

United Nations
Department of Economic and Social Affairs

Report on the Project LINK Meeting

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1. Introduction and opening of the meeting

The Fall 2012 Project LINK Meeting was held from October 21-23 2012 in New York, hosted by the United Nations and the University of Toronto. The agenda comprised the following main themes: the global and regional economic outlook; the way forward after the global financial crisis and the global debt crisis as well as the outlook for commodity markets and international trade, macroeconomic challenges for the global economy and policy alternatives, and global modelling issues. This document summarizes the presentations and discussions.

The LINK Global Economic Outlook prepared for this meeting by the Global Economic Monitoring Unit of DPAD-DESA, the LINK country reports prepared by country participants, and most of the documents presented at the meeting are available on the United Nations website (<http://www.un.org/esa/policy/>) and the Project LINK Research Centre website at the Institute for Policy Analysis at the University of Toronto (<http://www.chass.utoronto.ca/link/>).

Mr. Peter Pauly, University of Toronto, welcomed the participants, expressing his thanks to DESA and his colleagues at the University of Toronto for helping to arrange the meeting. He also noted that it was good to be back in the Secretariat, where previous sessions of the meeting had been held for many years.

2. World economic outlook

Mr. Pingfan Hong, UN DESA, began by thanking all of the LINK participants that contributed to the production of the global economic outlook report. He presented DESA's perspective on the state of the world economy focusing on three issues – global macroeconomic trends, policy issues and major risks and uncertainties. 5 years after the crisis many countries are still working to return to normal growth and many economies in transition and developing countries are facing growth slowdowns for 2013. There has been some improvement in some areas with the Euro Area coming out of recession and China backstopping its decelerating growth.

Mr. Hong then went on to describe the conditions in the various regions such as low growth in the US, varied rates in the euro area and Japanese growth boosted by government measures. In developing countries growth prospects for Africa are relatively robust, but this depends on rising global growth and conditions in other major developing country trading partners. Growth is expected to stabilize in East Asia and then pick up in the next two years. South Asia's growth has been lower than the past and is expected to continue to be subdued. GCC countries are faring well, but other countries in West Asia have been hampered by geopolitical tensions and Turkey is facing considerable financial pressure. Latin America and the Caribbean has seen growth slowing over 2013, but is expected to see improvements over the forecast period. Finally the Economies in Transition are growing slowly owing to weak exports and supply constraints.

There are a number of other concerns such as continuing high unemployment in many countries and significant turbulence in financial markets. One of the major risks is the potential impact on emerging markets from the unwinding of the large developing countries' quantitative easing programs (QE). The balance sheets of large central

banks have increased greatly, which had a role in promoting stability during the crisis, but now may have created distortions that could compromise macroeconomic stability in emerging markets. There are some countries such as Turkey and South Africa that are more vulnerable to external shocks, with some echoes of the Asian financial crisis of 97-98. Fortunately the external debt and foreign reserve positions of many countries is better than during previous crises.

The policy challenges are more varied as there are more diverse macroeconomic stances in many countries though in general there are less restrictive fiscal policies and less relaxed monetary policies. The key challenge is how to unwind the QE programs in a coordinated manner to minimize the detrimental spillover effects. The need to improve international policy coordination continues with efforts to move discussions from the G20 to the UN. In addition, Mr. Hong stressed the need to ensure that sufficient resources are made available to those in need, particularly in the LDCs and to boost ODA, which has dropped in the past 2 years.

Ms. Rupa Duttgupta, International Monetary Fund (IMF), presented the IMF's view on the global economic situation and perspectives for the world economy. The presentation was based on the recently released World Economic Outlook (WEO) of the IMF. The speaker stated that the central message of the WEO is that the global growth dynamics is transitioning to a new pattern.

According to the speaker, there are two new developments. The first one is that markets are anticipating change in US monetary policy, and the second one is that growth in advanced economies is accelerating, while growth in the major emerging market economies, including China, is slowing. As one of the consequences of the recent turbulence in financial markets, growth in emerging markets will be weak not only in the short-term, but also over the medium-term time horizon.

In the US, monetary policy has been tightened since May, despite some slack in the labor market and downward revision to growth. Consequently, the yield on long-term government bonds has increased by about 1 per cent. Tighter US monetary conditions have spilled over to the euro area, and to a lesser extent to Japan. Those tighter monetary conditions interacted with domestic weaknesses in emerging markets and complicated their access to funding. Exchange rates in the emerging market acted as protective buffers (the previous overvaluations have been corrected), however, weaker exchange rates are not expected to forestall low growth rates.

The speaker presented IMF's forecast for the global economy, which is based on a number of policy assumptions, such as gradual tapering of QE in the US (while keeping interest rates on hold until 2016) and accommodative monetary policies in the euro area and Japan. Meanwhile, less tightening of fiscal policy is expected in the US and in the euro area, while tighter fiscal policy is expected in Japan. For emerging markets, tighter external funding conditions should be a one-off phenomenon. Compared with the earlier IMF's forecast released in July 2013, the recent one has been revised downwards for all regions, with the exception of the euro area. According to the speaker, the near-term risks for the global economy will remain on the downside (although market indicators do not point on increased risk perceptions). Emerging markets face risks from higher interest rates in advanced economies, especially if interest rates are increased not in response to stronger growth, but

because of inflation concerns or higher risk premium on the US and EU debt. However, depreciated real exchange rates in emerging markets should mitigate the risks of capital outflows. Currently, emerging markets are in a more resilient shape than during the Asian financial crisis, as they have more flexible exchange rates, lower external debt and higher foreign exchange reserves. On the other hand, domestically denominated short-term debt may be a cause for concern. According to the speaker, a possible downside scenario is also possible in the medium-term, with lower potential growth in emerging markets, including China.

The speaker stated that for the US macroeconomic policy priorities include addressing short-term fiscal challenges and medium-term fiscal adjustment, maintaining easy monetary policy, and careful calibration and communication of exit strategy from asset purchases. Japan should work on all three areas of “Abenomics”. Emerging markets and developing countries should utilize exchange rate buffer, use monetary policy to keep inflation well anchored, and preserve financial stability using fiscal stimulus only when facing a major slowdown, and also embark on structural reforms.

Mr. Andrew Burns, World Bank, presented the World Bank’s assessment of the global economic outlook and the major risks. He first noted that the main “story” was similar to the one laid out by the United Nations and the IMF.

A mild recovery is expected in the advanced economies, where business confidence has steadily improved over the past 6 months. Faster growth in advanced economies should also provide support for developing countries. He emphasized that despite the recent weakness in some major middle-income countries, activity in developing countries had also started to strengthen and expand in line with potential output. In most developing countries output gaps were closed. According the World Bank’s baseline forecast, average growth in developing countries during the period 2013-15 is higher than it was in the years prior to 2005.

Despite the improved baseline outlook, the global environment remains fragile and there are substantial downside risks. These include financial pressures from the tapering of the US quantitative easing program, credit bubbles in parts of East Asia and uncertainties due to the US debt ceiling brinkmanship. He pointed out that medium-term growth in developing countries would come under pressure from higher borrowing costs and tighter financial conditions.

The recent episode of financial turmoil and weakness in developing countries related to the fears of an end to quantitative easing served as a wake up call. Countries with vulnerabilities have been granted a reprieve, but need to address their weaknesses now since the change in global financial conditions has only been delayed. The countries hit hardest during this episode have some of the following characteristics: relatively deep capital markets; commodity exporters; significant domestic imbalances; and adequate but declining foreign exchange reserves. Other countries should also rebuild buffers that have been depleted during the crisis and the subsequent recovery. Mr. Burns emphasized that the long-term growth prospects of developing countries primarily depended on structural reforms.

Mr. Moazam Mahmood, ILO, provided an overview of the situation in labour markets given the current macroeconomic picture. In view of the tepid GDP growth,

the job crisis persists. The employment picture is problematic also when considering other measures such as underemployment and vulnerable employment. It is noteworthy that during an economic contraction, employment appears less sticky, while the opposite is the case during an economic recovery. There are a number of reasons for the continuing employment gap. Household spending remains lower due to deleveraging, banks are reluctant to lend in view of non-performing assets and high public debt exerts pressure on interest rates. The costs of adjustment appear through austerity measures and efforts to increase competitiveness, which in turn imply employment adjustments.

Mr. Dave Turner, OECD, started by pointing out that in the United States, the debt level remains a major issue, with the possibility that a default in the absence of a higher debt ceiling could imply a recession for OECD countries. While the tax burden in the United States is not necessarily high, there appears to be a clear need for entitlement reform and greater entitlement efficiency. While the unemployment rate has come down, employment has remained flat, with the difference explained by a fall in the labour participation rate. A significant part of the fall in the participation rate appears to be structural. In Japan, there has been a greater focus on structural and fiscal policies. Monetary policy measures have contributed to an end of deflation and looking ahead, there is a clear need for credible fiscal policy. In the euro area, there is a need for a banking union with a shared fiscal backstop. Inflation is running at close to 1.0 per cent, implying the need for the ECB to move it closer to 2.0 per cent in line with its target.

Discussion

In the general discussion, it was pointed out that a major problem in Europe remains the lack of common policies. Regarding possible sources of demand, one speaker mentioned exports and measures by the ECB. One speaker pointed out that the ECB has already done a lot to support the economies in the euro zone and that the remaining margin is small. It now is even more up to the governments to play their role in reviving the economies.

