

World Economic Situation and Prospects 2009

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Main messages

1. Worst financial crisis since 1930s: a story foretold
2. Global economy is entering in recession
 - Synchronized slowdown worldwide
 - World per capita income will fall in 2009
 - Problems have not bottomed out
3. Downside risks of further financial meltdown and hard landing of dollar
4. Policy challenges – New Global Deal:
 - Massive, internationally coordinated fiscal stimulus needed on top of financial bailouts
(Align fiscal stimulus with sustainable development objectives)
 - Deeper reforms of the international financial architecture should urgently be set in motion
(financial regulation, reform of global economic governance, reform of reserve system and compensatory financing schemes)



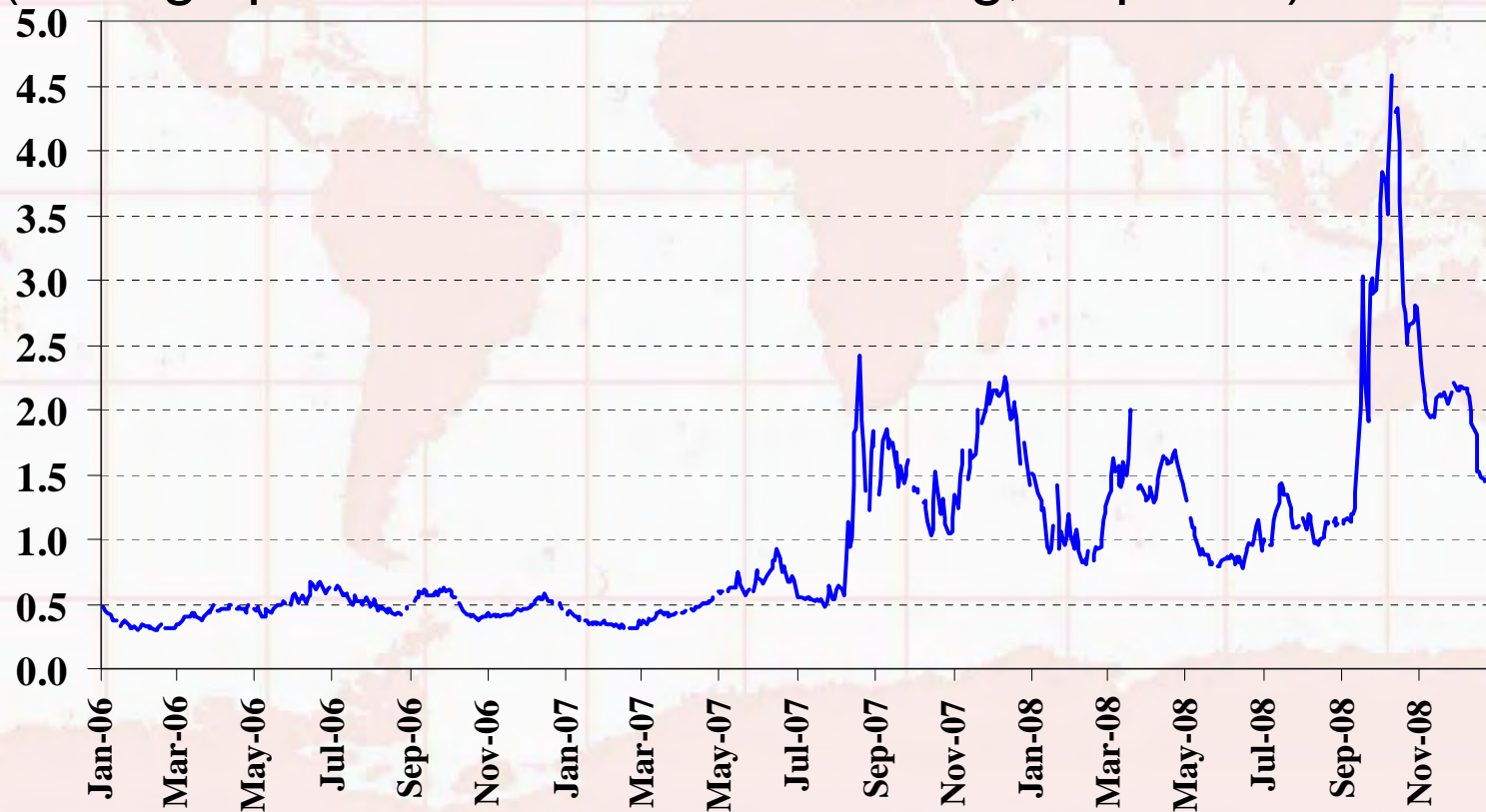
1. Story of a crisis foretold

- The global financial crisis and the rapidly deteriorating international economic environment**
- End of an unsustainable worldwide boom**

