World Economic Situation and Prospects 2014

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Executive summary

Prospects for global macroeconomic development

Global growth underperformed in 2013, but is expected to improve in 2014-2015

The world economy reached only subdued growth of 2.1 per cent in 2013. While most developed economies continued to grapple with the challenge of taking appropriate fiscal and monetary policy actions in the aftermath of the financial crisis, a number of emerging economies, which had already experienced a notable slowdown in the past two years, encountered new domestic and international headwinds during 2013.

Some signs of improvement have emerged more recently. The euro area has finally come out of a protracted recession, with gross domestic product (GDP) for the region as a whole starting to grow again; the economy of the United States of America continues to recover; and a few large emerging economies, including China, seem to have at least stopped a further slowdown or will see accelerating growth. World gross product (WGP) is forecast to grow at a pace of 3.0 and 3.3 per cent in 2014 and 2015, respectively.

Inflation outlook remains benign

Inflation remains tame worldwide, partly reflecting excess capacity, high unemployment, fiscal austerity and a continued financial deleveraging in major developed economies. Among developed economies, deflationary concerns are rising in the euro area while Japan has managed to end its decade-long deflation. Among developing countries and economies in transition, inflation rates are above 10 per cent in only about a dozen economies scattered across different regions, particularly in South Asia and Africa.

High unemployment remains a key challenge

The global employment situation remains dire, as long-lasting effects from the financial crisis continue to weigh on labour markets in many countries and regions. Among developed economies, the most challenging situation is found in the euro area, in which the unemployment rates have reached as high as 27 per cent in Greece and Spain, with youth unemployment rates surging to more than 50 per cent. The unemployment rate has declined in the United States, but remains elevated. In developing countries and economies in transition, the unemployment situation is mixed, with extremely high structural unemployment in North Africa and Western Asia, particularly among youth. High rates of informal employment as well as pronounced gender gaps in employment continue to characterize labour markets in numerous developing countries.

A number of countries are making concerted efforts to improve employment conditions, such as aligning macroeconomic policies appropriately with domestic conditions and taking steps to induce advances in productivity and innovation. However, further public investment in skills training and upgrading will be necessary to integrate those groups that have been excluded.

International trade and financing for development

Moderate rise in trade growth is anticipated along with flattening commodity prices

Growth of world merchandise trade weakened further in 2013, dragged down by slow global growth. Sluggish demand in many developed countries and faltering growth in developing countries led to a decline in world export volume growth from 3.1 per cent in 2012 to only 2.3 per cent in 2013—well below the trend prior to the financial crisis. The prospects for world trade are expected to improve, driven by a modest increase in demand in Europe, further recovery in the United States and a return to more dynamic trade in East Asia. Growth of world exports is projected to be 4.6 per cent in 2014 and 5.1 per cent in 2015. Trade in services, which appears to be recovering faster than merchandise trade, is expected to continue growing over the forecast period after a noticeable improvement in mid-2013.

Commodity prices have displayed divergent trends over the course of 2013 in the midst of an overall moderation. Food prices have gradually declined, owing to better than expected harvests of major crops. Soft demand, ample supply and high stock levels all contributed to declines in base metals prices. Oil prices have seen significant fluctuations over the course of the year as a result of various geopolitical issues. Commodity prices are expected to remain relatively flat on average across the forecast horizon.

Multilateral trade negotiations reach limited agreement while regional trade agreements boom

There have been some limited agreements in Doha Round negotiations in three areas: agriculture, development and trade facilitation. The economic effect of these changes is unclear at this point and is unlikely to affect trade in the forecast period. The international trading system has become more fragmented, and considerable uncertainty about particular forthcoming decisions remains.

Regional trade agreements (RTAs) continue to boom, with 379 already in force. There are currently two large RTAs being negotiated—the Trans-Atlantic Trade and Investment Partnership between the United States and the European Union and the Trans-Pacific Partnership, involving 12 countries including Japan and the United States. These agreements would cover a majority of world trade and are seen by some as a less ambitious, alternative version of the Doha Round. There is some concern about the potential effects on developing countries that are not a part of these RTAs, such as marginalization or impacts on their competitiveness. Steps to further South-South regional integration are being explored, including efforts by the African Union to fast-track the initiation of a Continental Free Trade Area by 2017.

Volatility of capital inflows and risk premium to emerging economies have increased

Capital inflows to a number of developing countries and economies in transition have shown a measurable decline during 2013, along with significantly increased volatility in the financial markets of emerging economies, featuring equity markets sell-offs and sharp depreciations of local currencies. This was partly triggered by the United States Federal Reserve announcement that it may begin tapering the amount of its monthly purchases of long-term assets later in the year. Waning growth prospects for emerging economies have also played a role in triggering the decline of capital inflows.

