World Economic Situation and Prospects
Monthly Briefing

No. 67 June 2014

Global issues

Despite downward revision, world economic growth is expected to accelerate in 2014-2015

Based on the latest forecast prepared in May 2014 by the Global Economic Monitoring Unit in the Department of Economic and Social Affairs at the United Nations, world economic growth is expected to accelerate in 2014 and 2015. Growth for these years is now projected at 2.8 per cent and 3.2 per cent, respectively, which is slightly lower than the forecast made in World Economic Situation and Prospects (WESP) 2014, released in January 2014.

A downward revision has been made, mainly in the growth projections for developing economies and the economies in transition (see table), as the situation in a number of countries in these two groups has become somewhat more challenging. However, developing countries as a whole will continue to comprise a large proportion of global growth.

As demonstrated in the two recent episodes of financial turbulence in mid-2013 and early 2014, a number of developing countries are vulnerable not only to international spillovers from the adjustments made to monetary policies by major developed countries, but also to a few country-specific challenges, including structural imbalances, infrastructural bottlenecks, increased financial risks, incoherent macroeconomic management and political tensions.

Growth in the developed economies is expected to accelerate (see table). For the first time since 2011, all major developed economies in North America and Europe are aligned on the same upward growth trajectory—hopefully forming a virtuous cycle to reinforce their recovery. Nevertheless, after five years of being mired in the aftermath of the financial crisis, these projected growth rates are insufficient to recuperate the output and job losses in most of these economies. They are still confronting a number of challenges, including remaining fragilities in the euro area, elevated unemployment rates in some countries, and unsustainable public finances in the longer term (see Monthly Briefing 65, April 2014).

International trade flows are expected to be stimulated by higher import demand in developed economies

World trade growth was flat in the first quarter of 2014. However, some gradual improvement is expected over the course of the year as import demand in major developed countries continues to gradually increase. Despite downward revisions to trade flows, real exports are forecast to grow by 4.1 per cent in 2014, almost twice as fast as in 2013, but still below the pre-crisis trend of double global output growth. Further improvement is expected to continue into 2015, with export growth rising to 5.1 per cent.

The outlook for trade has been revised downward, following downward revisions in output growth rates for Japan and a number of developing regions. Trade in services continues to grow more strongly than trade in goods, although still at a slower pace than in the pre-crisis years. World commercial services exports in 2013 reached $4.6 trillion, with a growth rate of 5.5 per cent, while according to preliminary joint estimates by the United Nations Conference on Trade and Development and the World Trade Organization, world exports of services grew by 6 per cent in the fourth quarter of 2013, as compared to the same quarter of 2012.

Capital flows to emerging economies are expected to pick up, after recent reductions

As the United States Federal Reserve Bank (Fed) gradually scales back its monthly asset purchases, developing countries and economies in transition have seen a marked reduction in capital inflows in

Summary

- World economic growth is expected to accelerate in 2014-2015
- North American and European economies will experience a similar growth trajectory
- Developing economies face stronger challenges, but will continue with relatively robust economic expansion


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2013 and early 2014 and they remain exposed to sudden changes in financial market sentiment. However, the episode of financial turbulence in early 2014 differed from the one in mid-2013 in several respects, including the fact that the most recent market correction was smaller and shorter in duration, with investors discriminating more among emerging economies. Some countries that were among the hardest hit in 2013, such as India and Indonesia, escaped the turmoil in early 2014, following improvement in key macroeconomic indicators. Global financial markets have since calmed and capital flows to emerging economies have stabilized.

Capital flows to emerging economies are projected to pick up slowly from the low levels seen in recent quarters, in line with the expected recovery in global growth. However, significant uncertainties and downside risks stem from the interaction between perceptions regarding the Fed’s recent tightening and the idiosyncratic weaknesses in some emerging markets.

**More effective international policy coordination is needed**

In spite of the relatively positive outlook, the recovery of the global economy remains fragile and various downside risks persist. Thus, against this backdrop, the need for more effective international policy coordination has become imperative. In particular, stimulating global demand and output growth should remain an overarching priority for enhanced policy coordination at the global level. At a meeting in early 2014, finance ministers of the Group of Twenty committed to raising their collective gross domestic product (GDP) by more than 2 per cent (or by US$ 2 trillion) above the five-year trajectory implied by current policies in order to reduce their output gaps.

Efforts are also needed in relation to international tax cooperation. Profits should be taxed where they are earned and all countries should sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in order to enhance compliance with domestic tax regulations.

In the area of international financial regulation, some progress has been made in recent months, with large banks on course to meet the new Basel III capital requirements almost five years ahead of the deadline. Still, financial reforms need to be implemented promptly and consistently, and international regulatory cooperation needs to be strengthened. Priorities should also be given to the implementation of the IMF quota and governance reforms agreed to in 2010.

