Monthly Briefing
World Economic Situation and Prospects

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Summary

- The world economy is rebounding but the recovery remains uneven, weak and fragile
- At the present speed of the recovery, unemployment rates will take five years to drop to pre-crisis levels.
- The recovery is still mainly driven by government stimulus measures. Concerns about widening fiscal deficits are pressuring for withdrawal of stimulus, risking taking steam out of the recovery.

Global issues

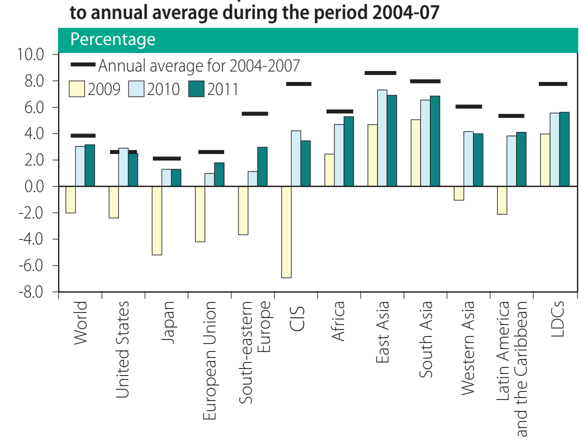
As stressed in the recent *World Economic Situation and Prospects: Update as of mid-2010*, the world economy continues to rebound from its deepest crisis since World War II. After contracting by 2.0 per cent in 2009, the world economy is forecast to grow at 3.0 per cent in 2010 and 3.2 per cent in 2011. However, the recovery continues to be uneven, weak and fragile.

It is uneven because not all economies are showing the same strength. Growth in developed economies is forecast to average 1.9 per cent in 2010 and 2.1 per cent in 2011, up from -3.4 per cent in 2009. The recovery is stronger in the economies in transition, with projected growth of 3.9 per cent in 2010 and 3.4 per cent in 2011. But this group also experienced the sharpest contraction in 2009 (-6.7 per cent). For developing economies, aggregated growth is expected to reach 5.9 per cent in 2010 and 5.8 per cent in 2011, bottoming out at 2.2 per cent in 2009. In addition to diverging patterns in these regions, there are also marked differences at the country level. For example, despite positive regional growth averages, 13 countries are expected to remain in recession during 2010, seven of them in the developed world.

Growth remains weak and is expected to stay below the 2004-07 annual averages in all sub-regions (figure 1). In addition, the level of real GDP of 48 economies will remain below the pre-crisis levels. The recovery is significantly weaker than was the case in previous post-recession cycles. Moreover, at the present speed and pattern of recovery, it may take no less than five years for unemployment rates to fall back to pre-crisis levels.

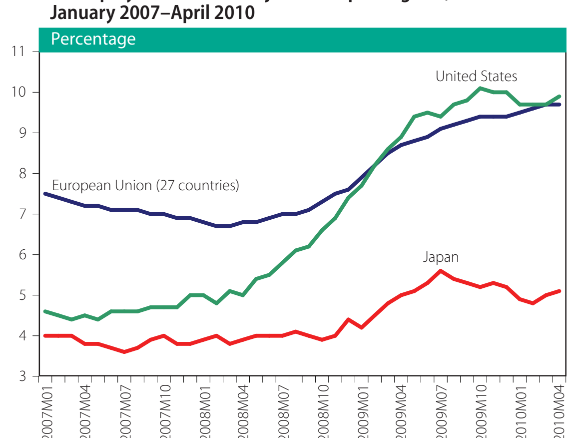
The recovery is still fragile. The levels of business and consumer confidence are still low, credit supply remains tight and private sector activity is still anaemic in most countries. The recovery is far from self-sustained and still highly dependent on government stimulus measures. In addition, unemployment rates remain high in most developed countries and still have to come down (figure 2). In developing countries, vulnerable employment has increased on average, mostly also implying lower and less secure incomes for workers and their families. The continued global jobs crisis is tempering output recovery as it keeps consumption demand down.

Figure 1:
Growth of world output in 2009-2011 related to annual average during the period 2004-07



Source: UN/DESA, *World Economic Situation and Prospects: Update as of mid-2010*

Figure 2:
Unemployment rate in major developed regions, January 2007–April 2010



Source: EUROSTAT.