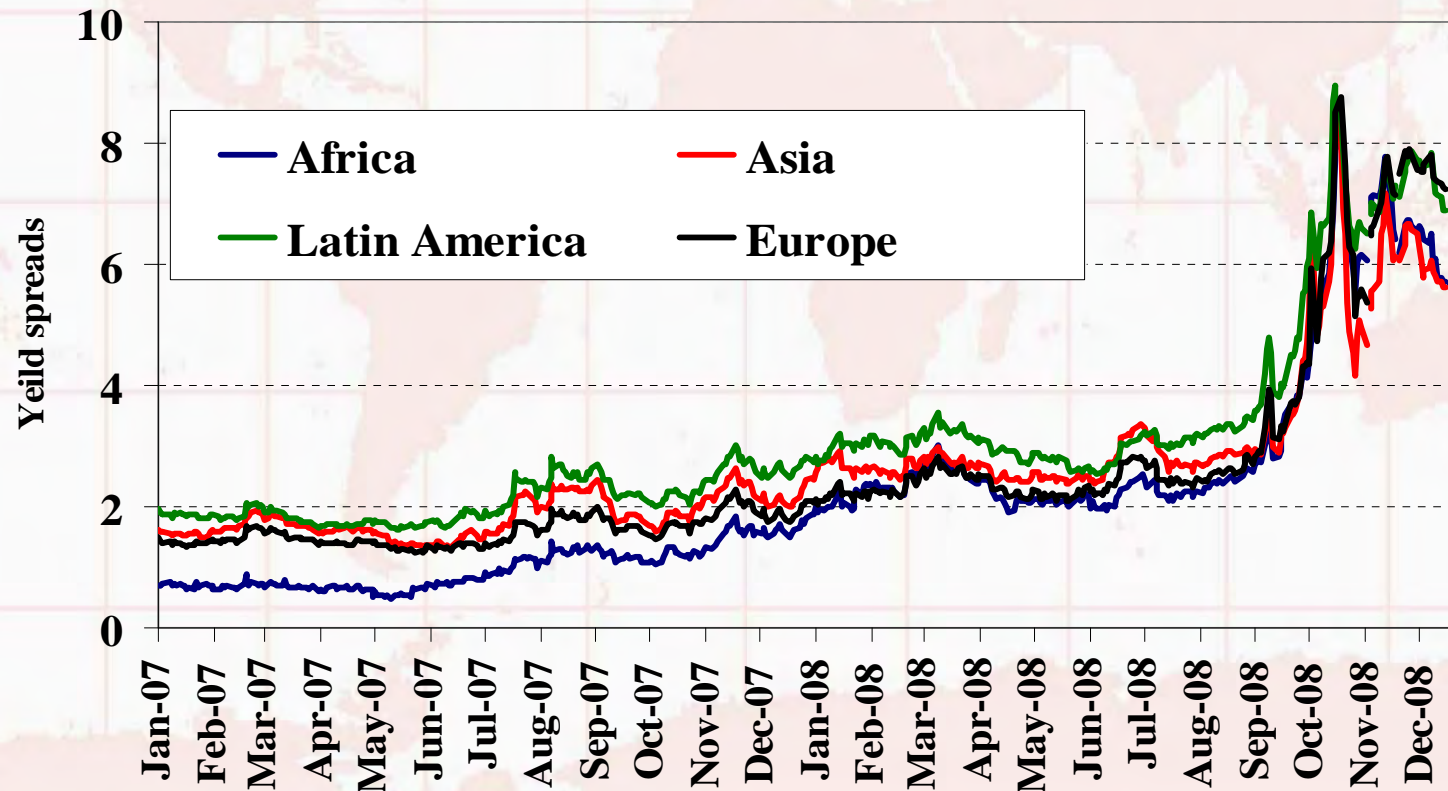
Credit crunch: retreat from initial rise in borrowing cost, but no resumption of lending



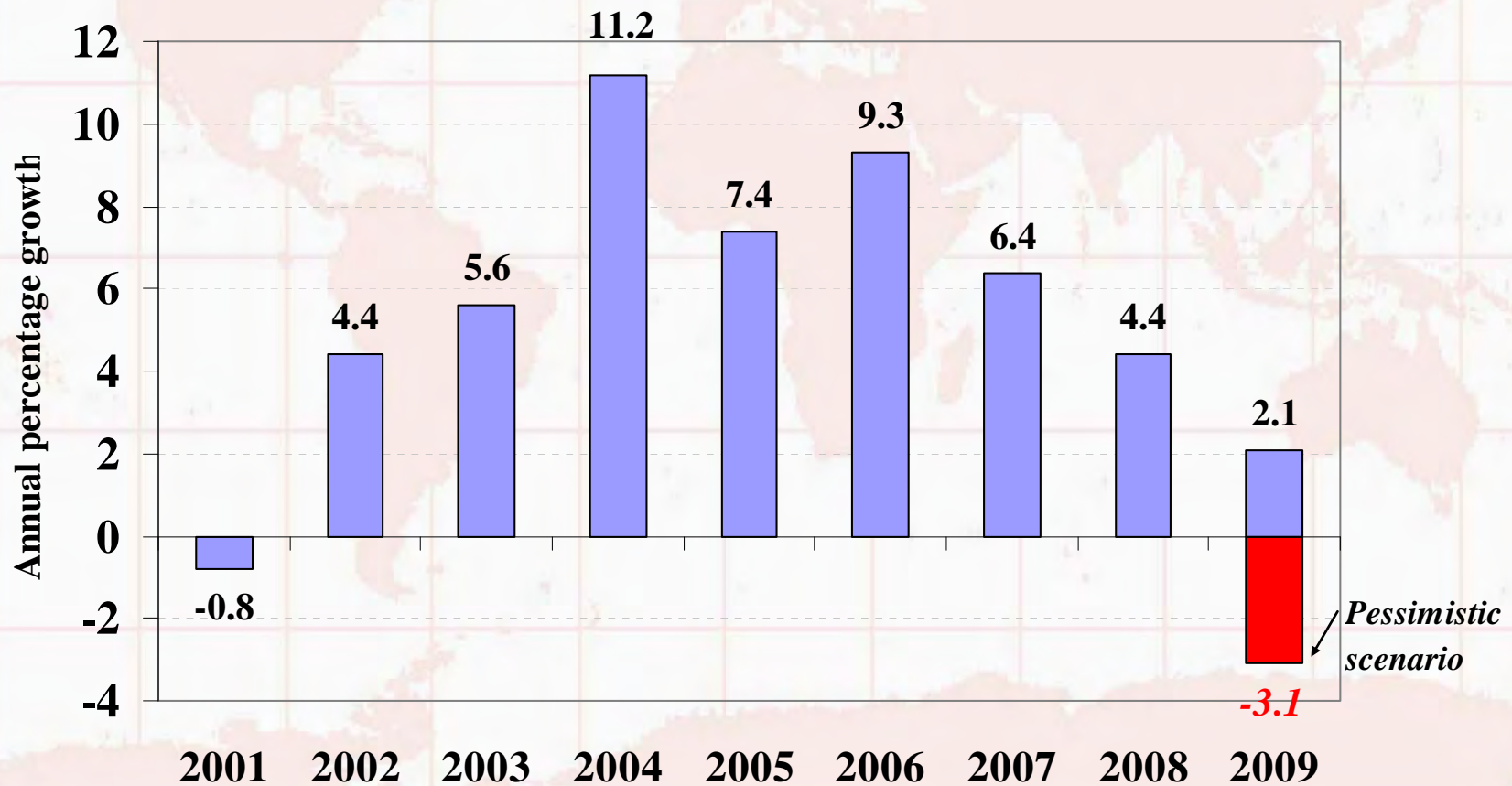
(Rising spread on interbank lending, % points)



