Chapter I
Global economic outlook

Prospects for the world economy in 2018–2019

Global growth has strengthened

The past decade has been characterized by fragile growth, high investor uncertainty and periodic spikes in global financial market volatility. As crisis-related fragilities and the adverse effects of other recent shocks gradually subside, the world economy has strengthened. Towards the end of 2016, global economic activity began to see a modest pickup, which extended into 2017.

World industrial production has accelerated, in tandem with a recovery in global trade that has been predominantly driven by stronger demand in East Asia. Confidence and economic sentiment indicators have also generally strengthened, especially in developed economies. Investment conditions have improved, amid stable financial markets, strong credit growth, and a more solid macroeconomic outlook.

In 2017, global economic growth is estimated to have reached 3.0 per cent when calculated at market exchange rates, or 3.6 per cent when adjusted for purchasing power parities\(^1\) — the highest growth rate since 2011 (figure I.1). Currently, all major developed economies are experiencing a synchronized upturn in growth. Compared to the previous year, growth strengthened in almost two thirds of countries worldwide in 2017.

Figure I.1
Growth of world gross product

As lingering fragilities following the global financial crisis subside, the world economy has strengthened

\(^{1}\) Purchasing power parities (PPPs) adjust for differences in the cost of living across countries. Developing countries have a higher weight in PPP exchange rate-based aggregations than when using market exchange rates. Since developing countries have been growing significantly faster than developed countries, the rate of global growth is higher when using PPP exchange rates.
At the global level, world gross product (WGP) is forecast to expand at a steady pace of 3.0 per cent in 2018 and 2019 (table I.1). Developing economies remain the main drivers of global growth. In 2017, East and South Asia accounted for nearly half of global growth, as both regions continue to expand at a rapid pace. The Chinese economy alone contributed about one-third of global growth during the year.

However, stronger economic activity has not been shared evenly across countries and regions, with many parts of the world yet to regain a healthy rate of growth. Moreover, the longer-term potential of the global economy continues to bear a scar from the extended period of weak investment and low productivity growth that followed the global financial crisis. Widespread weakness in wage growth, high levels of debt and elevated levels of policy uncertainty continue to restrain a firmer and more broad-based rebound in aggregate demand. At the same time, a number of short-term risks, as well as a buildup of longer-term financial vulnerabilities, could derail the recent upturn in global economic growth.

The recent acceleration in WGP growth, from a post-crisis low of 2.4 per cent in 2016, stems predominantly from firmer growth in several developed economies (figure I.2). Cyclical improvements in Argentina, Brazil, Nigeria and the Russian Federation, as these economies emerge from recession, also explain roughly a third of the rise in the rate of global growth in 2017.

The composition of global demand has shifted more towards investment over the last year. Gross fixed capital formation accounted for roughly 60 per cent of the acceleration in global economic activity in 2017 (figure I.3). This improvement, however, is relative to a very low starting point, following two years of exceptionally weak investment growth, and a prolonged period of lacklustre global investment activity. Business investment contracted in a number of large economies in 2016, including Argentina, Australia, Brazil, Canada,

Figure I.2
Contributions to change in world gross product growth by country, 2017

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<th>Percentage points</th>
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<td>Country-level forecasts underlying this summary table are reported in the Statistical annex. Unless otherwise specified, regional aggregations are based on 2010 market exchange rates.</td>
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### Table I.1
**Growth of world output, 2015–2019**

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<td>5.4</td>
<td>5.5</td>
<td>-0.3</td>
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**Memorandum items**

| World trade<sup>d</sup> | 2.9  | 2.2  | 3.7  | 3.5  | 3.6  | 1.0  | 0.2  |
| World output growth with PPP weights<sup>e</sup> | 3.3  | 3.1  | 3.6  | 3.7  | 3.7  | 0.1  | 0.0  |

*Source: UN/DESA.*

<sup>a</sup> Estimated.

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

<sup>c</sup> Fiscal year basis.

<sup>d</sup> Includes goods and services.

<sup>e</sup> Based on 2012 benchmark.
the Russian Federation, South Africa, the United Kingdom of Great Britain and Northern Ireland and the United States of America.

While investment is no longer a drag on global growth, the recovery remains moderate and contained to a relatively narrow set of countries. A more entrenched recovery in investment growth is likely to be held back by elevated levels of uncertainty over future trade policy arrangements, the impact of balance sheet adjustments in major central banks, as well as high debt and a build-up of longer-term financial fragilities. Further details on prospects for investment and its links to productivity over the medium-term are discussed in the next section of this chapter.

Recent economic gains have not been evenly distributed across countries and regions. East and South Asia remain the world’s most dynamic regions, benefiting from robust domestic demand and supportive macroeconomic policies. In contrast, economic conditions remain challenging for many commodity-exporting countries, underscoring the vulnerability to commodity boom and bust cycles in countries that are over-reliant on a narrow range of natural resources. Prospects in Africa, Western Asia and parts of South America remain heavily dependent on commodity prices (figure I.4).

Following the sharp global commodity price realignments of 2014–2016, commodity prices have not exhibited a common trend in 2017, but have been driven by sector-specific developments. As such, the economic performance of commodity exporters has diverged, with countries such as Chile starting to benefit from the upturn in copper prices, while the drop in cocoa prices has led to a deterioration in economic prospects in Côte d’Ivoire. For the most part, currency pressures associated with the steep price adjustments have eased, allowing some scope for policy easing in a number of countries. The moderate recovery in the price of oil from the lows seen in early 2016 has brought some respite to oil-exporting countries. However, given that oil prices stand at roughly half their average level in 2011–2014, growth prospects of the oil exporters will remain subdued over the forecast horizon, reinforcing the need for economic diversification.
The ongoing structural adjustments to commodity prices, coupled with political uncertainty or security challenges, explain much of the downward revision to GDP growth estimates in Africa and the Latin America and the Caribbean region for 2017 compared to forecasts reported in the *World Economic Situation and Prospects 2017* (United Nations, 2017) (figure I.5). At the global level, the current estimate for WGP growth in 2017 of 3.0 per cent represents a small upward revision to forecasts released a year ago. This adjustment is noteworthy in itself, as it marks the first occasion since 2010 that the world economy will exceed rather than disappoint expectations. The extended spate of downward revisions to forecasts over the previous seven years reflects repeated failures to recognize the extent of fragilities remaining after the global financial crisis. In addition, unexpected shocks such as commodity price realignment and the impact of policy measures — notably fiscal tightening in developed economies — were also underestimated. These headwinds have now eased.

The upward revision to growth estimates for 2017 stems predominantly from firmer-than-expected growth in several developed economies — notably in Europe and Japan — as well as a faster-than-anticipated recovery in the Russian Federation, which is supporting a broader growth revival in the region.

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3 In the case of Latin America and the Caribbean, a significant part of the downward revision is due to the deeper-than-expected recession in the Bolivarian Republic of Venezuela.
Figure I.5
Forecast revisions relative to WESP 2017, GDP growth in 2017

Source: UN/DESA.

Notes: Figures compare GDP growth forecasts for 2017 in WESP 2017 to GDP growth estimates for 2017 in WESP 2018. Libya and Venezuela (Bolivarian Republic of) are excluded from the figure. Only selected points are labelled for clarity. See Table J in the Statistical annex for definitions of country codes.
Chapter I. Global economic outlook

The uneven pace of global economic recovery continues to jeopardize prospects for achieving the Sustainable Development Goals (SDGs). While the overall growth prospects of the global economy may have improved, forecasts for a few regions, including some of the world’s poorest countries, have been revised downward. Many of these countries have even suffered setbacks in progress towards the SDGs, as GDP per capita declined in four major developing regions last year (figure I.6). Further setbacks or negligible per capita growth is anticipated in Central, Southern and West Africa, Western Asia, and Latin America and the Caribbean in 2018–2019. These regions combined are home to nearly 20 per cent of the global population, and more than one-third of those living in extreme poverty. This pushes the targets of eradicating poverty and creating decent jobs for all further from reach, and poses risks to many of the other SDGs.

At the same time, according to preliminary data, the level of global carbon dioxide emissions from fossil fuel combustion and cement production increased in 2017, after having remained flat between 2013 and 2016 (Global Carbon Project, 2017). This suggests that the return to stronger economic growth may also result in rising emissions levels. These factors underscore the importance of addressing some of the longer-term structural issues that hold back more rapid progress towards sustainable development.

Only a small handful of the least developed countries (LDCs) are expected to reach the SDG target for GDP growth of “at least 7 per cent” in the near term. As a group, the LDCs are projected to grow by 4.8 per cent in 2017 and 5.4 per cent in 2018. These figures are a significant improvement compared to the growth rates seen in 2015 and 2016, reflecting more benign global conditions and gradually rising commodity prices. However, the achievement of more rapid progress in many of the LDCs is hampered by institutional deficiencies, inadequate basic infrastructure as well as high susceptibility to weather-related or commodity price shocks, given the lack of economic diversification. These challenges are exacerbated by security and political uncertainty in several countries (see Box I.1 for further discussion on LDCs).

Figure I.6
Average annual GDP per capita growth by region

Prospects for least developed countries

Growth in the least developed countries (LDCs)\(^a\) is expected to rise modestly from an estimated 4.8 per cent in 2017 to 5.4 per cent and 5.5 per cent in 2018 and 2019, respectively. The acceleration is due mostly to more favourable external economic conditions and, in particular, firming commodity prices, which support trade, financial flows and investment in natural resource projects and infrastructure. GDP per capita grew by an estimated 2.5 per cent in 2017, which solidifies the recovery from the lows of 2015–2016, but remains subdued compared to the momentum reached before 2007. Prospects for the group are positive with per capita growth expected to accelerate to 3.0 per cent in 2018 and 3.2 per cent in 2019.

However, given the depth and extent of poverty and inequality among LDCs, tangible improvements in quality of life will remain limited. Structural challenges continue to hamper significant progress in economic and social development. This includes a lack of infrastructure and public services, political instability and institutional deficiencies and vulnerability to shocks from commodity revenue and extreme weather events.

Moreover, despite facing better prospects, the LDCs as a group will not accomplish SDG target 8.1 this year, which calls for “at least 7 per cent gross domestic product growth per annum” in the LDCs. Nonetheless, some countries in the group will achieve average growth above or close to 7 per cent in 2018–2019, and the majority will grow at a 5 per cent or higher rate by the end of 2019 (see figure I.1.1). Bangladesh is projected to be among the fastest growing LDCs in 2018 with expected real GDP growth of 7.1 per cent, supported by vigorous domestic demand, especially private investments.

Bhutan is also expected to grow by 7.1 per cent in 2018, benefitting from infrastructure investments. The fastest growing East Asian LDCs include Cambodia, the Lao People’s Democratic Republic and Myanmar with growth rates forecast to be slightly above 7 per cent in 2018–2019, mainly as a result of export growth and infrastructure projects.

\(^a\) South Sudan and Tuvalu are not included in the analysis due to insufficient data. Equatorial Guinea is excluded from the aggregation, as it became the fifth country to graduate from the least developed country category on 4 June 2017.

Figure I.1.1
Real GDP growth in the least developed countries group

Source: UN/DESA forecasts.
In Africa, the fastest pace of growth is in countries in the eastern region, including Djibouti, Ethiopia, Rwanda and the United Republic of Tanzania, underpinned by infrastructure investments, resilient services sectors and the recovery of agricultural production. Senegal in West Africa has joined this group, spurred by greater competitiveness, progress in structural reforms and favourable external conditions, such as positive terms of trade, favourable climatic conditions and a stable security environment.

Some LDCs face prominent growth challenges. Conflict-afflicted Yemen has been in recession for the past several years. The ongoing armed conflict has inflicted significant damage to the agriculture sector and the crumbling institutional infrastructure is expected to prevent a significant rebound in the near future.

Following estimated growth of only 1.3 per cent in 2017, Haiti is forecast to see a moderate pickup in economic activity by 2019, amid continued reconstruction of infrastructure and recovery in the agricultural sector. However, severe macroeconomic imbalances, political unrest and natural disasters threaten to derail the recovery.

Strong public and private investment is a common feature among those LDCs that are growing at over 7 per cent per year. As explained in the State of the Least Developed Countries 2017 (UN-OHRLLS, 2017), an additional investment of $24 billion per year would suffice to bring the group, on average, to 7 per cent GDP growth between 2016 and 2020.

Funding of such investment could come from a combination of sources. Domestic resource mobilization features prominently in the Istanbul Programme of Action and the Addis Ababa Action Agenda as a means to finance current investment gaps, namely in poverty alleviation and public service delivery.

As an analytical exercise, we can consider a scenario in which the additional investment of $24 billion is funded solely through domestic public resource mobilization. In this case, general government revenue in the LDCs would have to increase by approximately 13 per cent in 2018 and 2019. As most of these countries struggle to raise tax revenue, which amounts to less than 15 per cent of GDP in half of the LDCs (ibid.), an increase in tax revenue of this magnitude would prove overly burdensome for some countries in the short term.

An alternative scenario to consider is financing the additional investment through international public finance. Should official development assistance (ODA) from OECD Development Assistance Committee (DAC) members fill the investment gap in the LDCs, it would have to roughly double as compared to 2016 levels.

This would represent a commitment by DAC members of providing 0.11 per cent of gross national income (GNI) in ODA to LDCs. This would be 0.04 percentage points below the lower end of the 2030 Agenda target of achieving 0.15 per cent to 0.2 per cent of ODA/GNI to LDCs. Other types of concessional international public finance could also help fund investment needs, including lending by multilateral development banks, although debt sustainability is a concern for many LDCs.

