

Monthly Briefing

World Economic Situation and Prospects

No. 32

UN/DESA

6 June 2011

This special issue covers the highlights of the
World Economic Situation and Prospects 2011: Update as of Mid-2011, launched on 25 May 2011

Summary

- The United Nations forecast for growth of the global economy was increased slightly to 3.3 per cent in 2011 and 3.6 per cent in 2012.
- However, the pace of the global recovery remains uneven across countries. Output growth is strong among developing countries and feeble in many developed economies.
- Serious downside risks to the global recovery remain. Developed economies face continued financial sector fragility, sovereign debt distress and high unemployment rates. Many developing countries face new headwinds, including rising inflation, assets bubble risks and strong exchange rate appreciation.

Global issues

A still fragile recovery

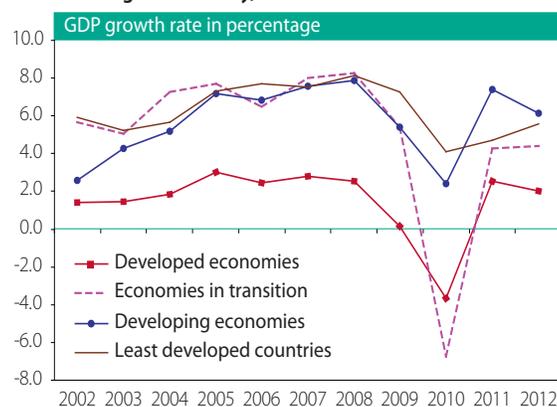
The world economy continues to recover from the global economic crisis, but the pace remains uneven across countries. Output growth is strong among developing countries and feeble in many developed economies. Residual effects from the global financial crisis continue to weigh on global growth, while new challenges have emerged (figure 1).

The United Nations baseline forecast for world gross product (WGP) was upgraded slightly to 3.3 per cent in 2011 and 3.6 per cent in 2012.¹

At the present pace of output growth, it will take another four or five years before employment is back to pre-crisis levels in developed countries. The banking sectors of major developed countries still look vulnerable to multiple risks from continued weak housing markets, sovereign debt stress and continued overall economic weakness. In addition, fiscal policies are shifting towards austerity in response to heightened concerns about the sustainability of public debt levels, which will weaken growth prospects in the short-run.

Developing countries and economies in transition, by contrast, have contributed significantly to the post-crisis expansion of the world economy. The strong recovery continues to be led by the large emerging economies in Asia and Latin America, particularly Brazil, China and India. However, the growth outlook in these economies is also moderating owing to several increasingly pressing concerns including persistently rising inflation and emerging domestic asset price bubbles, fuelled by large capital inflows and related upward pressure on their exchange rates. Many countries are responding by significantly tightening monetary policies and moderating fiscal expansion.

Figure 1:
Developing country growth is leading the recovery, 2002-2012



2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

Source: UN/DESA and Project LINK.

Note: Data for 2010 is partly estimated. Data for 2011 and 2012 are forecasts.

¹ The forecast in the *WESP 2011* was 3.1 per cent of growth of WGP in 2011 and 3.5 per cent in 2012.

Surging oil and food prices

Higher inflation was fuelled in part by surging primary commodity prices, which increased much more forcefully over the past six months than anticipated in the *WESP 2011*. The surge was driven in part by political unrest in Western Asia and North Africa, which—inter alia—disrupted oil production in the Libyan Arab Jamahiriya. The near-term trend in oil prices is hard to predict, but supply and demand conditions would not warrant a continued upward trend. Even though global oil demand has been growing faster than supply, inventories and spare capacity remain above the average of the past five years.

Food prices also soared in early 2011. Nonetheless, prices of major grains, such as rice and wheat, are still substantially below their peaks of 2008. Global food demand has remained strong, especially in developing countries, and demand for biofuel feedstock also increased along with higher oil prices. Growth of food supply fell short as it was affected by a number of weather-related shocks. A weaker United States dollar bolstered the upward trend in world market prices. In the short-term outlook, however, better harvests are expected to moderate food price inflation in the second half of 2011.

