



World economy slowing in 2007, but developing countries growth remains strong

Weakening US housing market a major factor

United Nations New York, 11 January: The world economy is expected to moderate in 2007 after three years of historically high growth according to new UN forecasts on the global economy. Stepping back from the all-time high growth in world gross product (WGP) of 4.0 per cent reached in 2005 and the estimated 3.8 per cent growth for 2006, global growth is expected to slacken at a pace of 3.2 per cent in 2007.

A weakening housing market in the United States is a major factor in the global slowdown, according to the annual UN report: *World Economic Situation and Prospects 2007* that was launched today. The cooling of the housing boom is expected to depress consumer demand and slow the growth of the US economy to a rate of 2.2 per cent in 2007. The economic recovery in Japan and Europe is not strong enough to replace the US as the engine for growth of the world economy.

Nevertheless, US “corporate finances are healthy and there is room for monetary easing; hence, the current situation need not degenerate into a recession,” says the report.

While growth has been strong worldwide in 2006, this has not led to substantial reductions in unemployment rates. Employment growth has been disappointing in particular in developing countries, despite exceptionally strong output growth during 2006. Developing countries and economies in transition reached average output growth rates of 6.5 and 7.2 per cent, respectively. Growth in developing countries is expected to remain robust in 2007, albeit with a mild moderation: 5.9 per cent for developing countries and 6.5 per cent for economies in transition.

East Asian economies continued to lead economic growth in the developing world, posting an average 7.6 per cent in 2006. China recorded a growth rate of more than 10 per cent. Also growth in South Asia, led by India, has been strong at 6.7 per cent in 2006. Prospects are that growth will remain strong, with East Asian economies expanding at 7.0 per cent on average and in South Asia, will slow somewhat in 2007.

The performance of the least-developed countries also remains remarkably strong, averaging nearly 7 per cent in 2006, especially in the oil-producers and other mineral exporters among these countries that benefit from high commodity prices. Growth in these countries is expected to remain equally strong in 2007.

Growth in Europe, which exceeded expectations in 2006, is expected to moderate to around 2 per cent in 2007 and in Japan, which also experienced robust growth in 2006, will slow to below 2 per cent in 2007.

The US current account deficit increased further to almost \$ 900 billion in 2006. About two-thirds of this deficit was matched by surpluses of the major oil exporting countries and Asian and other developing countries also run significant savings surpluses to counter balance the US deficit. In 2007, however, the UN’s baseline scenario predicts a moderate narrowing of these global imbalances, as the slowdown in the United States economic growth and moderation in oil prices will generate a reduction in the import bill of the world’s largest economy. At the same time, an expected further depreciation of the dollar would stimulate exports and curb import demand.

Table I.1.
Growth of world output, 2001-2007 (annual percentage change)

	2001	2002	2003	2004	2005	2006 ^a	2007 ^b
World output ^c	1.6	1.9	2.7	4.0	3.5	3.8	3.2
<i>of which:</i>							
Developed economies	1.2	1.2	1.9	3.0	2.5	2.9	2.2
Economies in transition	5.7	5.0	7.0	7.6	6.4	7.2	6.5
Developing economies	2.7	3.9	5.2	6.9	6.4	6.5	5.9
<i>of which:</i>							
Least developed countries	6.6	6.4	6.5	7.9	8.3	6.9	7.1
<i>Memorandum items:</i>							
World trade	-0.8	4.1	5.3	10.2	7.3	10.1	7.7
World output growth with PPP-based weights	2.6	3.0	4.0	5.2	4.8	5.1	4.5

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.

