Global issues

Faltering global economic growth in 2011
The pace of global economic growth slowed markedly in 2011. While official data covering the full year are not available for most countries, world gross product is estimated to have increased by 2.8 per cent in 2011, compared with 4 per cent in 2010. The slowdown was most severe for developed countries, where the average growth rate was cut in half, sliding from 2.7 per cent in 2010 to 1.3 per cent in 2011. Developing country growth also decelerated by 1.5 percentage points to an average of a still robust 6 per cent. The economic slowdown is projected to continue into 2012 in most parts of the world.

High unemployment is the Achilles Heel of the recovery
Unemployment remained elevated in most developed economies in 2011. The unemployment rate declined only slightly in Japan and the United States. In the latter, it remained above 8 per cent despite a contracting labour force. High unemployment also persisted in Europe, affecting 10 per cent of workers on average. The jobless rate is particularly high in the countries facing sovereign debt distress. Most developing and transition economies are also challenged by high unemployment, except for a small number of economies in Asia. Youth unemployment rates are exceptionally high worldwide.

Renewed volatility and heightened risk in financial markets in 2011
Global financial markets in 2011 were characterized by sharply heightened risks associated with sovereign debt distress in Europe. While the risk premium on long-term government bonds for a number of European economies rose markedly during the year, those for other countries with high levels of public debt, like the United States, Japan and Germany, declined. The latter trend was caused in part by risk-averse capital holders moving their investments into assets that are more liquid and consid-
Economic conditions in developed and emerging economies continued to be shaped by the global financial turmoil. Yield spreads on corporate bonds edged up across the board in developed countries, especially those on financial sector bonds.

Equity markets in both developed and emerging economies plunged in mid-2011. Only a few equity markets recovered thereafter, and most registered sizeable losses for the year as a whole. The upward trend in commodity prices that started in mid-2010 was reversed in mid-2011. Prices of agricultural commodities and industrial metals ended 2011 below levels reached a year ago. The price of oil, however, has remained well above the earlier level. Exchange rates were also volatile. The yen appreciated strongly against both the dollar and the euro during the year, while the dollar appreciated vis-à-vis the euro during the second half of the year. The currencies of most emerging economies depreciated sharply against the dollar in the second half of the year to end up lower than a year ago, except for the Chinese yuan which appreciated by 4 per cent against the dollar.

**Developed economies**

**North America: another year of tepid growth**

The expansion of the United States economy decelerated significantly in the first half of 2011. Although growth accelerated in the second half, GDP growth is estimated at only 1.7 per cent in 2011 and forecast to slide further down to 1.5 per cent in 2012. Persistent high unemployment, continued balance-sheet adjustment by households and the shift to fiscal austerity are three key factors that will hold back economic growth in the outlook. The unemployment rate, which fell slightly to 8.5 per cent at the end of 2011, is expected to drop only very slowly. Stagnant wage rate growth caused by the slack in the labour market is further holding back consumption growth. The value of homes is expected to remain below pre-crisis levels and, more importantly, below the value of the mortgages of many home owners. The heightened volatility and uncertainty in equity markets has made consumers even more cautious. Furthermore, the shift towards fiscal austerity has taken away any demand stimulus coming from the public sector.

The Canadian economy expanded by 2.1 per cent in 2011, but growth is forecast to slow to 1.7 per cent in 2012. The appreciated Canadian dollar and tepid growth in the United States are expected to limit export growth and affect the economy at large.

**Developed Asia and Pacific: will the post-disaster reconstruction boost Japan’s economy in 2012?**

The economy of Japan contracted by about 3 per cent in the first half of 2011 in the aftermath of the devastating earthquake and tsunami that hit the country in March. The recovery was strong in the third quarter, but tapered off towards the end of the year. While GDP is estimated to have fallen by 0.5 per cent for 2011 as a whole, growth of about 2 per cent is forecast for 2012 and 2013, driven by post-quake reconstruction. However, further weakening of aggregate demand in other major economies and fiscal challenges to finance the reconstruction could result in much slower economic growth.

In Australia, the recovery from the mammoth flood in the eastern states has been weaker than expected. GDP increased by a meagre 1.5 per cent during 2011, but growth is forecast to accelerate to more than 3 per cent in the outlook for 2012-2013. In New Zealand, the damage caused by the earthquake that hit the Canterbury region in February of 2011 was enormous, but an economy-wide recession was avoided. GDP increased by about 1.5 per cent in 2011 and is forecast to accelerate to about 3 per cent during 2012-2013.

**Western Europe: stagnation ahead**

After a strong start, growth in Western Europe decelerated sharply during 2011 and stalled by year end. GDP is expected to grow by only 1.5 per cent in the EU-15 in 2011 and given the extremely low momentum going forward, by only 0.5 per cent in 2012.