Q: With regards to Sub-Saharan Africa (SSA) – commodity prices are likely to be declining – what's the basis for optimism for growth despite that many of them are commodity exporters and prices are declining?

A: Ms. Duttagupta - for growth in immediate near term, even with lower commodity prices a large part of growth is coming from domestic demand, particularly investment – a lot of projects are coming on stream. One past chapter in the WEO was on “where does the optimism come from?” for SSA as a whole, its not just commodity exporters, many countries have underlying important developments – for example there has been less accumulation of external debt serving as a driver for growth as in previous high growth periods. There have been significant steps toward reducing size of government and increasing infrastructure coverage and we also see better political stability. There are some seeds of pessimism for instance borrowing has gone up and therefore some countries will need to build up more substantial fiscal buffers.

A: Mr. Moazam Mahmood, ILO – this is a critical point which may suggest some problems within developing countries, particularly lower income ones and what their growth has been based on. On the other hand they do deserve some credit for improving fiscal governance but many still need fiscal structural reforms. Another important issue is deindustrialization particular in SSA. Beneficiation and the problem of not enough value added as commodity super cycle comes down there will be issues which will require more investment in productivity, also in the services sector.

A: Ms. Duttagupta - I agree. We see that much of the growth is happening in high growth commodity sectors. As prices come down there will be a need to focus on other sectors.

A: Mr. Hong - on Sub-Saharan Africa we don't use that aggregation, rather we use ECA's 5 regional definition. That said, there has been some slight growth acceleration with increasing savings and investment rates in many countries up to 20-22 per cent and rising over the past few years. This will still needs to rise higher – in the case of East Asia the rates were around 30 per cent during the takeoff period. Agriculture has also shown some improvement although this may have been weather related.

A: Mr. Burns – its hard to prove high commodity prices are what's driving growth. Many non-commodity exporters also have high growth. Its likely a combination of factors. There have been a number fiscal, health, education, regulatory, etc. structural reforms. We're also seeing improved conditions on the ground such as investment in the resource base that was always there, but wasn't supported before. The question is - how enduring will this be as commodity prices come down? Many of these investments appear to be profitable under much lower price regimes – therefore that component of growth may not be as vulnerable. There are vulnerabilities on the government finance side though. Many governments are relying on commodity revenues which will impact their ability to provide important services that are aiding growth. There have also been significant improvements in TFP that go beyond what can be explained by commodity prices that could support growth.

Q. Both LINK and IMF forecasts for China for 2014 are lower, than estimated growth in 2013, what are the reasons for that?

A: Ms. Duttagupta - the difference in forecasts is small, but overall gradually China will move towards 7 per cent average for the medium term. The underlying reason is that there has not been much increase in consumption driven growth, but returns on investment are falling and stabilizing at a lower level.

A: Mr. Hong - China and rest of the world are facing different issues – it appears that we're in the process of a cyclical rebound for the rest of the world. China is facing structural adjustment – not a cyclical move. The expectation is that China will continue as the new administration has been, with a continued focus on structural adjustment rather than stimulus. Overall the slowdown has been relatively small. Growth of 7.5 per cent looks to be the medium term forecast while leaving some room for reforms.

Q: Did you consider recent opening of the Shanghai free trade zone?

A: Mr. Hong - the emphasis for that is on the financial sector not on trade – there is some resistance to financial reforms so they called it trade. It will be a mixed bag, but it seems the possible successes are limited. It's not possible to reform the financial sector in the same way that you reformed the countryside. Financial flows are quite flexible so it is much harder to build a fence to control that. But there is still resistance in many areas across the country so they had to do it at a smaller scale.

Q: To Ms. Duttagupta - to what extent do you consider structural vs cyclical factors in world growth? To Andrew – a few questions about changes in investment to China – do we know where the investment is going and what's the productivity in the various sectors? And what are the explanations for the assumptions of the slowing TFP growth by 2015?

A: Ms. Duttagupta - all countries that undergo financial crises have permanent changes in output – we saw this even in 2010 and 2011. At this point we have no further revisions downward in potential growth estimates therefore changes are now mostly due to cyclical factors. For EM economies we haven't done a country by country analysis to see what's cyclical vs structural, but seems to be structural factors are 50 per cent or a bit more although this varies a bit by country – more for China, India, less for South Africa.

A: Mr. Burns - for high income countries the IMF's analysis of long term impacts on developed countries from the financial crisis was useful. There's been some revision at some of the country desks at the IMF. They use production function methodology – which is pretty much the same for every country at WB. We use perpetual inventory for capital stock and the assumption that TFP growth will on average be the same as the period 1995 to 2005. For many slowing is a result of expectation of slowing TFP. I suspect that we're pretty close to IMF estimates of cyclical vs structural effects. On China – I'm not a China expert – but I understand that there has been a significant change with more investment going to housing and that kind of infrastructure and less to productive capacity – and therefore less of Marxian disjoint – but I'm sceptical of this sanguine view. This could be problematic in the banking sector.

Comment: A debt to GDP ratio should not necessarily be viewed as a vulnerability indicator. In Thailand, a large infrastructure investment was undertaken. The problem is not debt in itself, but how it is used. In China, it's not just investment into housing, but also lifting people out of poverty, especially in the Western part. The question is now how to address the last 100 million living in poverty.

Q: Any comment on regional a infrastructure bank for China?

A: Mr. Hong – I agree that the debt/gdp ratio is not a perfect indicator – it is important where debt is used. If debt is used for investment in future productivity then it can be good, but it is not so good if used for consumption. But there is no unique threshold for sustainability. On the question of a regional investment bank and here we're talking about the BRICS investment bank, governance issues are the stumbling block. Those countries have lost trust in multi-lateral organizations. They're looking for money from developing countries to be used in developing countries. Another question is how will governance be organized? Will it be based on share?

A: Mr. Burns – the debt/gdp ratio is an imperfect measure and it is strongly correlated with per capita income so it is reasonable to expect and want it to grow. The key is changes in the short term. This can lead to banking crises. 35 per cent of banking crises in developing countries have followed significant increases in private lending – a number of other crises can lead to these crises – and tightening can bring sovereigns under fire as they try to deal with the banking sector. The World Bank is in favour of regional development banks and we think it is good to bring more finance to developing countries.

Q: Latin America suffered significant debt crises in the 90s, now we are seeing reversal of capital inflows, rising interest rates, falling commodity prices, and rising debt/gdp ratios – what are the prospects for future debt crises?

A: Mr. Burns - I don't see the World Bank having very strong crises in Latin America in our forecasts. Analysis suggests that the region has learned the lessons of the 90s and fiscal prudence has risen. Countries have consolidated loan books and in general they've gone long with regards to maturities. There are some worries in the corporate sector – they've been accessing bond markets at very low interest rates – but it's more difficult to get a handle on what kind of vulnerabilities might be building up there.

A: Ms. Duttgupta - the baseline forecast is for an improvement, barring 1 or 2 countries, maybe Venezuela – but overall they're better positioned to react to shocks. But on top of worries about the corporate sector we are also concerned by increases in household sector credit.

Q: With regards to conditions related to employment – the downward revisions of potential growth are in line with ILO – how much is due to structural issues and what kind of structural reforms would you prescribe?

A: Mr. Burns – it's difficult to deal with employment issues in developing countries due to data issues. Often the data only deals with the formal sector and then often only for 1 or 2 cities. There is not enough data on that for developing countries, so it is difficult to separate the impact of labor market on potential output. With regards to policies and problems? There are probably as many policies as there are countries. There are serious problems of human capital – education, health care, social welfare – but this plays out differently in many countries. In MENA for example there is considerable insider-outsider queuing behaviour. The closer you get to high income, the more you see high income labour market issues. The response policies should be broad, tailored to specific circumstances. They can be different in middle-income countries and in high-income countries.

A: Mr. Hong - I don't know how the World Bank does it, but for DESA, for example in China, we look at labour market and demographic changes. The 16-64 age group is coming down for the first time. 1-1.5 per cent of growth is coming from demographic dividend and from now on this will be coming down gradually. Labour surplus transfer has slowed down and some say it is completely gone. Some say those left in country side are those either too young or too old so you still see a significant population, but these people would not be included in the labour force. That's why you're seeing wage rates rising 20 per cent in some areas per year in the past 5 years –

they can't find migrant workers to fill jobs. There are completely different demographic trends in other countries – particularly in India and Africa.

Mr. Pauly paused at a break in the sessions to note the passing of Lawrence Klein the night before at the age of 93. He was a professor of economics at the University of Pennsylvania and the recipient of numerous awards, in particular the Nobel prize in 1984 for pioneering work he conducted in applied econometrics. He was the founder of LINK and has guided it for many years. Dr. Pauly worked with him for 40 years and remembered him as a wonderful colleague and mentor. Many have known Dr. Klein as a friend, colleague or student and appreciated his kindness and unflagging support. Dr. Pauly stressed that the LINK participants owed Dr. Klein a tremendous debt of gratitude for the work he's done with them and for them and for the time that Dr. Klein's devoted to this project and his energy. Dr. Pauly noted it as a sad day coinciding with our meeting, but also as a recognition that a very full life had come to an end.

