Growth performance of the *CIS* was dismal in 2009, highlighting the region's reliance on external demand and external capital. With the global economy gradually recovering, and commodity prices, in particular for oil and metals, rebounding further from 2009 levels, the CIS is expected to grow by 4.2 per cent in 2010, compared to a 6.9 per cent contracti60(e)-1is 6ct9 businesses to financing, while low inflation will allow monetary policies to remain accommodative. On the downside, the current fiscal crisis in Greece may directly a ect Albania, the FYR Macedonia and Montenegro through weaker exports and remittances.

Developing economies

A rebound of exports and commodities prices contributed to a higher-than-expected GDP growth in *Africa* of 2.4 per cent in 2009, as did the fiscal and monetary stimuli, the continued rapid expansion of the telecommunication sector and the ongoing revival of manufacturing and increased investments. Overall, growth is expected to accelerate to

However, growth is expected to slow somewhat in 2010 mainly owing to slower credit expansion. The strong economic rebound, along with several direct and indirect government measures to support and generate employment, has led to a sustained labour market recovery. In some East Asian countries unemployment rates are now close to—or even below—pre-crisis levels, with further improvements expected in 2010. Consumer price inflation has picked up somewhat since mid-2009 as the region's economies rebounded and as commodity prices increased. However, in most countries inflation is not expected to accelerate strongly owing to subdued labour-cost pressures, remaining output gaps, some monetary tightening and low import-price inflation, partly as a result of appreciating currencies. Against the backdrop of mild inflation and ongoing risks in the global economy, monetary conditions will continue to support growth, though central banks will

Economic activity in *Latin America and the Caribbean* has also recovered more strongly than previously expected. GDP growth in the region will reach 4.0 per cent in 2010 and 3.9 per cent in 2011, compared to a contraction of 2.1 per cent in 2009. Following the mild recession that several economies experienced in 2009 in South America, activity

bubbles. To mitigate the impact of pro-cyclical and speculative private capital movements, several developing countries have responded by adopting capital controls. Lack of progress in internationally coordinated financial regulatory reforms may induce more countries to introduce capital controls.

After a surge during the global financial crisis, external financing costs for developing market economies have retreated to the pre-crisis levels, as measured through the Emerging Markets Bond Index (EMBI).

O□cial development assistance

O cial development assistance (ODA) increased slightly in real terms to reach $119.6 billion in 2009.[3] Nonetheless, at 0.31 per cent of donors' aggregate gross national income (GNI), this share was below historic patterns achieved throughout the 1980s. e level is also still well short of the Gleneagles commitment, according to which the 22 members of the Development Assistance Committee (DAC) would have raised their annual aid flows to about $150 billion (measured in current dollars) in 2010. C8(o)11(m)-16(m)-15(i)18(t)-19(t9o18(t)-19(t9)-1324-35(C) due to a weaker euro caused by the Greek and other looming debt crises. e situation has also exposed institutional weaknesses of the European monetary union, for lacking a (relative to the size of the economy), as was the case for several major developing countries, accelerated recovery.

