



# World Economic Situation and Prospects 2009

Coordinated, massive and swift economic stimulus required to counteract synchronized global downturn, new UN report asserts

- world per capita income expected to decline next year
- falling export growth and capital inflows and higher borrowing costs for developing countries, as contagion spreads from the major economies
- dollar set to resume its decline, with the possibility of a hard landing in 2009
- deep reforms of global financial system called for to prevent crisis recurrence

(DOHA, QATAR, 1 December) UN economists are recommending massive economic stimulus packages that are coherent and mutually reinforcing on a global basis, and linked with sustainable development imperatives. These should come on top of the liquidity and recapitalization measures already undertaken by countries in response to the economic crisis.

Also recommended in an advance edition of the UN annual economic report, issued today at the international Financing for Development conference taking place in Doha, are stronger regulation of financial markets and institutions, adequate international liquidity provisioning, an overhaul of the international reserve system and a more inclusive and effective global economic governance, to prevent against any future repetition.

According to the baseline scenario of *World Economic Situation and Prospects 2009*, world output growth will reach a meagre 1 per cent in 2009, compared to 2.5 per cent in 2008 and global growth rates of between 3.5 and 4 per cent in the preceding four years (see Table I.1).

Table I.1  
Growth of world output, 2003-2009

Annual percentage change	2003	2004	2005	2006	2007	2008 <sup>a</sup>	2009 <sup>b</sup>		
							Baseline scenario	Pessimistic scenario	Optimistic scenario
<b>World output<sup>c</sup></b>	2.7	4.0	3.5	4.0	3.8	2.5	1.0	-0.4	1.6
<i>of which:</i>									
Developed economies	1.8	3.0	2.4	2.9	2.5	1.1	-0.5	-1.5	0.2
United States	2.5	3.6	2.9	2.8	2.0	1.2	-1.0	-1.9	-0.5
Euro zone	0.8	2.1	1.7	2.8	2.6	1.1	-0.7	-1.5	0.3
Japan	1.4	2.7	1.9	2.4	2.1	0.4	-0.3	-0.6	0.5
Economies in transition	7.3	7.6	6.5	7.8	8.3	6.9	4.8	2.7	6.1
Developing economies	5.2	7.1	6.7	7.0	7.1	5.9	4.6	2.7	5.1
China	10.0	10.1	10.2	11.1	11.4	9.1	8.4	7.0	8.9
India	7.3	7.1	11.5	7.3	8.9	7.5	7.0	4.7	7.5
Brazil	1.1	5.7	2.9	3.7	5.4	5.1	2.9	0.5	3.0
Mexico	1.4	4.2	3.0	4.8	3.2	2.0	0.7	-1.2	1.5
<i>of which:</i>									
Least developed countries	5.2	7.2	7.9	7.7	7.8	6.4	5.1	2.0	6.1
<b>Memorandum Items:</b>									
World trade	5.6	11.2	8.0	8.8	6.3	4.4	2.1	-3.1	3.1
World output growth with PPP-based weights	3.6	4.9	4.5	4.9	4.9	3.7	2.3	1.3	3.0

Source: UN/DESA.

<sup>a</sup> Partly estimated.

<sup>b</sup> Forecasts, based in part on Project LINK.

<sup>c</sup> Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

The 2009 projection includes a 0.5 per cent decline in output in developed countries, along with average growth of 5.3 per cent in the transition economies and 4.6 per cent in the developing world. This works out to an overall drop in 2009 world per capita income.

Under a more optimistic scenario -- factoring in fiscal stimulus of between 1.5 and 2 per cent of gross domestic product (GDP) of the major economies, and further interest-rate cuts – UN economists foresee that the developed economies could post a 0.2 per cent rate of growth, and that growth in the developing world would be slightly over 5 per cent.

But given the great uncertainty prevailing today, a more pessimistic scenario is quite possible.

If the present credit squeeze prolongs and confidence in the financial sector is not restored in the coming months, the UN warns, the developed countries could enter into a deep recession in 2009. This would bring economic growth in developing countries down to 2.7 per cent, dangerously low for their ability to sustain poverty reduction efforts and social and political stability.

### **Harsh development environment**

Developing country policy makers spent the third quarter of 2008 tracking inflationary threats, acutely felt through the rising cost of basic commodities such as food and fuel. Those ignoring early warning signals were caught by surprise in October, when the financial crisis and economic downturn hit economies with the speed and strength of a tropical storm.

The cost of external borrowing has since risen sharply for developing countries, and capital inflows are reversing dramatically. Stock markets have dropped further in an already difficult year, while currency and commodity markets have become extremely volatile. The exchange rate is depreciating steeply in several countries, the UN reports, and the prices of primary commodities have tumbled since mid-year highs. Along with rapidly decelerating export growth, current account balances of many countries have shifted back into the red.

Contagion from developed countries – with many of them already in recession – to the rest of the world entails a “globally synchronized downturn [that] may be the first of its kind in the post-war era,” *WESP* says.

### **Crisis management has moved slowly . . .**

Monetary policy in the United States during the first half of 2008 was aggressively expansive in attempts to stave off a recession, while European central banks maintained a tightening stance in the face of perceived inflation threats (*see Figure I.11*).