Q: We're starting to have a recovery in the EU, but so far it is very weak and I'm not sure if it's going to be a real recovery. But we don't have a common policy. The best we have for now is ECB keeping rates low. We have high unemployment – not just in Spain – in the EU as a whole. Therefore we need more fiscal policies. When, how and who will be responsible for additional policies to solve the situation? The second question is to Mr. Mahmood and is related to previous papers. We need 2.9 per cent growth to create jobs. The thought is that employment is going to increase around 1 per cent. But where is that growth going to come from? Industry is around at this point is around 40 per cent of GDP. I'm not sure how growth is going to affect employment.

A: Ms. Hunter – on the question of where EU growth is going to come from we see exports as a key driver, particularly improvements in competitiveness will help with exports. From outside the EU a bullish view on the US leads to more imports and this spills over to US. We don't expect big recovery from peripheral countries.

A: Mr. Turner – who's responsible for increasing growth in EU? If it's a macro issue and inflation will be weak then it's an ECB responsibility. They're mandated to take some action against it. The ECB may be in denial about downside inflation risks. The commitment to do whatever it takes by the ECB was designed to buy time for other reforms such as a banking union, which could stave off catastrophe, but could also encourage lending and borrowing. You have to have an idea of what you're going to do with banks that fail stress tests. The ECB can do something, but EU policy makers need to step up.

A: Mr. Mahmood – we'll have to agree to disagree. We need to be consistent in our advice. In other words we need to have EU countries re-balance - if we say the same thing for China have to be consistent. Where is aggregate demand going to come from? It's not coming from developed countries and not solely by developing countries bootstraps. Then yes we have to talk about rebalancing and with that talk about Germany. There are two practical limits to competitiveness, one on the macro side and also there are issues with taxation.

A: Mr. Pauly – there was an interesting story in Germany after the election – voters there had a slightly more favourable attitude towards lending to periphery. This might stimulate periphery. At this point there are no prospects of demand stimulus in Germany, they're actually talking about tax increases to raise deficit.

Comment – on the question of where is growth coming from - foreign demand or increasing exports is a bit too simplistic. It will depend on where we're coming from or where we want to go. Many structural problems have existed for a number of years. The idea that ECB has to do whatever it can to raise growth is a bit simplistic. The ECB can't do it alone. It can help with some areas, but not with all the root causes. At this point there is a low marginal benefit to the ECB doing more. Governments will need to take steps. Accommodative policies will be there as long necessary. The European Commission is working now night and day to do SSM. You have to take into account the ECB's limits.

Comment – a banking union is essential and domestic structural reforms are essential. The ECB should really care about inflation, which is well below target and market expectations are well below target even 3-4 years out. Countries in southern Europe have a double challenge. They need to gain competitiveness and also to improve government balances. One the one side they need low inflation for the former, but this will hurt the latter. Some argue that the inflation target could be much higher, but the ECB should still take steps to ensure that they're not undershooting the target.

Comment – with regards to structural unemployment I agree with ILO that in more countries for example in South Africa employment issues are more structural. It is to a large extent socio-economic in nature and connected to hysteresis. This concept will ultimately translate cyclical unemployment into structural. Utilizing a production function approach one will need to take structural unemployment into account and one will have to adjust assumptions of unemployment – the non-accelerating unemployment rate of inflation (NAURI as opposed to NAIRU). Setting a growth target will not resolve the issue if unemployment is structural so we need to focus on reforms to improve productive employment.

3. Global outlook for commodity markets and international Tourism

Mr. William H. Meyers, University of Missouri, described the overall crop prices trends, comparing previous projections with more recent available data. He discussed the perspective and expectation of US farmers about prices. Mr. Meyers showed the inverted relationship between yield trends and price trends for corn in recent years. The upward trend in corn yields in 2013 brought corn prices down. Corn prices are however expected to stay flat in 2014 and 2015. For the last 5 or 6 years, ethanol has been the largest driver of corn price increases, but the market may have reached saturation so this factor may play a more muted role going forward. Wheat and other grain production has been flat. On the demand side, Mr. Meyers showed how China's situation is determinant. The rise in households' income and urbanization has contributed to higher demand for food, while there constraints on the supply side, including environmental issues, such as limited natural resources. Therefore, grain

and oilseed imports are expected to grow rapidly in China. Finally, Mr. Meyers presented some of the results from stochastic simulations in food prices

Mr. Robert K. Kaufmann, Boston University, made a presentation on the topic “Is the World Oil Market Unified? Regions in Quality, Risk, & Space”

He started with a comparison of different forecasts of oil prices for 2014 by a number of institutions. The forecasts diverge widely, ranging from \$92 pb to \$130 pb, and his own forecast is about \$95 pb (in terms of WTI). His relative bearish forecast is based on a steady growth in supply, contributed by additions to OPEC capacity mainly from Africa, increases in non-OPEC crude oil production from the United States, and increases in natural gas production worldwide. He also expected a slow growth in consumption demand, as a result of relatively moderate economic growth and increasing efficiency.

He has analyzed the question about whether or not world oil market has unified because production flows seamlessly across physical, technical, and political barriers. He believes the crude oil market is regionalized, based co-integration tests on daily spot prices for 33 crude oils for the period of November 27, 2002 through December 31, 2010, to test 528 pairings for co-integration using ADF.

He went on to discuss risks of investing in oil sector in individual countries, such as regulatory changes through government action, political events such as riots or civil wars, and natural events such as earthquakes and hurricanes. He also discussed geographic risks worldwide.

Mr. Sarbuland Khan, UN World Tourism Organization, stressed that it is important to consider tourism in modelling. He announced that the organization now has a new code of ethics. He defined tourism as a demand driven process. About 50 per cent of the demand was related to leisure. There is a complex tourism supply and value chain. Tourism is a major generator of jobs, etc. with significant multiplier effects. There are questions of effects on culture. It could be damaging, or could be used for cultural preservation. Overall the sector is 9 per cent of GDP. Mr. Khan pointed out that 2012 was the first year that there had been over 1 billion tourist arrivals globally. In addition tourist receipts topped \$1 billion in 2012. Tourism is a significant portion of many regions' trade in services. A significant development in the past few years is that the Asia Pacific region is now above Americas in terms of tourist arrivals and expenditures. The Middle East and North Africa have been declining due to political factors and Arab Spring. Tourism fared better in 2013 than in 2012. Arrivals are up 5.3 per cent, above previous forecasts of 4 per cent. Emerging economies saw higher rates of both inbound and outbound tourism. Even arrivals in the EU are rising. There has also been a rapid rise in Chinese outbound tourism. The Russian Federation has also had a significant increase in outbound tourist related expenditure and Brazilian citizens' expenditures are also up somewhat. The world outlook is now better, but likely to even out in the remaining part of the year. The overall growth rate is slowing, but absolute numbers of increases are expected to continue to be constant.

Discussion

Q: What about cotton and other industrial commodities which are very important for a number of countries? Also is the commodity boom over or will prices stay high? Why aren't mineral products covered? These are important for economic cycles.

A: Mr. Meyers – cotton is covered, but it was not in the presentation. I will put it in when posting slides. We also cover livestock and dairy products and those mostly follow lags in grain markets. As for boom and bust cycles - the late 1990s and early 2000s may have been an anomaly. Now commodity prices are much more closely linked to oil and ethanol industries. I believe that agricultural commodities are expected to be more closely related to oil prices than earlier. Prices will be higher and more volatile, but not as high as last year which was an outlier.

Q: I think that there should be some analysis of impacts of the weather and particularly its effects on agriculture. For example, in the Caribbean there has not been as much rain as normal which leads to two price effects. Most electricity comes from hydroelectric power so therefore next year electricity prices will be higher. In addition commodity prices will be affected. Every couple of years it would be useful to have something on the weather.

A: Mr. Meyers – the IPCC has said that climate change has led to greater changes in weather and will lead to greater volatility and uncertainty in commodities market.

Q: On tropical beverages – the highest reduction in prices has been for coffee and cocoa – any comments?

A: Mr. Meyers – I'm not sure what has been causing that price reduction.

Q: The level of oil coming out of the shale formations in the US seems to be a miracle. Any comments?

A: Mr. Kaufmann – it is kind of a miracle. Nobody thought they would be able to pull that much out of those formations. It's not clear how applicable this is to formations outside the US.

Q: Do you want to stand by the forecast? I think that the OECD may be more realistic. The US seems to be embarking on new policy, but it seems like it might be political rhetoric. Does the US have the tech to become a real major?

A: Mr. Kaufmann – I don't think that US will be net exporter, but smaller imports will mean more oil in the rest of the world. 4 million extra US barrels a day knocks 15 per cent off of OPEC capacity utilization. We're already seeing impacts of natural gas on coal as already mentioned.

Q: If the US comes close to being a net exporter – how do you see changes in the composition of the market, particular from those who are major exporter to US, i.e. Canada and Mexico? Also, what about environmental risks? What do you think the price impact will be?

A: Mr. Kaufmann – the point is that shale oil isn't economically viable at \$50 a barrel. So therefore we're going to see significant volatility. With regards to natural gas – there's so much gas produced that they couldn't sell it – therefore just stopped drilling. Environmental impacts from unconventional oil are a bit less than oil shale – but there are still risks, for example the oil spill in North Dakota. As for the impact on oil exporters – OPEC will have to take US production into account. There is room for many producers at \$70-\$80.

Q: What do you think about the applicability in EU of unconventional sources of oil?

A: Mr. Kaufmann – Reservoirs in the US are more amenable to this type of technology than those in the Brent formations.

Q: Are there efforts to ease visa requirements to make travel easier?

