



World Economic Situation and Prospects

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Global issues

Global recovery hampered by unfinished post-crisis adjustments

The global economy continued to expand during 2014 at a moderate and uneven pace, as the prolonged recovery process from the global financial crisis was still saddled with unfinished post-crisis adjustments. The global recovery was also hampered by some new challenges, including a number of unexpected shocks, such as the heightened geopolitical conflicts in various areas of the world. Growth of world gross product (WGP) is estimated to be 2.6 per cent in 2014, marginally better than the growth of 2.4 per cent registered in 2013, but lower than the 2.9 per cent projected in *World economic situation and prospects as of mid-2014*. Six years after the global financial crisis, gross domestic product (GDP) growth for a majority of the world economies has shifted to a noticeably lower path compared to pre-crisis levels (figure 1). Even though economic prospects are subject to a number of uncertainties and downside risks, the global economy is expected to strengthen in the following two years, with WGP projected to grow by 3.1 and 3.3 per cent in 2015 and 2016, respectively.

At issue is whether the shift to a lower path of growth in most countries will become entrenched and continue for a long

Summary

- Moderate global economic expansion in 2014, as post-crisis adjustments continued
- In 2015, developed economies to be led by a stronger U.S. economy, while downside risks remain significant in Japan and the euro area
- Developing economies to be led by East Asia, while several large emerging economies face internal and external challenges

period. According to some views, major developed economies are highly likely to be entrapped in a secular stagnation, while policymakers in China have indeed taken growth of 7.0–7.5 per cent as the new normal for the Chinese economy, compared with the average growth of 10.0 per cent that China achieved in the previous three decades. Many other large emerging economies, particularly those outside of Asia, have also seen a much slower growth trajectory in recent years as domestic weaknesses interact with challenging international conditions.

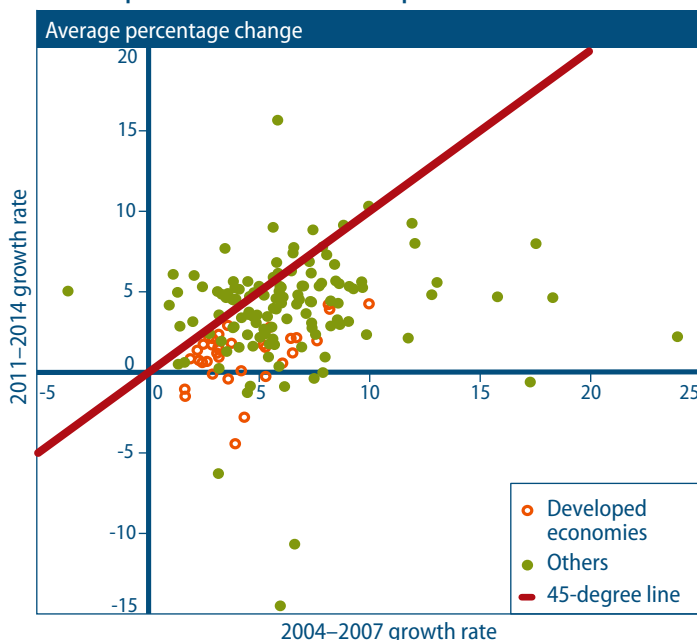
Developed economies to be led by the United States in 2015

A salient feature for major developed countries during 2014 has been the erratic movements in their quarterly GDP growth rates, while the growth picture remains diverse. The United States of America has managed to maintain an annual growth rate above 2 per cent in 2014, but the economic situation in Europe is precarious, particularly in the euro area, where a number of euro members teetered on the brink of falling back into recession. Meanwhile, in Japan, momentum generated by the fiscal stimulus package and monetary easing introduced in 2013 has receded. In the baseline outlook, further improvement is expected for developed countries, with growth projected to be 2.1 and 2.3 per cent for 2015 and 2016, respectively, compared with the 1.6 per cent estimated for 2014. However, downside risks remain significant, especially in Japan and the euro area, which saw renewed weakness in 2014.

Developing economies to be led by East Asia, while many large emerging economies face several internal and external challenges

Growth rates in developing countries and economies in transition have become more divergent during 2014, as a sharp de-

Figure 1
Growth performance: Pre-crisis vs. post-crisis



Source: UN/DESA.

celeration occurred in a number of large emerging economies, particularly in Latin America and the Commonwealth of Independent States (CIS). A number of these economies have encountered various country-specific challenges, including structural imbalances, infrastructural bottlenecks, increased financial risks and incoherent macroeconomic management, as well as geopolitical and political tensions. In contrast, East Asia, including China, managed to register relatively robust growth, while India led South Asia to a moderate strengthening. In the baseline outlook, developing countries as a group are expected to grow at 4.8 and 5.1 per cent in 2015 and 2016, respectively, up from the 4.3 per cent estimated for 2014.

