# World Economic Situation & Prospects

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## Strong global growth in 2005 hostage to how dollar and global imbalances unwind

(UNITED NATIONS, NEW YORK, 25 January) Global imbalances, and the United States trade deficit in particular, will not be corrected by a rapidly falling US dollar, contrary to many expectations, the United Nations warns today, in an otherwise upbeat assessment of the world economy at the beginning of 2005.

The cyclical economic recovery is peaking, the UN says, after a successful year in 2004, especially for developing countries *(see tables).*

But "the possibility of an abrupt and globally damaging correction persists, since a depreciation of the dollar alone seems unlikely to be sufficient to reduce the global imbalances to sustainable levels in an orderly fashion," according to *World Economic Situation and Prospects 2005,* launched today in New York. The UN report follows the release of November figures showing an acceleration in the accumulating US trade deficit.

The decline of the dollar is failing to bring about a correction because the United States is in the unique position of holding its debt in its own currency, which is the main currency of global exchange. Some of the weakening effects usually associated with depreciation are exported to US creditors, who suffer a loss of wealth because their large dollar holdings are now dwindling in value. The decline takes a toll on global demand, which softens the benefits to US exporters of the increased competitiveness provided by a cheaper dollar.

In essence, the global imbalance is between consumption and debt in the United States, and ballooning surpluses in many US trading partners. Currency changes by themselves, and especially bilateral currency manipulation, will not resolve the problem.

United Nations

**Growth of world output and trade, 1995-2005 (Annual percentage change)**

| | 2001 | 2002 | 2003 | 2004[a] | 2005[b] |
|---|---|---|---|---|---|
| **World output[c]** | **1.3** | **1.9** | **2.8** | **4.0** | **3 1/4** |
| **Developed economies** | **1.0** | **1.4** | **2.2** | **3.4** | **2 1/2** |
| United States | 0.5 | 2.2 | 3.1 | 4.2 | 3 |
| Western Europe | 1.6 | 1.1 | 1.1 | 2.3 | 2 1/4 |
| Asia and Oceania[d] | 0.6 | 0.0 | 2.5 | 3.6 | 2 |
| **Economies in transition** | **5.7** | **5.0** | **7.0** | **7.1** | **6** |
| Southern and Eastern Europe | 5.0 | 4.8 | 4.2 | 5.8 | 4 3/4 |
| Commonwealth of Independent States | 5.9 | 5.1 | 7.6 | 7.3 | 6 |
| **Developing economies** | **2.4** | **3.4** | **4.6** | **6.2** | **5 1/2** |
| Africa | 3.4 | 3.1 | 4.0 | 4.5 | 4 3/4 |
| East Asia | 3.8 | 6.1 | 6.0 | 7.2 | 6 1/2 |
| South Asia | 4.7 | 4.5 | 6.7 | 6.3 | 6 1/4 |
| Western Asia | -1.3 | 2.5 | 5.0 | 5.5 | 4 1/2 |
| Latin America and the Caribbean | 0.5 | -0.4 | 1.7 | 5.4 | 4 |
| **Other groupings:** | | | | | |
| Landlocked developing countries | 5.0 | 4.4 | 4.0 | 5.9 | 5 3/4 |
| Least developed countries | 5.1 | 4.9 | 4.1 | 5.2 | 5 1/2 |
| Small island developing states | 0.3 | 2.2 | 1.7 | 5.3 | 4 1/2 |
| Sub-Saharan Africa | 3.3 | 3.6 | 2.9 | 5.5 | 5 3/4 |
| **Memorandum item: World trade** | **-0.9** | **2.5** | **6.2** | **10.6** | **8** |
| **World output growth with PPP-based weights[e]** | **2.3** | **2.8** | **3.8** | **5.0** | **4 1/4** |

Source: Department of Economic and Social Affairs of the United Nations Secretariat (UN/DESA).

a Partly estimated.

b Forecasts, based in part on Project LINK, an international collaborative research group for econometric modelling, coordinated jointly by the Economic Monitoring and Assessment Unit of the United Nations Secretariat, and the University of Toronto.

c Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2000 prices and exchange rates.