A: Mr. Khan – we're working with countries in Africa, Asia and the West Asia to help them expedite with visa facilitation programs to make travel smoother. The idea is to make visas as standardized as possible to avoid competition among authorities. They've been working on this in a number of countries in Africa.

Comment – you showed Chinese expansion, which was enormous. In Costa Rica we get tourists from all areas, but not much from China, but we do get a lot of Chinese workers to work in service industry particularly servicing the tourism industry.

A: Mr. Khan – you need to look at patterns of work in China. Many Chinese travel domestically, but we're increasingly seeing Chinese people travelling internationally for leisure. There is a psychological dimension related to the idea of work hard play hard. This goes along with changing consumption patterns such as rising consumption of meat and fish. An inflection point is arriving soon – the Chinese economy will soon be more similar to advanced economies.

Q: We're working on global sustainable tourism initiative as part of a new trend to assess the sustainability of tourism – is there work happening at UNWTO? Are there any plans for future implementation of these programs in particular countries?

A: Mr. Khan – that is an interesting and important question. The UNWTO is very small, but we deal with a large sector and we deal with many other organizations – for example the Caribbean university has a department on sustainable tourism. We've been working to build coalitions to build sustainable tourism – particularly as a universal program. 5 years ago we started STEP – sustainable tourism and poverty eradication – with a standing committee of 11 UN organizations. We have developed a significant program that establishes sustainable tourism observatories. It is not run by UNWTO, but by local organizations and people. In Central America they're building an observatory in Honduras as part of 7 observatories that are planned – for instance one in Indonesia in Sumatra. This is designed to be demand driven – countries are expected to come to the UNWTO to ask for help. We also want to incorporate cultural sustainability into these programs.

4. Regional Outlook

Developed Regions

United States of America

Mr. Hung-Yi Li, UN DESA, presented the report on the United States economy, which has endured another year of subdued growth, but may enjoy better performance in 2014 and 2015 if the policy uncertainty can be avoided. The inappropriate speed in withdrawing the monetary easing and the political gridlocks in dealing with the budget and debt ceiling issues are the most important policy uncertainties in short- and medium-run. The response of federal bond yields in May to hint that Fed may start to taper the purchasing of government bonds highlighted the possible negative impacts of the inappropriate policy actions on the real economy.

The housing market continued the recovery; the rebound in the housing prices and building activities has lasted for almost two years. The higher housing prices have improved the balance sheets for household and reduced the speed of deleverages. However, the recent spike of mortgage rate may damage the future recovery in the housing market.

The recovery in the labour market nevertheless has been much slower than the typical speed of recovery in the employment at this stage of business cycle. It may take another one to two years to resume the pre-crisis employment level. The tepid performances of labour market also slow down the growth of private consumption. The persistent high unemployment might have also cause the decline in the labour participant ratio. If this impact turn out to be permanent, then the long-run perspective of economic growth for the United States will need be discounted.

Discussion

Q: You mentioned that productivity growth will be lower with respect to previous recoveries and poor behaviour of job growth is expected as well – are these two things consistent?

A: Mr. Li – technically no – we’re talking about per capita productivity – but I’m not sure how the two can be consistent.

Q: A question on participation rates for different age groups, if you take it back 5 or so years before crisis you can see some of the decline even before then and this points to a possible structural issue.

A: Mr. Li – I agree, the decline started much earlier. There are a lot of reasons for fewer young people working and it is likely that under the current circumstances this is more related to decisions about education. If its cyclical then we would expect the unemployment rate to eventually come back, but if its structural it could be sustained

Q: A question on participation rates – some withdrawals could be a result of collapse of housing market. As this comes back could participation rise and what do you think the Fed should or would do in that situation?

A: Mr. Li – you have to look at employment ratio and also into the employment growth rate. Employment drives household income so it could push this up.

Japan

Mr. Kanemi Ban, Osaka University, presented on the recent performance of Japanese economy, which has been centered on some policy actions taken by the Japanese Government, which has three targets for these actions: ending deflation, faster growth of output, and fiscal consolidation.

The Bank of Japan (BOJ) has adopted the Quantitative and Qualitative Monetary Easing (QQME) to end the deflation. Under this policy, BOJ will increase the holding of Japanese Government Bonds (JGB) by significant amount; the structure of JGB holding by BOJ will also be adjusted. The intention is to lower the yield for the yields for the JGB with longer time to mature. It is hoped that this will lead economic agents' inflation expectation toward higher level than before.

After the introduction of QQME, the year-over-year headline inflation has turned to positive since May 2013. Exchange rate for Japanese yen has also depreciated significantly starting late-2012 against the United States dollar, which also help to increase the inflation through higher cost of imported goods.

To prompt the economic growth, a supplement budget was introduced for the fiscal year ended in March 2013. Japanese Government will also introduce a set of structural reform packages to increase the potential output; however, the details of these packages are still not cleared.

The level of Japanese public debt in relation to GDP is the highest among the developed countries. But since only small proportions of those debts are held by foreigners, the yields for JGB have been able to remain low for now. For the purpose of fiscal consolidation, the consumption tax rate will increase from the current level of 5 per cent to 8 per cent in April 2014 and further up to 10 per cent in October 2015. To reduce the tax hike's negative impact, Japanese Government has also introduced another package of 5 trillion yen. In addition to the cash payments to low-income households, it also includes tax breaks to encourage business to purchase equipment, fund research and development. Tax breaks for firms that raise the workers' salary by more than 2 per cent will also be implemented.

Discussion

Q: Japan has tried a rapid increase in monetary base before, why would it lead to considerable growth this time?

A: Mr. Ban – the price of imported consumption goods has risen due to currency depreciation. Also there are higher energy costs due to nuclear shut-down. This raises inflation.

Q: If 70 per cent of debt is in the hands of financial institutions and they pay relatively low interest rates - what happens when interest rates rise? They'll have low yielding assets and have to pay higher interest rates.

A: Mr. Ban - This could be a problem, but the BoJ could change policy then and curtail monetary easing for that period.

Q: The government is trying to ease deflation by increasing the monetary base, and also a tax holiday for poor as well as transfers to the poor. Couldn't you just tax consumption of the poor to limit the number of policy instruments?

A: Mr Ban - People are expected to ramp up purchases ahead of the rise in taxes and that could increase growth.

European Union

Developing Economies and Economies in Transition

Africa

John Robert Sloan, UN ECA, presented the economic outlook for Africa. The outlook for both the short and medium term looks reasonably good, but this growth has not led to commensurate job creation. Growth is expected to rise from 4.5 per cent in 2014 to 5.4 per cent in 2015. Persistent high commodity prices, despite some declines, are still near historical highs. Increasing domestic demand, institutional changes and infrastructure investments are key factors in the expected improvement in growth. It is also interesting to note that African growth is higher than world average. Breaking out commodity and non-commodity exporters – oil exporters' growth fell somewhat in 2013 but is expected to return in 2014. He also reiterated the fact that ECA does not use the Sub-Saharan Africa, North Africa divide, but rather the breakdown based on the five regions which is partly due to a mandate by AU to address all 54 countries. In West Africa growth is up to nearly 7 per cent, helped by increased stability. Inflation is down from an average of 7 per cent in 2013, down to a projected 6.3 per cent in 2015. This is mostly owing to tightening monetary policies, lower food and fuel prices and exchange rate devaluations. This easing in inflation has allowed some countries to relax interest rates. There are mounting fiscal pressures, the overall fiscal deficit for the region increased slightly between 2012 and 2013. Oil importers have experienced larger deficits, whereas oil exporters have fiscal surpluses. Government spending is still a source of funding for important development programs which have had considerable impacts on poverty. The period between 2010 and 2015 will be the first during which the absolute number of those living below \$1.25 a day will decline. But this still leaves around 400 million people in poverty. In addition ODA has been declining, which has significant poverty impacts. FDI inflows rising 5 per cent from 2011 to 2012, but transfers from ODA donors have been falling. Savings, investment, and fixed capital investment have all rising. As well there are new sources of revenue such as new VATs or diaspora bonds in Ethiopia. Current account balances, which have deteriorated since the crisis, are expected to improve in 2014. There are significant divergences though, between oil and non-oil exporting countries. External debt stocks which previously were falling have come under pressure. It is important for African countries along with their external partners to continue to monitor the level and sustainability of their debt,

although data availability is a main limitation in this respect. Current account deficits are expected to decrease moderately.

An important issue is the link between the commodity boom and manufacturing. Mining and fuels exports far exceed other exports and this is important for foreign exchange earnings. These exports may represent significant percentages of the exports of particular countries. But many countries have not been able to link success in mining to manufacturing. Manufacturing is down from 15 per cent to 10 per cent of GDP between 1990 and 2008. There is a need to create both upstream and downstream linkages. A successful example is South Africa which is a main upstream supplier. In addition, Botswana has been able to tap into higher value added in diamonds. The question is, what are policy the imperatives? State efforts are necessary for establishing new industries. Local content requirements can also be successful. Policy coordination will also be necessary. The consensus among African member states is that there is very little policy space to make structural reforms and assistance should be directed towards these areas to promote diversification. There will need to be a holistic view of integrating mining into the greater economy. There are a number of external risks such as a slower than anticipated recovery, particularly in the EU and other developed countries. Other issues include plateauing oil prices. and the spillover effects from tapering by the Fed. Increased efficiency in commodity importers may also stem demand for Africa's exports. Weather related shocks still pose a significant risk in many countries. As well there are institutional barriers to a number of reforms. The lack of transformation whereby relatively robust growth hasn't translated into job growth will continue to weigh on the regions prospects. The question of demographic issues with 1.1 billion workers by 2040 is a serious one - will this lead to a demographic dividend? There is still a significant amount of informal employment. The chart the way forward successfully Africa will need to harness the commodity boom. Regional integration and intra-African trade are key. Lowering red tape and improving infrastructure and working to improve the business environment will also be important steps in the future.