Long-term financing is essential for promoting sustainable development

Discussions on the post-2015 development agenda have highlighted the enormous needs for financing the social, economic and environmental dimensions of sustainable development. Long-term financing will be essential for raising the resources required for a transition to a green economy and for promoting sustainable development. Yet, to date, the international financial system has failed to adequately allocate resources for long-term sustainable development needs. There has been insufficient investment in a number of critical areas: infrastructure; health, education and sanitation services for the world's poor; small- and medium-sized enterprises and financial services for all; and the green technologies necessary to address climate change in both developed and developing countries.

Uncertainties and risks

A bumpy exit of quantitative easing measures poses significant risks for the world economy

Great uncertainties and risks for global economic growth and the financial stability of the world in the coming years are inextricably associated with the unconventional monetary policies, such as quantitative easing (QE), adopted in major developed countries. Uncertainty and risk come into play particularly when the central banks of these countries start to change their stances on these policies. A bumpy exit from QE could lead to a series of disruptive events, such as: a surge in long-term interest rates, not only in developed economies but also in developing countries; a sell-off in global equity markets; a sharp decline of capital inflows to emerging economies; and a spike in the risk premia for external financing in emerging economies. Those first-round shocks in international financial markets could transmit quickly to the domestic real economic sectors of both developed and developing countries.

Many large developing countries, including Brazil, China, India and the Russian Federation, saw a significant deceleration in GDP growth in the past two years, owing to a combination of challenging external conditions and domestic impediments. In the baseline outlook discussed earlier, growth in these economies is expected to strengthen in some cases, such as Brazil, India and the Russian Federation, and to stabilize in others, such as China. Risks remain, however, for a further slowdown for some of these economies.

The systemic risks in the euro area have abated significantly, but fragilities remain in both the financial sector and the real economy. Uncertainties associated with the political wrangling in the United States over budget issues and the debt ceiling continue to loom. Moreover, beyond economic risks, geopolitical tensions might spiral out of control. These and other risk factors, unfolding unexpectedly, could derail the world economy far away from the projections outlined in the baseline forecast.

Policy challenges

Policymakers in major developed countries should work to harness a smooth process for the changes in QE coming over the next few years. Central banks in these countries should develop a clear communication strategy to articulate the timing and the targets of the policy action. A premature unwinding may risk choking off the economic recovery, but a delayed unwinding could risk creating financial bubbles. Efforts are needed to enhance the supervision, regulation and surveillance of financial markets in order to identify and mitigate financial risks and vulnerabilities.

For developing countries and emerging economies, the challenge is to forefend themselves against the spillover effects of the QE unwinding. These economies should address external and internal imbalances and build policy space. Supervision and regulation should also be strengthened to prevent a build-up of mismatches in foreign currency funding on bank balance sheets. Prudential oversight should be tightened, particularly for shadow banking activity.

In addition to macroeconomic policies, many countries, both developed and developing, have undertaken various institutional reforms, including reforms in social security, income distribution, financial sector, taxation, energy, transportation, education and health care. These reforms are crucial to the rebalancing of economic structure, removal of supply-side constraints, mobilization of resources for long-run investment, and improvement of macroeconomic management and financial regulation.

The globally concerted policy actions should be focused on a stronger recovery

The multiple and complex challenges in the world economy call for strengthening of international policy coordination. The primary focus of the globally concerted and coherent policy actions should be on a stronger recovery—particularly the recovery of jobs—and increasing attention should be given to mitigating the spillover effects emanating from the QE exit.

International policy cooperation and coordination are needed to advance the reforms of the international financial system on several fronts. Progress in financial regulatory reform has been slow, encountering growing resistance from the financial industry. Some progress has been made in amending the global financial safety standards for the banking sector. More forceful efforts are needed to address the issues of international tax avoidance and evasion, particularly through tax havens.

International policy cooperation should ensure that sufficient resources are made available to least developed countries

International policy cooperation should ensure that sufficient resources are made available to developing countries, especially least developed countries and countries that possess limited fiscal space and face large financing needs for sustainable development and poverty reduction. The decline in official development assistance flows over the past two years should be reversed. As the target date for the United Nations Millennium Development Goals (MDGs) is approaching, international donors should redouble their efforts to deliver on existing commitments. These resources are badly needed in order for developing countries to accelerate progress towards the achievement of the MDGs, and for all countries to build a solid foundation for long-run sustainable development beyond 2015.