



World Economic Situation and Prospects

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Global issues

World economy is expected to improve in 2014

Global economic growth is projected to increase over the next two years, building on the recent improvement in developed and major emerging economies. The global economy is expected to grow at a pace of 3.0 per cent in 2014 and 3.3 per cent in 2015, compared with an estimated growth of 2.1 per cent for 2013.

Although the world economy experienced subdued growth for a second consecutive year in 2013, some improvements in the latter part of the year have led to a more positive forecast. In the United States of America, fiscal tightening and a series of political gridlocks over budgetary issues weighed heavily on the economy in 2013, but monetary policy has been largely accommodative. Assuming a smooth tapering of the quantitative easing, gross domestic product (GDP) is expected to accelerate in the United States in 2014-2015. The European Union (EU) finally ended a protracted recession in the second quarter of 2013, led by net exports. Despite a better economic outlook, GDP growth in the EU will be constrained by several factors, including austerity programmes and low intraregional and extraregional demand. Although the Euro-

Summary

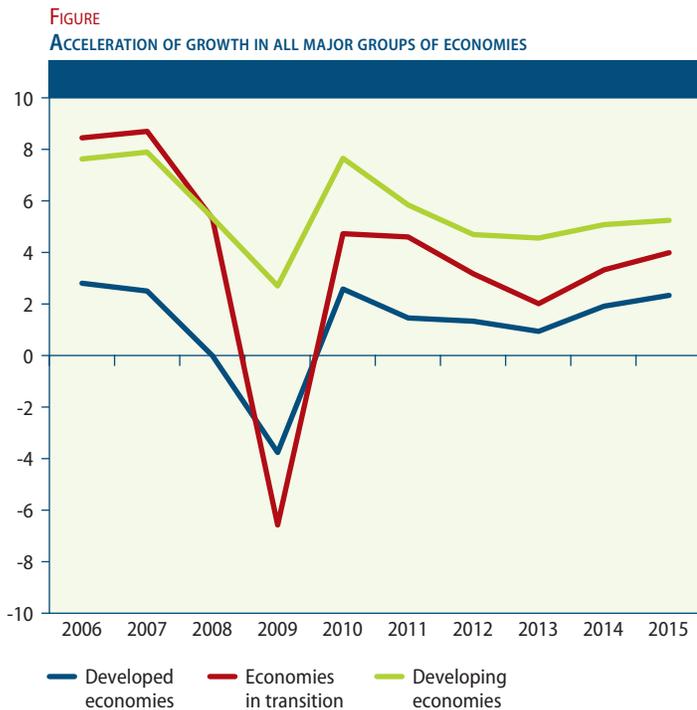
- World economy is expected to improve in 2014
- Unemployment rates remain a major challenge
- Downside risks to the baseline scenario persist

pean Central Bank has lowered interest rates to historical lows, lending conditions remain tight for peripheral economies, such as Greece, Portugal and Spain. Japan has been growing at a faster pace in 2013, boosted by expansionary policy packages, including fiscal packages and large-scale asset purchases by the central bank. The anticipated increase in the consumption tax rate over the next two years is expected to curb growth in 2014. Other developed economies, such as Australia, Canada, and New Zealand, are also expected to grow at a faster pace during the outlook period. A few large emerging economies, including Brazil, China and India, managed to backstop the deceleration they experienced in the past two years and veered upwards moderately (see more detailed analysis of the economic outlook in the regional sections).

High unemployment remains a major challenge in developed economies

A challenging global employment situation persists. In addition to high unemployment levels, the depth and length of labour market imbalances is leading to long-term and structural unemployment, becoming more than a mere cyclical issue. As long-term unemployment increases, labour force participation declines, masking real unemployment rates. Discouraged workers may join the labour market only after employment creation accelerates. Among specific social groups, young people have been particularly affected by the financial crisis. The world youth unemployment rate is close to 13 per cent, at least one-third of whom officially qualify as “long-term” unemployed, after finishing their educational and training programmes.