Q: Comments – on Angola – the oil sector is the main important area and increasing oil production is leading to GDP growth. For 2013 we expect 5 per cent growth (previously growth was around 7 per cent). In 2008-2009 Angola was seriously affected by the crisis. We have had fiscal sector reforms that have helped a lot. Angola has paid arrears to private sector and this liquidity in the private sector helped construction. We have also developed now links to China. Angola created an oil fund during the crisis to help as a buffer, which was previously a problematic political issue. Last year during this presentation we discussed inflation, which was a significant issue. It was down to single digits in 2012 and at around 8.8 per cent in 2013. Even with this deceleration Luanda is one of the most expensive cities in the world due to the need to import everything. Last year a new law was introduced that obligated all oil companies to pay in local currency. At least 80 per cent of transactions will now pass through local banks in local currency. The current account had a surplus of 6.7 in 2012 and around 11 per cent in 2011. The decrease in 2012 was due to importing significant fixed capital.

Q: A few comments – my main concern is the description of robust growth and prospects. The truth is that it's non-inclusive and there are concerns about slow rates of structural transformation. Growth is not structurally based and many are still concerned about commodity price trends. With regards to Nigeria – the country

contributes a significant portion of the continent's GDP. The strategy question is to see how to build up buffers in the medium term. They seem to be struggling with developing provisions to protect against a rainy day. The concern in policy circles is that current oil price levels are not sustainable. These price levels will need to be sustained to be able to sustain current level of imports. There is a need to create more jobs and increase productivity.

Q: There have been very interesting developments in Africa in the past few months or years such as big projects – multi-billion dollar projects – in East Africa. For example the \$16 billion project for pipelines across east Africa, gas discoveries in Tanzania, and coal in Mozambique. The Nigerian petrochemical industry is being developed by private sector, and this is a \$9 billion sector. The real issue is governance of these projects. Wherever we see these projects we see disruptions. How can we reduce risks in the medium and long term?

Q: Would have liked to see a little more on some of the crisis that we have had particular in East Africa. How is that affecting the GDP growth trend in the area? Also what about fast-tracking states in crisis from the US? Still issues with governance although some transparency has been achieved it is still a big problem this is why some exporters don't perform well. The biggest issue is that of exports of commodities which are not translating into growth. What are we doing about manufacturing which is a weakness for trying to achieve sustainable development? In addition there are issues with PPP projects and governance. Ghana is doing well mainly because of the start of oil exports. Despite the discovery of oil the fiscal deficit has increased.

Q: Comment on South Africa – we face a wage cliff. On the one hand have huge wage demands which is understandable based on high poverty, inequality and high costs of living. On the other hand you have a gap with production wage rate, i.e. what the firms can afford. We also have very low labour productivity. We see close to 1 per cent increases in productivity but wage increases have been close to 7.5 per cent. What we've seen is that it results in destabilizing labour actions – a number of mining protestors were killed. Wage demands result in aggressive and militant labour actions, which will have to lead to increases in wage rates, but won't lead to increases in productivity. Therefore we will have high production costs that could feed into inflation and thereby will drive down real income and begin the cycle again. There are large rigidities in the labour market such as high unionization and restrictive labour laws so we need to deal constructively with labour market reforms.

A: Mr. Sloan - thanks to the comments – ECA is working along with the AU to examine countries that are emerging from conflict and this applies to EA. With regards to exports of raw commodities this year's report looked at the easiest potential ways to improve local processing capacities.

Latin America and the Caribbean

Mr. Juan Alberto Fuentes, Economic Commission for Latin America and the Caribbean (UN-ECLAC), provided a comprehensive review of the macroeconomic situation in Latin America and the Caribbean. He covered mainly the impact of the external context in the economies of Latin America and the Caribbean, the policy

responses from national authorities, and the challenges facing Latin America and the Caribbean in the current international situation. Compared to a year ago, it seems that the international environment will be more favorable for Latin America and the Caribbean in 2013. Total imports by Latin American main trading partners appear to have stopped falling, although they remain sluggish. In addition, the downturn in the region's exports to its main trading partners seems to have bottomed out in the first quarter of 2013. However, current international economic conditions have led to a slight fall in the prices of the region's export commodities. Tourism has somewhat picked up in Central America, and to a lesser extent, in South America, and has declined in Mexico and the Caribbean. In the case of remittances, there is a mixed picture: they were up in Central America, while they declined in Ecuador and Mexico. As a result the current account continues to deteriorate in 2013 compared with 2012. The national authorities have responded with concrete policies. Public spending has trended upwards, especially in South America, in some cases as part of the efforts to invigorate domestic demand in response to the downturn in the external sector. Regarding fiscal revenues, the picture is mixed. Countries that are more dependant on exports of minerals and metals, hydrocarbons and tourism have registered negative growth in fiscal revenues. And as result, the fiscal deficit widened in the Caribbean and in South America.

Looking ahead, there are some risks coming from the international context. After the announcement that monetary stimulus could be phased out in the United States, exchange rate volatility increased in the economies more integrated with the international financial markets. A range of monetary policies have been adopted in response to financial instability, both in inflation target countries and countries with other monetary policy regimes. For instance, Brazil, Guatemala and the Dominican Republic raised their monetary interest rates. In countries with non-inflation target regimes, such as Argentina, Venezuela, Paraguay, Bolivia (Plur. State), and Uruguay, higher average growth for M1 were implemented, with rates close to 30 per cent. In 2013, several countries in the region reported slower growth of international reserves. Global financial volatility has also led to higher sovereign risk in several LAC countries. Finally, in terms of GDP forecast, for 2013, Mr. Fuentes expected that GDP growth for LAC should reach 3 per cent, slightly below the figures of 2012, although with high heterogeneity among countries.

The main challenges facing Latin America and the Caribbean in the current international situation were also discussed. Several countries will face the challenge of controlling inflation. Although GDP growth is expected to improve, the challenge will be to regain a path of sustained growth. Preventing employment from slackening and unemployment from rising may become more challenging as well in many economies. And at the same time, there is the challenge of driving growth with equality.

Q: Generally we saw a positive post-crisis recovery. But LATAM is converging to new lower potential growth at 3%. LATAM may not be able to sustain higher growth rates based on higher fiscal and monetary fiscal policies. The need will be to reform in the business environment by way of government policies and also to boost productivity.

Q: Comments in relation to Venezuela's economy – for the past 2 years the economy has been overshadowed by politics. Exports of oil are down and exports overall are down by 10 per cent. Imports by the private sector are down by 10 per cent, but public sector imports up by 24 per cent - a lot of which is concentrate in oil. There have also been goods shortages mainly owing to currency restrictions. Minimal growth is expected for this year and declines are expected for next year. Inflation is around 50 per cent this year and it is expected to go higher next year. We see here the possible elements for a crisis.

A: Mr. Fuentes – in some countries with high macro imbalances such as both Venezuela and Argentina there are issues of demand management. There are also issues in Mexico – fiscal policies have been restrictive – and this has cut growth this year.

Western Asia

Ingo Pitterle, UN DESA, presented in the place of a representative from ESCWA who was unable to attend the meeting. Economic development in West Asia remains characterised by continuing polarization, with the two key factors being high energy prices and the Syrian crisis. While energy producers are seeing fairly robust growth rates, most energy importers will see only sluggish growth. Both Turkey and Israel will see a mild pick-up in growth, although Europe will remain a drag in this respect. Among the various development challenges, unemployment and, in particular, youth unemployment remains the most prominent one. Major risks for the regional outlook include geopolitical factors and a decline in oil prices.

East and South Asia

Mr. Aynul Hasan, UN ESCAP, discussed growth in the Asia-Pacific region which remained subdued in 2013; challenged by uncertainty in the developed economies and some structural impediments. Growth is expected to be 5.1 per cent in 2013, lower than the 5.3 per cent achieved in 2012. Same observation applies to major developing economies in Asia. In 2014, the growth in GDP will improve for all sub-regions in Asia and reach 5.6 per cent for developing Asia as a whole.

Developing Asia is facing three policy challenges: uncertain global environment, regional slowdown, and the economic insecurity. The major global uncertainties consists of fiscal crisis in Euro area, possible fiscal gridlocks in the United States, the changes in the monetary policy stances, and the volatility in the commodity and energy prices. The slowdown in China and India has noticeable impacts on other developing Asian economies. The insecurity mainly comes in the form of slow job creation, high youth unemployment and low social security.

The structural impediments faced by developing Asia include growth inequality (inequality has reduced the social development gain by 20 per cent), inadequate tax revenue and progressivity (Asia has lowest tax burden among developing countries), infrastructure deficit (power and transportation are the most critical constraint) , and unsustainable resource use (Asia-Pacific economy is requiring more resources to produce one dollar of GDP as the economy grows).

For sustainable growth, greater emphasis on the quality and composition of public expenditure is necessary. More funds should invest in health, education and social security; more public investment should focus in environment.