Strong, but moderating rebound of world trade

World trade of goods and services expanded by almost 12 per cent in 2010, more than previously estimated, representing a strong rebound after the steep decline by 11 per cent in 2009. By the end of 2010, the volume of world merchandise exports had fully recovered to the pre-crisis peak, although it remained markedly below its long-term trend. The trade volume of developing countries has already surpassed the pre-crisis peak, but is still lagging in developed economies. Commodity-exporting countries experienced a strong recovery in the value of exports, owing to a significant upturn in primary commodity prices, but did not see much growth in the volume of exports. In the outlook, growth of world trade is expected to moderate to around 7 per cent in 2011 and 2012. While emerging economies are expected to continue to see robust growth in trade, the recovery in major developed economies remains weak.

Developed economies

The United States of America: fragile recovery and rising debt

The *United States* economy expanded by 2.9 per cent in 2010, driven mainly by domestic demand, while weaker net exports had a dampening effect on growth. Personal consumption increased by 1.7 per cent, while strong corporate balance sheets helped investment in equipment and software increase by more than 15 per cent. Government expenditure rose by only 1.0 per cent owing to the weak fiscal positions at the state and local levels. Headline inflation was stable until the recent spike in energy and food prices, while core inflation remains low. Labour market slack has kept wage growth in check, while firms increased productivity and reduced costs. The United States Federal Reserve has kept the federal fund rate at a historic low, but is expected to start raising its policy rate in early 2012. Government expenditure is expected to be cut in the outlook period. In April 2011, Standard & Poor's downgraded its outlook on United States sovereign debt, underscoring the urgency for policymakers to set up a credible framework to address its public debt.

Japan: rebuilding after the tsunami

Japan's economy suffered a severe shock from the earthquake of March 2011 and the subsequent tsunami and nuclear power plant crisis. Some 27,000 people lost their lives or are missing and the damage to buildings and infrastructure is estimated at about 25 trillion yen (5 per cent of gross domestic product (GDP)). Disruptions to production in many firms have pushed the economy into contraction in the second quarter of 2011. However, the reconstruction efforts will likely induce a recovery thereafter. A large amount of additional government spending for the reconstruction will further increase the public debt ratio, which already stands at more than 200 per cent of GDP.

Western Europe and the EU: uneven growth and continued debt distress

The recovery in *Western Europe* continues at a modest and uneven pace. Industrial business confidence indicators have returned to pre-crisis peaks in early 2011, but economies will face strong headwinds during the remainder of the year: GDP growth in the euro area is expected to average 1.6 per cent in both 2011 and 2012. Germany is expected to grow by 2.9 per cent in 2011, while the countries most affected by the fiscal crisis—Greece, Ireland, Portugal and Spain—will either remain in recession or, at best, register very modest growth rates. Private consumption expenditure is expected to gradually strengthen over the forecast period, however, the positive demand effects from slowly improving employment conditions will be dampened by the negative impact of fiscal retrenchment. Investment in equipment is expected to gradually pick up and become an important growth driver, but stagnant housing investment will remain a major drag on activity. Headline inflation continues to increase, boosted by the sharp rise in energy and food prices, but is expected to remain contained.

The new EU member States: an export-led recovery

The recovery in most new EU member States in *Eastern Europe* strengthened in the last quarter of 2010, with aggregate GDP expanding by 2.2 per cent in 2010 supported by strong export performance and inventory restocking. The recovery continued in early 2011 building on the same factors, but the effect of inventory restocking is tapering off. With the exception of Poland, domestic demand remains weak in most economies. Private consumption is currently constrained by slow wage growth, high household debt-servicing obligations, stagnant employment creation, higher indirect taxes and rising inflation. Public spending is also unsupportive, as many Governments are undertaking austerity measures aimed at reducing budget deficits to below 3 per cent of GDP in the medium-term, ostensibly to ensure public debt sustainability. Private investment is still weak, being constrained by credit rationing by banks and high debt payment obligations of companies, despite a moderate increase in inflows of foreign direct investment. In early 2011, inflation accelerated owing to higher food and energy prices and led to tighter monetary policy, especially in Hungary and Poland.