Note to the Secretary-General prepared by the Global Economic Monitoring Unit
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To maintain the momentum of the economic recovery, continued fiscal and monetary stimulus will be required. However, in order for the recovery to be more self-sustaining, the stimulus measures should be much more focused on employment generation so as to overcome the global jobs crisis. An increasing number of countries are facing a dilemma between the need for continued fiscal stimulus and the need to avoid the build up to a public debt crisis. Indeed, the G20 Finance Ministers at their meeting in Busan, Republic of Korea, in early June, called for urgent measures towards fiscal consolidation. Concerns about sovereign debt sustainability in Southern Europe have already wreaked havoc on currency markets, spilling over into financial and commodity markets. The euro depreciated further and dropped below $1.20 in early June. The increased risk aversion in financial markets was reflected in lower yields on German *bunds* and United States Treasuries as well as in higher prices for precious metals and increased interbank lending rates. The increased market uncertainty could affect growth prospects worldwide. Yet, as argued in the *World Economic Situation and Prospects: Update as of mid-2010*, premature withdrawal from the stimulus measures could be self-defeating as growth will remain subdued as a result. Moreover, failure to redress the global jobs crisis could risk entering in a double-dip recession which would further erode fiscal balances. The focus therefore should be on job creation in the short run, while laying out carefully designed medium-term plans for fiscal consolidation to prevent the emergence of public debt crises in the future could help calm financial markets.

Developed economies

United States and Canada: job recovery is lagging behind in the United States

After declining by 2.4 per cent in 2009, both economies have extricated themselves from the deep recession and resumed growth since the second half of 2009. The aggregate economy is expected to grow by 2.9 per cent in 2010 and 2.6 in 2011. The early stage of recovery has benefitted significantly from the turnaround of the inventory cycle, which has contributed more than half of United States GDP expansion since it bottomed out. In both economies, the employment has been hit hard by the recession. However, the rebound in the labour market is much stronger in Canada: the country has recovered about two third of lost jobs, while the United States has restored less than 10 per cent of employment.

After the debt crisis in Europe intensified, many investors turned to the United States dollar as a safe haven, causing a strong appreciation of the currency, especially against the euro.

Western Europe and the EU: the region has exited recession but economic activity remains weak

After its worst recession of the post-war period, Western Europe finally resumed growth in third quarter of 2009, but for the year as a whole GDP fell significantly (by 4.2 per cent in the EU15). Activity is expected to pick up slowly over the course of 2010 but will stay weak and in the EU15 economic growth is expected to average no more than 1.0 per cent in 2010 and 1.8 per cent in 2011. Growth will be held back by strong headwinds: financing conditions remain tight; uncertainty remains high; capacity utilization is well below average; and labour markets are exceptionally weak in many countries. Going forward, growth is expected to continue to be driven by exports as support from policy stimuli is expected to fade. Inventory re-stocking will play a significant role in the short-run. Fixed investment is expected to pick-up later, but consumption will remain weak due to continuing high unemployment.

The Greek debt crisis, quickly spread to other regional economies with perceived fiscal problems through widening sovereign bond spreads, exacerbated by repeated downgrading of credit ratings. In response, affected countries are enacting drastic fiscal consolidation programmes, which are likely to lower growth prospects for a number of years. The financial health of regional banks holding this debt has deteriorated, threatening a recovery in commercial lending. The crisis has also led to a loss of confidence in the euro. However, the resulting sharp depreciation in the currency has improved competitiveness and is stimulating export growth.

The new EU member States: recovery can only be export-led

The decline in output in the new EU member States in 2009 was dramatic, reaching double digits in the Baltic countries, and their aggregate GDP contracted by 3.5 per cent. Positive output growth is expected in most of the new EU members in 2010, driven largely by net exports. However, the recovery will be anaemic, with aggregate GDP increasing by 1.7 per cent. Growth is expected to strengthen to 3.2 per cent in 2011, assuming export demand will continue to pick up and lending to the real sector is restored.

Despite these positive signs, growth is being constrained by low private spending and the reluctance of businesses to invest and of banks to lend. Thus, with very little fiscal space left, an export-led recovery seems the only remaining, albeit insecure option for 2010. Monetary policies can remain accommodative as inflation is subdued. Meanwhile, unemployment has reached alarming levels in the Baltic States. The ongoing fiscal crisis in the EU-15 may affect the new EU members through austerity measures in those countries that will drag down import demand, which in turn would lower the prospects for export growth.