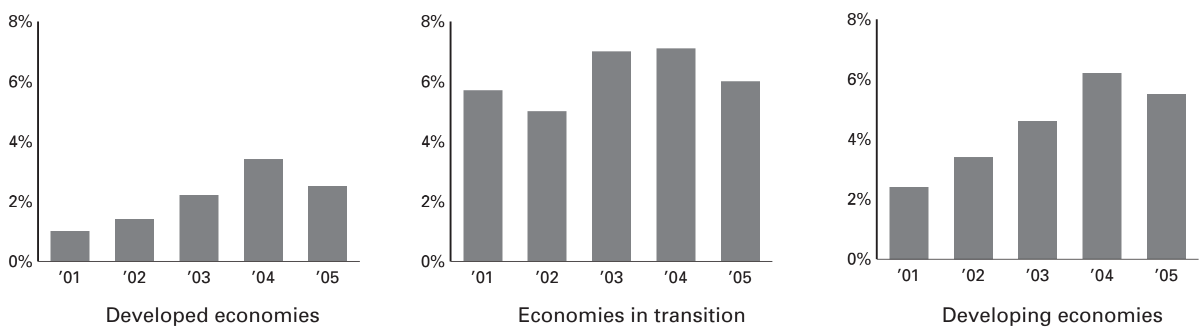
d Japan, Australia and New Zealand.

e Employing an alternative scheme for weighting national growth rates of GDP, based on purchasing power parity (PPP) conversions of national currency GDP into international dollars (see introduction to annex: statistical tables).

"Some correction of the United States' fiscal deficit and an improvement in its private savings rate seems indispensable, but the contractionary effect of such action should be counterbalanced by expansionary measures elsewhere," says *WESP 05.*

A global response to global imbalances would therefore incorporate stimulation of domestic demand, preferably through domestic investment, in countries with large external surpluses, such as Japan, Western Europe and some Asian developing countries. In addition, the reconstruction required following the December tsunami provides an opportunity to undertake large-scale investment in Indian Ocean rim countries.

Growth of world output, 2001-2005
(Annual percentage change)




Other features of the global economic profile entering 2005:

- Gross world product increased by 4 per cent in 2004, and is forecast to rise by $3^{1/4}$ per cent in 2005, absent a runaway market response to the implications of a falling US dollar and rising trade deficit.

- Chinese and US economies are jointly supporting global growth — US consumption stimulates the world manufacturing sector, while burgeoning Chinese demand for raw materials is improving the market for commodity-exporting developing countries, including as far away as in Africa and Latin America.

- Chinese demand, and a surging world economy, have reversed the longstanding decline in commodity prices. Prices of non-oil commodities were driven upward by 10 per cent in 2004, following gains of 11 per cent in 2003 and nearly12 per cent in 2002 — albeit expressed in a progessively weakening dollar. Even with this recovery, however, the average dollar prices of non-oil commodities remained about 25 per cent lower at the end of 2004 than in 1980.

- Spurred in part by stronger commodity markets, average 2004 growth in the developing countries of 5.5 per cent was the strongest in two decades, and output in the remaining countries in transit from centralized economies was the strongest since their transition began in the early 1990s.

- African growth of 4.5 per cent in 2004 was fuelled by higher agricultural output, improved political stability and incoming donor support, as well as stronger commodity markets, and "these same factors are expected to produce a similar outcome in 2005", the UN says. However, only six countries grew by more than the 7 per cent that is deemed necessary to attain the UN Millennium Development Goals in that region — 43 still remain below that benchmark.

- The price of oil rose by 50 per cent in the first half of 2004, before falling back. Price moderation is expected to continue this year. The reason: last year's rise was the result of a demand surge, not an output deficit, as occurred during previous shocks to the world oil market, and therefore is more amenable to smooth market adjustment.

*World Economic and Situation and Prospects* is produced at the beginning of each year by the UN Department of Economic and Social Affairs (UN DESA) and the UN Conference on Trade and Development (UNCTAD) in collaboration with the United Nations regional commissions. It is complemented by economic projections and analysis in UN *World Economic and Social Survey*, which comes out in mid-year.

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The full report can be downloaded at http://www.un.org/esa/policy/wess/.