In the United States the unemployment rate has been declining, from a peak of 10 per cent in 2010 to 7 per cent by the end of 2013, but this is still historically high. In the euro area as a whole, the unemployment rate stabilized at 12.2 per cent in 2013. The situation is particularly dramatic in some countries, such as Greece and Spain, where unemployment rates are about 27 per cent, as well as in Portugal with a rate of about 17 per cent. The main concern



¹ This issue summarizes the key messages in chapter I of *World Economic Situation and Prospects 2014*.

over the forecast period is the expected slow progress in reducing unemployment, as GDP growth will not be strong enough to create job growth. The employment-to-population ratio has not recovered either, after falling sharply in the aftermath of the Great Recession.

In developing economies, the unemployment situation is mixed. In North Africa and Western Asia, structural unemployment rates are particularly high. In South Africa and in some Caribbean countries, unemployment rates are also high. But in a great number of developing economies, unemployment rates remain low. They remain below 3 per cent in several East Asian countries, such as Malaysia, Thailand and Viet Nam. In Latin America, unemployment is relatively low, at about 6 per cent in Brazil and Mexico. In the Commonwealth of Independent States (CIS), the Russian Federation is experiencing an historical low unemployment rate of 5-6 per cent.

A number of countries have been making concerted efforts at addressing the labour market crisis, but additional policy action is required. Particularly in developed economies, Governments need to minimize uncertainty, in order to foster private investment and job creation. In the specific case of the EU, access to credit for small- and medium-sized enterprises is essential, as they play a significant role in job creation. Policy measures to tackle structural unemployment are also needed, particularly related to skill and occupational mismatches. Training activities are practical examples for addressing long-term unemployment in particular. And specific policies to stimulate youth employment and limit the concerns over a lost generation are urgently needed.

Major risks and uncertainties to the baseline scenario exist

Although the economic recovery seems to be gaining momentum, the baseline outlook presented in the World Economic Situation and Prospects 2014 is subject to a number of uncertainties and risks, mostly on the downside.

A major risk is associated with the unwinding of the expansionary monetary policies by central banks of major developed economies over the course of 2014-2015. As observed during the mini-financial crisis of mid-2013, the mere announcement of plans to taper its purchase of assets by the United States Federal Reserve (Fed) triggered global financial turmoil. Both equity and bond markets worldwide experienced a sharp sell-off. The shocks to emerging markets were more pronounced, leading to substantial declines of capital inflows for the first time since 2009. Unwinding represents even higher risks for the world economy, as it implies withdrawing liquidity from the economy, while tapering continues to add liquidity.

Emerging economies, particularly those with large external and fiscal deficits, are vulnerable to the adverse spillover effects from the unwinding of quantitative easing by major central banks.

In the euro area, systemic risks have abated, but both the banking sector and the real economy remain fragile. A large number of banks still have weak balance sheets, particularly in the southern region, and could face insolvency. This has heightened the urgency to create a region-wide banking union, but the form this union would take is far from resolved. In addition, the dangerous feedback loop between fiscal consolidation and economic weakness

remains a risk. The fiscal targets are challenging for some countries and will continue to hinder recovery.

In the United States, the Government managed to reach an agreement on the budget, but uncertainties remain about the debt ceiling and other fiscal issues for 2014. If the debt ceiling were not raised, the federal Government would be forced to cut expenditures and possibly default on the debt. That would have devastating consequences not only for the United States, but also for the world economy, as the dollar is the major international reserve currency and half of the government debt is held by foreign economies and institutions, including foreign central banks.