Growth in the least developed countries is expected to continue exceeding the global average, at 5.7 per cent in 2015 and 5.9 per cent in 2016. The economies in transition as a group are expected to grow at 1.1 per cent and 2.1 per cent in 2015 and 2016, respectively, up from the 0.8 per cent estimated for 2014. As in the case of developed economies, the risks to this baseline outlook are mainly on the downside. Many developing countries and economies in transition appear vulnerable to a tightening of global financial conditions and to the risk of a sharper-than-expected slowdown in major emerging economies, as well as a further aggravation of geopolitical tensions and an escalation of the Ebola epidemic.

Developed economies

The United States: growth prospects continue to improve

The economy of the United States is expected to expand in 2015 and 2016 at the pace of 2.8 and 3.1 per cent, respectively. Robust growth in business investment will be the major driver, but household consumption is also expected to strengthen, along with a continued improvement in employment. The fiscal drag on GDP growth from cuts in government spending will remain, but to a lesser degree. The contribution from the external sector to GDP growth will be limited, as export growth is expected to be curbed by the strong appreciation of the dollar.

Five years after the Great Recession, payroll employment in the United States has finally exceeded the pre-crisis peak registered in January 2008. The unemployment rate has declined more than 4 percentage points from its peak in 2009, to below 6 per cent in late 2014, although the rate of underemployment remains above 11 per cent. Employment is expected to continue increasing with the unemployment rate dropping to 5.5 per cent by 2016.

The United States Federal Reserve is expected to start raising interest rates from mid-2015 on, but the monetary policy stance will continue to be accommodative until the end of 2016. A possible significant increase in financial volatility in response to the normalization of monetary policy is one of the downside risks. Sizeable corrections in equity prices and bond yields could produce significant adverse effects on the growth and stability of the real economy.

Developed Asia: policy actions drive the short-term economic dynamics in Japan

Japan is estimated to grow by only 0.4 per cent in 2014, technically falling into a recession in the second and third quarters. The drop in private consumption following the consumption tax rate increase of 3 percentage points in April 2014 is the main reason for the slowdown. The Government introduced a new supplementary budget in early 2014, but the magnitude has not been sufficient to fully offset the negative impact of the higher taxes. Exports are expected to eventually benefit from the depreciation of the Japanese yen triggered by the monetary easing, while the planned cut in corporate taxes will support fixed investment. The growth rate is predicted to be 1.2 per cent in 2015 and 1.1 per cent in 2016.

The quantitative easing introduced in 2013 has predictably raised inflation expectations and driven down the yields on securities. After the sales tax hike, inflation increased further to 3.7 per cent within two months, but then started to decelerate. The central bank further expanded monetary easing substantially in October 2014. The inflation rate for 2014 is estimated to reach 2.7 per cent and is projected to be 1.3 per cent in 2015 and 1.5 per cent in 2016. Monetary easing has led to a strong depreciation of the Japanese yen vis-à-vis all major currencies. In early November 2014, the yen's value against the dollar was about 23 per cent lower than in late 2012.

Western Europe: growth expected to continue on a moderate path

Western Europe continues to struggle. In the EU-15, GDP growth is estimated to be only 1.2 per cent in 2014, with a slight pickup to 1.5 per cent and 1.9 per cent in 2015 and 2016, respectively. The region is held back by the travails of the euro area, where the level of GDP has yet to regain its pre-recession peak. Unemployment remains extremely high in many countries in the region and headline inflation is at alarmingly low levels. In the large economies, Italy is expected to contract for the second consecutive year and France has stagnated, while Germany started the year strongly, but has since slowed significantly. A ray of hope can be seen in the resumed growth in some of the crisis countries: Spain returned to positive growth in mid-2013 and has been strengthening since; Ireland and Portugal have also resumed positive growth. All three recoveries remain extremely fragile, however. The only example of more robust growth is outside the euro area in the United Kingdom of Great Britain and Northern Ireland.

