

Monthly Briefing

World Economic Situation and Prospects

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Summary

- According to preliminary UN estimates, the world economy will shrink by 2.2 per cent in 2009.
- There are clear indications that recovery is on its way and global output may increase by 2.4 per cent in 2010, according to the preliminary UN forecast. Recovery is still very fragile, however.
- A key risk is a premature withdrawal of the stimulus measures in major economies, which presently is a key factor driving the incipient recovery. Pursuing further stimulus now while at the same time ensuring a more sustainable and balanced global growth for the future is a main challenge facing policy makers collectively.

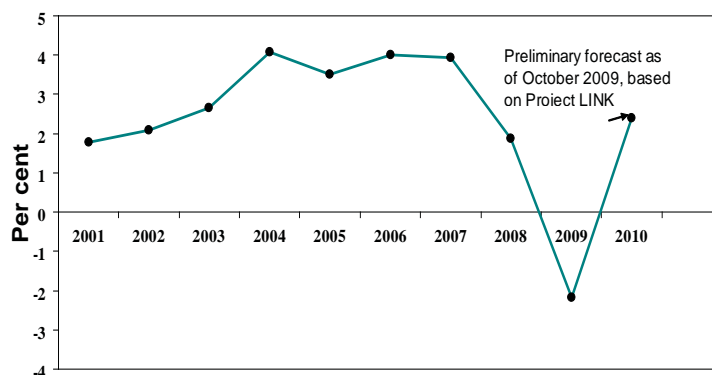
Global issues¹

After a sharp and synchronized global downturn in 2008 and most of 2009, the world economy is showing signs of improvement. According to preliminary UN estimates, World Gross Product (WGP) is estimated to register a decline of 2.2 per cent in 2009, even as an increasing number of economies have shown positive output growth since the second quarter of 2009. Premised on the assumption of a continued supportive policy stance worldwide, the preliminary UN forecast projects a mild growth of 2.4 per cent is forecast in the baseline outlook for 2010 (figure 1).

Since March 2009, financial markets worldwide have stabilized while international trade and industrial production in major economies have rebounded, moving the global economy away from the abyss where it stood in the beginning of the year when everything seemed to be in a free fall. Yet, much of the rebound is still very fragile, making prospects of a sustained recovery still highly uncertain. In developed economies, despite a decline in the risk premiums on lending, credit supplies to support private investment and consumption remain extremely tight and much of the recovery in international trade and industrial production seems linked to a cyclical adjustment in inventories. The still rather modest rebound of global aggregate demand rests further on the fiscal stimulus measures. However, the effect of both these factors, policy stimulus and inventory adjustment, should be expected to diminish in 2010.

Still rising unemployment rates and persistent large output gaps in most countries, along with other factors, such as the possibility of further spread of the H1N1 influenza pandemic, could significantly limit global economic recovery. There

Figure 1: Growth of world gross product



¹ This issue of Monthly Briefing is based on the LINK Global Economic Outlook (GEO), which can be found at <http://www.un.org/esa/policy/link/presentations09/geo200910.pdf>. The LINK GEO is customarily prepared in anticipation of the *World Economic Situation and Prospects* (WESP) and presents a preliminary perspective of the United Nations' outlook for the world economy. WESP 2010 with the definitive forecast will be first launched in early December 2009 and the full report will be available from the second week of January 2010.

is also a risk of a re-emergence of the trend towards widening global imbalances, which were a key factor at the origin of the present crisis. Such a return to past patterns of unbalanced global growth could well lead to significant erosion of confidence in the value of the United States dollar, which could be a source of renewed global financial instability.

Recovery may not be sustained, unless stimulus measures are continued and perhaps stepped up, as also recognized by leaders of the G20 at the Pittsburgh Summit. Concerns should not only be with the stimulus per se, but also with its coordination, so as to ensure a more balanced growth recovery in avoidance of further widening of the global imbalances, and with its alignment with long-term sustainability of global growth.

Developed economies

United States

The United States economy seems to have passed the trough of the worst recession since the Second World War, caused by the bubble-cycle of the housing sector and the associated credit crisis. The reduced value of housing and financial assets and the surge in unemployment induced households to adjust their consumption behavior in the form of higher savings. Both business and residential investment suffered a shock of a severe magnitude. With a slump in the first half of the year, the growth rate for 2009 as a whole is expected to be -2.5 per cent. Since mid-2009, signs of a turn-around have emerged in the housing sector. The predicted stabilization of the housing market is expected to help the recovery of private consumption. A modest GDP growth of 2.1 per cent is forecast for 2010.