e discretionary fiscal measures have contributed to widening budget deficits

Figure 3
General government debt of G20 countries

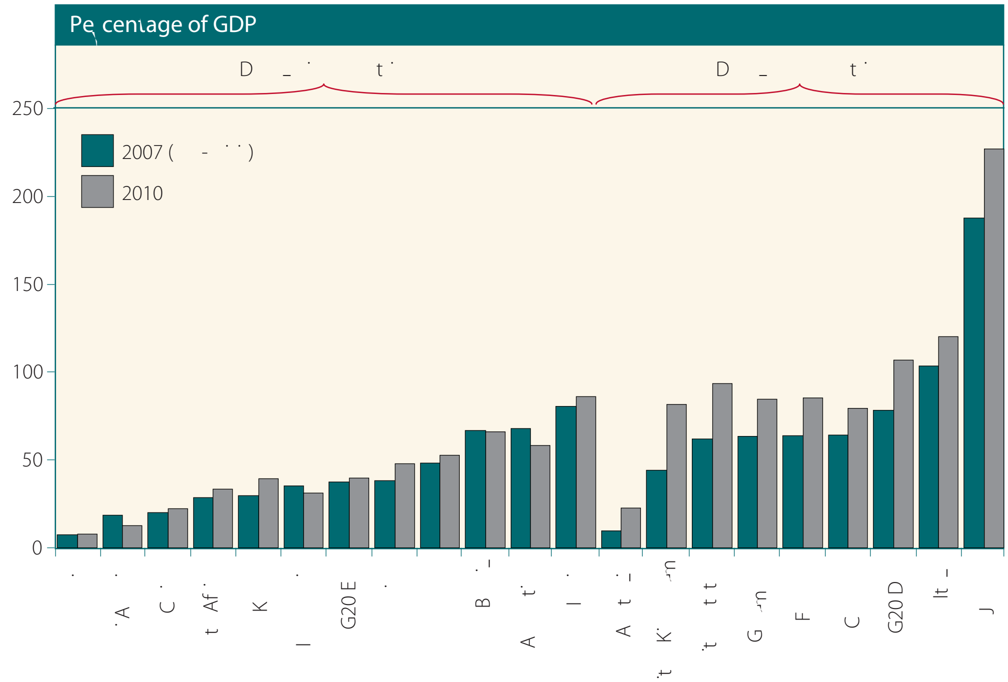
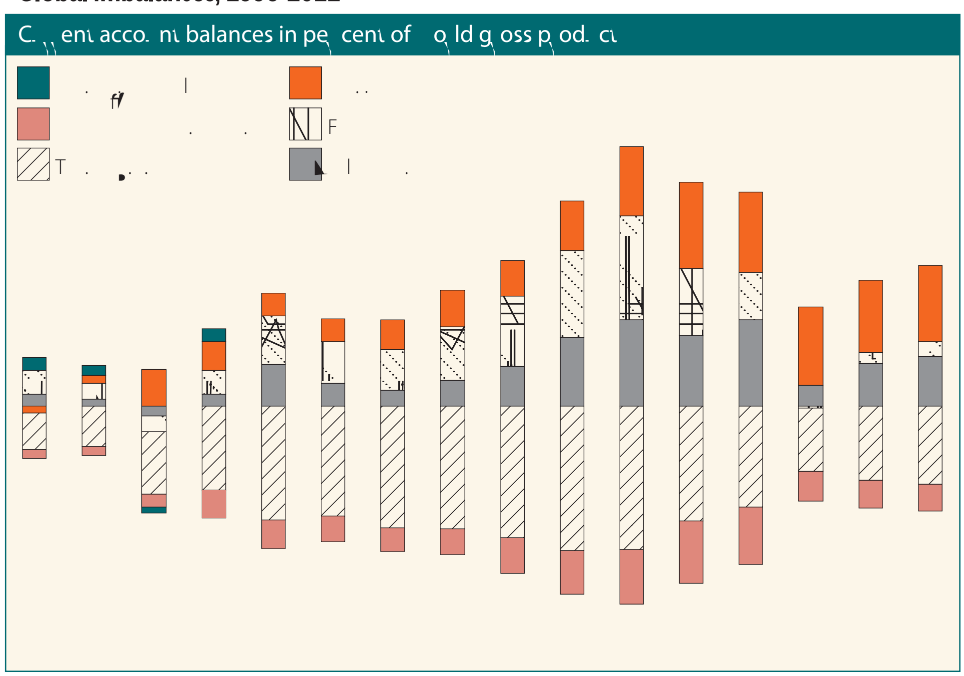