Regarding international development cooperation policies, flows of official development assistance have rebounded by 6.0 per cent in 2013— a record level since the decline in 2011 and 2012— but are still far below the United Nations target of 0.7 per cent of gross national income.

**Developed economies**

**The United States: economy is expected to pick up in 2014, after a weak first quarter**

In the United States of America, the growth momentum built in the second half of 2013 weakened notably in the first quarter of 2014. Economic output declined at an annualized rate of 1.0 per cent during the first quarter of 2014 from the previous quarter. Inclement weather hampered consumption of goods and construction activity for business and residential structures. More importantly, rapid deceleration in inventory stock-building during that quarter has caused GDP to decline by more than 1.6 per cent. The sudden deceleration of goods exports also disturbed GDP growth significantly. Nevertheless economic growth is expected to pick up going forward. GDP is expected to grow by 2.5 and 3.2 per cent in 2014 and 2015, respectively. Both private consumption and business investment are expected to increase at a stronger pace than in the past two years, along with a continued improvement in the labour market and the housing sector. Monetary policy is expected to remain highly accommodative during 2014 and into 2015, while fiscal policy will be less restrictive than in 2013. External conditions for the United States economy are expected to improve, but only slightly, as foreign demand from major trade partners is expected to remain relatively weak.

**Developed Asia: the Japanese economy is expected to expand moderately**

The Japanese economy expanded by 1.5 per cent in 2013 and is projected to expand by 1.4 and 0.9 per cent in 2014 and 2015, respectively. Economic growth was stimulated by a fiscal package introduced in 2013, but this stimulus is set to fade out. The Government has recently increased expenditure through a supplementary budget, but its magnitude is not enough to fully offset the negative impact of higher sales taxes introduced in April 2014.

Unconventional monetary policy implemented in April 2013 has driven down the yields of long-term securities and has guided inflation expectations towards a higher level, as intended. It has also led to a significant depreciation of the Japanese yen vis-à-vis other major currencies, giving a further boost to headline inflation. The hike in the sales tax rate in April 2014 triggered households to bring forward a significant amount of consumption of durable goods prior to the implementation of the tax. For example, total department store sales increased by more than 25 per cent from one year ago in March 2014, but dropped by 12.5 per cent in the following month. Consequently, GDP expanded at an annualized rate of 5.9 per cent in the first quarter, but it is expected to contract in the following quarters. In addition, the year-on-year headline CPI inflation jumped from 1.6 per cent in March to 3.4 per cent in April. However, wage growth has been limited and may not provide sufficient support to keep inflation close to the target of 2.0 per cent.

**Western Europe: growth is picking up, but the recovery remains weak**

Western Europe emerged from recession in the second quarter of 2013, after six consecutive quarters of decline. In the EU-15, GDP growth was stagnant during 2013, due to the weak start to the year, but is expected to grow by 1.5 per cent in 2014 and 1.8 per cent in 2015. This marks an upward revision from the WESP 2014 of 0.1 percentage points in both 2013 and 2014, with no change for 2015. Since the announcement by the European Central Bank of its Outright Monetary Transactions facility in August 2012, financial tensions in the region have subsided significantly and confidence has rebounded. Fiscal austerity programmes have lessened in intensity and balance sheet repair, while ongoing, is also less of a drag on activity. But the recovery remains weak, with GDP still below its pre-crisis level.
The substantial slack in the region, coupled with the slow growth profile, strong currencies and weaker commodity prices, has led to extremely low rates of inflation, to the point of triggering concerns about the risk of deflation. The weakness of the recovery is also a major factor behind the dire unemployment situation. In the EU-15, unemployment was 11.1 per cent in 2013 and is expected only to stabilize in 2014, before coming down to 10.6 per cent in 2015. This figure masks tremendous disparities across the region, with unemployment expected to be only 5.0 per cent in Germany in 2014 but 25.9 per cent in Spain.

The new EU members: recovery is firming

The recovery in the new European Union (EU) member States is firming against the backdrop of stronger activity in the EU-15, a modest pickup in domestic demand, less fiscal drag, and a turnaround in the inventory cycle. All countries in the region are expected to register positive growth in 2014, with the exception of Croatia. The aggregate GDP of the new EU member States is expected to grow by 2.4 per cent in 2014 and by 2.9 per cent in 2015. Households remain burdened by foreign-currency-denominated debt and continued deleveraging, but low inflation and strengthening of real wages should boost their spending. Although the economies still operate below full capacity and foreign direct investment (FDI) remains disappointing, investment should also pick up gradually, benefiting from improved business confidence and absorption of EU funds. Inflation in many of the new member States remained at historically low levels in early 2014 and should stay in the low single digits. This will allow loose monetary policy to continue, including unconventional measures. Labour market conditions improved slightly in early 2014, although the situation varies across countries.