Mobilizing domestic or international private sector resources to finance investment needs can be considered as a third scenario. Foreign direct investment (FDI) to LDCs is estimated to have totalled $33.4 billion in 2017. In order to meet the additional investment needs entirely through FDI, inflows would have to increase by 50 to 60 per cent in 2018 and 2019. In practice, FDI in LDCs remains heavily concentrated in a few countries and in the extractive industries. Directing FDI towards the longer-term infrastructure and economic diversification needs across all LDCs remains an important policy challenge.

Only a few of the LDCs are expected to grow fast enough to progress substantially towards the SDGs, while the others urgently need developed countries to meet their targets for ODA. Amid imperfect institutional frameworks and business environments, efforts and incentives are necessary to bolster both FDI and domestic resource mobilization. Finally, policies to promote economic diversification are needed, in order to support long-term sustainability and more inclusive growth.

Box I.1 (continued)

b For simplicity, the calculations in this section ignore linkages between financing sources.

Authors: Helena Afonso (UN/DESA/DPAD), Miniva Chibuye (UN-OHRLLS) and Michal Podolski (UN/DESA/DPAD)
Benign global inflation against a backdrop of stronger growth

In developed economies, the uptick in GDP growth has been associated with an easing of deflationary pressures, which posed a key policy concern in 2015–2016. In the first half of 2017, inflation dynamics in many countries were impacted by the steep year-on-year rise in energy prices relative to the lows seen in early 2016. While this transitory impact had largely dissipated by mid-year, longer-term inflation expectations in developed countries, as measured by the difference between nominal and inflation-indexed government bond yields, have edged upward relative to 2016 levels, suggesting that expectations of a return to deflation have diminished.

The upward shift in inflation led the President of the European Central Bank (ECB) to state in March 2017 that “the risks of deflation [in Europe] have largely disappeared”. Subsequently, the ECB halved the pace of its asset purchases. In Japan, inflation has edged above zero, while in the United Kingdom and the United States headline inflation exceeded the central bank targets of 2 per cent for at least part of 2017. In aggregate, inflation in developed economies is expected to average 1.5 per cent in 2017, up from 0.7 per cent in 2016 (table I.2), but still well below central bank inflation targets.

By contrast, price pressures have eased in many large developing economies and economies in transition. This created space for several countries in South America, parts of Africa and the Commonwealth of Independent States (CIS) to cut interest rates in 2017, easing monetary conditions and providing more support to economic activity (see figure I.A.5 in Appendix). In countries such as the Russian Federation and South Africa, this partly reflects a recovery in exchange rates, following sharp depreciations in 2015–2016. Meanwhile, high food price inflation has started to recede in a number of African countries, where agricultural shortages caused by severe drought and other weather-related shocks, compounded by distribution blockages related to conflict situations, drove food price inflation to double-digit levels in the first few months of 2017.

Figure I.7 compares the estimate for consumer price inflation in 2017 to the upper-end of central bank targets. Inflation is at or below target in about 75 per cent of the countries in the sample. The countries exceeding official inflation targets are predominantly in Africa, where inflation rates remain relatively high in several countries, despite stabilizing exchange rates and some easing of food price inflation. A few countries in the CIS also continue to experience high inflation relative to their targets. Nonetheless, inflation has for the most part come down over the course of the year in these regions.

Global inflationary pressures are expected to remain relatively benign. In developed economies, inflation is expected to hover close to central bank targets in 2018–2019. Despite low unemployment in many developed economies, wage pressures generally remain weak. This may in part be a reflection of rising inequality and limited bargaining power of those on the lower end of income scales. The rise in inequality bears its own risks for the real side of the economy, as discussed below. Unless demand accelerates or there is a marked shift in wage pressures, inflation in developed economies will likely remain moderate. A re-emergence of deflationary pressures would pose a policy challenge for central banks, as they move towards the withdrawal of monetary stimulus.

In many developing regions and economies in transition, steady or declining inflation may lead to more monetary easing. Nonetheless, there is a risk that market reactions to

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4 The sample only includes countries that have an explicit or implicit target rate for inflation, and so excludes some countries with very high inflation, such as the Bolivarian Republic of Venezuela.
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<th>2018c</th>
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</table>

Source: UN/DESA.

a Figures exclude Venezuela (Bolivarian Republic of).
b Estimated.
c Forecast, based in part on Project LINK.
monetary adjustment in developed economies could trigger greater volatility. If this were to lead to currency depreciations in developing countries — especially those with more open capital markets — inflationary pressures could rise, leaving countries exposed to capital withdrawal and higher financing costs.

Scope to reorient policy towards longer-term issues

Against the backdrop of stronger economic growth and benign inflationary pressures in developed countries, the world economy has reached a turning point in macroeconomic policy conditions. Many of the world’s major central banks are now able to start withdrawing the exceptional stimulus measures that have been in place for nearly a decade.

The United States Federal Reserve (Fed) has charted a path to normalize the size of its balance sheet and is inching towards interest rate normalization. The ECB has tapered the pace of asset purchases, and may stop expanding its balance sheet by the end of 2018. Meanwhile, the Bank of Canada raised interest rates by 50 basis points in the first nine months of 2017, and the Bank of England increased its policy rate by 25 basis points in November 2017, with the prospect of further interest rate hikes ahead. The monetary stance in Japan, by contrast, is expected to remain highly accommodative over the forecast horizon, as Japan continues to battle against deeply entrenched deflationary expectations.

Alongside a curbing of monetary stimulus, the fiscal stance in most developed economies has become less restrictive, moving away from the tight fiscal austerity programmes in place in many countries since 2010. Public sector investment has shown a strong rebound in Canada, Germany and the United Kingdom. This marks a significant reversal from the steep investment spending cutbacks pursued by most governments in developed countries since 2010. Overall, the net fiscal impulse is expected to be neutral or slightly expansionary in 2018 in most developed countries, with stronger fiscal stimulus measures in some, including Australia, Canada and Japan. Further details on specific fiscal policy assumptions are provided in the Appendix.
Chapter I. Global economic outlook

The less restrictive fiscal stance comes in the wake of extended fiscal spending cuts, leaving the size of the government sector significantly reduced in North America and Europe compared to before the global financial crisis.

In developing countries and economies in transition, some of the fiscal and monetary pressures in commodity-exporting countries have eased, as commodity prices have stabilized or partially recovered losses. Nonetheless, the policy stance will remain constrained in 2018–2019, as countries continue to adjust to the lower level of commodity prices. The policy stance in energy-importing countries, including most in East and South Asia, remains broadly accommodative, with several announcing measures to stimulate investment in infrastructure.

The slow withdrawal of stimulus by the Fed has thus far not led to a significant tightening of global financial conditions. Financial market volatility remains low, and capital has started flowing back towards developing economies. Many of the crisis-related legacies — such as sluggish demand, fiscal austerity and bank fragility — are easing, fostering a more conducive environment for a recovery in investment. Nonetheless, numerous cyclical and longer-term challenges persist in the world economy, including a legacy of weak investment and low productivity growth since the crisis, declining or stagnant average incomes in several regions, emerging protectionist tendencies in some arenas, and high levels of global debt.

Current high asset price valuations suggest an underpricing of risk, and developing economies — especially those with more open capital markets — remain vulnerable to spikes in risk aversion, an abrupt tightening of financing conditions, and sudden capital withdrawal. Elevated levels of policy uncertainty continue to cloud prospects for world trade, development aid, migration and climate targets, while rising geopolitical tensions could sharpen a tendency towards more unilateral and isolationist policies. These outlook risks and the policy challenges they pose are developed further in Chapter II.

Despite risks and uncertainties, current conditions include an alignment of the economic cycle among major economies, stability in financial markets and the absence of negative shocks such as commodity price dislocations.

As conditions for wider global economic stability solidify, there is a diminishing need to focus policy efforts on stabilizing short-term growth and mitigating the effects of economic crises. Coupled with improving macroeconomic and financial conditions to support the vast investment needed to progress towards many of the SDGs, this paves the way to reorient policy towards longer-term issues, such as strengthening the environmental quality of economic growth, stimulating more inclusive growth, and tackling institutional deficiencies that are hindering development prospects.

Investment and productivity

Conditions for investment have improved

Following two years of exceptionally weak investment growth, plus a prolonged episode of overall lacklustre global investment, some signs of revival in global investment have emerged. Conditions for investment have generally improved, supported by more favourable macroeconomic conditions and reduced banking sector fragilities in developed economies. Financing costs remain low, and spreads have narrowed in many emerging markets, reflecting a decline in risk premia. This has supported rising capital flows to emerging markets amid low global financial volatility; stronger credit growth in both developed and
developing economies — including a rise in cross-border lending — and recovery in some commodity sectors.

At the global level, investment is no longer acting as a drag on growth, and, in fact, contributed roughly 60 per cent of the acceleration in global economic activity in 2017. However, the recent revival in investment is relative to a very low starting point, and thus far remains contained to a relatively narrow set of countries. A firmer and more broad-based rebound in investment activity, which is needed to support stronger productivity growth in the medium-term and accelerate progress towards the SDGs, is likely to be held back by heightened policy uncertainty, high levels of debt, and a build-up of longer-term financial fragilities in several large developing economies. The longer-term impact of the improvement in investment conditions will depend on the extent to which available financing can be channelled into productive investments, rather than financial assets.

In developed economies, private non-residential investment generally showed more resilience in the first half of 2017, as illustrated in figure I.8. In Japan, a surge in investment was spurred by a strong rebound in credit growth supported by monetary policy measures. Adjustment in mining-related sectors continued to restrain investment in Australia and Canada, although in the case of Canada this was offset by stronger residential investment, driven by the steady rise in house prices.

In the United States, following two years of steep cutbacks, investment in mining exploration, shafts and wells rebounded sharply in the first half of 2017. This may in part reflect an easing of environmental regulation, as well as technology improvements in horizontal drilling and hydraulic fracturing, which have significantly increased productivity, reducing the breakeven price of tight oil extraction. Investment in the United States was also supported by a relatively strong housing market, and investment in machinery and equipment.

Heightened uncertainty surrounding the future relationship of the United Kingdom with its trading partners after it withdraws from the European Union (EU) has depressed

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**Figure I.8**

**Average annualized percentage change in private investment, decomposed by asset type (constant prices)**

![Graph showing average annualized percentage change in private investment, decomposed by asset type.](image-url)

**Sources:** United States Bureau of Economic Analysis, Eurostat, Statistics Canada, Cabinet Office of Japan and Australia Bureau of Statistics.

**Note:** Figures for EU and Japan include public sector investment.
investor sentiment, deterring investment in the United Kingdom. However, investment in the EU as a whole remains steady, supported largely by both residential and non-residential construction.

It is encouraging to note that, except in the case of Australia, investment in machinery and equipment has contributed a significant share of recent investment growth in developed economies. If sustained, stronger investment in machinery and equipment could underpin stronger productivity growth over the medium-term.

In developing countries and economies in transition, investment dynamics have differed starkly across countries and regions. To a large extent these differences reflect commodity sector developments since 2014, which have driven a broad shift in income away from commodity exporters and towards commodity importers. Global investment in natural resources surged during the commodity boom of 2011–2013. The subsequent collapse in investment, as commodity prices realigned at a lower level, exemplifies the vulnerability to boom and bust cycles of countries that are overly reliant on a small number of natural resources.

Figure I.9 illustrates recent investment developments in selected large developing and transition economies. A sharp decline in investment in the commodity sector has weighed on overall investment growth in Brazil, the Russian Federation and South Africa. Several oil-exporters in Western Asia have also seen steep cuts in public investment as part of fiscal adjustment to lower oil prices. In the Russian Federation, the decline in private investment also reflects the impact of international sanctions on access to capital and business sentiment, but an investment recovery is now underway, acting as an important driver of the recovery in the CIS region. Political uncertainty and social unrest have also impacted the investment climate in Brazil and South Africa. While in East Asia investment has remained relatively strong, in South Asia it has been restrained by fragilities in India’s banking sector.

Looking forward, firmer global investment may spread to a wider set of countries, in light of better investment conditions. However, investment growth will likely stay relatively modest in most countries. Investors may postpone major investment decisions, given deep uncertainties regarding tax policy and major trade policy agreements with Europe and the

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**Figure I.9**

*Average year-on-year change in gross fixed capital formation in selected developing and transition economies (constant prices)*

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<thead>
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<th>Percentage</th>
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<td>2016</td>
<td>1st half 2017</td>
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<td>-5</td>
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</table>

Sources: OECD Quarterly National Accounts, United Nations Statistics Division National Accounts Main Aggregates Database, CEIC, Project LINK.
United States. This could continue until it is clear how any policy shifts will impact production and transaction costs.

Considerable uncertainties regarding the impact on global markets of balance sheet adjustment in major central banks may also deter near-term investment decisions. If markets manage to weather the path of monetary policy normalization without severe disruption, the conditions for a stronger rebound in global investment over the medium-term — beyond the current forecast horizon — will start to take shape. However, high levels of debt and longer-term financial fragilities may continue to constrain investment in some large developing economies.

Productivity growth strengthening from a low level\(^5\)

The tentative revival of global investment marks an important step towards a more broad-based recovery in global productivity and rise in the longer-term potential of the world economy, especially if it becomes more decisively geared towards productive investment in machinery and equipment. However, the overhang of the extended period of weak global investment will likely weigh on productivity growth over the medium-term forecast horizon.

The improvement in the world economy since mid–2016 has been accompanied by a moderate pickup in productivity growth. After growing by only 1.3 per cent in both 2015 and 2016, global labour productivity is projected to increase by 1.9 per cent in 2017.\(^6\) This rate is, however, still slightly below the 1990–2015 average of 2.1 per cent (figure I.10). The recent upturn in productivity growth has been geographically broad-based, with most developed, developing and transition economies posting gains.