By the end of October 2009, the unemployment rate in the United States surpassed 10 per cent, the highest level in 26 years, and is expected to stay at an elevated level well into 2010. Simultaneously, there has been decline in wage growth. Downside risks to the forecast include the possibilities for a downward spiral in financial markets, soaring unemployment and a continuing drop in capital spending.

Western Europe and the EU

Economic activity in Western Europe continued to weaken in the first quarter of 2009, as exports dropped and investment spending reeled from the multiple shocks emanating from the financial crisis and the greatly weakened business sentiment. The second quarter of the year displayed signs of a stabilization of activity. France and Germany both registered positive growth, while Italy, Spain and the United Kingdom continued to contract but at a marginal rate. Leading indicators began to signal a possible turning point in March, with indices of economic sentiment indicating a gradual improvement in overall confidence. Industrial production has been continuously increasing since May.

Fiscal policy has played a major role in softening the impact of the numerous global shocks on the region. The recovery is expected to broaden across countries during the second half of 2009, but given the weakness at the beginning of the year, the aggregate GDP of the EU15 is expected to fall by 4.2 per cent in 2009 and will grow by about 0.5 per cent in 2010. Downside risks to further recovery in 2010 include further deterioration in labour markets, a premature removal of fiscal stimuli as well as a premature tightening of monetary policy.

The new EU member States

The new EU member states in 2009 recorded massive output losses as a result of collapsing export demand for their key industries and the serious distress of their financial systems. With the exception of Poland, all new EU member states will see a decline in GDP in 2009.

The sharply increased costs of external finance, deleveraging by foreign banks and the overall risk aversion have led to a liquidity crisis in inter-bank markets and a credit crunch in the region. To protect the financial system, some of the Governments in the region negotiated international assistance packages. Such assistance, led by the EU and the IMF, was provided to Latvia and Hungary in 2008 and to Romania in 2009. In addition, Poland has negotiated a precautionary flexible credit line facility with the IMF in 2009. The aggregate GDP of the new EU member States will decline by 3.4 per cent per cent in 2009, but is expected to recover by 1.6 per cent in 2010. The recovery is surrounded by great uncertainty.

Downside risks to the forecast include a delayed recovery in Western Europe and a failure to revitalize domestic banking systems.

Developed Asia and Pacific

The economy of *Japan* is recuperating from the worst recession in three decades. Since the second quarter of 2009, exports and industrial production have rebounded. A mild recovery of 1.7 per cent is expected for 2010, compared with an estimated slump of 5.6 per cent in 2009. The relatively high unemployment rate and the large slack in production capacity will, however, persist, with deflation remaining a key risk in the outlook. Various fiscal stimulus packages have been launched since mid-2008, including additional government spending totalling about 5 per cent of GDP. Fiscal and monetary stimuli are expected to continue into 2010 and are expected to remain a key factor in driving the recovery in aggregate demand.

The economy of *Australia* has managed to avoid falling into a recession amid the global financial crisis, as aggressive stimulus measures have supported consumption and investment to offset the external shocks. GDP is expected to grow by about 1.3 per cent in 2010, compared with an estimated 0.8 per cent in 2009. *New Zealand* showed a positive GDP growth in the second quarter of 2009, the first time since the end of 2007, ending its prolonged recession. While net exports made a solid contribution, both household consumption and business investment also increased, driven by record-low interest rates. GDP is expected to grow by 2.8 per cent in 2010, recovering from a decline of 1.3 per cent in 2009.

Economies in transition

CIS

The combined economy of the CIS is forecast to contract by 6.6 per cent in 2009. The significant economic contraction is largely a result of the decline in Russia and Ukraine. In fact, only Azerbaijan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan are likely to register positive growth rates in 2009. Overall, a return to positive, yet weak, growth of up to 1.7 per cent in 2010 is possible, although this depends on the external economic environment.

The global economic crisis affected the CIS through diminished export revenues due to lower commodity prices, lower demand for exports in the region's main export markets and a withdrawal of capital. Also, in many countries foreign direct investment (FDI) decreased and credit was curtailed as profits were repatriated in an attempt of financial institutions abroad to deleverage and to consolidate their balance sheets. Unemployment is increasingly becoming a concern in the region. The jobless rate is forecast to reach 10 per cent by the end of 2009 in the Russian Federation.

The resource-rich countries have been able to tap into their foreign-exchange reserves to finance their countercyclical fiscal measures. Other CIS countries needed standby arrangements with the IMF to obtain emergency financing and to avoid economic collapse.