ESCAP proposed a policy package consists of: a job guarantee programme; a universal, non-contributory pension; benefits to all persons with disabilities; increasing the share of public health expenditures; universal enrolment in primary and secondary education; and energy access to all.

Discussion

Q: Comment - I agree with the analysis for China from IMF, WB and UN, but I would like to introduce some other results. We expect 7.7 per cent growth for 2013 and 7.5 per cent for 2014. For investment growth in manufacturing significantly slowed down. Investment in tertiary industries grew. Consumption will increase by 13 per cent, about 1 percentage point lower than last year. Exports and imports are up 8 per cent for this year, slightly higher than last year.

Q: Comment – I broadly agree on India, but there are issues with Indian inflation statistics. They use the CPI as opposed to WPI indicator. This goes back to the debate between Bagwati and Sen on growth vs distribution. They've been looking more towards inclusive growth. Activist growth policies may be reducing growth in short term, but may provide benefits in long run. In general there are data issues and I feel ESCAP should improve the region's databases.

A: Mr. Hasan - the key to the new normal is a lower overall growth rate. China is now looking at more long term perspective. It was easier for China to move the millions out of poverty because they were close to the poverty line and also had skills so they just needed opportunities. Now have to contend with the hard core poor. The issue with CPI vs WPI is regional comparisons. On data issues we're continuing to struggle. In that respect, resource mobilization is a key issue.

CIS and other Economies in Transition

Mr. Robert Shelburne, UNECE, presented outlook for the transition economies. The speaker stated that compared with other areas of the world, growth in the economies in transition has been more volatile and the region's post-crisis growth slowed more in the medium-term. Real GDP growth for those countries has returned to its pre-crisis pattern, however, at a lower level.

According to the ECE's forecast, those countries, which registered the worst performance in 2013, will gain more in GDP growth in 2014. However, leading indicators recently turned down for a number of countries, including the Russian Federation. Exports from the CIS area and from about a half of the transition economies are still below its peak of the third quarter of 2008. The volume of exports of crude oil and oil products from the Russian Federation is stable, and the revenue depends on prices. For many economies in transition, remittances remain a significant

source of income. Economic downturn in the Russian Federation reduced remittances outflow to other CIS economies, but they have recovered.

Then the speaker said that FDI inflows still remain depressed in South-Eastern Europe and in the Russian Federation, but not in the other CIS countries. It is not clear yet if the accession to the WTO will boost FDI into the Russian Federation. Banking sector of the economies in transition faces risks, as the share of non-performing loans has tripled since 2008 and foreign exchange denominated loans are excessive.

Concluding his presentation, the speaker stated the some of the vulnerabilities of transition economies, such as available fiscal policy space, the state of parent banks in the EU and the share of non-performing loans, have worsened compared with 2008. On several other indicators, including the level of short-term external debt, potential of capital outflows, bank leverage ratios and current account deficits, the region is however performing better. The external environment for the region also appears to be better than in 2008, as the key markets in the EU are likely to recover.

Discussion

Q: Comment – on the Russian economy. Gdp growth for 2013 is expected to be 1.7-2 per cent as the global slowdown is curtailing access to credit by Russian companies. Some factors weighing on growth are high interest rates, rising costs of factors of production, rising rates of tariffs, particularly from gas and electricity, all of which are leading to companies losing competitiveness. Fiscal consolidation has also cut government investment. Government consumption will not grow in the forecast period. In addition, overheating of consumer credit will curtail growth. Exports will not grow considerably. The only factor that could boost growth would be investment and this is only expect it to grow due to investment by national monopolists. The allocation of money from national prosperity funds to major infrastructural investments along with private investment is associated with these types of projects. For example, major railway construction. Growth is expected to rise to 2.5 to 3 per cent.

A: Mr. Shelburne - growth is down because investment is down therefore you have to raise investment. The price freeze could be limiting investment incentives.

5. Global issues

Mr. Dave Turner, OECD, presented a paper examined the interest rate – growth differential for 22 OECD countries. The differential can be explained by inflation volatility, a global savings glut, the slope of the yield curve, the ratio of government debt to GDP and the ratio of external debt to GDP. The first two factors explain much of the trend decline in the differential, while the last factor is new and central to this analysis. In the findings on external and government debt, the analysis uses a threshold of 75 per cent for the ratio of government debt to GDP. There is evidence of an effect of net external debt on interest rates, but the effect seems weaker in the case of net external assets. For the non-euro countries, the relationship appears to be linear, but for the euro countries, there is a pronounced non-linearity, with an interaction between external debt and government debt. More specifically, higher government debt increases interest rates more with net external debt. The model captures the extremes of the euro area periphery, but it over-predicts interest rates in most large

countries in 2011 and 2012. One of the conclusions is that lower net external debt is possibly more important than lower government debt.

Ms. Tatiana Fic, NIESR, London, made a presentation on the spillover effects of unconventional monetary policy in major developed economies on developing economies. The presentation was based on a study of the effects of unconventional monetary policy in the US, the UK, the euro area and Japan on the economies of Brazil, China, India and Russia. According to the speaker, the developing countries repeatedly expressed concerns about the effects of QE, such as currency wars and the excessive liquidity in emerging markets. Also, they are concerned about the consequences of exit from the QE, such as the possibility of large capital outflows from emerging markets.

The speaker then presented an overview of the quantitative easing policies in the developed economies. The speaker noted that the size of the Federal Reserve's balance sheet expanded fourfold, that of the Bank of England – fivefold, while the sizes of the balance sheets of the ECB and the Bank of Japan doubled. Those unconventional monetary policies affected developing economies through a number of channels, such as global trade, global liquidity and global portfolio rebalancing. The impact varied across countries, depending on several factors, such as the scale of their exposure to developed countries, their individual cyclical position, and monetary authorities response to capital inflows.

The NIESR's quarterly macro-econometric model (NIGEM) was utilized to determine the impact of QE on the real economy of the BRIC countries on the basis of shocks to long-term yields, equity prices and investment premiums.

(This can be skipped: On the basis of event study, it can be stated that equity prices increased in the US, the UK, the euro area, Brazil, China and India, on the other hand, the impact on the Russian Federation was not so strong. Exchange rates of developed countries did not depreciate as a result of the QE, while Brazilian currency appreciated in real terms. The results of this event study were used to calibrate shocks to the model to analyze QE's impact.)

The speaker then presented the results of simulations of coordinated and uncoordinated scenarios of QE, solved with the model. In a coordinated scenario, when QE is introduced in coordination, shocks to financial markets in developed countries are accompanied with immediate policy reaction in developing countries. According the counterfactual scenario, when there is no QE, GDP average for a five-year period is 2-3 per cent lower than in the baseline scenario both in developed and in developing economies.

Summarizing her presentation, the speaker stated that QE had an impact on financial markets, leading to decreases in long-term rates in the US, the UK, the euro area, Japan and BRIC countries, increases in equity prices in most of the analyzed countries (except Japan and the Russian Federation), and appreciation of the Brazilian currency. In terms of real economy, the biggest effects were observed in the US and in the UK. For developing economies, the effects were smaller, with the exception of Brazil. According to the speaker, the impact of QE exit on the developing economies will depend on the sentiment in financial markets, the economic situation in developing

countries and the size of their output gap, as well as potential policy actions aimed at managing increased capital outflows. Those real effects can be limited, however, it will depend on the degree of coordination while exiting QE.

Mr. Ray Barrell, Brunel University, presented a joint paper with Dilruba Karim (Brunel University), entitled “What do we do about (Macro) pru? Macroprudential Policy and Credit?” In this paper, the authors examine the role of credit in early warning systems for crises in the post Bretton Woods period. The empirical analysis uses a sample of 14 OECD countries and 14 East Asian and Latin American countries.

Mr. Barrell first described the new regulations for capital requirements and buffers in the Basel III framework. He noted that the focus of the present study was the construction of the countercyclical buffer. The buffer as currently designed does not have full empirical support. Several recent studies were unable to find conclusive evidence for the role of credit growth in generating financial instability.

Mr. Barrell then presented the logit model used for predicting crises and described the dataset for the empirical analysis. The explanatory variables are taken from the early warning systems (EWS) literature and from own previous work. The dataset includes 23 crises in OECD countries and 23 crises in Latin America and East Asia over the period 1980-2010. He noted that the data could not be pooled because the capital data for Latin American and East Asia countries were risk-weighted, but those for OECD countries were not.

For each group, the role of three different credit variables is examined in separate models: (1) credit to GDP gap; (2) credit to GDP ratio; and (3) growth in credit to GDP ratio. The main objective is to come up with a parsimonious set of explanatory variables for crises through a sequential elimination process. For OECD countries, the authors end up in each case with the same model despite the different starting points. The most important explanatory factors for a crisis were liquidity and capital adequacy ratios as well as current account imbalances. For the group of Latin American and East Asian countries, by contrast, the three different starting points give three different solutions and a method is required to choose between the models. The results also suggest that in this group the ratio or growth of credit to GDP is an important determinant.

Mr. Barrell then explained the concepts of receiver operating characteristic (ROC) curves and the area under the curve (AUC) which can be used to discriminate between competing models. A good ROC has high good calls and low false calls. For the Latin America and East Asia sample, only credit growth turned out to be a useful indicator. For OECD countries, all three credit variables were useful and the model performed well out of sample, making only few false calls.