Figure I.10
Labour productivity growth, developed versus emerging and developing economies

![Graph showing labour productivity growth](image)

**Source:** UN/DESA, based on data from The Conference Board Total Economy Database™, May 2017 Update.

**Note:** Country groupings differ slightly from those defined in Statistical annex Table A.

\(^5\) The main source of data used in this section is the Conference Board’s Total Economy Database (TED), May 2017 Update available from http://www.conference-board.org/data/economydatabase/. Regional aggregates differ from those defined in the Statistical annex.

\(^6\) Labour productivity is measured here as GDP (output) per person employed. While output per hour worked is generally a preferred measure, it is not available for many developing countries. Global and regional aggregates as well as cross-country comparisons of productivity growth are therefore generally based on output per person.
Among developed economies, Japan, the United States and Western Europe have all seen productivity growth strengthen over the past year, albeit from low levels. Average labour productivity growth in developed economies is estimated to have accelerated from 0.5 per cent in 2016 to 1 per cent in 2017.

It is unclear, however, whether this recent improvement in productivity growth can be sustained going forward. In order to have a better picture of the outlook, it is important to understand the factors that have been driving productivity growth developments in the past. The period since the global financial crisis has been characterized by exceptionally slow labour productivity growth in developed economies. As illustrated in figure I.11, the slowdown can be attributed to lower contributions from capital deepening (information and communications technology (ICT) and non-ICT) and total factor productivity (TFP) growth. In fact, the average contribution of TFP growth to labour productivity was negative during the period 2011–2016 in both the United States and Western Europe.

Much of the recent weakness in labour productivity is the result of sluggish private and public investment in the wake of the global financial crisis, the euro area debt crisis and the sharp fall in commodity prices. The level of capital stock in developed economies has remained stagnant since 2008 (figure I.12), as investment over this period has been barely sufficient to cover the depreciating value of existing capital stock. Weak investment has not only slowed capital deepening, but has also weighed on TFP growth by hampering the adoption of capital-embodied technologies.

A range of factors have been identified as contributing to the investment slump, including subdued aggregate demand, widespread austerity policies, fragile bank balance sheets, elevated policy uncertainty and low commodity prices. While still relevant, some of these restraining factors have eased over the past year. This suggests that the recent upturn in investment and productivity growth may prove more sustained than other temporary episodes in recent years.

However, slow productivity growth across developed economies cannot solely be attributed to the legacies of recent economic and financial crises. As documented by Dabla-
Norris et al. (2015), productivity growth has been gradually declining since the 1970s and 1980s in virtually all developed countries. The global financial crisis and other cyclical shocks over the past decade merely exacerbated an ongoing trend. Structural, long-term forces that are contributing to the secular decline in productivity growth include demographic trends (especially aging populations), waning gains from the ICT revolution and a slowing pace of innovation and trade integration (see, for example, Adler et al., 2017). Examining productivity trends from a sector-level perspective in developed economies, Dabla-Norris et al. (ibid.) show that the long-term slowdown in productivity growth — in particular TFP growth — reflects two broad factors: a reallocation of resources to sectors where productivity levels and growth were lower, in particular service industries; and declining productivity growth within the sectors that account for an increasing share of employment, such as social and administrative services.

A return to sustained labour productivity growth in developed economies of about 2 per cent — as seen in the 1990s and early 2000s — will therefore likely remain elusive without far-reaching policy reforms that address the short- and longer-term barriers.

In developing and transition economies, average productivity growth has also improved notably over the past two years, rising from 1.7 per cent in 2015 to an estimated 2.7 per cent in 2017. For the first time since 2011, all regions are expected to record positive labour productivity growth. Despite a modest recovery, however, growth in Africa and Latin America and the Caribbean is still subdued. Furthermore, average productivity growth in these regions remains far lower than in Asian economies, including China and India.

As in the case of developed countries, the latest upturn follows a marked decline in productivity growth following the global financial crisis. As illustrated in figure I.13, this slowdown has been largely due to a sharp downturn in TFP growth, whereas the contribution of non-ICT capital services held up well. In Africa, East Asia and Latin America and the Caribbean, average TFP is estimated to have fallen between 2011 and 2016. This
suggests that developing countries have been experiencing slower efficiency gains and technological absorption since the global financial crisis.\footnote{Measurement problems resulting from the fact that TFP is a residual may also have played a role in the observed slump in TFP growth.}

The reasons behind the weakness in TFP growth vary from country to country and include both cyclical factors — such as weak developed market demand and low commodity prices — and structural influences, including slower trade integration and less dynamic economic transformation processes. In the cases of Africa and Latin America and the Caribbean, the recent poor productivity performance reflects more fundamental, long-term challenges. As shown in figure I.14, labour productivity growth since the 1980s has rarely exceeded 2 per cent in these regions. Rodrik (2016) attributes this weakness to a broad-based absence of industrialization or even premature deindustrialization.

For developing economies, prolonged weak productivity growth will not only adversely impact medium-term growth prospects, but could severely undermine progress on the SDGs. Therefore, policy measures to revive productivity growth, such as tackling infrastructure deficits, improving the quality of education and enhancing research and development should be prioritized.

**Modest progress in renewable energy investment**

Investment in renewable energy accounts for approximately 1.5 per cent of total global fixed capital formation. Approximately 138.5 gigawatts of global renewable power capacity (excluding large hydro-electric projects of more than 50 megawatts) were added in 2016, but only for 11.3 per cent of global power generation.
up 9 per cent from the 127.5 gigawatts added the year before. This means that renewables accounted for over 55 per cent of all newly installed power generation capacity for the first time. The current share of renewables in global power generation is thought to have prevented the emission of 1.7 gigatons of carbon-dioxide equivalent, or 5.3 per cent of total carbon emissions in 2016. However, renewable energy (excluding large hydro), still accounts for only 16.7 per cent of global power capacity and 11.3 per cent of global power generation. Renewable energy investment continues to be dominated by just two sectors — solar and wind, which represent 93.7 per cent of new investment.

In value terms, total global spending in 2016 on renewable energy investment (excluding large hydro) decreased 23 per cent compared to the previous year, totalling $241.6 billion — the lowest level since 2013 (figure I.15). This was partly due to falling costs — the average investment costs per megawatt of solar photovoltaic and wind power fell by over 10 per cent (Frankfurt School-UNEP Centre/BNEF, 2017). It was also due to lower levels of investment in China, Japan and some emerging markets.

Developed economies regained their lead over developing countries in renewables investment, mostly due to lower levels of investment in China, as weaker-than-expected electricity demand and delayed grid connections slowed energy investment in 2016–2017. However, China remains the world’s biggest investor in renewables, with investment of $78.3 billion in 2016, which accounted for 32.4 per cent of global new renewables investment. In Europe, investment peaked during the 2010–2011 solar expansions in Germany and Italy, but a boom in offshore wind saw huge projects being approved by both Germany and the United Kingdom in 2015 and 2016, including the world’s largest non-hydro renewable energy investment — the 1.2 gigawatt Hornsea offshore wind project, located off the coast of England. Africa and the Middle East have also started to account for a greater number of large projects. In Asian and Pacific countries, a long upswing in investment came to an end in 2016 with slowdowns in the financing of photovoltaic projects, including in Japan.
Despite the drop in 2016, preliminary data indicate slightly higher levels of renewables investment in 2017. In the first three quarters of 2017, new renewables investment in clean energy increased by 2 per cent year-over-year (Louw, 2017). Seven massive wind projects, each costing between $600 million and $4.5 billion, in Australia, China, Germany, Mexico, the United Kingdom and the United States, were part of this boost.

**International trade and commodities**

**Emerging Asia drives rebound in international trade flows**

Buoyed by the cyclical upturn in global growth, world trade rebounded in 2017, expanding at an estimated pace of 3.7 per cent during the year (figure I.16). This follows exceptionally weak trade flows in 2016, with global trade volume expanding at a post-crisis low growth rate of 2.2 per cent.

The recovery in international trade was accompanied by a pickup in world industrial output and a rise in the Global Manufacturing Purchasing Managers’ Index to a six-year high. Demand for international air freight and container shipping also gained momentum in 2017, amid stronger export orders and relatively higher prices of key commodities, in particular crude oil and metals. The modest investment revival in several developed and developing economies — which has contributed to increased trade of capital and intermediate goods — is seen as spurring the global trade rebound.

Nevertheless, while trade elasticity (calculated as the ratio of global trade growth to WGP growth) rose from 0.9 in 2016 to 1.2 in 2017, it remains low compared to the ratios seen in the 1990s and early 2000s. This suggests that structural factors are continuing to weigh on the growth momentum of global trade, as elaborated below.

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8 Clean energy investment differs from renewable energy investment, as the former also includes low carbon services (e.g., carbon markets) and energy smart technologies (e.g., battery storage and electric vehicles). Renewable energy investment accounted for around 82 per cent of global clean energy investment in 2015.
In the first eight months of 2017, world merchandise trade grew at its fastest pace in the post-crisis period. The strong growth, however, was in part due to a low base effect, given the exceptional weakness in trade flows observed in the first half of 2016. From the imports perspective, there was a marked variation in the strength of import demand between regions (figure I.17).

In the first eight months of 2017, emerging Asia contributed 60 per cent of growth in global merchandise imports. This was triggered by stronger domestic demand across the region and supported by policy stimulus measures in many economies, including China. In several major developed economies, including the EU, Japan and the United States, imports of capital goods rebounded during the first half of 2017, as firms responded to improving conditions for investment, as discussed in the previous section.

Among the other developing regions, Latin America saw a modest recovery in import demand as large economies, including Argentina and Brazil, emerged from recession. In contrast, however, import demand from Africa and the Middle East continued to decline, reflecting the continued weakness in commodity-related revenue, depreciated domestic currencies and dampened investment activity. Notably, investment prospects remain subdued in many Organization of the Petroleum Exporting Countries (OPEC) member countries, weighed down by cuts to oil production on top of fiscal consolidation efforts. Investment activity in many economies in the region has also been affected by political uncertainty.

From the exports perspective, the recovery in global merchandise exports was broad-based across developed, developing and transition economies (figure I.18). A pickup in investment activity in developed economies as well as in a few developing economies, including China, provided an impetus to export growth of the developing regions. In the emerging Asia region, exports were also buoyed by an upturn in trade in electrical and electronic products (see further details in the section on East Asia in Chapter III), reflecting the region’s close integration with global value chains in the industry. Meanwhile, exports from the United States benefited to a certain extent from a weaker dollar.

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9 Merchandise trade volume data comes from the CPB Netherlands Bureau for Economic Policy Analysis. Regional groupings differ from those defined in the Statistical annex.
Chapter I. Global economic outlook

Looking ahead, world trade is expected to remain on a moderate growth trajectory, expanding by 3.5 per cent in 2018 and 3.6 per cent in 2019. These projections, however, are contingent on continued benign growth and investment conditions in the global economy. For the commodity exporting economies, the projected modest rise in global commodity prices will support import demand, amid easing pressures on revenue and domestic currencies.

Trends in global capital expenditure have important implications for international trade flows, given the high import intensity of fixed investment relative to other compo-

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**Figure I.17**

**Contribution to global merchandise import volume growth by region**

![Chart showing contribution to global merchandise import volume growth by region]

*Source: UN/DESA based on data from CPB Netherlands Bureau for Economic Policy Analysis.*

**Figure I.18**

**Contribution to global merchandise export volume growth by region**

![Chart showing contribution to global merchandise export volume growth by region]

*Sources: UN/DESA based on data from CPB Netherlands Bureau for Economic Policy Analysis.*

World trade to continue growing at a moderate pace
nents of aggregate demand (Bussière et al., 2013). Auboin and Borino (2017) found that the
sharp slowdown and subsequent subdued recovery in the most trade-intensive components
of GDP, particularly investment, accounted for 80 per cent of the global trade slowdown
in the post-crisis period. On average globally, the import content of investment amounts to
about 30 per cent, as compared to 23 per cent for private consumption and 15 per cent for
government spending (IMF, 2016).

While cyclical headwinds to global trade have largely dissipated, several downside
risks remain. In particular, if trade protectionist tendencies were to increase, this could pose
a significant setback to the recovery in global trade. The decisions of the United States to
renegotiate the North American Free Trade Agreement (NAFTA), and to reassess the terms
of its other existing trade agreements have raised concerns over possible retaliatory measures
by other countries, which could lead to a sharp escalation in trade barriers.

Notwithstanding the risk of more restrictive trade policies, uncertainty surrounding
the United Kingdom’s negotiations for “Brexit” — as it prepares to leave the EU — may
also undermine the global trade outlook through a deterioration in business confidence
and investment activity in Europe. Sudden monetary policy shifts, such as a faster-than-ex-
pected withdrawal of stimulus by the Fed, could trigger abrupt financial market adjust-
ments, which may affect the availability of trade finance. In addition, a significant shift in
import demand from China would alter the global trade outlook. In particular, a decline in
demand for commodities in China could adversely affect commodity exporters, especially
exporters of metals. In 2016, China accounted for over 70 per cent of global demand for
iron ore, and over 40 per cent of demand for nickel and copper.

Several ongoing structural shifts remain constraints to trade growth in the medi-
um term. These include the diminishing effects of structural changes in the 1990s and
2000s, including the rapid expansion of global value chains, China’s accession into the
World Trade Organization (WTO) and the ICT revolution. A gradual transition towards
non-traded renewable energy may also impact global trade growth over the longer-term,
as traded fuels account for 10–15 per cent of global merchandise trade. Nevertheless, new
multilateral efforts, such as the “Belt and Road” initiative, 10 aimed at strengthening trade
and investment linkages between developing countries, may provide some impetus to glob-
al trade prospects going forward.

