

Monthly Briefing on the World Economic Situation and Prospects

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Summary

- World economy will contract by 2.6 per cent in 2009; recovery in 2010 is possible, but risks of prolonged recession are high.
- Developing countries are disproportionately hit by the crisis.
- Fiscal responses, while significant, are asymmetric: more financial transfers to developing countries are needed as part of better coordinated global efforts.

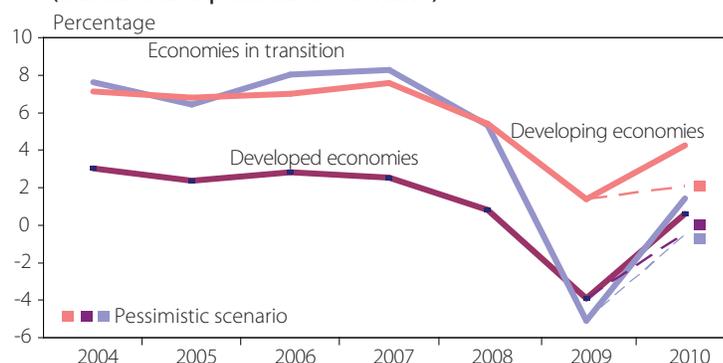
Global issues

Prospects for 2009 remain bleak; conditions for recovery are highly uncertain

The world economy is in the worst recession since World War II. According to the preliminary revised United Nations forecasts, world gross product (WGP) is expected to fall by 2.6 per cent in 2009, compared with an average rate of growth of more than 3 per cent in the years prior to the crisis (figure 1).¹ A mild recovery in WGP growth is expected in the baseline scenario for 2010, but this will require that fiscal stimulus measures worldwide gain traction and that financial sector problems ease during 2009. Even as some observers see “glimmers of hope”, most key economic indicators suggest that the recession is far from bottoming out. Risks for a more prolonged recession remain very high. The collapse of global trade is still ongoing, financial sector deleveraging continues, and business and consumer confidence are at very low levels in most economies.

Developing countries suffer from capital reversals, falling export earnings and declining remittances. Growth of per capita GDP is expected to drop to zero on average for all developing countries, down from 4 per cent in 2008 and an average of 6 per cent per year during 2004-2007. The setbacks are across the board, but strongest in the Commonwealth of Independent States (CIS), sub-Saharan Africa and Latin America. At least 60 developing countries are expected to suffer negative per capita income growth (figure 2). This will imply significant setbacks in poverty reduction. Compared with a scenario of continued pre-crisis growth, UN-DESA estimates that an additional 105 to 145 million people—across all developing regions—will remain poor or fall into poverty. Unless urgent countercyclical action is undertaken, there will be major disruptions in the hard-won progress made towards the other Millennium Development Goals (MDGs) as well.

Figure 1: Real GDP Growth 2004 - 2010
(baseline and pessimistic scenario)



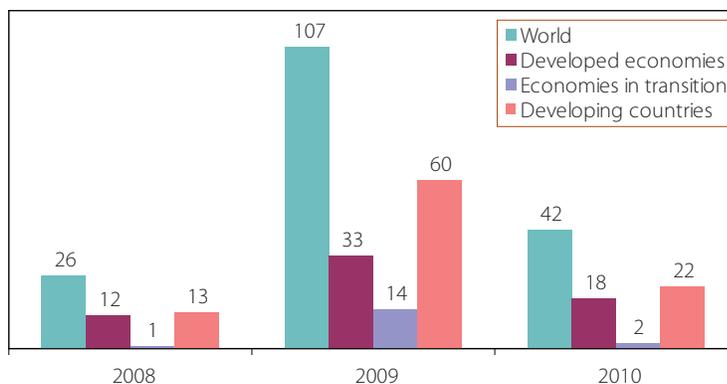
Source: Department of Economic and Social Affairs of the United Nations Secretariat.
Notes: Data for 2008 are partly estimated. Data for 2009 and 2010 are preliminary forecasts based in part on Project LINK (solid lines for 2010 reflect the baseline scenario, dotted lines the pessimistic scenario). Final forecasts will be presented in the WESP mid-2009 update which will be released on May 26, 2009.

¹ Final United Nations forecasts for 2009 and 2010 will be provided in United Nations (2009) *World Economic Situation and Prospects Update as of mid-2009* (to be released 26 May 2009 and made available at <http://www.un.org/esa/policy/index.html>).