Mr Barrell concluded by saying that the overall evidence on the role of credit as a driving factor of crises was weak. The countercyclical buffer is likely to be counterproductive, with no clear evidence that it will reduce the incidence of financial crises or stress.

Discussion

One speaker pointed out that it is less the absolute debt level that matters, but rather the debt level relative to other countries. This explains the currently low interest rate levels. Dave Turner replied that this might not be the only factor and that other factors are relevant as well, as otherwise a bad setup would be helpful for individual economies. A further comment referred to the saving glut and the supply of capital in view of a lack of demand.

Q: It seems like the key is relative interest rates

A: Mr Turner – I don't think that its relative government deficits that are the key.

Q: You could include global savings glut. This model deals with the demand side, but you don't include supply side. There has been a shrinkage over the crisis of safe assets. There are questions of the overall rate and magnitude of changes in debt as opposed to just the level. There is also the issue the of composition of domestic debt.

A: Mr. Turner - there are big problems with global savings glut variable. We want an ex-ante variable before interest rates adjust, but this is impossible so this is an issue, but I'm not sure what the alternative is. Non-linear debt is worth investigating the problem is that there are a limited number of degrees of freedom that you can use to push non-linearities. Net external debt seems to be a key. Total debt can't necessarily be the issue itself – look at Belgium and Japan. Who holds debt must be important and its hard to get a consistent dataset on that for all of these countries. We hope that net external debt is a good proxy for this.

Q: This paper seems to be studying the risk-free rate of interest. The question should then be why rates rise above this level. It seems to be a combination of government debt, risk of default and how much foreigners hold. But some theories say that there isn't a link between growth and interest rates so the question is why the dependent variable?

A: Mr. Turner – there are two components to growth one is related to inflation. The other argument is the opportunity cost idea of interest rates. We test whether there is a unit elasticity and the tests come up with less than one – 0.6 – 0.8, but are still positive.

Q: The simulation of a counterfactual scenario (no QE) for a five-year period and comparison with the baseline is based on the assumption of rational expectations. But in reality the duration of QE is not known, and therefore some “learning part” should be incorporated into the model.

A. Ms. Fic - this is difficult to do, but in order to address this question, the shocks can be run gradually.

Q: Is there any sense that thresholds were important?

A: Mr. Barrell – the BoJ did a study on threshold effects using the same datasets and they found them for capital, but there's a data issue. In a panel there's not enough degrees of freedom so you could have spurious interactions.

6. International economic policy issues

Mr. Sudip Ranjan Basu, ESCAP, presented a paper titled, “Growing Together with Growth Polarization and Income Inequality”, which presented some of the stylized facts and trends in income inequalities, as well methodological issues in the measurement of inequalities, before presenting some key results and policy options. Recent data shows that there is global convergence between countries in income per capita, although there is still a long way to go to reach similar living standards between developed and developing countries. Looking at inequalities within countries, there is a mixed picture, as inequalities have increased in many countries, but they also decreased in many others.

The main question, however, is to understand why inequalities matter. Mr. Basu presented a list of risks caused by inequalities. Social and economic inequalities can tear the social fabric, undermine social cohesion and prevent nations from thriving. Societies where opportunities are scarce are vulnerable to upheaval and conflict. Inequalities can also jeopardize the well-being of large segments of the population through low earnings/wages, leading to decrease in healthy life and development. Vulnerable populations have lower levels of education, lack skills and abilities that can allow them to compete in labour markets. They often represent structural barriers and constraining domestic markets, while they can breed crime, disease and environmental degradation. Inequalities can also hamper economic growth and thereby poverty reduction. Finally, if inequalities continue to widen, development may not be sustainable.

Mr. Basu identified three types of policies to promote equity. There are forward-looking macroeconomic policies, which can ensure sufficient, productive and decent employment, and make growth inclusive, resilient and sustainable. These policies would also include financial market and trade policies. A second group of policies would be associated with institutional and governance reforms to address discriminatory and exclusionary practices, as well as recourse mechanisms for disadvantaged groups and individuals to claim their rights. In part these are related to reforms in income tax, corporate tax and public finance systems. A third group of policies would be social welfare programmes. These programmes include minimum wage policies, social protection legislations, employment guarantee programmes and land reforms to provide quality basic public services for investing in human capital, their growth and capabilities, education, health, food, housing and social security. Globally (in) equity is emerging as a central plank in discussions on the United Nations post-2015 development agenda.

Discussion

Q – Comment from Mr. Pauly – I wanted to add 1 observation. There are a lot of different things are being talked about so we need to separate. The cross-country focus seems to be a good new story on many aspects, for example look at Angus Deaton’s new book. I don’t think we need to be conceptually concerned about. We need to look at the billionaires graph as this cuts across all societies. This has to do

with global trends and a shared global problem. It is not necessarily something that domestic policies can do anything about. We also need to look also at domestic inequality. Some of this is globalization related, but some is country specific and idiosyncratic, and has to do with policy regimes and regulatory structures. We need to recognize the high and excessive inequalities are an Anglo-Saxon market economy issue which have occurred over the past 20-30 years. There are some market economies where this is much less of an issue with more uniform distributions.

Q: Related to Peter's concern, I worry about micro foundations. Is it necessarily the case that declining inequality globally would translate to declining inequality at the national level? What's the policy implication for individual countries that may have good growth but with distributional issues?

A: Mr. Basu - policies are taken at national level so we're looking at social programs and institutions. The ways to introduce and implement policies exist in many countries as ways to promote equal distribution. You'll need cooperation internationally, but most of this really starts at the national level.

7. International economic policy issues / global modelling

Ms. Charlotte Du Toit, Plus Economics, Pretoria, gave a presentation entitled "The Rand Exchange Rate – The Fundamental Truth". The study examines deviations of the rand exchange rate from its true/fundamental path, trying to differentiate between temporary deviations and fundamental shifts.

Ms. Du Toit started by showing long-term trends in the rand/dollar exchange rate, which has been subject to considerable speculation and volatility. In 2001, for example, the rand lost more than 50 per cent of its value against the dollar. Since the high level of volatility and uncertainty creates challenges for economic policymaking, there is a need to understand the driving forces of the movements. The analysis focuses on the nominal dollar exchange rate since the dollar is the main currency for international transactions and all other exchange rates are related to the dollar/rand trends. Ms. Du Toit then pointed out that South Africa's floating exchange rate regime has been an important absorber of shocks, enabling the economy to adjust in the face of the global financial crisis.

The empirical analysis uses a sticky-price, Dornbusch-type monetary model specification for exchange rate analysis. The structural exchange rate model is integrated with a dynamic, full-sector macro-econometric model. This model framework aims at providing guidance and insights in distinguishing between short-run volatility and longer-run structural adjustments in the exchange rate.

Ms. Du Toit then presented the major empirical results of the study. According to the developed "exchange rate barometer" the rand was considerably overvalued before the onset of the global financial crisis. The crisis acted as a trigger for the imminent correction which had to take place in adjusting the rand to its true or fundamental value. After appreciating notably in 2009/10, the rand appeared to be again overvalued at levels around 7.30 rand/dollar. The current true fundamental value is around 8.50 rand/dollar.

Mr. Christian Viegelahn, ILO, gave a presentation on a new paper he had prepared with Ekkehard Ernst titled, “Hiring Uncertainty: a New Indicator”. The International Labour organization has developed a new indicator to track the uncertainty in regarding to hiring in the labour market. It was motivated by the observation that hiring activity is still down compared to pre-crisis level in many countries; even the out level has resumed the pre-crisis level. The authors believe this is caused by the uncertainty in the expected return from hiring.

The discussed uncertainty can be measured by: news analysis, disagreement of forecasters, dispersion of productivity shocks in firm-level data, conditional variance of major macroeconomic indicators, and the implied option-implied volatility of equity prices. This paper focus on economic uncertainty as perceived by employers and developed indicators of uncertainty that is forward-looking, it also tried to make this indicator can be applied to many countries and at sector-level.

This indicator is based on the derived formula that hiring threshold (in terms of labour productivity) is the key deterrent of the uncertainty. The benchmarked unit labour cost data from OECD and the hiring demand data from Manpower *Employment Outlook Survey* are used for testing. The uncertainty indicators for G-7 countries based on this formula are quite consistent with policy uncertainty calibrated by other researchers. It also shows that, for the United States, the uncertainty in GDP growth is most important contributor to the uncertainty in hiring.

Mr. Ekkehard Ernst, ILO, presented a paper prepared jointly with Faten Saliba titled, “Housing Wealth: Blessing or Curse for Job Growth”. The purpose of this research is on the impact of house prices on employment. It started with the observation that house price-income ratio has been significantly higher than historical average in many developed countries. It is also observed that the co-movement between house price and financial asset price is significant in many countries. Authors believe there are some fundamental relationships between employment, house price and financial asset price. First, housing price increase the wealth of households and wealth effect generates the pro-cyclical movement between house price and economic activity. Second, housing investment reduces the geographical mobility of household and limits the sectorial and geographical labour market adjustment. Finally, higher house price tends to push up the wage rates and capital cost which reduces firm’s competitiveness.

The authors set up a model structure consist of: flow model of the labour market, housing investment model, and the wage-price dynamics mode. The estimation of the model structure uses the reduced-from panel estimates with the system-GMM option to control for endogeneity. Authors also use the estimated model for policy scenario analysis. In order to deal with the asset bubbles, it is found that reducing the wage pass-through of housing prices can avoid the loss of competitiveness; also it is discovered that strong adjustment in policy rate as response to the asset prices.