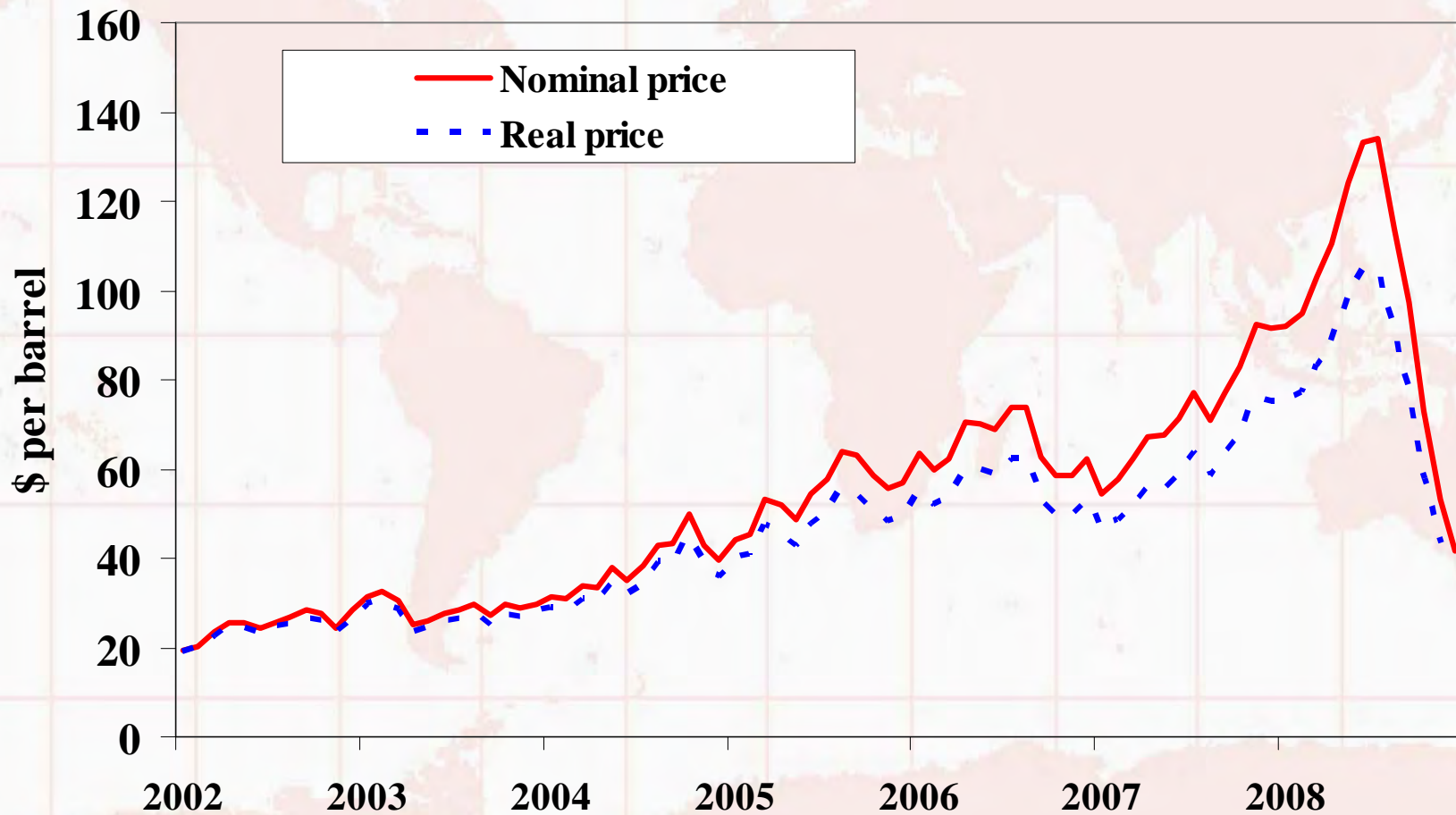
... borrowing costs for developing countries remain high and private capital flows are reversing