Developed economies

The United States: better economic outlook, but downside risks remain

The economy of the United States is estimated to have grown at a meagre pace of 1.6 per cent in 2013, significantly lower than the 2.8 per cent of 2012. Looking ahead, GDP is expected to grow by 2.5 and 3.2 per cent in 2014 and 2015, respectively, based on the assumption that the debt ceiling will be raised and the future unwinding of the monetary easing will be smooth. Private consumption is projected to expand by about 2.5 and 2.7 per cent in 2014 and 2015, respectively, while the pace of fixed investment is expected to pick up. Both the trade deficit and the current-account deficit are expected to stay at their current ratios relative to GDP in 2014-2015. The federal funds interest rate is anticipated to remain within the range of 0.0-0.25 per cent until mid-2015. The Fed is expected to gradually reduce the amount of its purchases during 2014. Fiscal policy is likely to remain restrictive, but less severe than in 2013. Government spending in real terms will be flat in 2014-2015. Risks are associated with fiscal and monetary policies. Political wrangling over fiscal issues may continue to linger in the coming years if public finance is not put on a sustainable path. The Fed is facing a dilemma: purchasing long-term assets for too long could cause asset bubbles, but tapering off too quickly might choke the economic recovery and destabilize financial markets.

Developed Asia: Japan is out of deflation with mild recovery

A new set of bold stimulus policies has boosted economic growth in Japan and ended a decade of deflation. GDP is estimated to grow by 1.9 per cent in 2013, by 1.5 per cent in 2014, and by 1.2 per cent in 2015. Fiscal policy actions include a 10.3 trillion yen supplemental budget for the 2013 fiscal year and 5 trillion yen for 2014 to compensate for the negative impacts of the higher consumption tax, which will be increased in April 2014. The Bank of Japan (BoJ) announced the new Quantitative and Qualitative Monetary Easing policy (QQME) on 4 April 2013. With the large-scale purchasing of government bonds, the BoJ expects to bring down the yields of longer-term securities. The ultimate goal is to increase the annual consumer price index inflation rate to 2 per cent. The introduction of QQME has changed inflation expectations of economic agents, and the sharp depreciation of the Japanese yen has also put upward pressure on the prices for imported goods. The annual inflation rate is forecast to increase to 2.0 per cent for both 2014 and 2015.

Western Europe: growth is expected to pick up gradually

The crisis in the euro area has cooled considerably, but remains a significant risk factor for the world economy. Western Europe only emerged from recession in the second quarter of 2013, after six consecutive quarters of declining GDP. Activity in the region is expected to slowly pick up over the next few years, but with significant differences across countries. In the EU-15, given the very poor starting point, GDP is expected to decline by 0.1 per cent in 2013, but strengthen to 1.4 per cent and 1.8 per cent in 2014 and 2015, respectively. Among the large countries, the United Kingdom of Great Britain and Northern Ireland is expected to grow by 1.4 per cent in 2013 and strengthen to 2.2 per cent in 2014, while Germany and France are expected to grow by 0.4 per cent and 0.1 per cent respectively in 2013, but pick up to 1.9 per cent and 0.8 per cent in 2014. The crisis countries are showing signs of turning the corner, but they remain in delicate positions. The region as a whole continues to face significant headwinds: fiscal austerity programmes, while lessened in intensity, remain in force; intraregional demand is still exceptionally low, while extra-regional demand has slowed; balance-sheet repair is still an ongoing process for banks, non-financial corporations and households, which places a significant drag on consumption and investment spending; and lending conditions are heterogeneous, with bank credit amply available in some countries, while conditions remain extremely tight in others. The sharp deceleration of inflation at the end of 2013 points to some risks of deflation.

The new EU members: tentative green shoots of recovery

Many of the new EU member States from Eastern Europe continued negative economic trends in the first half of 2013, but the outlook for the region has improved with the euro area's return to positive growth in the second quarter of 2013. In 2013, the aggregate GDP growth for the region is estimated at 0.5 per cent. The speed of economic expansion should strengthen in 2014 and 2015 to 2.1 per cent and 2.7 per cent respectively. A more robust growth is needed, however, to return these countries to the path of sustainable convergence with the income levels of their EU-15 peers.

For most of the region, with the exception of the Baltic States and Hungary, growth in 2013 was largely driven by net exports, as domestic demand remained suppressed by high unemployment, stagnant real wages and the ongoing fiscal consolidation. The prospects for 2014-2015 still look basically positive. However, while private consumption may pick up in the near-term, investment is likely to remain subdued. Inflation markedly weakened over the course of the year, reaching record lows in several countries. Although unemployment may slightly decline in 2014 and in 2015, its structural nature in the region will impede serious employment gains. In 2013, monetary policy was the main macroeconomic tool used to bolster economic activity in the countries with flexible exchange rates and policy interest rates at record lows. However, credit growth in the region remains either anaemic or negative.