Trade in services

Trade in services could boost prospects for international trade growth. Between 2005 and
2016, growth in world services exports outpaced goods exports in value terms, resulting in
a rise in the share of services in total exports in both the developed and developing econo-
 mies. Trade in services has also exhibited higher resilience compared to trade in goods. In
2016, global services exports rebounded to show positive growth following a contraction
in 2015 (figure I.19). In contrast, goods exports continued to experience a decline in value
terms. Major economies continue to dominate global exports and imports of services. The
top 10 exporters accounted for over 50 per cent of global services exports in 2016, reflecting
the uneven participation in global services trade.

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10 The initiative of jointly building the Silk Road Economic Belt and the 21st Century Maritime Silk Road was
launched in 2013 by China.
Chapter I. Global economic outlook

Increased trade in services could potentially boost the growth and development prospects of developing economies. Services exports of developing economies have risen rapidly over the past decade, as reflected by the increase in developing economies’ share of global services exports from 23 per cent in 2005 to 29 per cent in 2016. By category, the main shares of global services exports of developing economies comprise construction, travel and transport services, in contrast with the trade profile of developed economies, which are more focused on higher value-added services (figure I.20). Nevertheless, the stronger growth of exports in telecommunication and ICT, financial and other business services — all growing at an annual pace of over 6 per cent between 2008 and 2016 (figure I.21) — is in line with the aspirations of developing economies to diversify their economic structures.

Conventional balance of payments statistics do not fully reflect the importance of services trade to an economy. Services can provide intermediate inputs in the production process and are often bundled into the final value of goods produced. This implies that there is a services element included in the value-added of output in all sectors. Exporting this element is referred to as mode 5 of services trade (Cernat and Kutlina-Dimitrova, 2014). In 2011, the value-added of services accounted for 44 per cent of total exports in developed economies and 32 per cent in developing economies. These figures are significantly higher than the direct exports of services reported in balance of payments data in the same year, of 25 per cent of total exports in developed and 14 per cent in developing economies (figure I.22). In recent years, close to two-thirds of the growth in the value added of direct exports has been attributed to an increase in services embodied in exports.

Furthermore, neither cross-border services trade data nor analyses of value-added in gross exports capture the increasing importance of services within manufacturing companies. In 2015, by adding services activities within manufacturing firms, the contribution of services to overall exports was close to two-thirds (Miroudot and Cadestin, 2017).
Moreover, both the analyses of value-added in gross exports and of in-house services in manufacturing firms revealed that the importance of services for trade is on par with their relevance for output, investment and employment. For example, in developing economies, services accounted for 55 per cent of output and 53 per cent of investment inflows in 2015, and 44 per cent of employment in 2016. These analyses also confirm the increased tradability of services, particularly when they are associated with inherently tradable goods and services.
Chapter I. Global economic outlook

The importance of services trade has also been underestimated given that under the General Agreement on Trade in Services (GATS), the definition of services trade is significantly broader than that defined by balance of payments statistics. Based on GATS, cross-border trade represents only one out of four different modes of services trade. Other modes of services trade such as commercial presence (mode 3) and the movement of natural persons (mode 4) are increasingly important (UNCTAD, 2016a). In 2013, 69 per cent of services exports in the EU were through mode 3. In addition, given the sizeable value of remittances channelled to developing countries, mode 4 of supplying services is of substantial importance for developing countries. In 2016, worldwide remittance flows were estimated to be $575 billion, with $429 billion flowing to developing countries (World Bank, 2017a). The relevance of migration for the services sector is also highlighted by the fact that around 71 per cent of migrant workers (150 million of the 232 million migrants in 2013, according to ILO, 2015) are concentrated in the services sector.

Services can boost an economy by providing inputs that increase the efficiency and capacity of all sectors, and by inducing a structural transformation which may favour higher-yielding sectors (see Box I.2). Services are, therefore, a valuable component in a country’s efforts to achieve the 2030 Agenda for Sustainable Development.

For a country’s economy to efficiently integrate GVCs, it needs to possess a well-developed ecosystem of business, professional and infrastructure services. Such an ecosystem helps micro, small and medium size enterprises (MSMEs) to also participate in global and regional value chains, leading to more developmental gains. Infrastructure services, such as financial services and telecom and ICT services, are especially important in this regard. Financial services are mentioned in both targets of SDGs that refer to MSMEs (8.3 and 9.3), and telecom and ICT services promote MSMEs’ inclusion through digital financial services and e-commerce.

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11 For more information, please see https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm

12 The cited number of migrant workers in services does not include those working in the construction sector.
Box I.2
Services and structural transformation

The services sector, which encompasses a wide range of activities, plays an increasingly important role in determining the direction of structural transformation in the global economy. Services constitute a major share of output, employment and investment, and play an increasingly important role in international trade, especially in developing countries, where they have grown faster and with more resilience than goods.

Services can provide intermediate inputs to all economic activities. They can be bundled with goods. They can also be developed within manufacturing companies. When considering all of these roles in conjunction with direct trade in services, services account for close to two-thirds of overall exports in a large sample of countries (Miroudot and Cadestin, 2017).

Through this wide range of channels, services facilitate productive and export processes and enable participation in global value chains (GVCs). They allow different activities to interact. Knowledge and technology-based services facilitate specialization.

These channels can support gains in efficiency and effectiveness, which in turn reduce production and trade costs, contribute to productivity gains and increase productive and export capacity. The shifts in relative prices from these gains are an important force driving structural transformation in production, employment, investment, trade and consumption decisions. Sectors supported via these services channels can outperform other sectors and develop a more prominent role in the economy’s structure.

Structural changes driven by these services roles may favour sectors with higher productivity, technological intensiveness or upgrading potential, leading to services-led growth. This implies significant development opportunities, as called for in target 8.2 of the SDGs, especially given the large productivity gaps between sectors in low-income countries (Mashayekhi and Antunes, eds., 2017).

The scope for productivity gains through these channels is particularly high in developing countries, where the value-added of services remains lower than in developed countries in many sectors (figure I.2.1). In fact, according to some estimates, the services sector is responsible for two-thirds of total productivity growth in developing countries (te Velde, forthcoming).

Figure I.2.1
Shares of services in total backward linkages in exports of selected sectors, 2011

Source: UNCTAD, based on World Bank’s Export Value Added Database.
Chapter I. Global economic outlook

Development linkages between services and structural changes are demonstrated by shifts from low to high-productivity sectors that have stimulated growth in Asia since 1990. In Viet Nam, services have contributed to transforming the economy and promoting industrialization. As a result, manufacturing has grown rapidly and no less than one-third of aggregate productivity growth can be linked to services (Hoekman and te Velde, eds., 2017).

Still, services-led changes do not automatically spur growth. In Africa and in Latin America and the Caribbean, structural changes involved worker displacements to lower-productivity activities, including services and the informal sector. This led to reduced growth. In Latin America, the contraction in the manufacturing sector contributed to this outcome by forcing a resource reallocation across sectors, (McMillan, Rodrik and Verduzco-Gallo, 2014).

Services are more likely to support a positive structural transformation in countries that exhibit strong productivity growth in manufacturing. Most successful countries have seen simultaneous productivity changes in services and other sectors, in a balanced growth strategy, but in many countries services have assumed the role of the main growth driver. For example, in India, Hansda (2006) found that services are more growth inducing than agriculture or industry.

Effective policies and regulations are required to ensure that services-led economic transformation favors sectors with higher productivity, particularly because the development potential of the service economy and trade is yet to be fully explored in many developing countries (Mashayekhi, Olarreaga and Porto, 2011).

Having sound regulatory frameworks as a precondition to trade liberalization, and linkages to international markets — by allowing access to foreign services and to inputs and factors that strengthen domestic services — can strengthen the transformative role of services. The importance of trade for supporting productivity growth in services is confirmed by the higher productivity of exporting services firms in low income countries compared to non-exporting services firms, as well as the higher productivity of exporting services firms compared to some exporting firms in other sectors, notably agriculture (te Velde, forthcoming).

Favouring trade openness requires a multidimensional trade policy with bilateral, regional and multilateral trade agreements, trade promotion, market intelligence and trade facilitation. Preferential treatment, flexibilities and capacity building for developing countries are key components of this trade policy mix (Mashayekhi, 2017).

Box I.2 (continued)

Authors: Bruno Antunes, Taisuke Ito and Mina Mashayekhi (UNCTAD/DITC)

International transport and the environment

In line with stronger world trade growth, the volume of international transport is expected to grow significantly in the coming years. While on the one hand this is a welcome sign of a healthier economy, it also comes at an environmental cost from the associated rise in carbon dioxide (CO₂) emissions. Two key sectors linking world trade and emission levels are international shipping, which moves over 80 per cent of global traded volume (UNCTAD, 2017b) (see figure I.23), and international aviation, which is closely related to the expansion of tourism, 55 per cent of which is done by air (UNWTO, 2017) (see Box I.3 and figure I.24). In 2015, total emissions from these two industries amounted to 4 per cent of global emissions. Longer-term projections suggest that over the next 25 years, approximately 30 per cent of the global rise in oil demand will emanate from the aviation and shipping sectors (IEA, 2017).

International shipping and aviation emissions do not fall under the purview of the Paris Agreement on climate change. Since the agreement targets domestic emissions, international emissions are not explicitly covered within the framework of nationally determined contributions, which reflect national targets and actions. In other words, though the emissions are calculated as part of the national greenhouse gas inventories of the United Nations Framework Convention on Climate Change Parties, they are excluded from national totals.
Box I.3
Trends in international tourism

International tourist arrivals in the first half of 2017 grew at its strongest pace since 2010
International tourist arrivals (overnight visitors) increased by 4 per cent to reach 1,235 million in 2016, up
by 46 million visitors compared to 2015. It was the seventh consecutive year of growth above the long-
term average. A comparable sequence of uninterrupted solid growth has not been recorded since the
1960s. The strong expansion in international tourism activity has been broad-based across destinations,
supported by higher travel demand, increased connectivity and more affordable air transport—partly
linked to the lower cost of oil.

Growth in international tourist arrivals accelerated in the first six months of 2017, with an expansion
of 6 per cent compared to the same period last year, the strongest half-year increase since 2010. The
performance was underpinned by sustained growth across many destinations, combined with a recovery
in regions that suffered declines in previous years due to security incidents. By World Tourism Organ-
ization (UNWTO) regions, growth was strongest in the Middle East (+9 per cent), Africa and Europe (both
+8 per cent), followed by Asia and the Pacific (+6 per cent) and the Americas (+3 per cent).

The Mediterranean, in particular, enjoyed strong demand in the first half of 2017, with major desti-
nations such as Croatia (+25 per cent), Portugal (+13 per cent) and Spain (+11 per cent) reporting remark-
able growth in international arrivals, while Egypt (+51 per cent), Tunisia (+27 per cent) and Turkey (+24
per cent) rebounded strongly from declines in previous years.

International travel was fuelled by strong outbound demand from major markets, including
Canada, China, France, the Republic of Korea, Spain, the United Kingdom, and the United States. Furthermore, growth in spending rebounded markedly in Brazil and the Russian Federation, following a few
years of decline.a

International tourism receipts reached US$1.2 trillion in 2016
International tourism receipts increased by 2.6 per cent in real terms (adjusted for exchange rate fluctu-
ations and inflation) to reach $1,220 billion in 2016, based on visitor expenditure data reported by desti-
nations worldwide. International tourism receipts comprised of earnings generated from expenditure by
international visitors (both overnight and same-day) on goods and services, including accommodation,
food and drink, local transport and entertainment. In the past decade, growth in tourism receipts has
largely mirrored the trend of international tourist arrivals, though at a slightly slower pace.

Source: UNWTO.

a For the latest tourism data
and trends, please refer to
UNWTO (2017) or the UNWTO
World Tourism Barometer at
mkt.unwto.org/barometer.
Figure I.3.2
Inbound tourism

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International tourist arrivals
International tourism receipts (real terms)


Source: UNWTO.

International tourism generated an additional $216 billion in exports through international air passenger transport services (rendered to non-residents), bringing the total value of tourism exports to $1.4 trillion, or $4 billion a day on average. This represents 7 per cent of the world’s exports of goods and services, and 30 per cent of services exports alone.

As an export category, tourism ranks third globally, behind fuels and chemicals, and ahead of food and automotive products. In many developing economies, tourism is the top export category and the main source of foreign currency revenue. For both advanced and emerging economies, the sector generates much needed employment opportunities, contributing to inclusive and sustainable growth and development.

Manila conference sets roadmap to measure sustainable tourism

The United Nations has designated 2017 as the International Year of Sustainable Tourism for Development (IY2017), b reiterating the potential for tourism to advance the 17 Sustainable Development Goals (SDGs) and the 2030 Agenda for Sustainable Development. The IY2017 aims to support a change in policies, business practices and consumer behaviour that contribute to a more sustainable tourism sector, in line with the SDGs. It aims to promote the role of tourism in five key areas:

1. Inclusive and sustainable economic growth;
2. Social inclusiveness, employment and poverty reduction;
3. Resource efficiency, environmental protection and climate change;
4. Cultural values, diversity and heritage; and
5. Mutual understanding, peace and security.

A significant number of events have taken place around the world in the context of the IY2017. In June 2017, over 1,000 stakeholders from 88 countries, including ministers, chief statisticians and the private sector, gathered in Manila, the Philippines for the 6th International Conference on Tourism Statistics: Measuring Sustainable Tourism. c Organized by UNWTO and the Government of the Philippines, the conference aimed to build international consensus on ways to measure sustainable tourism. This is led by the conviction that effective sustainable tourism policies require an integrated, coherent and robust information base. The conference agreed to expand current tourism statistics beyond their economic focus to also include the social and environmental aspects of tourism.

The Manila Conference represents a global commitment towards sustainable tourism and the need to measure it through a consistent statistical approach. The resulting ‘Manila Call for Action on Measuring Sustainable Tourism’ reflects the collective vision and commitment of all participants to develop and implement a statistical framework for Measuring Sustainable Tourism (MST) d in its economic, environmental and social dimensions, as well as across relevant spatial levels (global, national and subnational).