World trade growth decelerating rapidly

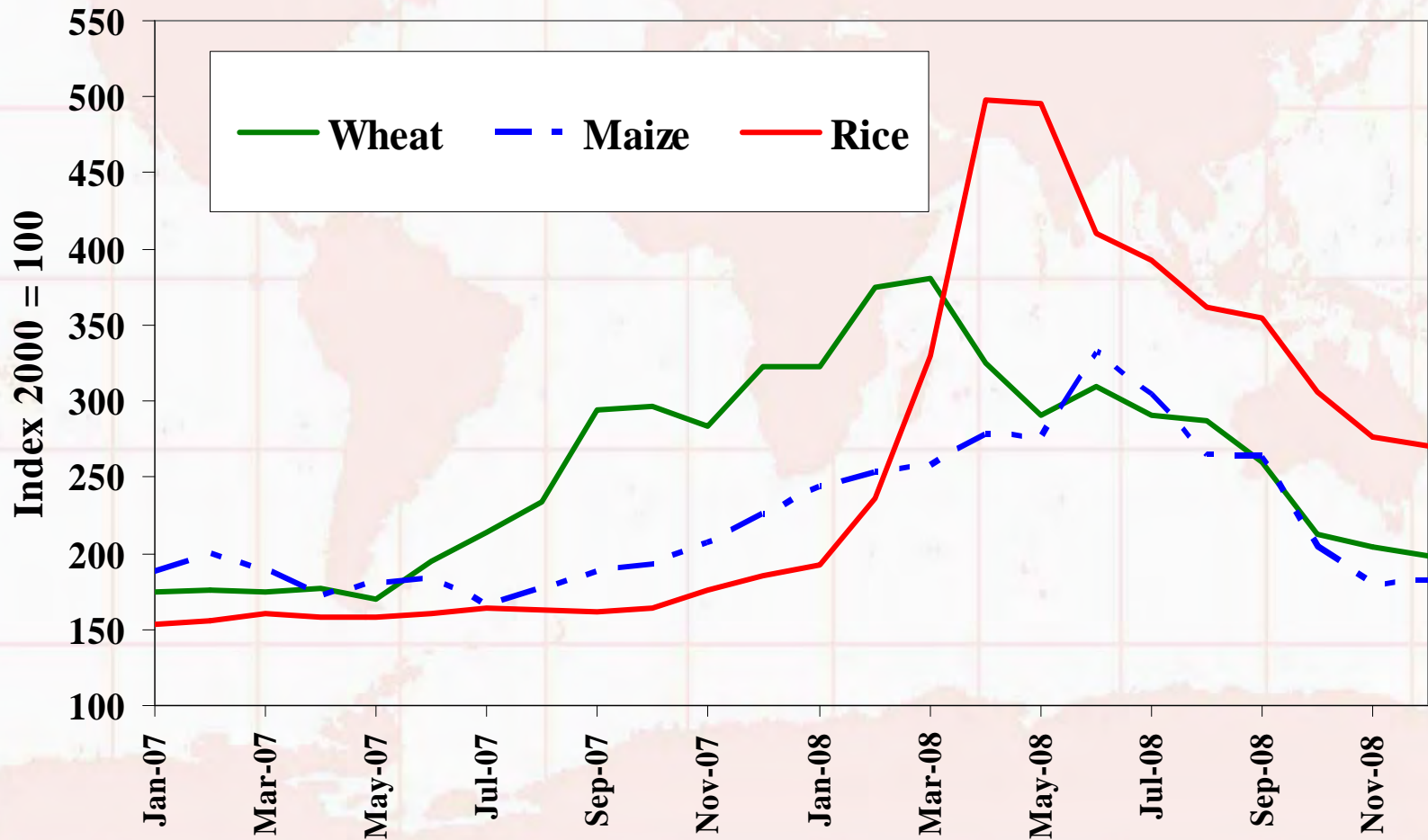


Plunging oil prices





World food prices are also declining

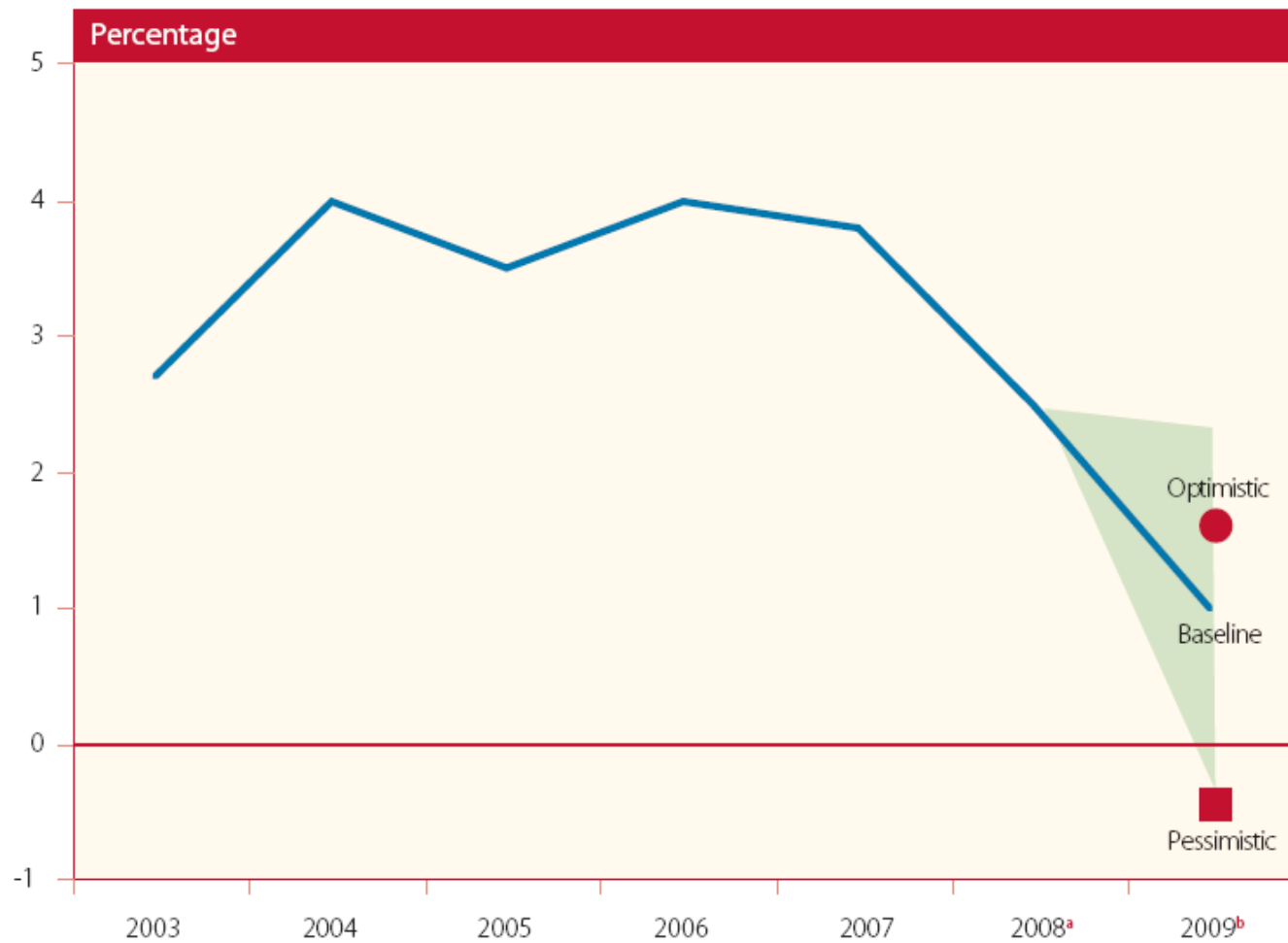




2. What consequences?

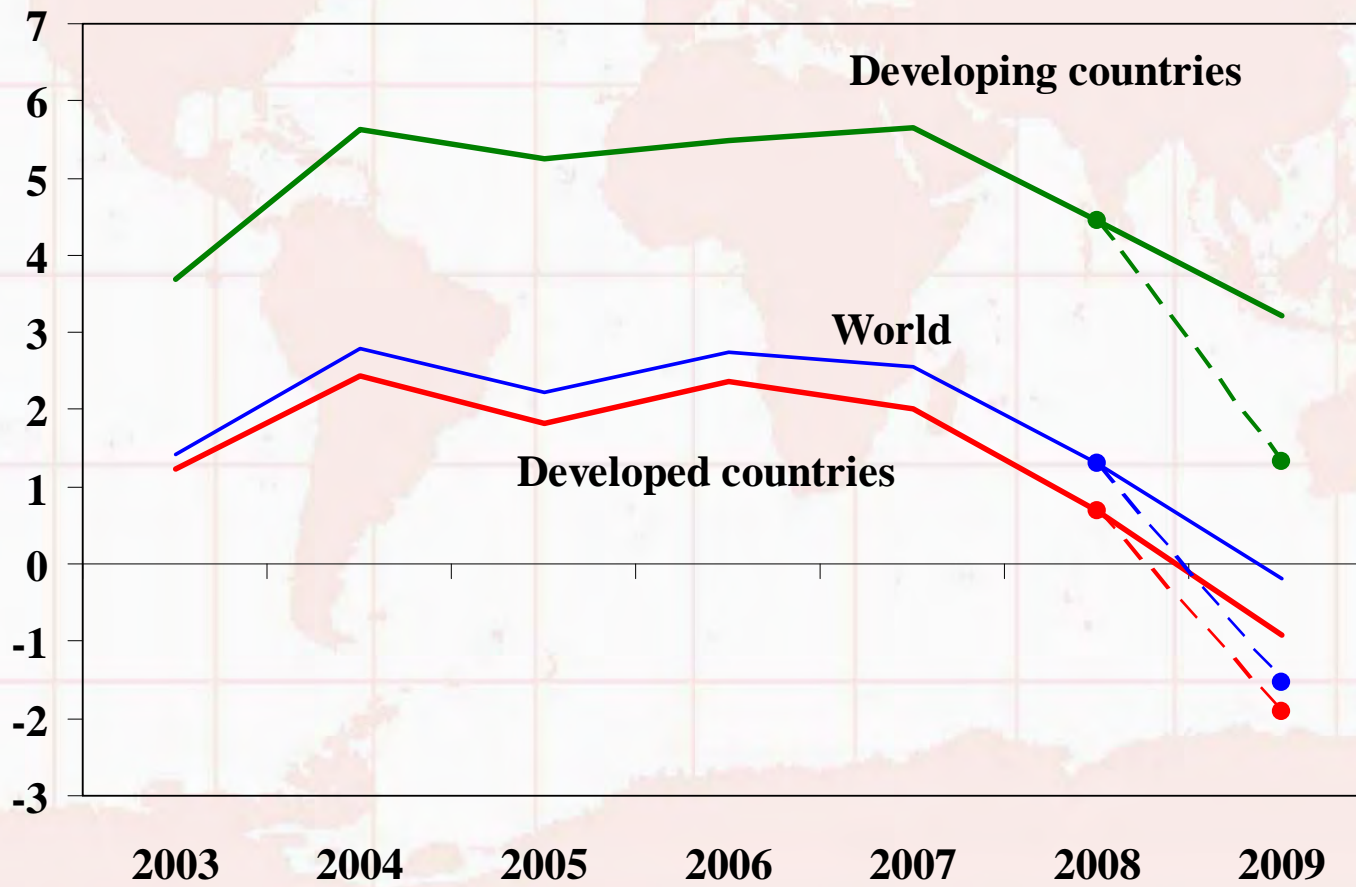