Japan: lacklustre recovery

Japan's economy contracted by more than 5 per cent in 2009; its worst performance since the oil shock in the early 1970s. While a collapse in exports was the major cause of the recession, macroeconomic stimulus measures and a rebound in exports have turned the economy around. Despite a slight decline in the unemployment rate, employment and income conditions remain inauspicious while persistent deflationary pressures continue to form a major obstacle to a more robust recovery. Growth is expected to remain lacklustre throughout 2010-2011, below 2 per cent over the two-year period. Being highly dependent on exports, the economy remains susceptible to any relapse in the recovery of its major trade partners, while high unemployment and low consumer confidence will curb household spending and concerns about public debt may constrain continuation of the fiscal stimulus.

Economies in transition

CIS: euro depreciation may prolong weak and jobless recovery in CIS

In 2009, GDP of the CIS contracted by 6.9 per cent. Growth is expected to reach 4.2 per cent in 2010 before slowing to 3.5 per cent in 2011. The dismal growth performance in 2009 highlights the region's reliance on external demand and external capital. While the gradual global recovery and higher commodity prices explain the stronger performance in 2010, subdued export demand will continue to restrain growth. Moreover, ample idle capacity implies that the recovery in 2010 will be largely jobless. Low-income countries of the CIS will thus continue to be affected by lower workers' remittances.

In May 2010 the euro reached its lowest rate against the Russian rouble since December 2008. This will contribute to lower inflationary pressures in the CIS. It will however also increase pressures on producers of consumer goods and food, especially in the Russian Federation, which compete against imports from the euro zone.

South-eastern Europe: return to growth is possible, but uncertain

Most of the South-eastern European economies stabilized in the first quarter of 2010 and the sub-region is expected to return to growth. Overall, aggregate GDP of the region is expected to expand by 1.1 per cent in 2010. The recovery may accelerate to 3 per cent in 2011, assuming favourable external conditions and a moderate recovery in domestic demand. However, the recovery may be severely constrained if demand for exports (especially from the EU) remains weak, FDI does not pick up, and the worsening liquidity situation of companies caused by difficulties in collecting receivables and obtaining loans cannot be redressed. Private consumption will be restrained by rising unemployment and increased taxes. Governments are expected to keep anti-recession policies in place during 2010, although the scope for further stimulus is generally limited.

Fallout from the current fiscal crisis in Greece may directly affect Albania, the former Yugoslav Republic of Macedonia and Montenegro through lower foreign exchange earnings from remittances and exports. It may also worsen the region's terms of borrowing in international capital markets through higher yields on sovereign debt. If subsidiaries of Greek banks in South-eastern Europe are forced to pull back resources to repair balance sheets at home, thereby further constraining credit supplies in the region, the economies of South-eastern Europe may be further affected.

Developing economies

Africa: growth strengthens but remains below potential

Africa's growth is expected to accelerate to 4.7 per cent in 2010 and to 5.3 per cent in 2011, from 2.4 in 2009. This upturn is mainly driven by the rebound of exports and commodity prices (particularly oil and minerals), the ongoing revival of manufacturing and investments, the fiscal and monetary stimuli and the fast-growing telecommunications sector. The sharpest rebounds will occur in some of the major hydrocarbon- and mineral-exporters, such as Angola and Botswana. Growth will also pick up in the other low-income countries that managed to navigate relatively well through the crisis, owing to their isolation from the financial turmoil and their terms of trade gains. The largest economy in the region, South Africa, is also expected to see clear recovery, despite still subdued domestic demand. Nonetheless, growth is expected to remain below pre-crisis levels in most countries of the region.

In addition, recent weaknesses in commodity markets could decrease the revenue prospects of countries reliant on exports of metals and oil. By contrast, exporters in the CFA-zone could benefit from the recent depreciation of the euro against other major currencies.