Unprecedented global response is still not enough

The global policy response so far has been unprecedented. Monetary, financial and fiscal measures to stabilize financial markets and revive global growth total more than \$20 trillion, or 30 per cent of WGP. In addition, the G20 Summit in April 2009 reached an agreement to substantially increase the resources of international financial institutions, which was subsequently confirmed at the IMF/World Bank Spring meetings. However, more than 80 per cent of the countercyclical response is concentrated in the developed countries and little of the response is being coordinated. In particular, the asymmetries in the capacity to respond have not been adequately addressed so far. Most developing countries lack the fiscal space to engage in such responses. Therefore, a much larger share of the additional resources—both short-term liquidity and long-term development financing—will need to be made available to developing countries, especially the low-income countries, to help them mitigate the impact of the crisis, strengthen social safety nets and increase investments with a view of reinforcing economic resilience and ensuring progress towards long-run sustainable development goals.

Figure 2: Number of countries with declines in GDP per capita



Source: Department of Economic and Social Affairs of the United Nations Secretariat, including population estimates and projections from *World Population Prospects: The 2006 Revision*.

Notes: 2008 data are partly estimated. 2009 and 2010 data are forecast, based in part on Project LINK.

Developed economies

United States: unemployment rises sharply as economy remains in recession

In the baseline scenario, GDP in the United States is expected to contract by 3.5 per cent in 2009, and to grow by a mere 1.0 per cent in 2010. The credit crisis and the slump in the housing sector continue, along with a sharp retrenchment in both business investment and household consumption. Consumer confidence has fallen to its lowest level in 30 years owing to reduced household wealth and rising unemployment. Policy measures have been scaled up significantly in early 2009, including a continuous expansion of the balance-sheet of the Federal Reserve Bank, a new fiscal stimulus package of \$787 billion, and the Public-Private Investment Program of more than \$1 trillion to dispose of the legacy assets. However, it will take time for these measures to cleanse the clogged financial system and to restore economic growth. Uncertainties remain about the actual effects of the policy measures. The risk for the economy to fall into a protracted deflation is increasing as financial deleveraging continues and unemployment rises sharply. The unemployment rate is expected to further increase from 8.5 per cent in March 2009 to about 10 per cent by the end of the year.

Western Europe and the EU: economies are mired in deep and prolonged recessions

Western Europe is in the depths of a severe recession with activity expected to rebound only marginally at the end of 2009 and into 2010. In the Euro area, GDP is expected to decline by 3.7 per cent in 2009 after registering 0.8 per cent growth in 2008. Despite the assumption that current fiscal and monetary stimuli gain some traction over the course of 2009, the EU economies should expect no more than a gradual stabilisation of activity with an expected near zero growth of GDP in 2010. Economic woes differ across the Western European countries as these face differing degrees of exposure to downturns in housing markets, construction sectors, manufacturing exports and banking sectors. Across the region, though, unemployment rates are surging and are expected to continue to increase even after the decline in output has stopped. On average, the unemployment rate in the Euro area is expected to increase to 10 per cent in 2009, up from 7.5 per cent in 2008.

The new EU member States: countries are severely hit by financial turmoil

The economies of the new EU members, especially those of the Baltic States, have sharply deteriorated since mid-2008. The region is affected by very weak import demand from the EU-15 as well as by the global financial crisis through sharply increased costs of external borrowing, deleveraging by foreign banks, a squeeze of liquidity in inter-bank markets, and the abrupt slowdown in domestic credit growth. The combined GDP of the new EU members is expected to shrink by 1.7 per cent in 2009 and to recover only modestly by 1.5 per cent in 2010. The Governments and Central Banks have implemented measures to strengthen confidence in the financial system and to boost the economies. However, discretionary fiscal spending is constrained by financing difficulties, the conditionality of IMF-led assistance packages and the commitment to maintain exchange rate stability against the backdrop of a highly indebted private sector.

Japan: policymakers fight deepest recession in three decades

The Japanese economy is now falling into a deep recession. The severe downturn in global demand, particularly for automobile products and information technology and machinery goods, has led to a collapse in Japan's exports, which in turn resulted in falling corporate

profits, tightening financial conditions, rising unemployment, declining household wealth, and weakening domestic demand. In response, the Central Bank has reduced interest rates, along with other measures to stabilize financial markets and facilitate corporate financing. The Government has adopted fiscal stimulus measures, with additional government spending totalling about 5 per cent of GDP. In the outlook, GDP is expected to fall by 7.1 per cent in 2009, with a mild recovery anticipated in 2010.