Economies in transition

CIS: challenging external environment and domestic risks

The Commonwealth of Independent States (CIS) region continues to face a challenging international environment and, in addition, many countries are confronted with domestic challenges and risks. Several large CIS economies stagnated in early 2014. Growth in the Russian Federation, which has a strong influence over the region, was already disappointing in 2013 and the conflict around Crimea and the possibility of economic sanctions targeting broader sectors of the Russian economy have led to a massive outflow of capital and further weakening of business and consumer confidence. Depreciation of the currency in early 2014 added to inflation, undermining private consumption, and the resulting hike in the policy interest rates will further curb private investment. Growth in 2014 is expected to be very low, despite fiscal expenditure on a number of infrastructure projects. The economy of Ukraine is expected to shrink in 2014 because of the political crisis, weakness in private consumption, disruptions in trade flows, and significant fiscal retrenchment. By contrast, economic expansion, driven by commodity exports, is expected to continue in Central Asian economies.

Average inflation in the CIS region is likely to accelerate in 2014. The weaker currencies in Kazakhstan, the Russian Federation and Ukraine will contribute to imported inflation, while inflation in the energy exporters of Central Asia will remain high due to foreign exchange inflows and continuing public spending. For the lower-income CIS economies, such as Armenia, Kyrgyzstan, the Republic of Moldova, Tajikistan and Uzbekistan, the weakening of the Russian and Kazakh currencies may adversely impact the value of remittances sent home by migrant workers, restraining private consumption and, possibly, growth.

The prospective establishment of the Eurasian Economic Union in 2015 should contribute to stronger intraregional economic ties. The aggregate GDP growth in the CIS region and Georgia is expected to decelerate from 2.0 per cent in 2013 to 1.6 per cent in 2014, strengthening only modestly to 2.3 per cent in 2015.

South-Eastern Europe: modest acceleration of growth

The aggregate GDP of South-Eastern Europe increased by 1.9 per cent in 2013. Although still subject to numerous risks, growth is projected to accelerate to 2.0 per cent in 2014 and to 3.1 per cent in 2015, along with recovering FDI flows and strengthening domestic demand. Acceleration of growth to about 3.0 per cent would be a welcome development, but this still would be below pre-crisis growth levels and insufficient to address the region’s structural needs for reindustrialization, higher labour participation ratios and a reduction of high unemployment rates, especially among youth. The region remains dependent on external financing to cover large current-account deficits and faces repayments of private debt and loans taken from multilateral institutions. Obtaining access to external funding may pose challenges against the backdrop of cooling investor sentiment towards emerging markets.

Developing economies

Africa: economic growth in Africa remains solid, despite downward revision

Growth in Africa will remain solid this year at 4.2 per cent, although this has been revised downward from previous forecasts because of issues in a number of countries. Disruptions to oil output and exports in Libya continue to be a major drag on growth and have contributed to a significant downward revision in growth expectations for North Africa. Growth in Central Africa will increase markedly, owing to base effects from negative growth in 2013, although the political situation in the Central African Republic continues to be perilous. Output is expected to expand by 5.1 per cent in 2015 as South Africa sees stronger growth from solid export demand and increasing consumption and investment, and North Africa rebounds with Libyan oil exports recovering. Steady or lower commodity prices will continue to drive inflation’s downward trend, falling from 6.9 per cent this year to 6.5 per cent in 2015. However, these price trends have contributed to exchange-rate depreciation in some commodity-exporting countries, which has offset some of the decrease in inflation. In addition, these economies will face pressure on fiscal revenues, caused by falling commodity prices and fluctuations in external budgetary support. Depreciation and high inflation in selected countries will continue to underpin the tightening trend in monetary policy. High unemployment and widespread underemployment will remain serious issues, particularly in the light of the lower growth forecast. Export growth is expected to rise and import growth should remain strong.
East Asia: Robust growth expected for 2014 and 2015

East Asia is expected to see robust growth in 2014 and 2015 as exports to developed countries strengthen and domestic demand in most of the region’s economies remains firm. Economic activity is projected to grow by 6.0 per cent in both years, the same pace as in 2013. China’s growth rate is expected to moderate further, with GDP projected to expand by 7.3 per cent in 2014 and 7.1 per cent in 2015, down from 7.7 per cent in 2013. This lower growth trajectory is in line with the Government’s focus on raising the quality of development and restructuring the economy. Thailand’s short-term outlook has deteriorated sharply over the past few months as continuing political unrest takes an increasing toll on domestic demand. The slowdown in China and Thailand will likely be offset by a pickup in growth in the region’s most export-oriented economies, which are expected to benefit from stronger demand in the United States and the EU. In most East Asian economies, household consumption and fixed investment are projected to grow at a steady pace, helped by generally mild inflation, stable labour markets and accommodative monetary policies. Governments are expected to maintain their current prudent fiscal policy stances. Against the backdrop of improved global conditions, higher U.S. interest rates, and a slight acceleration in inflation, central banks may start tightening monetary policy in the course of 2015.

