



## UN: Uncertainties, risks and policy constraints imperil economic rebound in 2003

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(NEW YORK, 9 January) – The gradual world economic recovery that is underway is held hostage to a number of imminent risks, and policy makers have limited room for manoeuvre in response, UN analysts warned today, in an assessment of year-ahead prospects. Despite the 2001-2002 shakeout in equities and tech investment, impediments to a decisive return to strong world economic growth in 2003 and beyond remain, in the form of overcapacity, overvalued asset prices, shaky investor confidence and macroeconomic imbalances, the United Nations said.

Following a slow start, the world economy is expected to pick up steam in the second half of 2003. After an expansion of only 1.7 per cent in 2002, the world economy is projected to grow by 2 3/4 per cent this year, the UN projects in *World Economic Situation and Prospects 2003*.

But in the developed countries, falling equity values and weak business spending are constraining economic recovery, with weak and volatile equity prices contributing to the erosion of consumer and business confidence. Despite two years of historically large corrections, stock prices remain overvalued according to traditional benchmarks. A prolonged depression in major equity markets could trap the global economy in a protracted period of low growth or even send it into a tailspin, the UN warns.

Because the United States remains the main engine of the global economy, limits to the sustainability of the US trade deficit and the value of the dollar pose another major downside risk of global proportions. The recent addition of a government deficit to the trade deficit in the US "may render the adjustment process more complicated than anticipated previously", the report says.

An added complication comes from rising geopolitical tensions in West Asia, which have already pushed up oil prices and dampened business and consumer confidence. If military action were to take place in West Asia, it "would be a further brake on world economic growth", the UN says.

"The United States will continue to lead the global recovery, but without significant momentum", the UN report says. "With domestic demand lacking vigour, economic recovery in Japan and Western Europe continues to rely chiefly on external demand and will remain fragile."

Table 1. Global economic growth and world trade, 2002-2003  
(Annual percentage change)

	2002 (estimated)	2003 (forecasted)
Gross world product	1.7	2 3/4
PPP weighted	2.6	3 1/2
Developed market economies	1.3	2 1/4
Japan	-0.4	1
United States	2.4	3
EU-15	1.0	2
Economies in transition	3.5	4
Russian Federation	4.0	4
Developing countries	2.9	4 1/4
Latin America and the Caribbean	-0.7	2 1/4
Africa	2.9	4
South and East Asia	5.2	5 1/2
China	7.2	7
Western Asia	1.3	3
World export volume	2.3	6 1/4



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Most other countries continue to be afflicted by the overall weakness in the world economy. But in contrast, domestic demand in China has been important not only in sustaining the country's own high growth during the global slowdown but also in providing some stimulus to exports from other countries, particularly in East Asia. Domestic demand has also provided many of the economies in transition with some cushion against weak global markets, and growth in these countries is projected to remain firm in the year ahead. (See Table 1.)

## **Uneven trade recovery and reduced FDI**

World trade is forecast to grow by a modest (relative to expansion in the 1990s) 6 per cent in 2003, following less than 2 per cent in 2002 and a decline in 2001. Key to the prospects of several developing countries, the weakness of global demand has exerted downward pressure on the prices of non-oil commodities, although many dollar-denominated prices rose because of the depreciation of that currency. In addition, low investor confidence has reduced inflows of private capital, making 2002 the sixth consecutive year in which developing countries made a net outward transfer of financial resources.

Flows of foreign direct investment (FDI) to developing countries are estimated to have declined by about one-fifth in 2002, to some \$165 billion, according to the UN Conference on Trade and Development (UNCTAD). This marks a level of barely one-third of the peak attained in 2000. Once again, the noteworthy exception was China, which surpassed the United States as the largest recipient of FDI in 2002.

There is some hope that financial flows to developing countries will increase if the rich countries deliver on the promises of additional aid that were made in the context of the Financing for Development Conference in March 2002 and as a result of the on-going efforts to resolve developing countries' debt problems. The report is less sanguine about immediate prospects for fundamental improvements in the international trading system, because several 2002 deadlines in the Doha work programme were not met.

## **Policy squeeze**

Accommodative national macroeconomic policies in many of the leading economies over the past year have been helpful in preventing the world from falling further into a widespread downturn, the UN finds.

But most other countries have been constrained in their ability to adopt policy stimuli and the measures implemented have proven insufficient for activating a strong global recovery.

In particular, many developing countries faced a deteriorating fiscal situation and increased balance-of-payments pressures born of falling non-oil commodity prices and slackening investor flows. This in turn severely limited their ability to adopt countercyclical policies.

"A number of economies in Latin America were mired in such a vicious cycle in 2002, and remain vulnerable to a further deterioration", the report says.

"The sluggish economic recovery suggests the need for more fiscal stimuli, but the majority of economies are facing growing difficulties in adopting such measures because the global slowdown has worsened budget balances due to a fall in tax revenues, or a rise in government expenditures, or both."

The UN report calls for greater macroeconomic policy coordination among the major economies, with a varying mix of stimulatory monetary and fiscal policy measures within countries, as a means to revive global growth. Thus, countries with high fiscal deficits could rely more on monetary measures, while those with constraints on interest rates could exercise more flexibility in stimulative spending. In either case, short-term measures to revive world economic growth and improve prospects for achieving the Millennium Development Goals should not undermine fiscal responsibility in the medium and long term, the UN says.

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*World Economic Situation and Prospects 2003* is prepared jointly by the UN Division for Development Policy Analysis and the UN Conference on Trade and Development (UNCTAD). It is published annually as a companion volume to the United Nations flagship economic publication, *World Economic and Social Survey*, issued by the United Nations each year in July.

For more information, contact Tim Wall of the UN Department of Public Information at 1-212-963-5851; [wallt@un.org](mailto:wallt@un.org)