Canada: economy is hit by the US recession

The economic outlook for Canada remains grim as poor business expectations and low consumer confidence, coupled with the recession in the United States and the fall in global trade, will result in a GDP contraction of about 3 per cent in 2009. Unemployment will increase to an annual average of about 9 per cent in 2009, up from 5.8 per cent at the end of 2007. Next year, the fiscal expansion in Canada and the rest of the world may trigger a return to positive growth of about 0.5 per cent.

Australia and New Zealand: recovery depends on improvement in external conditions

The economies of both Australia and New Zealand are contracting in 2009. The recovery in 2010 will highly depend on an improvement of the international financial markets and global demand.

Economies in transition

External shocks cause sharp contractions of economic activity

After strong economic growth of over 7 per cent for several years in a row, economic conditions in the CIS have deteriorated sharply since the global financial and economic crisis hit the region. On average, GDP in the CIS is expected to contract by 5.4 per cent in 2009 followed by a weak recovery in 2010. This significant downturn is largely driven by falling prices for oil, gas, cotton and metals, tightening credit conditions and reduced external demand. The deeper-than-expected slump reflects large swings in the growth rates of the largest economies—the Russian Federation, Ukraine and Kazakhstan—where declines in industrial output, construction and investment were followed by shrinking consumption in the first quarter of 2009. Unemployment is on the rise throughout the CIS, with significant disparities within countries. To mitigate the impact of the external shocks, some Governments in the region that have accumulated funds during the years of high oil prices, such as the Russian Federation and Kazakhstan, introduced fiscal stimuli to boost liquidity and aggregate demand. Other economies, such as Belarus, Armenia, Kyrgyzstan and Ukraine, have turned to the IMF for support of their currencies and balance-of-payment positions.

The economies of South-eastern Europe weakened sharply since the last quarter of 2008. The sub-region suffered massive setbacks owing to shrinking exports, lower FDI and portfolio capital inflows, declining remittances, slowing domestic credit growth, and higher costs of external financing. The decline in export demand has led to a slowdown in manufacturing and extractive industries. Weak domestic demand has caused a sharp slowdown in the construction sector and in financial intermediation. As a result, all economies of the sub-region, with the exception of Albania, are forecast to see negative GDP growth in 2009. The combined GDP of the region is expected to decline by 1.9 per cent in 2009 before increasing by 1.0 per cent in 2010.

Developing economies

Africa: economic outlook deteriorates due to external factors

Africa's growth perspectives have deteriorated severely as a result of contracting world demand and lower capital inflows, including foreign direct investment, portfolio capital, remittances, and tourism revenues. In 2009, average growth is expected to slow to 0.9 per cent, from 4.9 per cent a year before. Oil exporters like Angola and Nigeria are predicted to contract by 2.4 and 0.5 per cent respectively, while growth in South Africa is forecast at -0.8 per cent owing in particular to a contraction of the manufacturing sector. Botswana, Mauritius, Morocco and Tunisia are also strongly affected as they mainly export manufactured products to high-income countries. Food-exporters might be more resilient as the demand for such commodities has not declined substantively. The credit squeeze forced Kenya, Nigeria, Tanzania and Uganda to postpone their Eurobond issuance, harming planned essential infrastructure investment. Meanwhile, the depreciation of many currencies led to higher import prices, offsetting much of the decline in world market prices and keeping domestic food prices well above pre-2008 levels. Assuming there will be moderate global recovery, Africa's growth is expected to pick up in 2010, averaging 4.0 per cent for the year.

East Asia: growth is slowing sharply as exports and investment decline

East Asia is facing a severe economic downturn since the global financial crisis deepened in September 2008, with merchandise exports and industrial production continuing to drop sharply. Falling external demand, tightened access to credit and increased economic uncertainty have also precipitated significant declines in domestic investment spending across the region. Average growth in East Asia is

expected to slow from 6.1 per cent in 2008 to 3.0 per cent in 2009 despite massive monetary and fiscal stimulus measures. China is forecast to register relatively robust growth of 7.6 per cent in 2009 as the Government's large fiscal stimulus package is expected to strengthen domestic consumption and investment expenditure. In 2010, average growth in the region is expected to increase to 5.6 per cent on the back of a moderate recovery in global demand. With manufacturing output plummeting, unemployment across the region is expected to rise considerably in 2009. While inflation across East Asia will continue to fall throughout most of this year, the risk of a sustained deflationary spiral of declining output and prices appears to be low.