South Asia: Growth is projected to pick up gradually

Average economic growth in South Asia is projected to pick up gradually, after remaining near a two-decade low in 2013. GDP is estimated to expand by 4.6 per cent in 2014 and 5.1 per cent in 2015, up from 3.9 per cent in 2013. The moderate recovery is expected to be underpinned by stronger consumption and investment in the context of enhanced macroeconomic stability. External demand is also projected to strengthen as activity in developed economies gains momentum. The recovery in South Asia will, however, be constrained by structural impediments, including energy shortages, lack of transport infrastructure, political unrest and violence, and problems in implementing economic reforms. India’s economy is forecast to grow by 5 per cent in 2014 and 5.5 per cent in 2015, only slightly up from 4.8 per cent in 2013, as the new Government faces major challenges in reviving the economy. The Islamic Republic of Iran is projected to see a return to mildly positive growth in 2014 as the partial lifting of sanctions will help non-oil exports. In several South Asian economies, a moderation in inflation has, at least temporarily, reduced the pressure on central banks to further tighten monetary policy. Fiscal balances have slightly improved, but deficits are still large and more sustained consolidation requires significant policy changes on the expenditure and the revenue side.

Western Asia: economic expansion remains weak compared to pre-crisis trends

In Western Asia, internal instabilities and lower oil exports continue to shape the economic outlook. Economic activity is still relatively weak in comparison to pre-crisis trends, with growth forecast to reach 3.6 per cent in 2014 after a 3.8 per cent gain in 2013, before accelerating to 4.4 per cent in 2015. Nevertheless, the member States of the Gulf Cooperation Council have been on a stable growth path, as economic activity has been supported by expansionary fiscal policies. The economies of Iraq, Jordan, Lebanon, the Syrian Arab Republic and Yemen have been hampered by continuing political instability, social unrest, security incidents and geopolitical tensions. The war in the Syrian Arab Republic has been taking a particularly heavy human toll and has led to the widespread destruction of crucial infrastructure. An extraordinarily large number of refugees have fled to neighbouring countries, posing a severe challenge for public policy and fiscal budgets. In Turkey, the surge in capital outflows and the depreciation of the exchange rate led to sharp increases in policy interest rates at the beginning of 2014. Thus, after accelerating to 4 per cent in 2013, Turkey’s GDP growth is expected to slow down to 2.2 per cent in 2014, before bouncing back in 2015, aided by a pickup in exports. The Israeli economy is expected to remain relatively stable with a moderate improvement throughout the forecast period when growth will pick up more broadly, helped by strong consumer spending and external demand. Inflation in the region will continue to be relatively stable. One exception is the Syrian Arab Republic, where inflation is expected to remain extremely high. Geopolitical tensions can further affect the region’s economic prospects.

Latin America and the Caribbean: growth remains subdued, with increasing heterogeneity across countries

Economic growth in Latin America and the Caribbean is expected to remain subdued in 2014, amidst increasing difficulties in some of the largest economies. The region is expected to grow moderately in 2014, by 2.6 per cent, although with significant heterogeneity across subregions. Economic growth in Mexico and Central America is strengthening, benefiting from the pickup in activity in the United States, with Mexico expected to grow by 3.2 per cent in 2014, accelerating from growth of 1.1 per cent last year. By contrast, growth in South America is decelerating markedly from 3.2 per cent in 2013 to 2.1 percent in 2014. Argentina is experiencing a noticeable slowdown, amidst decreasing business confidence and persistent inflation pressures, while the Bolivarian Republic of Venezuela is likely to enter into recession. Brazil’s economy continues to expand at a very moderate rate of 1.7 per cent in 2014, with meagre prospects for investment demand and increasing pressure for fiscal consolidation. Other South American countries, such as Bolivia, Colombia and Peru, are expected to continue on a more solid growth path. Meanwhile, growth in the Caribbean is expected to accelerate to 3.6 per cent in 2014. Despite the continuing subdued growth, the unemployment rate is likely to remain relatively low. The inflation outlook is also fairly stable and low, with the noticeable exceptions of Argentina and the Bolivarian Republic of Venezuela. In adjusting to the domestic business cycle and the tapering of the Fed’s quantitative easing programme, the monetary stance remains mixed. Some countries with relatively low inflation, such as Chile, Mexico and Peru, have opted to reduce interest rates, while Brazil and others have tightened their monetary conditions. Meanwhile, fiscal policy is moving towards a more supportive stance. However—and more importantly—reforms are needed in the region in order to boost growth in investment and productivity.

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