- **Slower world economic growth**
- **Recession in rich countries**
- **Severe slowdown in poor countries**
- **Problems have not bottomed out yet**

World economy has entered into a recession





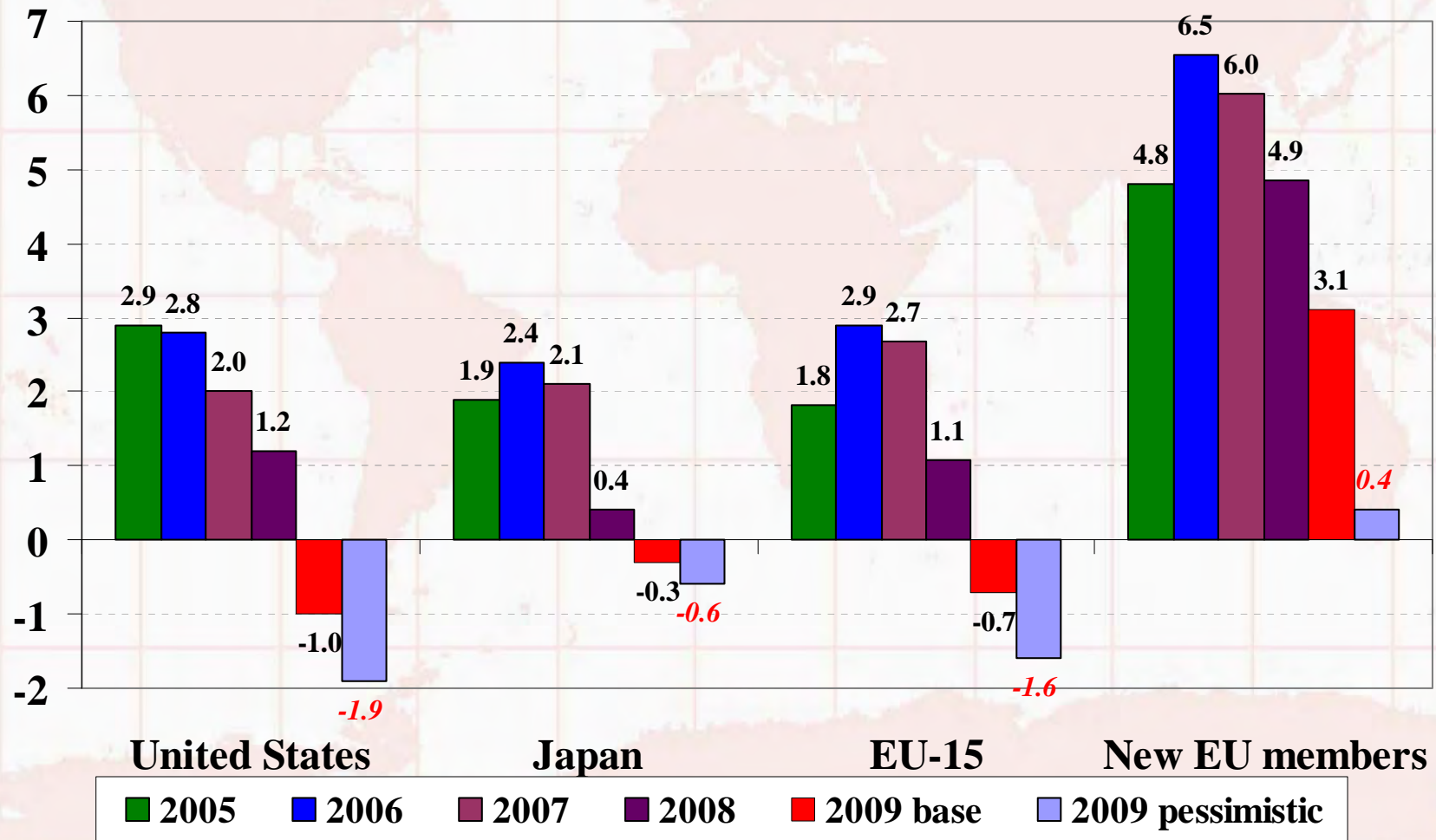
World income per capita will decline in 2009