South-Eastern Europe

The economies of South-eastern Europe slipped into a recession in 2009. Exports of the region dropped by 25 to 30 per cent, FDI declined significantly, portfolio capital inflows became negligible, domestic credit markets stagnated and the flow of remittances has shrunk. As a result, all South-east European economies, except Albania, will register negative GDP growth in 2009. Economic expansion in 2010 will be hindered by weak export prospects, delays in FDI-related projects and the limited availability of credit. Rising unemployment, higher taxes and declining real estate values will constrain private consumption. The aggregate GDP of the region, after shrinking by 3.4 per cent in 2009, will expand by only 0.7 per cent in 2010.

Developing economies

Africa

Signs of a recovery begun to appear in Africa and economic prospects for many mineral- and oil-exporters look brighter than they were in early 2009, in particular as world market prices of oil, minerals and metals have rebounded notably from the second quarter of the year. While economic conditions vary considerably, almost all African economies still have a long way to go for a return to the high rates of growth achieved during 2002-2007. Considerable economic difficulties remain in the two largest sub-Saharan African economies. In South Africa, manufacturing activity and the labour demand remain depressed. In Nigeria, the banking system is under severe distress. More worrisome, hunger levels are soaring in East Africa where seven countries have been experiencing a severe and persistent five-year drought.

The average growth for Africa is estimated to be around 1.6 per cent in 2009, below the rate of population growth of 2.3 per cent. The consequent decline in per capita income marks an unfortunate reversal of the strong performance during 2002-2008, when per capita income growth exceeded 3 per cent per annum. As global demand and commodity prices, as well as capital inflows are expected to recover, Africa's growth could average 4.3 per cent in 2010.

East Asia

The East Asian economies rebounded strongly in the second and third quarters of 2009, following sharp downturns over the previous six months. In China, Indonesia, the Philippines, Thailand, and Viet Nam, strong increases in government spending have been key drivers of the recovery. In addition, aggressive monetary easing fuelled credit growth and domestic demand, most notably in China and Viet Nam. The gradual recovery of exports and manufacturing output during the second quarter also contributed to the rebound in economic activity across the region.

In the majority of countries fiscal policy is likely to remain expansionary during the first half of 2010 before Governments begin to move to a more neutral stance. Malaysia and a few other countries may start to tighten at the beginning of 2010.

Growth across the region is projected to gain further momentum, averaging 6.6 per cent in 2010 as global demand continues to recover. The region faces a number of downside risks, such as a renewed downturn of global demand for manufacturing goods. Continued large capital inflows, combined with strong domestic credit growth, could fuel asset bubbles and inflationary pressures, forcing central banks to tighten monetary policy.

South Asia

South Asian economies, most notably Bangladesh and India, have shown considerable resilience owing to robust domestic demand and relatively limited dependence on exports. The slowdown in growth over the past year was less severe than in other developing regions. Several economies, including India, Sri Lanka and possibly Pakistan, seem to have passed the lowest point of the downturn. Merchandise exports across the region have fallen sharply since the global financial crisis intensified. This has been partially offset by domestic demand supported by continued strong growth in remittance inflows, reduced inflationary pressures, accommodative monetary policies and sizeable fiscal stimulus measures in several countries. Average growth in South Asia is nonetheless projected to decline from 6.1 per cent in 2008 to 4.7 per cent in 2009, the lowest rate since 2001. In 2010, economic activity across South Asia is expected to gain further strength, particularly in India and Sri Lanka, with average regional economic growth forecast at 5.5 per cent.

Western Asia

West Asia experienced an economic contraction of 1.2 per cent in 2009, driven in particular by lower oil prices, a fall in external demand and less investment inflows. In 2010, the region is forecast to experience a rebound in economic growth to 3.8 per cent, underpinned by a solid performance of the oil-exporting economies in light of higher oil prices. Non-oil exporters, by contrast, will face greater problems in regaining their footing, with continued weakness in global demand putting pressure on exports.

Latin America and the Caribbean

Overall economic activity in Latin American and the Caribbean fell by 2.2 per cent in 2009. Mexico, whose economy declined by 10.4 per cent in the first half of the year, as well as Central American countries are showing the strongest negative growth figures this year. In 2010, the region is forecast to see economic recovery of 2.9 per cent.

Latin American and Caribbean economies suffered primarily from weak external demand and lower export prices. Since the beginning of 2009, the inflow of remittances has fallen markedly. This led to a rapid contraction of private consumption and investment. Counter-cyclical policies prevented a much sharper deceleration in several countries. The region as a whole is expected to recover in 2010 mainly due to the rebound of commodity prices and higher external demand. The pace of recovery is expected to vary across the region, however.

The regional unemployment rate is expected to increase to 8.5 per cent in 2009 and is expected to stay high into 2010. This will limit income growth for workers, and hence domestic demand, in the outlook. Also the space for further countercyclical measures in 2010 is limited in most countries, making the recovery highly dependent on what happens in the world at large. ■