Economies in transition

CIS and Georgia: slowdown follows tepid recovery

The post-crisis economic expansion in the CIS area began to moderate in 2012 and further slowed down in 2013. The global economy continues to provide a challenging environment for these economies, characterized by weak external demand and difficulties in accessing external finance. Sluggish growth in the Russian Federation has had a dampening effect on economic activity throughout the region. Nevertheless, all of the CIS, especially the other energy-exporting countries, have sustained growth, except for Ukraine, which flat-lined in 2013. The aggregate GDP of CIS and Georgia expanded at about 2.0 per cent in 2013. Economic activity is expected to strengthen modestly in 2014, with aggregate output of the area expanding by 3.4 per cent, and to recover more solidly in 2015, with a growth rate of 4.0 per cent. In the Russian Federation, where GDP growth has already slowed to 3.4 per cent in 2012, the economic slowdown has been driven by weak investment, despite public support for infrastructure development. Net private capital outflows persisted in 2013. Similar to 2012, inflationary trends in the CIS area diverged in 2013, with inflation rates recorded at close to double-digit rates in Central Asia and a near-zero inflation rate registered in Georgia and Ukraine.

South-Eastern Europe: moderate growth, but high unemployment and financial vulnerabilities

Real economic activity in South-Eastern Europe turned positive in 2013, after experiencing a decline in GDP of almost 1 per cent in 2012. Growth should pick up slightly in 2014, owing largely to the improving growth prospects in the EU. The aggregate GDP of South-Eastern Europe increased by 1.8 per cent in 2013. Growth is projected to accelerate to 2.6 per cent in 2014, provided the tentative recovery in the EU strengthens, and 3.1 per cent in 2015, along with gradual recovery in FDI flows and domestic demand. However, growth at these subdued rates will not be sufficient to address the region's long-standing needs for reindustrialization, to significantly lower the region's exceedingly high rates of unemployment that have plagued it since the 1990s, and to increase the labour force participation ratio. Growth at these rates is also not sufficient to warrant the large current-account deficits in the region.

Developing economies

Africa: growth will accelerate during the forecast period

Africa's growth prospects remain relatively strong, with the GDP growth rate projected to accelerate from 4.0 per cent in 2013 to 4.7 per cent in 2014. Some of the pickup in growth is expected to come as a result of reversals of slowdowns due to particular circumstances. But medium-term growth prospects are expected to be supported by improvements in the global and regional economic environment, and by relatively high commodity prices. Other important factors for Africa's medium-term growth prospects include increasing domestic demand (especially from a growing class of new consumers associated with urbanization and rising incomes), easing infrastructural constraints, and improvements in economic

governance and management. Inflation across Africa is expected to decelerate slightly from an average of 8.0 per cent in 2013 to 7.8 per cent in 2014, owing to a variety of factors, including moderating international food and fuel prices and monetary policy that is tightening in most African countries, despite increased investment in infrastructure. Although the growth picture is positive for many African countries, the employment situation remains a major problem across the region, both in terms of the level of employment as well as the quality of jobs that are generated.

East Asia: solid growth expected for 2014-2015, supported by recovery in exports

After slowing markedly in 2011 and 2012, economic growth in East Asia stabilized over the past year. While East Asia remained the fastest-growing region in the world in 2013, economic activity was adversely affected by continued sluggish demand in developed economies, the gradual adjustment to lower growth in China, and weakening consumption and investment demand in several countries, including Indonesia, Malaysia and Thailand. China's economy is estimated to have grown by 7.7 per cent in 2013, the same pace as in 2012, but well below the double-digit growth rates recorded for much of the past decade. The region's high-income and strongly export-oriented economies—Hong Kong Special Administrative Region of China, the Republic of Korea, Singapore and Taiwan Province of China—saw a moderate recovery in growth as net exports and investment performed slightly better than in 2012. Average GDP growth in the region stood at 6.0 per cent in 2013. A further mild pickup in regional growth to 6.1 per cent is forecast for 2014 and 2015, supported by a gradual export recovery amid improving conditions in developed countries. In most East Asian economies, private consumption and investment will likely continue to expand robustly, supported by stable labour market conditions, low inflation and fairly accommodative monetary policies. Fiscal policies are expected to remain moderately expansionary, providing support for growth.