Dashed lines represent pessimistic scenario

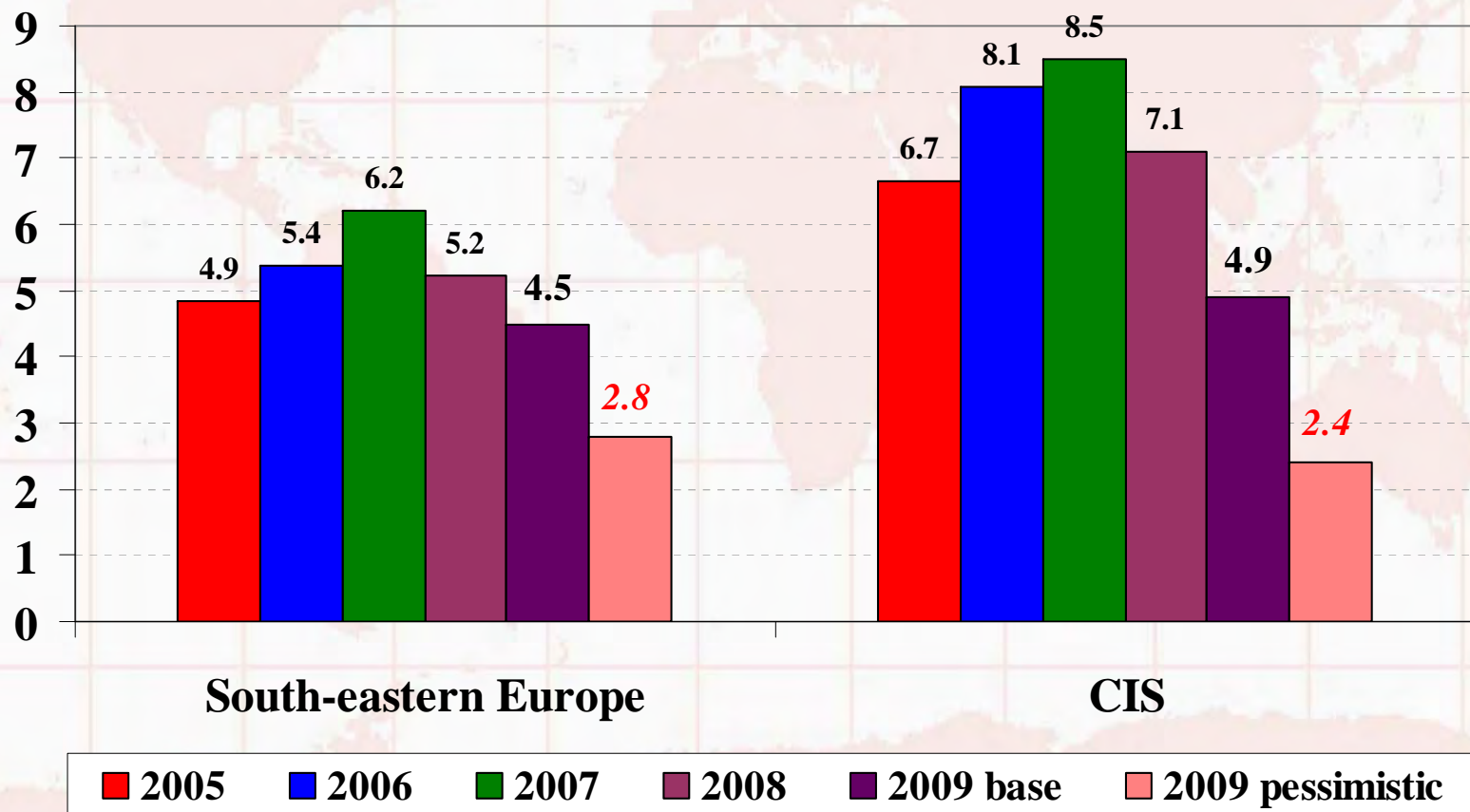


Recession in most developed economies





Growth slowing in the economies in transition...