Economies in transition

CIS: capital outflows amidst robust growth

Growth in the *CIS* bounced back to 4.6 per cent in 2010 fuelled by higher oil and metals prices and stronger domestic demand. This contributed to a reduction in fiscal deficits through higher government revenues, particularly in the net-energy exporting countries. The improved economic environment led to a further decline in unemployment rates, including among migrants. Remittances to Armenia, Kyrgyzstan, Tajikistan and Uzbekistan increased on average by more than 20 per cent in 2010. However, unlike other emerging economies, capital has been flowing out of the *CIS*. In the Russian Federation, where investors have grown insecure about Government policies, and have perceived certain measures to be harmful to their interests, outflows exceeded \$21 billion in the first quarter of 2011. The appreciation of the rouble is mainly owing to the boom in commodity prices. Since late 2010, inflationary pressures have increased significantly, in response mainly to the impact of adverse weather on agriculture. Averaging 7.3 per cent in 2010, annual inflation in the *CIS* is forecast to accelerate to 9.9 per cent in 2011, before subsiding in 2012. Monetary policy has been tightened in response to the inflationary pressures.

South-eastern Europe: weak domestic demand, sluggish growth

The economies of *South-eastern Europe*, except Croatia, showed a modest rebound in 2010, but the recovery remains feeble. Strong export growth, including tourism services, and a slight recovery in remittances pulled the region out of its recession. Domestic demand continues to be weak. In 2011, GDP growth is projected to continue to be led by exports and accelerate to 2.2 per cent, but private consumption will remain weak, as wage and credit growth and consumer confidence remains subdued. Inflation has picked up with the surge in global energy and food prices, but is mitigated by slow wage growth and weak consumer confidence. Unemployment increased further in Croatia and Serbia in early 2011 with no signs of improvement on the short-term horizon. Monetary policies remain accommodative in general, aimed at inducing banks to start lending again to the private sector.

Developing economies

Africa: governance changes along with growth to come

Economic growth in *Africa* is forecast to moderate to 3.6 per cent in 2011, before accelerating to 5.4 per cent in 2012. This outlook is surrounded by great uncertainty, however. In North Africa, public protests have led to significant changes in political governance that might be beneficial in the long run, but could cause further disruptions to economic activity during the transition period. In sub-Saharan Africa, many countries will see continued strong growth, supported by expansionary fiscal policies and infrastructure investments. Higher oil prices will provide a boon to fuel-exporters, while fuel-importers will have to cope with rising external deficits and domestic price levels. A number of countries are benefiting from a recovery in worker remittances. Overall, internal conflicts, weak institutions and infrastructure deficits are major obstacles to higher and more sustained growth. Without major shifts in income distribution, growth will also be far from sufficient to accelerate poverty reduction in most sub-Saharan African countries.

East Asia: fastest-growing region in the world

East Asia's economies experienced a strong recovery in 2010, with GDP growth averaging 9.1 per cent. While average growth is forecast to moderate to 7.3 per cent in 2011 and 7.2 per cent in 2012, East Asia will remain the world's most dynamic region. In many economies, growth of investment and exports is likely to weaken, and household consumption will become more important as a driver of growth. Countries with a high share of manufacturing exports in GDP, such as Malaysia and Singapore, will experience a more pronounced deceleration than countries with large domestic markets, such as China and Indonesia. Strong growth has also

lifted employment to pre-crisis levels or higher in most countries. Fiscal balances have also continued to improve as the recovery boosted revenues. Inflation has accelerated markedly, owing to higher food and energy prices, strong domestic demand and rising wages. Many central banks, including the People's Bank of China, have responded by tightening monetary policy, despite concerns that higher interest rates could attract more inflows of portfolio investment, increase the upward pressure on exchange rates and, eventually, moderate GDP growth.