Figure 4
Global imbalances, 1996-2011



Global imbalances

As the crisis unfolded, the global imbalances narrowed markedly in 2009 (see figure 4). The large external deficit of the United States declined from $700 billion of 2008 to about $420 billion in 2009, approximately 3 per cent of its GDP. This was mirrored by smaller savings surpluses in China, Germany, Japan and a group of oil-exporting countries. This adjustment was a pure effect of the recession with the sharp retrenchment in imports of deficit countries and the collapse in exports of surplus countries, especially in early 2009. In the United States, declining import demand was closely linked to lower household consumption and a precipitous fall in both residential and business investment. The household savings rate increased from 1.7 per cent in 2007 to 4.2 per cent of disposable household income in 2009.[6] Government savings, in contrast, declined along with the widening of the budget deficit which surged from 1.2 per cent of GDP in 2007 to 9.9 per cent in 2009. Adjustments in savings and investment balances of major surplus economies vary across countries, but falling government savings has been a common trend. Among the surplus countries that entered into recession, like Germany and Japan, falling tax revenue and higher fiscal spending as part of stimulus measures are key factors behind the decline in their aggregate savings surpluses. The decline in investment demand in Germany and Japan only partly offset this trend. In China, in contrast, fiscal stimulus and a strong increase in investment demand are main factors behind the reduction in its savings surplus in 2009. Consumption demand in China also increased markedly, but compared with other major economies total consumption relative to GDP still remains extremely low.

Table 2
Mid-term scenario of risk of resurging global imbalances

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		A 2004-2007	2009	2011	2013	2015
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2011. The results are based on simulations with the United Nations Global Policy Model (http://www.un.org/esa/policy/publications/ungpm.html) under the assumptions given above. It is highly uncertain whether such a scenario will actually materialize, but what it shows is the risks associated with a path of largely uncoordinated economic recovery that has been set in. Public debt ratios in the Europe and the United States would continue to increase over the medium run and the net external liability position of the United States, which is already large, would increase further. This will increase the cost of borrowing in deficit countries and enhance the likelihood of much larger exchange rate volatilities. The fundamentals are for a much weaker United States dollar which could strengthen export growth. But, in combination with a continued high public debt overhang in both Europe and the United States, the risks for a disorderly adjustment and volatility in currency and financial markets at large would increase substantially. Much stronger macroeconomic policy coordination will be needed to avert such risks and put the global economy on a more sustainable path of recovery.

Policy challenges

Since the onset of the crisis government support has contributed to a progressive stabilization of global financial markets. Significant fiscal stimulus packages were enacted, central bank policy rates were cut decisively and a wide range of unconventional monetary measures were introduced. As financial market conditions improved and signs of a gradual recovery have strengthened, most short-term liquidity measures have been wound down e subdued and uneven recovery of the global economy poses additional policy challenges. First, dealing with the jobs crisis is of immediate urgency as persistent high unemployment and underemployment rates are slowing the global recovery itself as well as progress towards poverty reduction in developing countries. Much of the demand recovery still rests on government support. In most countries, these support measures will need to be maintained during 2010 and perhaps into 2011. In order to accelerate recovery in job markets, however, much more of the demand stimulus will need to be focused on providing incentives to productive employment creation. Job growth will also be a key ingredient in redressing the trend towards widening fiscal deficits by stemming the drop in tax revenue and reduce the need for social protection spending. Exit strategies from the extraordinary stimulus measures thus will need to be closely coordinated with labour market policies.

Second, there is a need for more resources and greater e orts to make up for the significant setbacks in progress towards the Millennium Development Goals (MDGs). Low-income countries with limited fiscal space are in need of additional ODA to finance the expansion of social services and programs needed to meet the MDGs and engage in counter-cyclical policies. ese increased needs contrast wid,(s)-50(a)-2t eid,(s)6id,(s)6id,(s)6id,0cd,(s)6(fi)-1n0.005 Tc 0 -1.

undertake policies to support private savings and to consolidate their fiscal deficit, while

For further information,

see http://www.un.org/esa/policy/wess/wesp.html

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