This policy mismatch typifies the lack of coordination during the boom years, when growth was strong and the over extension of credit in the United States and excess savings in surplus countries could have been addressed with less pain and more room for manoeuvre. Along these lines, the UN’s *World Economic Situation and Prospects* for 2007 and 2008 advocated consolidation in the US economy matched with fiscal stimulus in surplus countries such as China, Japan, and in Europe.

From October 2008, national responses took on a more comprehensive, less piecemeal approach, and unilateral national approaches gave way to increased international cooperation and coordination. About \$4 trillion worldwide was injected in efforts to unfreeze credit and money markets. Interest rate cuts took shape rapidly in developed as well as some developing countries.

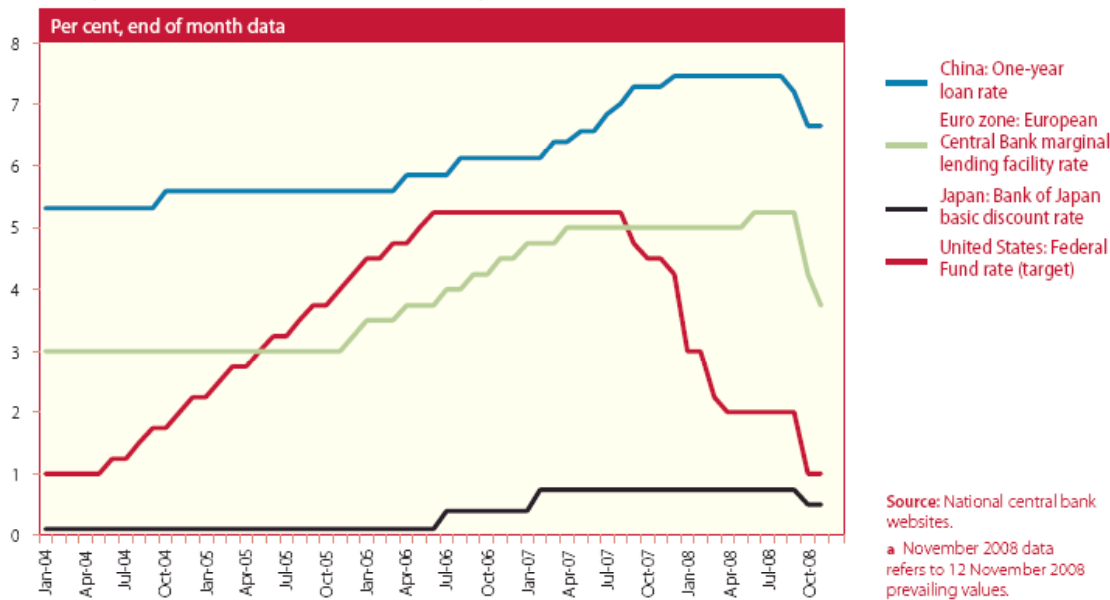
“But with consumer and business confidence seriously depressed and banks reluctant to lend, further lowering of interest rates by central banks will do little to stimulate credit supplies . . . and private spending,” UN economists caution.

With limited space for monetary stimulus, fiscal policy options are needed to reactivate the global economy.

China has already launched a \$586 billion fiscal package - 15 per cent of its GDP - to be implemented in two years, which may contribute to global as well as domestic demand. In the US, fiscal stimulus equal to 1.1 per cent of GDP in the first half of 2008 probably kept economic growth out of the red for an extra quarter. The Republic of Korea recently announced a package of similar size relative to its GDP.

UN economists argue for fiscal stimulus to be provided in an internationally coordinated fashion. In a globalized economy, fiscal stimulus in a single country is undercut by import leakage and other such effects; when internationally coordinated, a reinforcing multiplier effect can take hold.

Figure I.11  
Policy interest rates of major economies, January 2004–November 2008\*



sees an opportunity to align fiscal stimulus packages with long-term sustainable development goals. The massive resources required for fiscal stimulus can be applied in part to public investments in infrastructure, food production, education and health and renewable energy sources, helping developing countries to diversify their economies and meet their Millennium Development Goals.

**... but bold reforms are needed to prevent future crises**

At present, however, there is no credible, institutionalized mechanism for international coordination of stimulus packages or monetary policies. Such a mechanism will need to be created alongside other fundamental reforms.

Such reforms should also address the weakness of a global financial system with the dollar at the centre as reserve currency. With net indebtedness of the United States still growing -- to about \$2.7 trillion at the end of 2008, up from \$2.5 trillion in 2007 – a disorderly adjustment of global imbalances and a hard landing of the dollar remain major downside risks. In that case, investors might again embark on a “flight to safety”, but this time away from dollar-denominated assets instead of to them, pulling the US economy down further, and the global economy with it.

Further steps advanced by UN economists and development experts include:

- fundamental reforms of existing systems of financial regulation and supervision to prevent the re-emergence of excesses;
- reform of the present international reserve system, away from the almost exclusive reliance on the US dollar and towards a multilaterally backed multi-currency system;
- reforms of liquidity provisioning and compensatory financing mechanisms, backed, among others, by better multilateral and regional pooling of national foreign exchange reserves, and avoiding onerous policy conditionality.
- A leading role by the IMF and the World Bank for enhanced international policy coordination while ensuring more equitable governance, policy advice and operations and increased weight and participation of emerging and developing countries.

The “Global Outlook” chapter of the *UN World Economic Situation and Prospects 2009* is released today in Doha. The full report, including regional overviews and detailed trends in global trade and finance, is due out in January 2009.

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