Growth is hindered by a number of factors. The global manufacturing cycle has peaked and is now in a downturn as global demand slows. Fiscal austerity programmes are in force across the region. The sovereign debt crisis has led to plunging confidence of both producers and consumers, as well as to a weakening of the already vulnerable banking system.

Consumption is expected to remain very subdued in 2012, constrained by continuing fiscal austerity measures, grim labour market prospects, instability from the debt crisis and tightening bank lending conditions. Investment is expected to weaken, impacted by decelerating external demand coupled with deteriorating financing conditions and declining capacity utilization and, more generally, by increasing uncertainty. Low housing investment will continue to be a drag on activity. Given the subdued outlook, unemployment is expected to remain near current levels, with the crisis countries deteriorating further or, at best, remaining at elevated levels.

**New EU members: facing dangers from weakening of the rest of the EU**

During 2011, the new EU member States continued to recover from the deep recession that started in late 2008. In the Baltic States, the initial export-led expansion has evolved into a broader based recovery, while exports remain the main driving force in Bulgaria and Hungary. The recovery, however, is still mired by high unemployment, feeble consumer and business confidence, and strong social discontent over the fiscal austerity measures imposed by governments.
For many reasons, including much improved current account positions, the new EU members are not as vulnerable to financial woes in the euro area as they were to the global financial crisis in 2008. They seem to have exhausted most of their fiscal space, however, and would face difficulties conducting counter-cyclical policies in the occurrence of another recession. Given the slowdown in the euro area, short-term macroeconomic prospects will heavily depend on the recovery of domestic demand. In the outlook, new EU members are forecast to experience moderate growth only, as private consumption is constrained by the high degree of household indebtedness and the suspension of many investment projects. Growth of aggregate GDP is estimated at 2.9 per cent in 2011, but is expected to slow to 2.6 per cent in 2012.

**Economies in Transition**

**CIS: weakening of growth in 2011 will continue in 2012**

Economic activity expanded by an estimated 4.3 per cent in the Commonwealth of Independent States (CIS) and Georgia in 2011. Stronger commodity prices gave impetus to the expansion of output in several economies, including the Russian Federation and Ukraine, which remained important sources of economic dynamism in the CIS. Nevertheless, output growth registered in 2011 marks a slight slowdown compared to the 4.5 per cent of 2010 and remains well below pre-crisis levels.

The external environment deteriorated towards the end of 2011 as commodity prices declined and access to external financing became more difficult. Access to external financing is critical for countries that do not export energy, because they continue running large current-account deficits. Financial sector fragility is dampening domestic demand in several CIS economies. Renewed global turmoil would take a high toll in the region as many economies would be hit through multiple channels, paying a high price for their heavy reliance on exports of natural resources and external financing as well as their strong economic ties with the EU. In the outlook, GDP growth is forecast to weaken further to 4.0 per cent in 2012, but the CIS economies could well enter into a recession should the situation in Europe and the United States worsen considerably.

**South-Eastern Europe: an already slow recovery threatened by euro area troubles**

The tentative economic recovery in South-Eastern Europe that began in 2010 gained further ground in 2011, driven initially by export growth and thereafter by rising domestic demand. The region continues nevertheless to experience below-trend growth as household consumption and investment remain subdued by weak consumer sentiment, limited availability of credit, slow real wage growth and tepid FDI inflows. The continued financial turbulence and weak growth in the euro area threaten to spill over to the region via trade and financial channels and could easily unsettle the recovery.

GDP growth was positive in 2011 in all of the region’s economies, averaging about 2 per cent. In 2012, none of the economies are expected to see strong output growth given that their major export markets in the EU are facing the prospect of a protracted slowdown. Domestic consumption and investment are also expected to rebound only slightly, although Croatia should eventually see a turnaround in its investment cycle. Counter-cyclical stimulus measures are unlikely to be enacted by the Governments in South-Eastern Europe, as they have already shifted towards fiscal austerity, although they are protecting public investment spending. Aggregate GDP is forecast to expand by 2.3 per cent in 2012.

**Developing economies**

**Africa: regional growth increases, but unevenly**

Africa is forecast to see an increase in its overall growth figure from 2.7 per cent in 2011 to 5.0 per cent in 2012, marking a pronounced recovery from the disruptions caused by political unrest as well as the return to the solid growth trend that had emerged after the economic slowdown at the peak of the global economic crisis. Relatively strong commodity prices, solid external capital inflows and a continued expansion of demand and investment from Asia are important driving forces for this trend. However, the continent will continue to see widely diverging growth outcomes across countries. While South Africa, for example, and oil-exporting economies like Nigeria and Angola are forecast to register solid growth rates in 2012, the economic and humanitarian situation will remain problematic in large areas in the Horn of Africa, requiring continued outside humanitarian assistance. At the same time, high unemployment and widespread poverty remain major problems across the continent. One major underlying cause of the continuing high unemployment is the lack of economic diversification into higher productivity and job creating activities.