South Asia: regional growth projected to pick up gradually, driven by recovery in India

Economic growth in South Asia remained lack-lustre over the past year as a combination of internal and external factors hampered activity, particularly in the region's large countries (India, the Islamic Republic of Iran and Pakistan). India's economy, which accounts for over 70 per cent of total output in South Asia, slowed further in 2013, held back by weak household consumption and sluggish investment. South Asia's combined gross domestic product is estimated to have grown by 3.9 per cent in 2013. The weak growth performance has taken its toll on labour markets as evidenced by rising unemployment and declining labour force participation in several countries. Looking ahead, regional GDP growth is forecast to pick up gradually to 4.6 per cent in 2014 and 5.2 per cent in 2015. The recovery will likely be led by stronger external demand, a moderate upturn in domestic demand in India and slowly improving economic conditions in the Islamic Republic of Iran. The region's economic performance will greatly depend on the progress

in tackling growth bottlenecks, such as energy and transport constraints and volatile security conditions, as well as macroeconomic imbalances. The room for monetary and fiscal policies to stimulate domestic demand is limited by elevated inflation, large fiscal and current-account deficits, and volatile global financial conditions.

Western Asia: solid growth overall despite the fallout from military conflicts

Western Asia has seen slightly slower aggregate growth of 3.6 per cent in 2013 than in 2012, and is projected to accelerate to 4.3 per cent in 2014, but to moderate to 3.9 per cent in 2015. However, Arab countries in Western Asia exhibited further divergence in their economic performances. On the one hand, the member countries of the Gulf Cooperation Council have been on a stable recovery path. Non-oil sectors, particularly the real estate sector, regained their strength, partly owing to active fiscal policy in the subregion. On the other hand, the economies of Iraq, Jordan, Lebanon, Syrian Arab Republic and Yemen have been hampered by continuing political instability, social unrest, security incidents and geopolitical tensions. In Turkey, financial markets have been under pressure since May 2013, with the currency depreciating and interbank interest rates rising as a result of a reversal in international capital inflows. These unfavourable factors are expected to weigh on real economic growth in the near term. GDP is estimated to grow by 3.2 per cent in 2013 and by 5.0 per cent in 2014, before decelerating to 3.0 per cent in 2015. The GDP of Israel is estimated to grow at a pace of 3.2 per cent in 2013, driven mainly by consumer demand and net exports. In the outlook, GDP is forecast to grow by 2.2 per cent in 2014 and 3.3 per cent in 2015.

Latin America and the Caribbean: growth to accelerate in 2014-2015

In Latin America and the Caribbean, economic growth is estimated to be 2.6 per cent in 2013. Although weak global economic conditions have hampered the region's growth, economies in the region were mainly supported by resilient domestic demand. In 2014 and 2015, GDP growth is expected to pick up to 3.6 per cent and 4.1 per cent, respectively, underpinned mainly by a gradual recovery in developed economies, sound macroeconomic policies, and resilient domestic demand. The downturn in the region's total exports seems to have bottomed out during 2013, as export values picked up during the second half of the year. In 2014 and 2015, an increase in export volumes is expected to follow economic recovery in developed economies. In addition to external risks, domestic policies to support economic activity face a number of challenges. In the current context of high volatility of capital inflows and significant uncertainties in developed countries, the region will face the challenge of coordinating fiscal, monetary and exchange-rate policies in order to preserve financial stability and stimulate economic growth. Some countries also face country-specific risks. A case in point is the Bolivarian Republic of Venezuela, where policymakers are challenged to deal with soaring inflation driven by supply constraints and currency devaluation.