Discussion

Q: With regards to offshore trading of Rand, South Africa is one of the few developing countries where this happens. 87 per cent is offshore and much by non

South Africans and 70 per cent are non-deliverable forwards (NDF). NDF is used for hedging forward risk in non-convertible currencies – but the Rand is fully convertible so this points to this as purely speculative. Also there is a relatively large forex trading relative to trade volume – something on the order of 50 times. The unregulated NDF market explains much of the volatility and mispricing. The Reserve Bank hasn't yet worked out a macroprudential response to this yet.

A: Ms. Du Toit – we're not interested in short run volatility, we wanted to get out to the real feedback effects. Therefore you need to focus on how to get around the noise. The Reserve Bank needs to get a better handle on where fundamentals are going to try determine whether there are fundamental shifts or speculative attacks. NDF is important to be cognisant of, but it is not the focus of the model – but we need to take a different approach if we're assessing if the Reserve Bank should act and look at fundamentals.

Q: Looking at just the graphs the indicators appear better than Baker, et al, with regards to recession properties – why do you feel the need to compare?

A: Mr. Viegelahn – we wanted to check to see how it compared in general.

Q: The uncertainty measure was based on expected productivity – how did you measure that? And with regards to costs – were taxes included?

A: Mr. Viegelahn - one over unit labour costs was used as a measure of productivity, but the expectations were based on actual unit labour costs, but the uncertainty measure captures those questions to a degree.

Q: Is it possible to divide between OECD measures of unit labour costs and productivity?

A: Mr. Viegelahn – this could be included.

Q: A minor question some people worry about home-ownership and how declines in house values affect mobility?

A: Mr. Ernst - at the aggregate level we haven't really looked at this issue although we acknowledge its importance.

Q: I would like to reinforce the question on the connection between housing investment and wage rises, but I'm not sure whether this happens?

Q: It was actually a monetary policy response – so it may not actually a macro-prudential change. Another concern is with the short term Taylor rule – it may have stronger effects for spillovers to other sectors.

A: Mr. Ernst – that is a fair point and need to develop the financial side of the model further.

Q: I'm not sure if you've accounted for house price changes in consumption - too much investment can depress housing prices.

A: Mr. Ernst – it might be worth integrating consumption into the model.

8. Closing Session

Mr. Peter Pauly, said that he wanted to make 3 observations – that it had been a very good meeting with lively discussion and which covered crucial policy issues, particularly monetary policy, particularly with uncertainty so high. The cliché is that at each meeting we say that its an interesting time. But this time there are legitimate questions about how all of this monetary policy and EU banking regulation will unfold. There is a combination of high uncertainty, volatility and complexity. It is hard to categorise where we stand – is the glass half full, empty?

He brought the discussion back to the issue of Lawrence Klein's passing, which was announced the first day of the conference. The meetings started with some saddening news, but his death so close to the meeting was particularly poignant. Many participants haven't met him personally as he hasn't been coming for the past 5 years so many people may not appreciate what he means to the group both as a scholar and intellectual force behind it, but also as a gentle human being. One has to appreciate the difficulty of being an intellectual giant and also a good human being – so he was one to treasure. He brought up the fact that Dr. Klein started after the war as a die-hard Keynesian and wrote the book on some Keynesian theory. He also drew satisfaction that some of these ideas had come back to the fore – such as the liquidity trap, aka the zero lower bound. There are times when it helps to have a good memory and historical knowledge. There has been a lot of good theory since then, but also value in crucial insights in Keynesian theories – such as real demand shortfalls. Dr. Klein would have followed the monetary policy discussion with great interest – he would have been sceptical of the wisdom of such actions, but would have appreciated and been intrigued by the alternative policies that were necessary to get out of the trap. He had a long career and adapted and was au courant with public policies. He had a good sense of how the discussion has changed to a somewhat more formal approach. Would have appreciated the discussions

He thanked everyone and reminded them about an opportunity to send condolences to Dr. Klein's family. He also thanked UN for hosting and organizing and arranging for the conference to be in the building and allow everyone to use the facilities. He thanked Mr. Hong, Mr. Altschuler and Mr. Yi, and all the rest of the division. He also thanked Ms. Erin Bell for getting all the participants to the conference. Lastly he raised the question of where do we go from here? Would we continue to have this tradition of having a meeting now around UN forecast cycle? He said he would like to get back to having two meetings a year. One more reason to have another meeting – would be to recognize Dr. Klein's contribution so it might be worth working to organize a meeting around May. This would be primarily devoted to econometric papers, or applied econometric studies (not so much on forecasting).

Mr. Pingfan Hong, added a few points such as agreement with Mr. Pauly on his assessments on what we've covered. He expressed the desire to have more

presentations from developing countries beyond the economic outlook. This could either be by developing country participants or on developing country issues. He raised the issue of how can UN DESA's small team compete with the IMF and WB? He mentioned that DESA has a good team that is competent. In addition he said there is a larger team behind the small team – the LINK participants – from more than 60 countries. Economists from their own countries know the situation better than those from outside. He said that the best way to remember Dr. Klein is to carry on with the LINK meetings. He stressed that we should continue the direction that he started with studying macro modeling and policy – and noted that keeping this going is the best way to remember him. Dr. Klein was an intellectual giant, but also a paragon and Mr. Hong stated that we should continue this project.

Participants rose for a round of applause for Dr. Klein.

ANNEXES

United Nations
Department of Economic and Social Affairs
Project LINK

UN DESA Expert Group Meeting on the World Economy
(LINK Project)
October 21-23, 2013
New York

PROGRAMME

Side Presentation to the Economic and Social Council (ECOSOC)

“Inequality and Growth”

*Peter Pauly, Professor and Interim Dean, Rotman
School of Management University of Toronto*

Monday, October 21, 2013

10:00 – 13:00

World Economic Outlook

Chair: Peter Pauly

*DESA's
Outlook
Pingfan Hong, UN-
DESA*

*IMF's
Outlook
Rupa Duttagupta, IMF*

*World Bank's
Outlook
Andrew Burns,
World Bank*

14:15 – 15:45

World Economic Outlook (cont.)

Chair: Peter Pauly

*ILO's
Outlook
Moazam Mahmood, ILO,
Geneva*

*OECD's
Outlook
David Turner, OECD,
Paris*

*Oxford Economic's
Outlook
Sarah Hunter, Oxford Economics*

16:00 – 17:45

World Economic Outlook (cont.) and Commodity Markets
Chair: *Byron Gangnes*

Agricultural Commodities
Willy Meyers, FAPRI, University of Missouri

The World Oil Market
Robert Kaufmann, Boston University

“Is the World Oil
Market Unified?”
*Robert Kaufmann,
Boston University*

Prospects for International Tourism
*Sarbuland Khan,
UNWTO*

Tuesday October 22, 2013

9:30- 11:30

Regional Outlook: Developed Regions
Chair: *Delia Nilles*

United States
Hung-Yi Li, UN-DESA

Japan
Kanemi Ban, Osaka University

Europe
Dawn Holland, NIESR, London

“Macro-Economic Outlook for the Euro
Area” *Pavlos Karadeloglou, ECB,
Frankfurt*

11:45–13:15
Transition

Regional Outlook (cont.): Developing and Economies in

Chair: *Eustaquio Reis*

Africa
John Robert Sloan, UN-ECA

Latin America and the
Caribbean *Juan*
Alberto Fuentes, UN-
ECLAC

West Asia
ESCWA, presented by Ingo Pitterle, DESA/DPAD

14:15–15:45

Global Issues
Chair: *Mette Rolland*

“The Effect of Government Debt, External Debt, and
Their Interaction on Interest Rates”
David Turner, OECD, Paris

“The Spillover Effects of Unconventional Monetary Policies in
Major Developed Economies on Developing Economies”
Tatiana Fic, NIESR, London

“What Should We Do about (Macro) Pru? Macro Prudential
Policy and Credit”
Ray Barrell, Brunel University, London

16:00–17:30
Transition

Regional Outlook (cont.): Developing and Economies in

Chair: *Alfredo Coutino*

East Asia and South
Asia *Aynul Hasan,*
UN-ESCAP

CIS and other economies in
transition *Robert Shelburne,*
UN-ECE

Wednesday, October 23, 2013

9:30-11:30

International Economic Policy Issues
Chair: *Adolfo Castilla*

“Fiscal Stimulus in Germany in the Aftermath of the
Great Recession” *Gyorgy Barabas, RWI, Essen*

“Sustainability as Determinant of Potential Output in Open Economies” *Zsolt Darvas and Andras Simon, Corvinus University and Central Bank of Hungary, Budapest*

“A review of alternative measures of sustainable output incorporating macroeconomic imbalance indicators”
David Turner, OECD, Paris

“Growing Together with Growth Polarization and Income Inequality” *Sudip Ranjan Basu, ESCAP, Bangkok*

11:45–13:15

Global Modelling

Chair: *Clive Altshuler*

“The Rand Exchange Rate – The Fundamental Truth” *Du Toit, Plus Economics, Pretoria*

“Hiring Uncertainty: a New Indicator”
Christian Viegelahn and Ekkehard Ernst, ILO, Geneva

“Housing Wealth: Blessing or Curse for Job Growth” *Ekkehard Ernst and Faten Saliba, ILO, Geneva*

13:15-13:30

Closing Session

Economic Outlook Reports- Provided by Participants

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