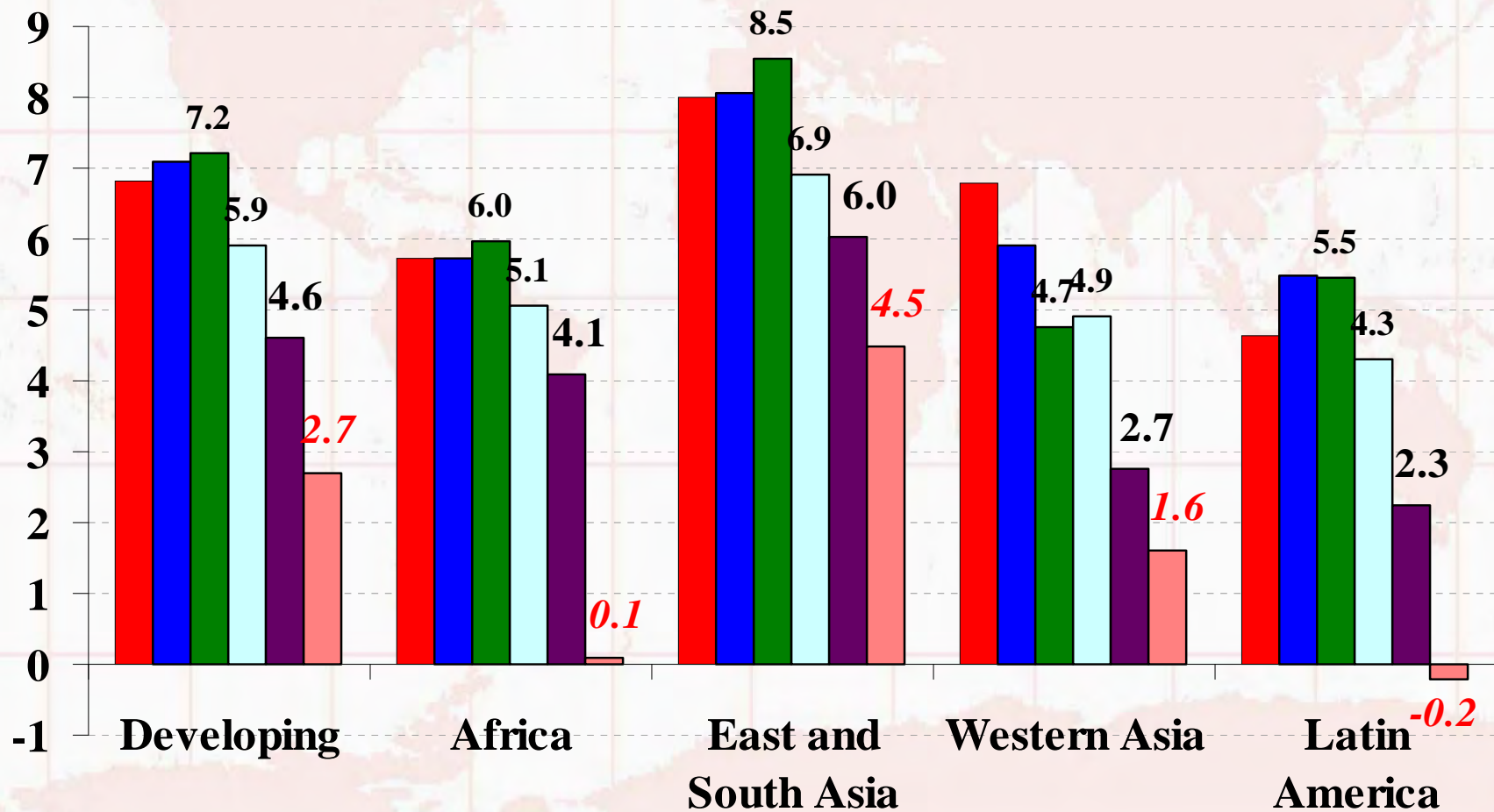


Developing countries will be hit hard through trade and finance channels

- Spill-over effects through financial markets likely will hit strongest on the **middle-income countries**
- **All developing countries** will be affected through slowing trade.
- **Primary exporters** will also see deterioration in terms of trade
- **Low-income, net food and oil-importers** may see improving terms of trade, but will suffer mainly through reduced demand for exports
- Balance of payments constraints likely will emerge in growing number of countries and vast reserves may quickly evaporate