The new EU members: slow but stable recovery amid geopolitical tensions

The recovery in the new EU member States gained further ground in 2014 thanks to emboldened domestic demand, gradual abandonment of fiscal austerity and a turnaround in the inventory cycle. The region is confronted with a difficult external environment, as prospects for the core euro area countries are downgraded; however, domestic demand is becoming an increasingly

important driver of growth. Although households' foreign-exchange-denominated debt still remains a major macroeconomic problem in some of those countries, private consumption is expected to strengthen in the outlook period, and investment is benefiting from the expansion in public sector projects. Inflation in the region hit record lows in 2014, thanks to lower food and energy prices; in a number of countries it was negative, and is expected to remain very low in 2015. Labour markets continued to improve, although the progress was very uneven across the countries. In the countries with flexible currencies, interest rates are reduced to record low levels and in 2015 monetary policy should remain accommodative. However, as deleveraging by foreign banks is not completely over yet, the recovery in credit markets is still lagging. The aggregate GDP of the new EU member States is expected to grow by 2.6 per cent in 2014, by 2.9 per cent in 2015 and by 3.3 per cent in 2016.

Economies in transition

CIS and Georgia: uncertainty damages economic prospects

In the CIS, economic expansion slowed down sharply in 2014. The geopolitical tensions in the region resulted in a difficult external environment with high levels of uncertainty. Economic activity in the Russian Federation came to a standstill, thus reducing growth prospects in the region; in Ukraine, a severe contraction in output followed years of sluggish expansion. Smaller CIS economies were affected by a contraction in the inflow of remittances. The prospects for 2015 are weak, due to the near-zero growth expected in the Russian Federation, the high cost of capital deterring private investment, and the possibility of further recession in Ukraine; however, some of the Central Asian energy-exporters will continue to see strong growth. Inflation in the CIS accelerated in 2014, as currency depreciations created price pressures in many countries, including in the Russian Federation. Despite the slowdown in economic activity, the unemployment rate in the Russian Federation reached historical lows during the year; by contrast, labour market conditions worsened in Ukraine and in lower-income Central Asian countries.

The aggregate GDP growth of the CIS and Georgia is expected to decelerate from 2.0 per cent in 2013 to 0.8 per cent in 2014, strengthening only modestly to 1.1 per cent in 2015 and 2.1 per cent in 2016. There are serious downside risks to this outlook related to the recent fall in oil prices: if prices remain depressed over the course of 2015, the economy of the Russian Federation may contract by several percentage points, face balance of payments and fiscal problems and difficulties in repaying external corporate debt, and risk a banking crisis. Such developments would have spillover effects on the entire CIS region.

South-Eastern Europe: South-Eastern Europe: slow recovery derailed by natural disasters

After returning to growth in 2013, overall economic activity in South-Eastern Europe slowed down in 2014, as massive floods in May caused severe damage in Bosnia-Herzegovina and

Serbia. As a result, the economy of Serbia contracted in 2014. Economic performance in the rest of the region modestly improved. External demand remained the main driver of growth in early 2014, driven by the improved performance in Europe. After contracting for two years, domestic demand also modestly recovered, with the notable exception of Serbia. Infrastructure, tourism and energy projects have supported economic expansion in the region. Growth is expected to pick up in 2015, boosted by reconstruction work in flood-affected areas and planned infrastructure projects, although high unemployment, ongoing fiscal adjustments and elevated indebtedness will constrain the speed of economic expansion. The aggregate GDP of South-Eastern Europe is expected to increase by 0.7 per cent in 2014; growth rates of 2.7 per cent and 3.0 per cent are projected for 2015 and 2016 respectively.

Developing economies

Africa: solid aggregate growth accompanied by significant downside risks

Africa's overall growth momentum is set to continue, with GDP growth expected to accelerate from 3.5 per cent in 2014 to 4.6 per cent in 2015 and 4.9 per cent in 2016. Growth in private consumption and investment are expected to remain the key drivers of GDP growth across all five subregions and all economic groupings, underpinned by increasing consumer confidence, the expanding middle class, improvement in the business environment and the reduction in the cost of doing business. Net exports will continue to moderately pull down growth. Inflation in Africa will remain flat, at an average of 6.9 in 2015, in the light of moderating global prices for commodities, food, oil and industrial imports, as well as prudent monetary policies. Government consumption will remain high and fiscal balances will remain negative, owing to infrastructure spending, public wage bills and social sector projects. However, its contribution to growth will decrease because of fiscal consolidation measures, mostly in Central, Southern and West Africa. A number of internal and external risks remain, such as a continued slow recovery in the developed countries, a slowdown in China, tighter global financial conditions, the Ebola outbreak, political instability, terrorism and weather-related shocks.