East Asia: the economic outlook is favourable despite potential fallout from debt crisis in Europe

East Asia's economies have rebounded strongly over the past year and the prospects for 2010 and 2011 are largely favourable; industrial production and exports are growing rapidly and improved labour market conditions are bolstering household demand. The region's recovery from the crisis has not only been faster than anticipated but is also remarkably broad-based and well balanced between different growth components. Led by strong growth in China, regional GDP is expected to increase by 7.3 per cent in 2010, up from 4.7 per cent in 2009. In 2011, growth is forecast to slow to 6.9 per cent in part owing to tighter monetary and fiscal policies.

Because of East Asia's strong macroeconomic fundamentals, the debt crisis in Europe is unlikely to have a severe negative effect on the region. Nevertheless, subdued growth across Europe, combined with a significant depreciation of the euro against East Asian currencies, could harm the region's export sectors. At the same time, if the crisis results in a renewed increase in global risk aversion and further deleveraging in the financial industry, the high level of corporate debt in countries such as the Republic of Korea may become a concern for policymakers.

South Asia: regional prospects improve as India's economy returns to strong growth

Economic activity in South Asia gained strength over the past year, driven by monetary and fiscal stimulus measures and a gradual recovery in private sector demand. Regional growth is forecast at 7.9 per cent in 2010 and 8.1 per cent in 2011, up from 5.1 per cent in 2009. In India and Sri Lanka, growth has picked up significantly on the back of strong expansions in manufacturing and services output and the prospects for 2010 and 2011 are positive. By contrast, economic conditions have remained weak in the Islamic Republic of Iran and Pakistan. Inflationary pressures continue to be elevated in most countries, especially for food products and utilities.

The overall impact of the debt crisis and the fiscal tightening in Europe on South Asian economies is likely to be limited. However, weaker demand as a result of subdued growth across Europe may limit the region's export recovery. In addition, countries with weak fiscal and external positions, such as Pakistan and Sri Lanka, may face difficulties in obtaining loans.

Western Asia: economic rebound subject to oil prices and exchange rates

Following a contraction of 1.0 per cent in 2009, aggregate regional growth in West Asia is forecast to reach 4.2 per cent in 2010, and 4.0 per cent in 2011. Oil-exporting countries continue to benefit from higher oil prices which, in turn, will back expansionary fiscal policies and thereby support private consumption. In Saudi Arabia, for example, GDP growth is expected to recover to 3.4 per cent in 2010, up from 0.2 per cent in 2009. The non-oil exporting countries will see a continued recovery in light of improved global economic conditions. For example, GDP growth is expected to reach 3.5 per cent in Turkey in 2010, compared to a contraction of 4.7 per cent in 2009. Growth rates have also been revised upwards for Lebanon and Israel. Non-oil exporters will see further increases in their growth rates in 2011 if external demand continues to recover as projected in the baseline forecast.

This outlook is subject to considerable uncertainty, especially in view of recent developments in financial markets. For the oil-exporters, a more pronounced and sustained fall in oil prices would upend fiscal budgets and, as a secondary effect, could pull the plug out of the measures stimulating investment and consumption demand. For non-oil exporters such as Turkey and Israel, recent appreciation of their currencies vis-à-vis the euro holds the potential to crimp the economic recovery through weaker exports.

Latin America: economic recovery is varying significantly across countries

After contracting by 2.1 per cent in 2009, the economies in Latin America and the Caribbean are rebounding strongly on the back of higher commodity prices. Regional GDP is expected to increase 4.0 per cent in 2010 and 3.9 per cent in 2011. The recovery varies significantly across countries, however. South American economies, with the exception of Venezuela (Bolivarian Republic of), will rebound more strongly, benefiting from vigorous mining exports and robust domestic demand. Brazil, for instance, is expected to post 5.8 per cent of GDP growth in 2010. In contrast, the economies of Mexico, Central America and the Caribbean are expected to see only a modest rebound from there steep contractions in 2009, given their dependence on the speed of recovery in the United States. Governments of the countries in the sub-region have limited fiscal space for additional stimuli and most of the smaller economies are expected to face higher current account deficits and may need to seek further support from multilateral financial institutions.

The recent instability in financial markets triggered by the debt crisis in Europe could increase downside risks in South America through two mains channels. First, lower commodity prices and euro depreciation are expected to decrease export revenues. In addition, higher risk aversion and tighter money are expected to reduce capital flows to the region—particularly foreign direct investment from Europe—if the banking situation in Europe deteriorates.