**East Asia: growth is moderating and risks are tilted to the downside**

East Asia’s strong growth momentum moderated in 2011, particularly in the second half of the year, as the region felt the impact of increased global uncertainty and weaker demand in developed economies. The region’s GDP is estimated to have expanded by
7.2 per cent in 2011, down from 9.2 per cent in 2010. With exports projected to weaken further in the coming quarters, regional growth is forecast to slow down to 6.8 per cent in 2012. In general, countries with large domestic demand bases, notably China and Indonesia, are in a better position to maintain robust growth in 2012 than the more export-oriented economies. The risks for the economies of East Asia are clearly tilted to the downside. Deep and prolonged recessions in major developed economies would have a severe impact on growth in the region; a fall in exports and increased uncertainty could trigger a slowdown in private investment and consumption. Inflation moderated in the second half of 2011, a trend that will likely continue in 2012. While price pressures have abated only slowly, central banks have started to shift their focus from fighting inflation towards stimulating growth.

South Asia: growth expected to remain resilient owing to robust domestic demand

Economic growth in South Asia moderated in 2011, primarily owing to a slowdown of India’s economy after the central bank tightened monetary policy aggressively to fight inflation. After expanding by 7.1 per cent in 2010, the region’s GDP is estimated to have grown by 6.4 per cent in 2011. South Asia is expected to remain fairly resilient to a global economic downturn in 2012. Driven by robust domestic demand, average growth is forecast to accelerate slightly to 6.7 per cent in 2012. However, growth disparities within the region remain wide: Bangladesh, India and Sri Lanka recorded growth of 6.5 per cent or higher in 2011, whereas the Islamic Republic of Iran, Nepal and Pakistan saw growth of less than 4 per cent. In most countries, inflation remained stubbornly high in 2011, mainly owing to rapidly increasing food prices. Average consumer price inflation is projected to decline slowly from 10.3 per cent in 2011 to 9.1 per cent in 2012 as food and commodity prices ease and the impact of monetary policy tightening is felt in Bangladesh and India. Given the rising risks to the global economy, the focus of monetary authorities has started to shift from containing inflation towards supporting domestic demand.

Western Asia: strong, but weakening growth

Western Asia’s growth momentum accelerated in 2011, as political unrest pushed up oil prices and revenues of oil-exporting countries. Political unrest negatively affected economic activity, especially tourism, in some countries of the region. This also had spillover effects on the economies of neighbouring countries. Declining external demand restrained economic expansion in Turkey and Israel during the second half of the year. As a result, regional GDP growth is estimated to average 6.6 per cent in 2011, but is forecast to pursue its declining trend down to 3.7 per cent in 2012.

In the wake of political unrest, Arab policymakers made unprecedented use of fiscal policy to increase public sector employment and wages as well as access to housing. While restoring stability and boosting growth in the short run, these social spending measures significantly raised expenditures as well as the fiscal break-even price of oil. They did not, however, increase inflationary pressures, which had peaked in the first quarter of the year and dampened thereafter, with the exception of Turkey where year-on-year inflation was still high at 10 per cent in December.

In the outlook, Western Asia faces several downside risks, including the possible revival of domestic unrest or international tensions. The region is also vulnerable to a global downturn. Falling external demand would result in declining oil and exports revenues. A drop in the oil price could potentially jeopardize fiscal sustainability in oil-exporting countries. More diversified economies in the region, like Jordan, Lebanon and the Syrian Arab Republic, would be affected through other channels (including weaker demand for their services trade), but most likely to a lesser degree than the fuel exporters.

Latin America and the Caribbean: slowing growth and returning fiscal expansion

The region’s GDP grew by 4.3 per cent in 2011, down from 6.0 per cent in 2010. The economies in South America grew on average by 4.6 per cent, as expanding employment and rising commodity prices drove up, respectively, consumption demand and export revenue. Output growth in Mexico and Central America slowed to 3.8 per cent and in the Caribbean to 3.4 per cent, mainly as a consequence of weaker economic conditions in the United States and other developed economies.

Inflation was above the policy target in most countries in 2011, owing to strong domestic demand and rising food and asset prices. This was the case in particular in Mexico, Nicaragua, and Central America, as well as in Argentina and the Bolivarian Republic of Venezuela, which recorded double-digit inflation rates.

The economic slowdown is expected to continue in 2012. South American economies are forecast to grow by 3.6 per cent while projections for the Caribbean, Central America and Mexico average 3 per cent. In anticipation of this deceleration, some countries have already adopted expansionary policy stances. In Brazil and Ecuador, government spending was expanded, while central banks in Brazil and Chile cut policy rates by 50 and 25 basis points, respectively.