East Asia: growth projected to be robust, but downside risks remain

East Asia remains the world's fastest growing region, even as GDP growth slowed from 6.4 per cent in 2013 to 6.1 per cent in 2014. The outlook for the region as a whole is robust, with average growth forecast at 6.1 per cent in 2015 and 6.0 per cent in 2016. China's transition to more moderate growth of about 7 per cent is expected to be offset by higher growth in other economies, such as Indonesia, Singapore, Thailand and Viet Nam. In many economies, investment and exports are projected to pick up in the forecast period, supported by government programmes and a gradual recovery in developed countries. Household consumption is expected to remain strong following subdued infla-

tion, robust labour markets and generally low real interest rates. Fiscal policy remains moderately supportive of growth and most countries have sufficient space to provide additional stimulus, if necessary. The key downside risks for East Asia are related to the upcoming tightening of global liquidity conditions—which could result in weaker growth of domestic consumption and investment—and to a sharper-than-expected slowdown in China.

South Asia: growth set to strengthen, led by gradual recovery in India

Economic growth in South Asia is set to gradually pick up from an estimated 4.9 per cent in 2014 to 5.4 per cent in 2015 and 5.7 per cent in 2016. While the recovery will be led by India, which accounts for about 70 per cent of regional output, other economies such as Bangladesh and the Islamic Republic of Iran are also projected to see stronger growth in the forecast period. Growth is expected to be underpinned by a moderate strengthening of domestic consumption and investment as well as robust external demand. The recovery is, however, held back by persistent structural weaknesses, such as energy and infrastructure shortages, ongoing political instability and large fiscal deficits. With international oil prices declining, inflation has eased across the region, giving some central banks room to loosen monetary policy. At the same time, several countries, notably India, are likely to make progress in implementing economic policy reforms, thus providing support to business and consumer confidence. There are significant downside risks to the region's outlook owing to the continuing fragility of the global economy and considerable country-specific weaknesses, including fragile security conditions (particularly in Pakistan) and the agricultural dependency on the monsoon.

Western Asia: modest economic pickup is projected, despite serious downside risks

Lower oil prices and armed conflicts in Iraq, Gaza and the Syrian Arab Republic hampered economic growth in Western Asia throughout 2014. The external environment was also not conducive to growth for non-oil exporting countries, given the relatively subdued economic growth in many developed economies. On the domestic front, the Cooperation Council for the Arab States of the Gulf (GCC) partially offset weaker external demand for oil by increasing fiscal spending, whereas other countries, such as Turkey, had to implement restrictive policies, either to limit their fiscal deficit or to avoid further depreciation of the national currency and inflation pressures. As a result, GDP growth has

slowed to 3.0 per cent in 2014 from 3.7 per cent in 2013. During the forecast period, the aggregate economic situation is expected to pick up, although with only relatively modest GDP growth compared to previous years. Despite low oil prices, the economic forecast for Western Asia assumes that domestic demand will remain strong in GCC members, stimulated by ongoing public investment in infrastructure. Nevertheless, this will depend on each country's fiscal breakeven price and financial reserves accumulated in recent years (see Monthly Briefing No. 73). Turkey will benefit from better external demand, provided that the depreciation of the national currency will continue to help the export sector, with GDP projected to grow by 3.3 per cent in 2015 and 4.0 per cent in 2016. The downside risks notably include any possible further fallout from the conflicts in Iraq and the Syrian Arab Republic. Moreover, should the Brent oil price remain below \$70 per barrel, it would hurt business confidence significantly in GCC countries and limit fiscal expansionary policies.

Latin America and the Caribbean: moderate recovery is expected for 2015, but significant downside risks remain

Latin America and the Caribbean continues to face challenging economic conditions, amid serious domestic weaknesses and a less supportive external context, particularly lower commodity prices. After meagre economic growth of 1.3 per cent in 2014, the region is expected to improve moderately to an average growth of 2.4 per cent in 2015, although with considerable cross-country differences and significant downside risks. Among the subregions, Mexico and Central America are forecast to expand by 3.5 per cent in 2015, up from 2.6 per cent in 2014. By contrast, South America is expected to grow by only 1.9 per cent, compared to 0.7 per cent in 2014. The Caribbean economies are expected to expand by 3.8 per cent, similar to 2014. Despite considerable heterogeneity among countries, investment demand is estimated to gradually pick up after a continuing slowdown in recent years, led by the implementation of large public investment projects in countries such as Brazil, Chile and Mexico. Accommodative monetary conditions and supportive fiscal stances are also expected to support economic activity in some countries. On the external front, a sustained recovery of the United States is projected to further benefit Mexico and Central America through trade, tourism and remittance channels. The downward risks are related to the political gridlock on the implementation of some reforms, a larger-than-expected slowdown in China and potential financial spillovers from the expected increments of interest rates in the United States.