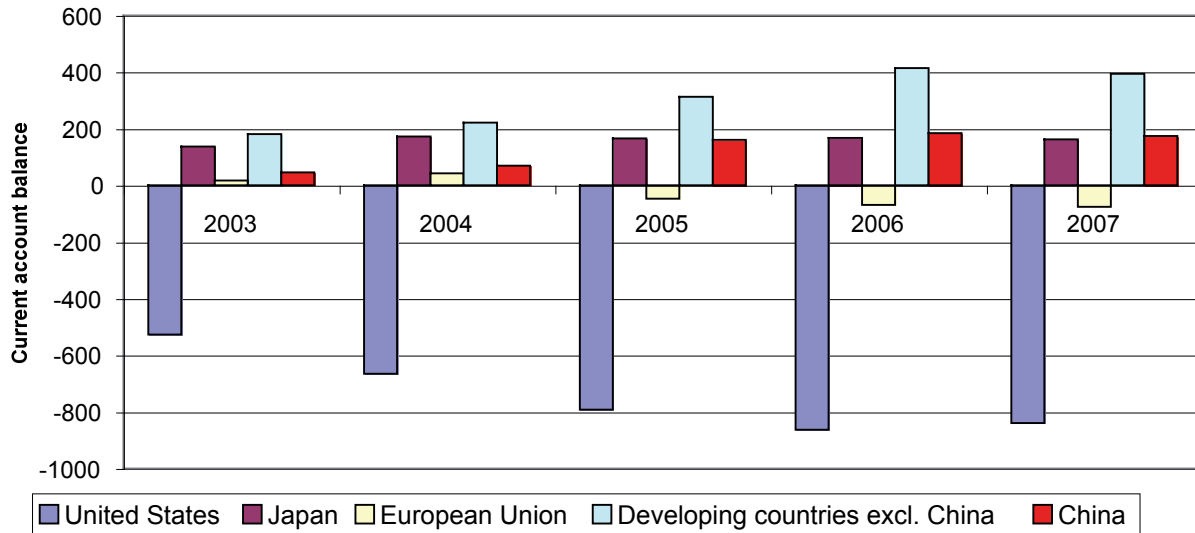
Nonetheless, the report warns that the risk of a disorderly adjustment of these financial imbalances remains. As a result of its continued and widening current-account deficit, the indebtedness of the US has deepened to a level which more seriously calls into question the sustainability of the current constellation of global imbalances and confidence in the dollar as the world's main reserve currency could erode rapidly. A hard landing of the dollar would further raise uncertainty among international investors and could upset financial markets. Developing countries would likely suffer most from the more volatile and less buoyant international economic environment caused by such adjustment, should it occur.

The UN report further warns that there is a possibility of a more severe downturn in the global economy should there be a more dramatic fall in US home prices of, say, by 15 per cent. Such a decline, the report says, would not only cut US growth to a pace below 1 per cent in 2007 but would also substantially reduce world economic growth by at least one percentage point. Such a decline in housing prices could provoke a crisis in mortgage markets and set in motion a deflationary adjustment in the global imbalances, enhancing the risk of a major upheaval in financial markets.

The *World Economic Situation and Prospects 2007* calls for concerted action in macroeconomic policy making to avoid a disorderly adjustment and create confidence in the stability of financial and foreign-exchange markets. The report states there is a pressing need to refocus the existing national macroeconomic policy stances which are ill-suited to adequately deal with the global imbalances.

The report proposes to create a new mechanism of consultations to reach agreement on coordinated macroeconomic policy stances and targets aimed at reducing the imbalances, while avoiding a global recession. Such an initiative may well constitute the desirable second-best outcome in the absence of any more fundamental changes to the global monetary and financial system. Such an agreement would seek to increase savings and exports and lower US debt, and strengthen domestic demand in the main creditor countries, particularly in Japan, developing Asia and the major oil producers.

Table II.
Current account imbalances have widened further in 2006



Source: UN/DESA and project LINK.
 a/ 2006 partly estimated
 b/ 2007 forecast.

The UN report says that existing platforms with narrow membership such as the Group of Eight (G8) and other venues for discussion are unsuitable for reaching agreement on macroeconomic policy coordination on global imbalances. It therefore proposes an international consultation mechanism that includes an outside mediator such as the International Monetary Fund (IMF) which could help generate consensus on the nature and extent of the current problems. Such consultations should involve all major players, hence including a fair representation of developing countries.

For interviews or to obtain more information, contact the Development Section of the UN Department of Public Information through Newton Kanhema, 1-212-963-5602, kanhema@un.org or Oisika Chakrabarti, 212.963.6816, chakrabarti@un.org.

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