Authors: Michel Julian, John Kester and Javier Ruescas (UNWTO)
and reported separately. However, if added to national totals, emissions would be as large as the fifth largest CO₂ emitter in the world (Japan). Considered independently, each industry would rank as a top 10 emitter.

The environmental regulation of international shipping and aviation has been entrusted to the International Maritime Organization (IMO) and the International Civil Aviation Organization (ICAO), respectively. It is up to these organizations to set emissions targets for the two industries. Both agencies, under current policies, may not be delivering sufficient measures to reduce emissions to levels consistent with the objectives of the Paris Agreement (UNCTAD, 2016b). In 2016, the United Nations Secretary-General reminded both agencies of the urgent need to address the growth of emissions under their mandates.
Chapter I. Global economic outlook

Both industries also enjoy tax-exempt fuel, unlike domestic transportation fuel.

Emissions from these modes of transport have been on the rise and will continue to rise if left unchecked. CO\textsubscript{2} emissions from fuel combustion from international marine and aviation bunkers in 2015 were, respectively, 77 per cent and 105 per cent higher than in 1990, growing faster than road transport (IEA, 2017). Global CO\textsubscript{2} emissions from fuel combustion increased 58 per cent in the same period (ibid). In business-as-usual scenarios, emissions from both sectors are projected to triple or even quadruple by 2050, despite improvements in fleet efficiency (ICAO, 2016; IMO, 2015).

These rises highlight the urgent need to improve energy efficiency and restrict CO\textsubscript{2} emissions in these sectors (Sims et al., 2014). In 2016, ICAO adopted the Carbon Offsetting Scheme for International Aviation (CORSIA), which mandates that, starting in 2021, aircraft operators will be required to purchase qualifying carbon offset credits from greenhouse gas reduction and limitation projects in other industries to offset growth in CO\textsubscript{2} emissions above a 2019–2020 baseline level.\textsuperscript{13}

However, despite this historical progress, the new scheme still needs more precision (for example, regarding the penalties for non-compliance and enforcement criteria to be utilized) and may not sufficiently address aviation greenhouse gas (GHG) emissions (Olmer and Rutherford, 2017). Importantly, the scheme does not aim to reduce aviation emissions beyond baseline levels. Instead it focuses on offsetting surplus emissions. In the shipping sector, by contrast, GHG reduction policy options are currently only under consideration. The IMO will have a first GHG emissions reduction strategy in April 2018. An operational strategy will not be ready before 2023. Emissions from ships could be included in the Emission Trading System of the EU from 2023 if the IMO does not deliver a global measure to reduce GHG emissions for international shipping (IMO, 2017).

Beyond emissions reduction, it is also important to focus on non-CO\textsubscript{2} impacts to protect the environment and human health. For instance, the Arctic’s ecosystems are under increasing pressure as global warming melts sea ice across the region and new shipping routes gradually open up in the Arctic regions, and as both the Arctic and Antarctic become increasingly popular tourist destinations. The IMO International Code for Ships Operating in Polar Waters (Polar Code), which entered into force on 1 January 2017, establishes mandatory measures and recommended provisions to manage shipping in Arctic and Antarctic polar waters for the safety of those on board as well as pollution prevention. Some aspects are still under discussion, such as the use of heavy fuel oil in the Arctic.

Air pollution measures have recently been strengthened in both industries. In October 2016, the ICAO issued new recommendations regarding local air quality. In the same month, the IMO decided to reduce the maximum sulphur content of ship fuel oils from 3.5 per cent to 0.5 per cent, effective from 1 January 2020, with more stringent caps in certain regions (designated emissions control areas). Ship owners will either have to switch to more expensive and higher quality marine fuel or use alternative fuels such as liquefied natural gas. Alternatively, ships can fit emissions-cleaning systems (often referred to as “scrubbers”) or use any other technological method to limit sulphur emissions to 6 grams per kilowatt hour or less. Knock-on effects of this change in rule could ripple out to the oil industry by increasing the price of oil products (diesel, jet fuel and petrol) and to commodities trading through higher freight rates.

\textsuperscript{13} As of 23 August 2017, 72 States, representing 87.7 per cent of international aviation activity, had expressed their intent to participate in CORSIA from its outset.
Nevertheless, reducing air pollution remains vitally important. The sulphur cap limit is expected to save thousands to millions of lives in the coming decades, mainly in coastal communities in the developing world (Corbett et al., 2007; Corbett and Winebrake, 2016; Winebrake et al., 2009). Airborne particulate matter pollution from ships has also been shown to enhance lightning density directly over shipping lanes, with consequences for human life and the global economy through wind and hail damage, as well as from direct lightning strikes (Thornton et al., 2017).

Commodity prices

Commodity prices act as a link between the real and financial sectors, and play a key role in the economic dynamics of the majority of countries in Africa, South America and Western Asia (see figure I.4). Some developed economies, such as Australia and Canada, as well as many economies in transition, are also very sensitive to developments in commodity prices.

Commodity price movements are heavily correlated, driven by a common trend (see Diebold, Liu and Yilmaz, 2017). In late 2014 and in 2015, most commodity prices dropped sharply from the high levels reached in the boom period of 2011 to 2013. Most sectors saw an upward trend during 2016. However, since early 2017, these cross-asset price linkages have played a much smaller role, and price dynamics have been driven primarily by sector-specific developments rather than a common trend. The recent evolution and prospects for major commodity sectors are discussed below with additional detail in the Appendix.

The oil market is in the process of rebalancing, as demand growth surpasses supply growth. The level of commercial crude oil stock has already been in decline despite rapid crude production growth in the United States. The market is likely to rebalance by the first quarter of 2018, eroding the excess crude oil inventory built up since 2014.

OPEC and non-OPEC oil exporters, including Azerbaijan, Kazakhstan and the Russian Federation, agreed to implement a coordinated reduction in production from January 2017 to March 2018, amounting to 1.8 million barrels per day (bpd) in total, although considering compliance performance, actual cuts may be considerably less. Meanwhile, supply restraint related to production cuts will be offset by increased supply from non-OPEC countries. Crude oil supply from non-OPEC countries in 2017 is forecast to increase, driven by the United States. In total, world crude oil supply for 2017 is expected to record a modest rise from 2016 levels.

Strong demand is expected from China, India and the United States — the world’s three largest energy consumers. A recovering demand from Europe is another supporting factor for the solid growth projection coupled with the recent rise in refining margins in Asia, Europe and the Americas throughout 2017.

Speculative activity continues to remain influential, creating short-term price fluctuations. Oil prices weakened in June 2017 over the market’s concern vis-à-vis the slow decline of commercial crude oil stock. However, the Brent spot price recovered to reach $59 per barrel in mid-September as the market confirmed a consistent demand growth for crude oil (figure I.25). While prices may continue to fluctuate in response to the short-term news, the Brent spot price is expected to average $52.5 per barrel in 2017 and $55.4 per barrel in 2018. Compared to average levels in 2011–2014, price levels have roughly halved.

The upward trend in commodity prices that started at the beginning of 2016 came to a halt in 2017. Individual commodity markets have shown a mixed pattern in the first half of 2017, but all sub-indices of the UNCTAD Non-oil Nominal Commodity Price Index
decreased between January and June 2017. The third quarter of 2017 has seen rising prices for minerals, metals and ores, but overall, commodity prices are still significantly lower than at the peak of the last commodity boom (figure I.25). It seems unlikely that commodity prices will return to their peak levels of 2011 in the near future.

Among the subcategories of the UNCTAD Non-oil Nominal Commodity Price Index, agricultural raw materials showed the steepest price drop from January to August 2017, at 8.8 per cent, followed by food at 7.7 per cent. The price index of minerals, ores and metals rose by 7.7 per in August 2017 compared to January 2017, mainly based on a price rally in July and August 2017.

In the period between January and August 2017, the prices of major commodities showed a diverse pattern (figure I.26). Sugar declined the most, by close to 30 per cent. Rubber, cottonseed oil, palm oil, and coconut oil also saw prices drop by double digits. However, aluminium, copper and tropical logs increased by more than 10 per cent, with aluminium showing the largest increase at 13.4 per cent.

All sub-indices of the UNCTAD food price index saw marked losses between January and August 2017, with vegetable oilseeds and oils experiencing the sharpest drop (figure I.26). Cocoa bean prices are close to their lowest level in almost a decade. This sharp price drop had dramatic consequences for cocoa producers, particularly in Côte d’Ivoire (see Box I.4). Looking ahead, growing demand is unlikely to outpace strong production and cocoa beans prices are expected to remain low.

The price of minerals, ores and metals rallied in 2016, mainly driven by supply cuts and uncertainties. This upward trend came to a halt at the end of the first quarter of 2017. The UNCTAD minerals, ores and metals price index was down 8.5 per cent from 254 points in February 2017 to 232 points in June 2017, but rallied to 265 points in August.
2017. The main driver of this downward movement was a sharp decline in iron ore prices, due to expectations of lower iron ore demand from China.

**Global financial flows**

**Revival in capital flows to emerging economies**

Global financial conditions improved in 2017, supported by the improving outlook in the world economy and expectations for a smooth and gradual monetary policy transition in the United States. In addition, financial volatility has visibly declined across major asset classes, reaching record-lows in recent months. Furthermore, international bank lending has also shown signs of recovery, while stock markets have registered large gains, not only in developed countries — climbing to record highs in some cases — but also in several emerging economies (figure I.27). This points to a rising appetite for risk among investors, although it should also be viewed with some caution, as an underpricing of risk could lead to sudden corrections in stock markets.

The improving global financial and liquidity environment, coupled with the ongoing pickup in global trade, is aiding the recovery of investment and supporting global growth. Yet, there remain significant risks and uncertainties, which could rapidly alter the current financial environment and even hamper a more robust and sustained trajectory for the world economy.
Commodity markets and the Sustainable Development Goals: Some policy lessons

There are several direct and indirect linkages between developments in the international commodity markets and the Sustainable Development Goals (SDGs). For instance, a direct relationship exists between food prices and SDG 2, which is aimed at ending hunger and achieving food security. For poor net food-buying households, an increase in food prices constitutes a loss of purchasing power and poses a threat to food security. For net food-selling households, however, an increase in food prices entails higher revenue and thus higher food security. Over the medium term, market adjustments might mitigate such first-round effects on poverty, but in the short term, hikes in food prices pose a serious challenge to meeting the SDGs in developing countries.

The extent to which international commodity markets impact development indicators also depends on existing policy frameworks. Policies such as social safety nets can mitigate the negative impact of commodity price shocks on the poor segments of the population. At the same time, redistributive policies are needed to ensure windfall revenues are more widely shared.

Zambia’s experience during the last commodity boom is a useful example. Between 2004 and 2010, Zambia, a major exporter of copper, experienced annual average GDP per capita growth of above 5 per cent, driven by the sharp increase in global copper prices. During the same period, however, the poverty head count ratio increased from 56.7 per cent to 64.1 per cent of the population and the prevalence of undernourishment from 48.5 per cent to 51.7 per cent (figure I.4.1). This suggests that the commodity windfall revenue from the copper price boom was not effectively redistributed to benefit the poor. In addition, the doubling of retail prices of maize between 2004 and 2009 exacerbated poverty and undernourishment in Zambia, given that it is the population’s main food staple.

This example demonstrates that there is no automatic process linking commodity price booms with improvements in the living conditions of the poor in commodity-dependent developing countries.

Figure I.4.1
GDP growth and poverty indicators in Zambia, 2000–2015

Sources: Author’s own elaboration based on data from the World Development Indicators online database and World Bank (2017b) and UN/DESA estimates for the poverty headcount ratio in 2015.
Box I.4 (continued)

(CDDCs). Rather, policies must be adopted to ensure that upward commodity price movements contribute to meeting the SDGs in the CDDCs.

When designing national commodity sector policies, the links between international commodity markets and local conditions need to be considered. Managing risks due to unanticipated commodity price movements is also important for the sustainability of the commodity sector in CDDCs. In this regard, recent developments in the cocoa sector in Côte d’Ivoire provide important lessons.

The cocoa sector in Côte d’Ivoire has undergone several reforms since 2012, which include the introduction of a mechanism of forward selling anticipated crop and guaranteed minimum producer prices. In October 2016, the Government also raised producer prices to CFA1,100 per kg — equivalent to about US$ 85 per pound — at the beginning of the 2016/17 season, when the international market price for cocoa stood at US$ 123 per pound. However, in January 2017, the price of cocoa plummeted to US$ 100 per pound and to US$ 90 per pound in July 2017. Many traders who had bought cocoa in advance defaulted on their contracts since the margin between producer prices and international market prices was not sufficient to make a profit. Consequently, the livelihoods of many of the estimated six million Ivorians who depend on cocoa as their main source of income were threatened. In other words, the most vulnerable group within the cocoa value chain bore the brunt of unfavourable international commodity price developments.

More equitable risk sharing along the cocoa value chain and better overall risk management could have mitigated this financial stress on cocoa farmers and their families. Thus, risk management tools could include insurance against contract default and other risks or quick access to the existing cocoa stabilization fund to protect farmers’ incomes.

In summary, policymakers need to consider the deep linkages between international commodity markets and the SDGs in the CDDCs. Importantly, more coherent and effective strategies must ensure that commodity price movements do not harm the most vulnerable segments of the population, and that poor households benefit from positive commodity price developments. Given the integration of small producers into international commodity markets, managing risks emanating from commodity price volatility is a key element of such policies.