South Asia: resilience in domestic demand mitigates the downturn

The global economic and financial crisis hit South Asia at a time when most economies were still struggling with the adverse effects of surging international commodity prices, including increased fiscal and current account deficits and higher inflation. Nevertheless, the economic downturn in South Asia is expected to be less severe than in other developing regions since manufacturing exports account on average for a small share in GDP and domestic demand is anticipated to hold up reasonably well in most countries. Average growth is forecast to drop from 6.8 per cent in 2008 to 4.1 per cent in 2009 before recovering to 5.4 per cent in 2010. Despite rapidly weakening export demand, India is expected to achieve fairly robust growth of 5 per cent in 2009 on the back of increased government expenditures and resilient private consumption. In Pakistan, where a \$7.6 billion IMF emergency package helped to avert a balance-of-payment crisis, growth is forecast to slow to 2.2 per cent in 2009. Inflation across the region has fallen markedly since mid-2008, but remains elevated in several countries owing to increased inflationary expectations and a weakening of local currencies relative to the dollar. The scope for fiscal stimulus in the region is limited as a result of considerable cumulative budget deficits in recent years and relatively high levels of public debt. Nonetheless, Bangladesh, India, and Sri Lanka have announced fiscal stimulus packages.

Western Asia: lower oil prices and declining trade weigh on economic activity

After growth of 4.5 per cent in 2008, Western Asia is expected to see an economic contraction by 0.7 per cent in 2009 and a return to positive growth of 2.9 per cent in 2010. The fall in oil prices and cuts in oil production are main factors behind the economic slowdown in the region. In 2010, with oil prices expected to trend upwards, growth in the oil-exporting countries is likely to recover. In the non-oil exporting countries, economic activity is expected to be depressed by the sharp contraction in global trade and a slowdown in tourism. The fiscal stimulus packages initiated in major economies such as the United States and China have the potential to stabilize external demand in the region in 2010, which in turn would support domestic consumption and investment. Throughout the region, unemployment is expected to increase in 2009 owing to weakening economic activity and a continued increase in the labour pool as a result of rapid population growth in recent decades. This puts additional strains on fiscal budgets as expenditures on social welfare and employment creation increase.

Latin America: economies woes rise as domestic and external demand weaken

Economic activity in Latin American countries deteriorated at a faster-than-expected pace since the end of 2008, dragged down by weakening external demand and a rapid contraction of domestic demand owing to tight credit conditions and fears about growing unemployment. In 2009, on top of the deteriorating external environment, consumer confidence remains sluggish and industrial activity continues to contract, as observed in several countries, including Brazil and Mexico. At the same time, the slowdown in capital inflows will remain a main concern, creating difficulties for investment financing. Accordingly, the combined GDP of the region is expected to shrink by 1.8 per cent. Mexico and the Central American countries will experience the strongest economic contractions as they suffer most from the recession in the United States. South American countries will be impacted most by lower commodity prices, which negatively affect their terms of trade and fiscal revenues. Despite aggressive monetary easing in several countries, including Brazil and Chile, a deceleration in credit growth will continue to affect private consumption and investment. The Caribbean will see mild growth in 2009, reflecting a sound economic performance in Cuba, which benefits from the easing of US restrictions.

Least Developed Countries: as growth slows sharply, importance of aid increases

While most LDCs escaped the direct effects of the sub-prime crisis owing to their lack of integration into the international financial system, they were not immune to the global economic slowdown. Average growth in LDCs will slow from 6.1 per cent in 2008 to 2.7 per cent in 2009, the lowest rate since 1994. Without Bangladesh, average growth in LDCs would fall to 2.1 per cent in 2009. A total of 18 LDCs are expected to experience negative per capita income growth. Foreign aid remains critical to development efforts in the LDCs, particularly in some East African countries with ratios of aid to government spending as high as 60 per cent in some countries as is the case in the post-conflict countries of Liberia, Uganda and Sierra Leone. These could be hard hit if aid budgets in donor countries come under pressure because of the crisis. It is therefore crucial, especially for these fragile states, that the international community deliver on its commitments. ■