Leading to slowdown of growth in all developing countries



■ 2005 ■ 2006 ■ 2007 ■ 2008 ■ 2009 pessimistic ■ Pessimistic



3. Downside risks

- **Deeper and prolonged crisis**

- (a) prolonged credit crunch in major economies and deeper recession

- (b) steep capital reversals in emerging markets

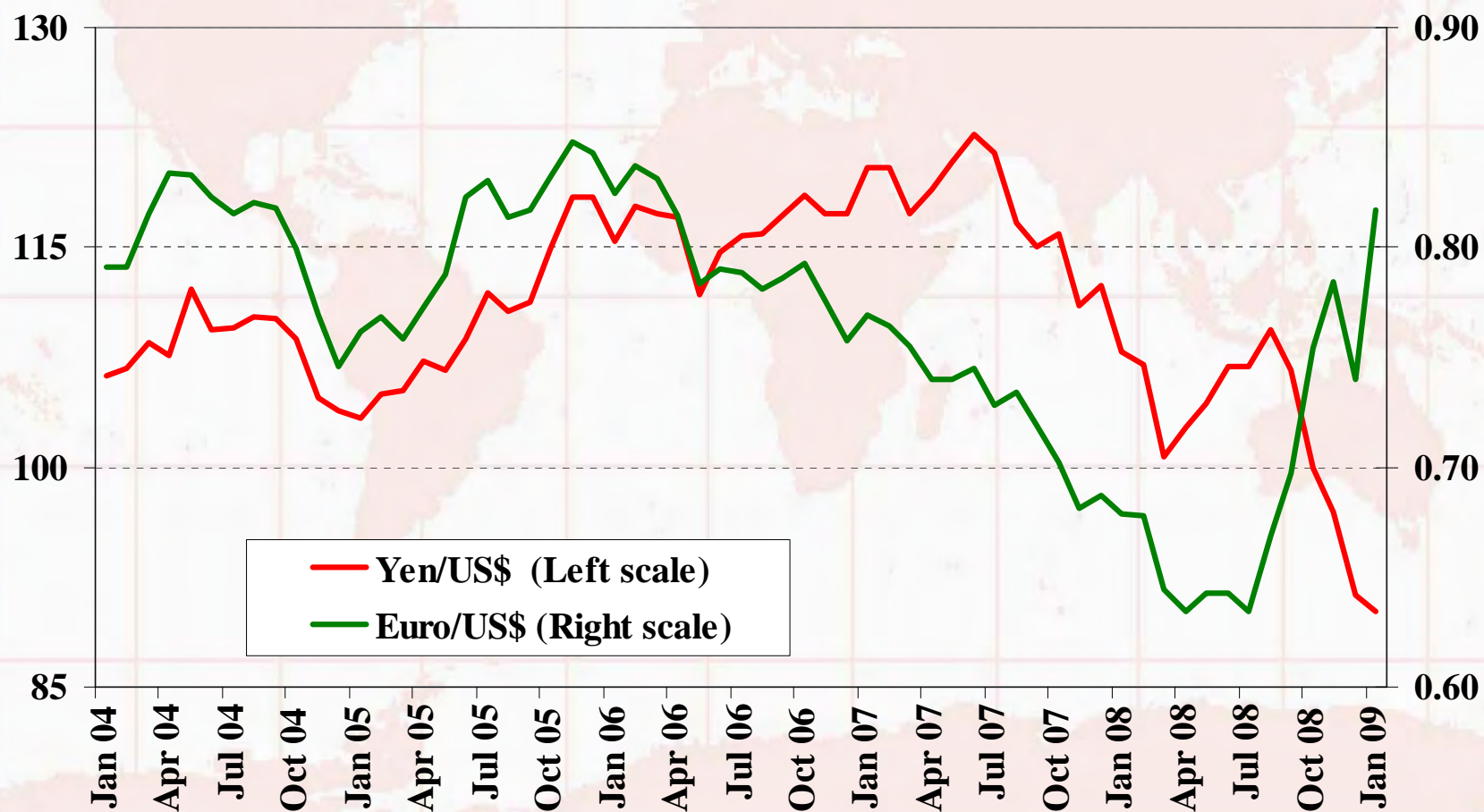
- (c) less ODA for low-income countries

- **Failure of rescue measures and fiscal stimulus**

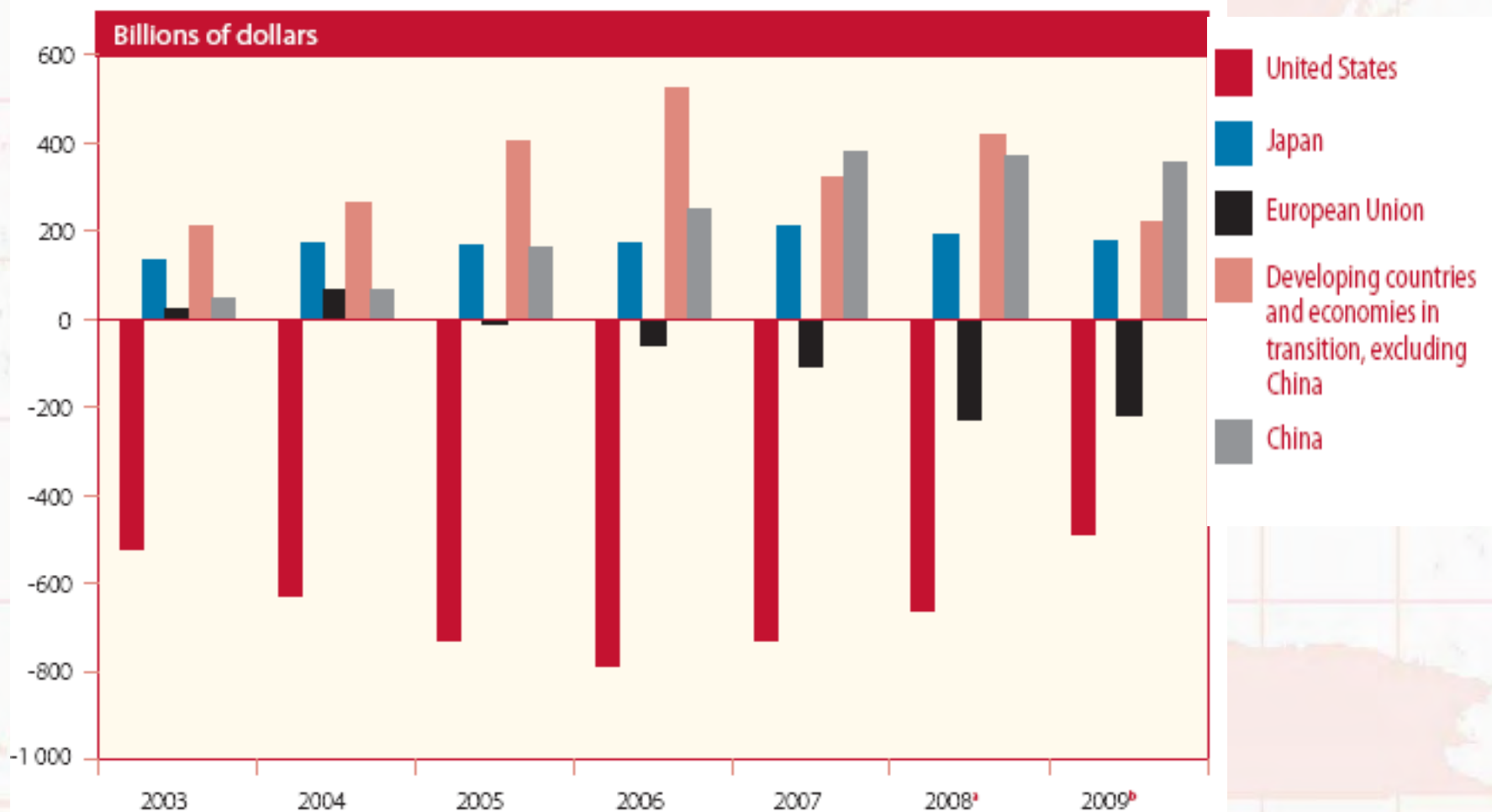
- Could lead to hard landing of US dollar

- Global deflation

The dollar (and yen) have appreciated recently



...but risk of hard landing of dollar remains as global imbalances persist



4. Policy challenges (1) - “Fighting the fire”



- We have seen extraordinary responses to deal with crisis
 - More than \$11 trillion of committed public funds so far (about 20% of WGP)
 - Financial landscape has changed
 - Coordinated monetary responses
- More and even bolder action is needed:
 - Further actions required to reactivate lending in credit markets
 - Massive, internationally coordinated fiscal stimulus
 - Align stimulus with sustainable development and poverty reduction objectives
 - Alleviate financing constraints for developing countries to enhance their fiscal space

.....but we must be aware of risks that could fuel the fire further, if:



- the, thus far, uncoordinated responses may prove too little, too late (*so far “only” \$1.9 trillion committed over various years*)
 - the financial system continues to fail to respond
 - money is printed much faster than the fiscal stimulus is taking effect, causing further (expectations of) asset deflation and a possible hard landing of US dollar
- These risks strengthen the argument for well coordinated solutions**



4. Looking ahead – Reforming the International Financial Architecture

- Establishing a credible and effective mechanism for international policy coordination and reform governance IMF.
- Fundamental reforms of existing systems of financial regulation and supervision
- Reforms of liquidity provisioning
- Reform of the present international reserve system.