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Capital inflows to emerging economies gain momentum, driven by portfolio and banking flows

Against this backdrop, private non-resident capital inflows to developing countries and emerging economies gained momentum in 2017, reversing the trend observed in previous years (figure I.28). After a marked downturn in 2015 and 2016, non-resident capital inflows in emerging economies are estimated to exceed $1.1 trillion in 2017, while resident capital outflows are projected to fall from more than $1.0 trillion in 2016 to about $770 billion (IIF, 2017).14 Thus, net capital inflows entered positive territory in 2017, following two years of large contractions in net capital inflows. The revival of capital inflows to emerging economies and developing countries was driven by portfolio and banking flows.

Together with the more favourable global financing conditions and the upward trend for some commodity prices such as metals and oil, the recovery in capital inflows has been facilitated by the improving economic outlook in several large emerging economies.

After almost a decade-long decline, the growth differential with between developed and developing countries is rising again. Also, while some emerging economies, such as Brazil and the Russian Federation, are gradually recovering from deep downturns, others went through major macroeconomic adjustments in response to the lower commodity pric-

14 The data for capital flows from the Institute of International Finance (IIF) encompasses 25 emerging economies: Argentina, the Bolivarian Republic of Venezuela, Brazil, Chile, China, Colombia, the Czech Republic, Egypt, Hungary, India, Indonesia, Lebanon, Malaysia, Mexico, Nigeria, the Philippines, Poland, the Republic of Korea, the Russian Federation, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine and the United Arab Emirates.
Chapter I. Global economic outlook

and capital flows observed between 2014 and 2016. For instance, current accounts deficits have narrowed visibly in India and South Africa, and inflation has declined in several countries. Importantly, greater exchange rate flexibility, high levels of reserves and in many cases improved policy frameworks, including the use of countercyclical policies, have not only facilitated macroeconomic adjustments but have also improved emerging economies’ resilience to external shocks.

Figure I.27
Stock market indices

Figure I.28
Capital inflows to emerging economies

Source: UN/DESA, based on JP Morgan.


Note: The sample of countries include 25 large emerging economies. Net capital inflows exclude errors and omissions. Data for 2017 are projections.
The resurgence in capital inflows has led to a reduction of financial spreads and the appreciation of domestic currencies in emerging economies. For instance, sovereign and corporate bond spreads reached historically low levels in developing countries in Asia and Europe, while exchange rates have also recovered from the downward trend observed in previous years in Brazil, Mexico, the Russian Federation, South Africa and Turkey (figure I.29).

In addition, stock markets have risen in several economies, with the MSCI index reaching a multi-year high in September, more than 20 per cent above the levels in September 2016. In these circumstances, a key policy challenge is to favour the channelling of financial resources into greenfield investments with positive effects on productive capacities, infrastructure and, ultimately, a more sustained growth trajectory. While recent evidence shows that FDI, equity and cross-border banking flows support growth in emerging economies, this depends critically on policy responses associated with larger inflows (Blanchard et al., 2016).

In the economic outlook, projections of capital inflows to emerging economies and developing countries are moderately favourable, contingent on the ongoing growth recovery in these economies, and subject to significant risks, including monetary normalization in major economies, global policy uncertainties and geopolitical risks.

In particular, the ongoing monetary policy transition in the United States, and the prospects for a similar path in other major developed countries, represent a key risk. Sudden changes in investors’ expectations, large stock market corrections or monetary policy missteps by major central banks could trigger significant financial turmoil, leading to spikes in volatility, rising financing costs and disruptive capital outflows. However, emerging economies are in a relatively stronger position to navigate turbulent global financial conditions. Recent evidence confirms that macroeconomic fundamentals do not provide full insulation, for example, to sudden spikes in risk aversion and large capital flows reversals, including episodes of “sudden stops” (Eichengreen and Gupta, 2016).
In containing the build-up of excessive financial risks while at the same time supporting growth, emerging economies should consider the use of a wide range of policy instruments. Macroeconomic and foreign exchange policies can be supported by macro-prudential policies, such as targeted and selective capital controls. This is a challenging task for economies that are well integrated into financial markets, as recent evidence suggest that global financial conditions tend to generate large spillovers into local financial markets. For example, Rey (2015) highlights a global financial cycle in capital flows, asset prices and credit growth, which is not aligned with a country’s idiosyncratic macroeconomic conditions. This can severely limit the independence and effectiveness of emerging markets’ monetary policies.

**Portfolio flows**

The recovery in capital inflows in emerging economies throughout 2017 has been driven by portfolio flows, particularly debt flows. The “search for yield” boosted portfolio flows, which are estimated to reach about $350 billion in 2017, after posting only $163 billion in 2016 (figure I.30). For instance, sizeable inflows into emerging markets have led to strong gains in the Emerging Market Bond Index (EMBI) in 2017. Bonds issuances also gained momentum in China, Colombia, India, Indonesia, Mexico and Turkey, while issuance of sovereign bonds in oil-exporting and low-income countries also visibly increased in 2017 (BIS, 2017a; IMF, 2017a).

In fact, the relatively high and in some cases rising interest rate differentials, coupled with improved inflation prospects, have encouraged the demand for domestic currency bonds in Brazil, India and the Russian Federation (IIF, 2017). Meanwhile, equity flows increased in Asia and Latin America in countries such as Brazil, India, the Republic of Korea and Thailand, leading in some cases to significant gains in stock markets.

Portfolio capital outflows from China have also tempered, after a significant upsurge in previous years, encouraging authorities to relax some monetary rules supporting the renminbi.

**Figure I.30**

*Portfolio inflows to emerging economies*

![Chart showing portfolio inflows to emerging economies from 2007 to 2017. The chart indicates the distribution of inflows between debt and equity. The inflows are in billions of US dollars.*

*Source: IIF (2017).*
Moderately positive expectations regarding portfolio flows to emerging economies are on the horizon, contingent on the growth rate differential with developed economies and a smooth monetary transition by the Fed. In fact, stock market valuations also appear attractive in several emerging economies vis-à-vis developed countries, as illustrated by cyclically adjusted price-earnings ratios (BIS, 2017a; IIF, 2017). Yet, unexpected turbulences in global financial markets could impact portfolio flows, generating major challenges to emerging economies, especially those with a more highly indebted corporate sector.

**Bank flows**

Cross-border bank lending to developing countries has remained volatile and largely subdued in recent years, as large international banks, particularly in Europe, have continued to face deleveraging pressures. The collapse in cross-border bank finance was the main contributor to the slump in overall private financial flows following the global financial crisis. From January 2007 to December 2016, banks divested assets worth at least $2 trillion in the world economy, of which more than half was divestment by European banks (Lund et al., 2017). Interestingly, this encouraged lending activities by several banks from large emerging economies, illustrating the higher relevance of South-South lending. For example, China’s four largest banks have quadrupled their share of foreign assets on their balance sheets in the last decade. Banks from Brazil, India and the Russian Federation are also expanding international activities (ibid.).

More recently, the financial position of the banking sector in developed countries has continued to improve. For instance, global systemically important banks (G-SIBs) have strengthened their balance sheets with additional capital injections, while liquidity has also risen due to declining loan-to-deposit ratios and less reliance on short-term funding (IMF, 2017a). Against this backdrop, cross-border banking flows are showing gradual signs of recovery. Data until the first quarter of 2017 shows that year-on-year growth in international bank claims turned positive for the first time since 2015 (BIS, 2017a). For instance, larger banking flows to emerging economies have been visible in China, Mexico and Nigeria. A further increase in banking flows is expected in the near term in tandem with the pickup in global trade, which could support credit and investment growth in some emerging economies, contingent on their broader economic prospects.

**Foreign direct investment**

Foreign direct investment (FDI) flows remain the most stable form of capital flows. In 2017, FDI to developing countries should remain moderate but rise throughout the year, due to improving growth prospects, the gradual pickup in global trade and higher profits in the corporate sector (UNCTAD, 2017c). The moderately positive picture encompasses most developing regions, especially Asia. Also, major recipients such as China, India and Indonesia are intensifying policy efforts to attract FDI.

In Africa, FDI inflows are also expected to increase in the near term, due to moderately higher commodity prices, especially metals, and recent advances in both inter- and intraregional integration. Meanwhile, FDI in Latin America has declined in recent years, due to lower commodity prices and weak economic activity in the largest economies.

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15 In the case of the Russian Federation, part of these activities is linked to the recapitalization of Russian-owned banks overseas.
FDI is expected to remain subdued in the near term (ECLAC, 2017). For example, foreign investments in some parts of the region, especially in Mexico and Central America, are likely to be restrained by lingering policy uncertainties in the United States and the ongoing renegotiation of NAFTA. Likewise, Africa also experienced a decline in FDI in 2016, as growth slowed, amid challenging political and security situations in several economies.

In addition, some countries continue to grapple with severe structural impediments in attracting stronger FDI flows, particularly LDCs and small island developing States (SIDS). The limited amount of FDI in these countries not only reduces access to external financial resources but also constrains expansion of their productive capacities. FDI flows to structurally weak and vulnerable economies remain concentrated in extractive industries, where their development impact is limited. In 2016, FDI to LDCs and SIDS fell by 13 per cent and 6 per cent, respectively (UNCTAD, 2017b).

From a longer-term perspective, developing economies are emerging as an increasingly important source of investment to LDCs, landlocked developing countries, SIDS and some other countries in Africa. While a large share of these investments has been channelled into natural resource sectors, there have been signs of diversification recently.

More generally, the scope for beneficial linkages and technology absorption arising from South-South FDI is supported by the fact that the technology and skills of multinational firms from developing countries is often closer to those in firms in host countries. In this regard, South-South FDI may help develop and diffuse clean technologies. It stands to reason that policymakers promote FDI within South-South cooperation and collaboration frameworks.

Despite the favourable outlook for FDI, flows could be muted by renewed geopolitical risks or a surge in policy uncertainties. Global financial turbulence triggered by a sudden adjustment in expectations over the Fed’s monetary policy normalization could also have an impact in the near term. Finally, tax reform in the United States could affect FDI flows, if the reform encourages multinational firms to reduce retained earnings held by overseas affiliates.

Trends in net resource transfers and international reserves

Net transfer of resources

Net financial transfers to developing countries remained negative in 2017, albeit less so than in previous years, thanks to a recovery of capital inflows (figure I.31). In total, the net transfer of financial resources from developing and transition countries to developed economies is estimated at $405 billion, corresponding to 1.3 per cent of their aggregate GDP. This measures the total receipts of net capital inflows from abroad minus total income payments (or outflows), including increases in foreign reserves and foreign investment income payments. The recent trends in net financial transfers continue to be driven by large capital outflows from China.

In relative terms, the economies in transition have seen the largest net outflow of resources in 2017, equivalent to 4.2 per cent of GDP (figure I.31). East and South Asia also recorded significant net outflows, estimated at 2.4 per cent of GDP. In absolute terms, this constitutes by far the largest regional outflows, totalling $493 billion, driven mostly by China. By contrast, Africa and the LDCs have continued to experience positive net transfers of resources. While these inflows account for more than 5 per cent of GDP, they
International reserves

By definition, a combined surplus (or deficit) in the current, financial and capital account is reflected in an increase (or decrease) in the level of international reserves. As capital outflows increased in recent years, many developing countries, particularly China, used international reserves to help stabilize exchange rates.

As shown in figure I.32, total international reserves as a share of world gross product fell to 15.5 per cent, or $12.23 trillion in 2017. Foreign exchange reserves as a percentage of GDP of developing countries and economies in transition stood at 10.6 per cent in 2017, down from a peak of 12.3 per cent in 2013. This suggests that countries were spending reserves to moderate the impact of capital outflows on exchange rates. As noted above, China experienced large capital outflows in 2015 and 2016, and as a result, holdings of foreign exchange reserves also declined.

Central banks typically invest reserves in safe liquid assets. The share of global reserves held in dollar-denominated assets was 63.8 per cent in the second quarter of 2017, down slightly from 65.8 per cent at the end of 2015. The holdings of Chinese renminbi as foreign reserves, which make up 1 per cent of reserves globally, were reported by the IMF for the first time in 2016.

Trends in public resources

International public finance complements efforts by developing countries to mobilize domestic resources for development. In addition, international public finance plays an impor-
tant role in financing global public goods. The provision of international public finance, including ODA from members of the OECD Development Assistance Committee and lending by multilateral development banks, increased between 2015 and 2016, continuing a rising trend since the turn of the millennium. While the provision of international public finance from developing countries, in the form of South-South cooperation, has also tended to increase in recent years, it remains volatile.

Official development assistance

As displayed in figure I.33, global ODA flows increased to $142.6 billion in 2016, representing an 8.9 per cent rise in real terms from 2015. As a share of gross national income of donors, ODA averaged 0.32 per cent, still significantly below the United Nations target of 0.7 per cent. Only six countries reached this target. In real terms, i.e. correcting for inflation and currency fluctuations, ODA has doubled since 2000 (OECD, 2017a). However, although donors agreed to halt the recent decline in ODA to LDCs in the Addis Ababa Action Agenda (AAAA), preliminary figures indicate that bilateral aid to LDCs fell by 3.9 per cent in real terms in 2016 to $26 billion. ODA makes up more than two thirds of external finance for LDCs (OECD, 2017b).

The increase in total ODA in 2016 was partly due to higher expenditures on in-donor refugees. Excluding these expenditures, ODA still grew by 7.1 per cent in real terms. ODA expenditure to host refugees inside donor countries increased by 27.5 per cent in real terms from 2015 to reach $15.4 billion. This equates to 10.8 per cent of total net ODA, up from 9.2 per cent in 2015 and 4.8 per cent in 2014, in line with the higher number of refugees over the past two years. Meanwhile, ODA reporting rules for hosting refugees were updated and clarified in the 2017 high-level meeting of the OECD Development Assistance
Committee, as standards used by providers were not uniform. Humanitarian aid rose by 8 per cent in real terms in 2016 to $14.4 billion (OECD, 2017a). These increases have raised concerns that spending on refugees and humanitarian aid, while urgently needed, could negatively impact funding for long-term development projects.