South Asia: robust growth, but high inflation

Economic growth in *South Asia* in 2011 and 2012 is expected to remain close to its 2010 average of 7.1 per cent. However, prospects vary significantly in the region, with growth projected to range from 3 per cent in the Islamic Republic of Iran to 8 per cent in India and Sri Lanka in 2011. While private consumption and investment are the main growth drivers, government consumption has also expanded in most economies and will likely continue to increase in the outlook period. In the fast-growing economies of India and Sri Lanka, budget deficits are nonetheless expected to narrow as a share of GDP. Exports have rebounded over the past year, but rising fuel prices and resurgent domestic demand have pushed up import spending, leading to a slight widening of trade and current account deficits in most countries. Inflation remains high throughout the region owing to a sharp increase in commodity prices, combined with aggregate demand pressures and lower fuel subsidies in several countries. The central banks of Bangladesh, India and Pakistan, in particular, have responded by further tightening monetary policy. While unemployment has declined in India and Sri Lanka, underemployment and vulnerable employment remain widespread.

Western Asia: uneven growth amidst political unrest

Western Asia experienced a regionally balanced recovery in 2010 with most economies growing by more than 4 per cent. Prospects for 2011 and 2012 are more mixed, as uncertainties created by continuing and spreading political unrest and higher oil prices are strengthening the fuel-exporting economies and highlighting the vulnerabilities of fuel importers. Among the former, Governments have enough fiscal space to offer generous economic support measures to their populations aiming to quench political unrest. Among the latter, export volume growth has been insufficient to offset the deterioration in terms of trade. Furthermore, their already large fiscal deficits have widened further. Inflationary pressures are strong as a result of increasing food and energy prices and domestic demand expansion. The Gulf Cooperation Council countries and Yemen have their currencies pegged to the United States dollar and have limited control of monetary policy to curb inflation. The employment situation, which was one of the catalysts to the spreading political unrest, remains dire. In the long run, policy inaction, in relation to youth unemployment in particular, represents a major risk.

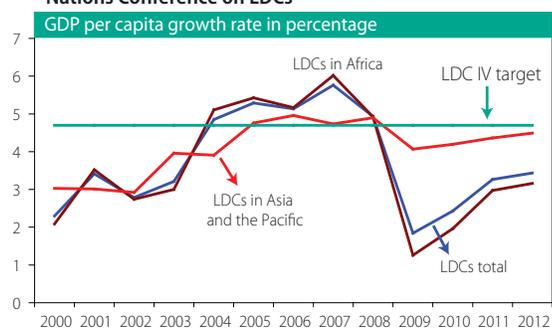
Latin America and the Caribbean: fading fiscal support

After a strong recovery in 2010, economic growth in *Latin America and the Caribbean* is expected to decelerate to 4.5 per cent in 2011 and 4.9 per cent in 2012, down from 5.9 per cent in 2010. Central American economies rebounded in 2010, but the prospects for 2011 are weaker, in part because they are net importers of food and energy. Continued surges in capital inflows in Brazil, Colombia and Mexico are resulting in further upward pressures on currencies. Rising interest rates induced by tighter monetary policies are further fanning these pressures. The strong output recovery during 2010 pushed employment levels back up, but with much of the job growth taking place in informal, low-productivity sectors.

LDCs: development in its regional context

The *least developed countries* (LDCs) have benefited from the generally more positive international economic environment, particularly the LDCs in Asia. However, LDC performance has generally been uneven. Fuel-exporting LDCs in Africa are seeing gains from higher oil prices, while most net-energy importers have suffered deteriorating terms of trade moderating their growth outlook. On the whole, average per capita income growth among LDCs in Asia is expected to be close to the growth target set at the Fourth United Nations Conference on LDCs, held in Istanbul in May 2011, while per capita income growth in African LDCs is projected to fall well short of this target in the outlook for 2011 and 2012 (figure 2). ■

Figure 2:
Diverging per capita income growth among LDCs,^a
but falling short of target of the Fourth United
Nations Conference on LDCs^b



Source: UN/DESA.

^a In the graph, not all LDCs are included. The group of African LDCs includes Haiti.

^b The target refers to that set at the United Nations Fourth Conference on the LDCs, which is 7 per cent of GDP growth per annum. In the figure the target is redefined in per capita terms.