Estimates of South-South cooperation expenditure suggest it surpassed $20 billion in 2014 (United Nations, 2016b), while the OECD, which also estimates concessional development finance from developing countries, arrived at comparable figures of $24.6 billion in 2015 (OECD, 2017b).

**Multilateral development banks**

While public financial flows from multilateral development banks (MDBs) are much smaller than their private counterparts, they are generally less volatile and play a key role in financing sectors and long-term projects critical to sustainable development. MDBs have responded to the high expectations in terms of SDG financing set out in the AAAA, and proposed an action plan to optimize balance sheets at the 2015 November meeting in Antalya, Turkey, which was subsequently endorsed by the Group of Twenty (G20) leaders. The first results of the steps taken by the MDBs to improve their balance sheets and expand lending are visible. Annual commitments of non-grant subsidized finance from the seven MDBs reached $84.9 billion in 2016, an increase of 14.3 per cent, with disbursements totalling $65.8 billion, an increase of 14.8 per cent (see figure I.34). The growth of commitments suggests a possible further increase in disbursements in 2017.

Figure I.35 illustrates the trends in disbursements of the major MDBs. The disbursements of the World Bank’s International Bank for Reconstruction and Development rose sharply by 18.5 per cent to $22.5 billion in fiscal year 2016 over 2015 (World Bank, 2016a). The International Finance Corporation, the private sector arm of the World Bank Group, saw an increase of 7.4 per cent in lending disbursements to $10 billion. Meanwhile, the European Investment Bank decreased its disbursements, yet remains, by a wide margin, the largest bank in terms of disbursements.
Recent trends vary significantly among the multilateral development banks that are based in developing countries. These differences in part reflect strong variations in local economic conditions over the past few years. For instance, the disbursements of the Development Bank of South Africa fell sharply by 27.5 per cent in 2016. The scaling back of its lending activities follows weak economic growth in the country and a change of government. In the case of the Brazilian Development Bank, disbursements declined for a third consecutive years, falling by 35 per cent. By contrast, disbursements by the Corporacion Andina de Fomento grew by over 40 per cent to almost $8.5 billion in 2016. The New

Some multilateral development banks based in developing countries have scaled back lending amid weakness in the local economy.
Development Bank and the Asian Infrastructure Investment Bank completed their first full year of operations in 2016 with combined commitments of $3.3 billion (New Development Bank, 2017; Asian Infrastructure Investment Bank, 2017).

## Inclusiveness of economic growth

### Labour market challenges

While economic activity has picked up in recent months, the protracted period of weak global growth since 2008 has left a significant imprint on employment, wages and household welfare. This reaffirms concerns about the ability of the global economy to generate a sufficient number of high-quality jobs and ensure that the gains of growth are widely shared between and within countries. According to ILO estimates, there are around 200 million people unemployed in 2017.\(^{16}\) While the global unemployment rate is expected to remain stable in 2018, as the labour force expands in line with demographic developments and participation, the level of global unemployment may rise further. Women are more likely to be unemployed than men, and face significant obstacles to participation in the labour market (see Box I.5). Youth are around three times as likely as adults to be unemployed (United Nations, Economic and Social Council, 2017). Moreover, more than one-third of the population in low income countries that are in work are living in poverty, and more than 40 per cent of the world’s workers are in vulnerable forms of employment, with little or no access to social protection, low and volatile income, and high levels of job

\(^{16}\) ILOSTAT, ILO modelled estimates, November 2016.
Box I.5

What is holding women back in the labour force?
Multi-dimensional challenges to labour market attainment

The World Employment and Social Outlook: Trends for Women 2017 (ILO, 2017a) shows that women around the globe continue to fare worse than men across most labour market dimensions. Their participation rate — at just over 49 per cent — is nearly 27 percentage points lower than the rate of men. When participating in the labour market, they face higher unemployment rates, and are often subject to significantly different employment conditions. For instance, 14.9 per cent of women are contributing family workers, as opposed to 5.5 per cent of men. The combination of differences in employment conditions, sectoral and occupational segregation, and outright discrimination results in a significant gender pay gap.

Indeed, women face multiple labour market barriers. The decision to participate or not in the labour market depends on the interplay of three fundamental factors, which are shaped by social norms and life-cycle circumstances. First, a woman’s personal preference to pursue paid work is a very important determinant. Surveys indicate that some 70 per cent of women — regardless of their employment status — prefer to work at paid jobs.

In reality, however, more than half of all women globally are out of the labour force. This implies that a preference for paid work is not sufficient in itself to ensure the participation of women in the labour force. It also suggests that significant challenges restrict the capacity and freedom of women to participate in the workforce. Second, women are often pressured to conform to gender roles prescribed by the family, community, class, religion or society to avoid the risk of social exclusion. Indeed, gender roles embodied in some religions can have a strong negative influence on a woman’s probability to participate in the labour market. Third, socio-economic constraints, such as having to care for dependents or the need for transportation, especially in developing countries, compete with the potential returns from the labour market. However, the ultimate decision to participate in the workforce depends on the relative strength of these factors. The personal preference to pursue paid work is an important driver of participation, but its importance is often outweighed by socio-economic and gender role constraints.

Estimates reported by the ILO (ibid.) suggest that reducing the gap in participation rates between men and women by 25 per cent by the year 2025 (as G20 leaders committed to in 2014) would yield significant economic gains, raising global GDP in 2025 by an additional 3.9 per cent (equivalent to raising global GDP growth over the next eight years by almost half a percentage point per annum). The regions with the largest gender gaps, namely the Arab States, North Africa and South Asia, would see the greatest benefits.

The achievement of such a goal would also unlock large potential tax revenues of about $1.5 trillion (in 2010 US dollars, using PPP exchange rates). Using a fraction of this additional revenue to address gender inequalities in the labour market, such as the socio-economic constraints discussed above, would result in positive multiplier effects in the economy. Reducing and redistributing unpaid care work through improved public care services and social infrastructure would allow women to have better access to the labour market. This includes the provision of adequate maternity protection and parental leave and benefits for both men and women. Women’s labour market participation should also be supported by flexible working arrangements and reintegration measures that allow women to reconcile work and care responsibilities and transition more easily from maternal leave back to work. For instance, in its most recent budget, Canada made an historic commitment to an inclusive, high-quality, and accessible care framework. This will help to make sure that even vulnerable communities have equal access to care and, hence, further enable women to take part in the labour market. Moving forward, the ILO proposes a comprehensive policy framework that rests on three pillars: reshaping gender role conformity and personal preferences, addressing socio-economic constraints and raising equality in labour market conditions.

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insecurity (ILO, 2017b). South Asia and sub-Saharan Africa are the regions most affected by vulnerable employment.

Notwithstanding these deeper challenges, headline labour market indicators in a broad spectrum of developed economies, economies in transition and developing economies continue to exhibit some improvements. Figures I.37 and I.38 compare current and long-term unemployment rates to levels prevailing in 2010. In the sample of countries shown, unemployment rates have come down since 2010 in the vast majority of countries. Exceptions include Greece, Italy, Spain and South Africa, which have suffered exceptional challenges post-2010. Several commodity exporting countries that suffered a sharp drop in revenue in 2015–2016 have also seen a deterioration in labour market conditions.

The share of long-term unemployment remains high in a number of countries, although a few countries, such as Israel, the Republic of Moldova, the United Kingdom and the United States have seen significant outflows from long-term unemployment into jobs since 2010.

The relatively large pools of long-term unemployed in some countries have been one factor behind weak wage growth and rising wage inequality in recent years (OECD, 2011). Growth in real wages has not kept up with productivity, partly as a result of the prevalence of low quality, low paid jobs, and more part-time and temporary contracts. This has compounded a deterioration in workers’ bargaining power.

Figure I.39 shows real wage growth in 2016 and average annual wage growth since 2007 in selected countries. Most countries in the sample exhibited some real wage gains in 2016, although wages deteriorated significantly in Norway, reflecting income losses related to the decline in oil prices.

Despite Greece’s strong wage growth in 2016, over the past decade real wages have sharply deteriorated. The level of average real wages in Greece remains nearly 20 per cent below its level in 2007. Average real wages in Italy, Mexico, Portugal and the United Kingdom also remain below 2007 levels. For the most part, real wage growth has averaged less than 1 per cent per annum in the sample of countries. Stronger wage growth in Canada and Norway reflects income gains during the commodity boom of 2011–2013, while Germany and Sweden both recovered from the global financial crisis more rapidly than many other countries.

The relatively modest wage growth in recent years has restrained a more rapid rebound in household demand, which has in turn held back investment, compounding the slow growth in aggregated demand.

National average wages may not fully reflect developments in household welfare if wage gains have not been shared evenly across income groups. Since 2007, in a number of countries, including Denmark, Germany, Ireland, the Netherlands, Norway and the United States, real wage growth for those on lower incomes has lagged behind wage growth for the highest 10 per cent of earners. Minimum wage growth has failed to keep pace with average wages in several countries as well.

The recent rise in wage inequality in some developed economies prolongs the general trend of rising wage inequality over the last two decades. Over the same period, a number of developing economies, predominantly in Latin America, have seen wage inequality decline (ILO, 2017c).

Rising wage inequality amplifies the macroeconomic impacts of weak average wage growth, as households with lower incomes tend to consume a greater share of current
Figure I.37
Unemployment and long-term unemployment in selected developed economies

Source: ILOSTAT, Unemployment and labour underutilization.

* Data for 2017Q1 rather than 2016.

Figure I.38
Unemployment and long-term unemployment in selected developing and transition economies

Source: ILOSTAT, Unemployment and labour underutilization.

* Data for 2017Q1 rather than 2016.
Figure I.39
Average annual real wage growth

Figure I.40
Change in wage inequality measures since 2008

Source: OECD employment and labour market statistics.

Note: Sample period varies by country depending on available data, but to the extent possible covers 2008–2016.

* Change in average wage relative to minimum wage not available.
income than wealthier households, who tend to channel more into savings. Further rises in wage inequality in developed economies risk reigniting deflationary pressures, complicating the conduct of monetary policy and increasing the probability of spikes in financial market volatility.

The challenge of eradicating poverty

At least 750 million people live below the extreme poverty line in 2017, with almost no change from last year. At the same time, the Food and Agriculture Organization of the United Nations estimates that 815 million people were undernourished in 2016, compared to 777 million in 2015 (FAO, 2017). Put simply, this means that raising people above the extreme poverty line of $1.90 per day may only be sufficient to provide them with adequate food. Reaching the target of eradicating extreme poverty, therefore, should be viewed as a small, but crucial, step towards the ultimate goal of eradicating poverty in all its forms.

To provide some perspective: supporting around 750 million people in 2017 with $1.90 a day would cost around 0.7 per cent of global GDP, or 1.1 per cent of GDP of the richest 1 billion people — a goal that should be within reach.

There is no doubt that extreme poverty has declined over the past two decades. In the 1980s and in the beginning of 1990s almost 2 billion people lived on less than $1.90 a day, which was 30 to 40 per cent of the global population. In 2000, about a quarter of the world remained in extreme poverty. In 2017, 13 years before the 2030 Agenda aims to end extreme poverty and hunger, around 10 per cent of the population live below the $1.90 threshold.

Despite enormous progress, especially in the last 20 years, the evidence shows that not enough has been done to ensure the SDG target of eradicating extreme poverty is met by 2030. Current estimates based on projections for consumption growth17 and population growth estimates from the United Nations Population Division, suggest that there may be around 650 million people living in extreme poverty in 2030.

Reducing poverty is likely to be uneven. Progress in poverty reduction over the last 20 years has been achieved mainly through enormous progress in large Asian economies, such as China (figure I.41). The number of people living in extreme poverty in Asia dropped from around 1.5 billion in the beginning of 1980s to around 300 million people currently. Model-based projections suggest these numbers may further halve by 2030, leaving only about 3 per cent of people in Asia in extreme poverty.

The situation looks different on the African continent (figure I.42), especially in the sub-Saharan region. In the beginning of the 1980s, around 45 per cent of Africans lived in extreme poverty, reaching almost half of the population in the 1990s. Since then, this share has declined to around 30 per cent. Nevertheless, the projections suggest that over 25 per cent of people in Africa may remain in extreme poverty by 2030. Moreover, despite the improvement in poverty rates, expressed as a share of the population in figure I.42, unless more effort and action is taken, the level of extreme poverty in Africa may rise by almost 60 million by 2030 (figure I.43).

17 Projections carried out as an extension of the current short-term forecast baseline, using the World Economic Forecasting Model (https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/2016_Apr_WorldEconomicForecastingModel.pdf). Inequality, as captured by the standard deviation of the log of income, is assumed to remain constant over the projection period. The reported projections represent a single scenario, based on a relatively neutral set of assumptions regarding trend productivity growth and other key parameters.
Because of its geographical, historic, economic, and climate complexity the changes among African regions and countries are far from even. The scenario suggests that all countries on the continent will reduce the share of people living below the poverty line. In the region of Sahel, progress is likely to be minimal as a result of challenging climatic conditions as well as multiple conflict situations. The fastest growing economies in East and West Africa are expected to see the steepest falls in poverty rates, raising more than 10 percent of their populations out of extreme poverty by 2030, although given the strong population growth, the number of people in extreme poverty may nonetheless rise.
The scenario presented illustrates the urgent need to foster an environment that will both accelerate medium-term growth prospects and tackle poverty through policies that address inequalities in income and opportunity. Policies that have been largely successful at reducing income inequality include short-term transfers and income support to smooth consumption among the most deprived, and longer-term policies that address inequalities in opportunity, such as investment in early childhood development, access to healthcare and education, and investment in rural roads and electrification (World Bank, 2016b).
Appendix

Global assumptions

Baseline forecast assumptions

This appendix summarizes the key assumptions underlying the baseline forecast, including recent and expected developments in major commodity prices, monetary and fiscal policies assumptions, and exchange rates for major currencies.

Commodity prices

Food and agricultural commodities

Between January and October 2016, the price of sugar (average ISA daily prices) climbed from 14.05 cents per pound to 22.22 cents per pound due to a widening supply-demand gap (figure I.A.1). The price hike triggered a supply expansion, which brought the price of sugar down to 14.37 cents per pound in August 2017. Going forward, forecasts of rising global supply suggest that price increases are unlikely for the upcoming season.

The price of rice (Thailand, white milled, 5 per cent broken) has dropped from $414 per ton in August 2016 to $382 per ton in August 2017. Looking forward, rice stocks are expected to slightly increase during the 2017–2018 season so that further significant price increases seem unlikely.

The 2016–2017 season marked a record production of wheat and maize. As a consequence, the wheat price (Hard Red Winter No.2) at $191 per ton in April 2017 was down 4.5 per cent year-on-year. After a brief price rally from May to July 2017, the wheat price settled at $203 per ton in August 2017. The maize price (Yellow Maize No. 3) reached its lowest level in more than seven years at $158 per ton in April 2017 and remained low at $159 per ton in August 2017. Strong demand is projected to lead to a reduction of grain stocks, which could generate a mild increase in prices.

Projections of a record production for soybeans for the 2016–2017 season led to a price decline among vegetable oilseeds and oils during the first half of 2017. In August 2017, the UNCTAD Vegetable Oilseeds and Oils Price Index averaged 223 points, 12.2 per cent down from January 2017. Forecasts for 2017–2018 show increasing demand but also rising oilseed production so that prices are expected to remain stable.

The International Coffee Organization composite indicator price for coffee followed a downward trend in the first half of 2017, based on favorable supply and a weakening Brazilian real. In August 2017, the coffee price averaged 128 cents per pound, down 2.1 per cent year-on-year. Forecasts of healthy production during the 2017–2018 season suggest that price increases are unlikely in the absence of unfavourable weather conditions.

The markets for tea were characterized by high variability over the past two years. Between July 2015 and April 2016, the tea price (Kenya, BPF 1, Mombasa auction prices) plummeted from 403 to 238 cents per kilogram, mainly driven by surplus supply. After a
trend reversal in mid-2016, the tea price averaged 362 cents per kilogram in August 2017. The tea price is expected to remain volatile as weather-related risks in main growing regions complicate supply forecasts.

Prices of cocoa beans started to trend downwards in July 2016 amidst predictions of a supply surplus for the 2016–2017 season. In April 2017, the price of cocoa beans averaged 89 cents per pound, its lowest level in almost a decade. This price trend was fueled by expectations of significant production increases in Côte d’Ivoire and Ghana and a record supply surplus. The sharp price drop had dramatic consequences for cocoa producers, particularly in Côte d’Ivoire (see Box I.4). Looking ahead, growing demand is unlikely to outpace strong production and cocoa beans prices are expected to remain low.

The price of rubber (RSS 3, Singapore) surged 21.8 per cent from 223 cents per kilogram in December 2016 to 271 cents per kilogram in February 2017 after floods in Malaysia and Thailand constricted supply. Rubber prices receded to 188 cents per kilogram in August 2017 after supply conditions eased. Going forward, demand growth is expected to outpace production increases so that mild price increases seem likely.

The price of cotton (Cotlook Index A) is considerably higher in 2017 than in 2016. The average monthly cotton price during the first half of 2017 was 86 cents per pound, 24.2 per cent higher than during the same period of 2016. The market outlook for cotton tentatively predicts an increase in production as well as a continuation of Chinese government auctions of stockpiles, which could cause downward pressure on prices.

Figure I.A.1
Selected commodity prices, January 2011–August 2017

Source: UNCTADstat.
Minerals, ores and metals

The price of nickel \((\text{London Metal Exchange})\) followed a downward trend during the first half of 2017 (figure I.A.1). After mine shutdowns in the Philippines due to environmental concerns had driven the nickel price up to $11,010 per ton in December 2016, the nickel price receded to $8,928 per ton in June 2017. The price of nickel increased thereafter to $10,849 in August 2017 amidst strong demand and uncertainty about supply conditions in major exporters, namely the Philippines and Indonesia.

The price of iron ore \((\text{China import, fines 62\% Fe, spot, CFR Tianjin port})\) is strongly driven by Chinese demand, as the country imports more than two-thirds of the world’s total seaborne iron ore. The price almost doubled between January and December 2016 based on recuperating demand from China and lower output from high-cost mines. In the second quarter of 2017, weakening demand for steel in China and concerns over oversupply caused a drop in the iron ore price, which stood at $76 per dry ton in August 2017. Favourable supply conditions make substantial price increases unlikely in the near future.

The price of copper \((\text{London Metal Exchange})\) was fluctuating around an upward trend in the first half of 2017. In August 2017, the copper price stood at $6,477 per ton, which was 36.2 per cent higher than in August 2016. According to latest projections, the copper market will be in deficit in 2017 and 2018 so that further increases seem likely.

Zinc markets have been characterized by high volatility over the past two years. Mine closures and production cutbacks led to a supply deficit that triggered a rally of the zinc price \((\text{London Metal Exchange})\) of 88.4 per cent between January 2016 and February 2017, when it reached $2,848 per ton. During the second quarter of 2017, the zinc price was volatile and stood at $2,981 per ton in August 2017. The high zinc prices will likely induce supply to increase, restraining further price rises in future.

The gold price increased by 7.5 per cent from $1,193 per troy ounce in January 2017 to $1,282 per troy ounce in August 2017. This is 4.4 per cent below the level of August 2016, when the gold price was at the peak of a price rally driven by geopolitical and macro-economic uncertainty. Going forward, increases in the United States policy rates remain a downside risk to the gold price, while upside risks include geopolitical conditions.

Oil price

Amid a rebalancing of demand and supply, the price of Brent crude oil is assumed to average $52.5 per barrel in 2017, $55.4 per barrel in 2018 and $59.7 per barrel in 2019 (figure I.A.2).

Monetary policy

Many of the central banks in developed economies will begin to ease or withdraw monetary stimulus measures in 2018–2019, although monetary conditions will remain broadly accommodative. Interest rates will continue to diverge between the euro area, Japan and the United States (figure I.A.3), reflecting differences in the timing and pace of withdrawal.

North America: The Fed is expected to raise its key policy rate by 25 basis points by the end of 2017. The target for the federal funds rate will then increase gradually, by 50 basis points in 2018 and 75 basis points in 2019. The Fed initiated its balance sheet normalization program in October 2017, and will gradually reduce its holdings by approximately $10 billion per month over the forecast horizon (figure I.A.4). Meanwhile, the Bank
of Canada raised interest rates by 50 basis points in the first nine months of 2017, and is expected to roughly track the interest rate rises in the United States over 2018–2019.

**Japan:** To pursue the inflation target of 2 per cent, the Bank of Japan (BoJ) is expected to maintain a set of unconventional monetary easing measures, known as Quantitative and Qualitative Monetary Easing (QQE). The measures include a negative interest rate on commercial banks’ excess reserves of -0.1 per cent, while the BoJ also guides the yield on 10-year Japanese Government Bonds between 0 per cent and 0.1 per cent. The BoJ is expected to maintain the pace of the monetary base expansion by actively purchasing financial assets. Consequently, the total assets of the BoJ are projected to surpass Japan’s nominal annual GDP by early 2018.
Chapter I. Global economic outlook

European Union: In 2017, the ECB reduced the amount of its monthly asset purchases, albeit with an extension of the purchase program, and dropped the reference to possibly lower interest rates in its policy guidance. The ECB is expected to initiate further steps to remove some of its stimulus in 2018, gradually tapering asset purchases, which will continue until at least September 2018. At the same time, the ECB is expected to continue the reinvestment of maturing asset holdings for an extended period of time, maintaining a significant element of support for financial markets. Interest rate normalization will begin only well past the end of the asset purchase program, with a first 25 basis point rise expected by the end of 2019. In response to higher inflationary pressures, the Bank of England is expected to further tighten its policy stance in 2018.

Monetary policy stances vary among developing countries and economies in transition. Figure I.A.5 illustrates the share of each major global region that has increased and reduced interest rates over the course of 2017. There has been a clear tendency towards monetary loosening in the economies in transition and in Latin America and the Caribbean — partially reversing the interest rate hikes in 2015 or 2016.

Commonwealth of Independent States (CIS): As inflationary pressures caused by the sharp exchange rate adjustments in 2015–2016 are abating and currencies rebound, most central banks in the CIS continued to relax monetary policy in 2017, with several policy rate cuts in the Russian Federation. In certain cases, high levels of dollarization and weak financial intermediation are hampering control over the lending rates and money supply. Concurrently, some countries (for example, Kyrgyzstan) are taking measures to restrict dollar-denominated lending and to convert outstanding foreign exchange loans to domestic currency loans. Compared with other emerging markets, real interest rates remain high in many CIS economies.

South-Eastern Europe: In South-Eastern Europe, formal or informal currency pegs or unilateral euroization constrain the conduct of monetary policy, but the overall monetary conditions are accommodative. In countries with flexible currencies, policy rates remain at a record low, such as in Albania, thanks to the earlier disinflationary trend and the continuing ECB monetary loosening. Interest rates were also gradually reduced in Serbia. Looking
forward, gradual monetary tightening by the Fed and the reversal of the ECB stance may put some pressure on monetary policy in the region.

**Africa:** While inflation remains elevated in many countries, disinflationary pressures are creating space for several central banks to ease monetary policy. However, monetary policy is expected to remain tight in the Democratic Republic of the Congo, Egypt, Sierra Leone and Tunisia, to stabilize currencies and inflation. In terms of exchange rates, most currencies stabilized in 2017, following the high volatility witnessed by many African currencies in 2016.

**East Asia:** Against a backdrop of subdued inflationary pressures and high external uncertainty, monetary policy in the East Asia region is likely to remain accommodative over the forecast period. In 2017, Indonesia and Viet Nam reduced their key policy rates, in efforts to stimulate bank lending and boost growth. For many countries, however, there is fairly limited room for further rate cuts. Policy rates are at historic lows in several countries, with rates in the Republic of Korea, Taiwan Province of China and Thailand at below 2 per cent. Furthermore, as developed economies normalize monetary policy, central banks in East Asia are faced with the risk of managing potential large capital outflows. In China, the People’s Bank of China (PBoC) is expected to maintain a neutral and prudent monetary policy stance. Amid concerns over growing financial risks, the PBoC is expected to use a range of monetary and macro-prudential tools to curb financial vulnerabilities while preserving growth.

**South Asia:** Monetary policies continue to be moderately accommodative amid subdued inflationary pressures and lingering output gaps in some economies. Yet, credit growth remains subdued in most economies. Accommodative monetary stances are expected to continue in the outlook period, with further easing in some countries. However, sudden changes in global financial conditions could significantly affect the monetary stances and trajectories in the region.

**Western Asia:** Central banks in Bahrain, Jordan, Kuwait, Qatar, Saudi Arabia and the United Arab Emirates are expected to raise policy interest rates in line with the Fed. The Central Bank of the Republic of Turkey is expected to ease its policy stance moderately.
as the inflation rate has started declining in the second half of 2017. The Central Bank of Israel is projected to maintain its policy rate at 0.1 per cent.

**Latin America and the Caribbean:** Against the backdrop of rapidly declining inflation, weak economic activity and improved financial stability, several South American central banks (including those in Brazil, Chile, Colombia and Peru) eased monetary policy during 2017. The Central Bank of Brazil has cut its main policy rate aggressively from 14.25 per cent in October 2016 to 8.25 per cent, the lowest level since 2013. As South America’s recovery gains momentum and economic slack diminishes, the monetary easing cycle is expected to come to an end. In the absence of negative shocks, policy rates are projected to remain largely unchanged over the next year. A moderate tightening of monetary policy is possible in the latter part of the forecast period.

In Mexico, the lengthy tightening cycle that started in late 2015 and lifted the main policy rate from 3 per cent to 7 per cent has likely come to an end. With inflation starting to come down, but remaining well above the 3 per cent target, the central bank is expected to pursue a neutral stance in the short term.

In countries that are fully dollarized (Ecuador, El Salvador and Panama) or operate a peg to the dollar (Antigua and Barbuda, Dominica, Bahamas and Barbados), monetary policy is essentially imported from the United States. Local interest rates are projected to rise in line with those of the Fed.

**Fiscal policy**

Fiscal policy in most developed economies is expected to be broadly neutral in 2018–2019. A few countries have announced more expansionary measures, including Australia, Canada, Japan and New Zealand.

**United States:** While the budget for 2018 remains unclear, policy changes are expected to contribute marginally to growth in 2018 (roughly 0.1 percentage points), and remain neutral in 2019. Additional government spending, largely in the areas of defence, will be partly offset by cuts in spending on education, healthcare, environmental protection and development aid. Some degree of corporate tax cuts is expected, which will have a small, but positive, impact on growth in both years.

**Japan:** Fiscal policy will remain accommodative over the 2017 and 2018 fiscal years. In 2017, general expenditures increased by 0.9 per cent, and the same margin of increase is expected in the 2018 fiscal year. While health care and social welfare expenditures will rise to cope with the rapidly aging society, the Government will commit to fiscal consolidation after 2018, and targets a primary balance surplus in 2020.

**European Union:** Fiscal policy will have a broadly neutral impact on growth in the forecast period. The implemented fiscal adjustments have led to measurable improvements in fiscal positions. In 2016, only Spain and France exceeded the EU limit for budget deficits of 3.0 per cent of GDP by registering deficits of 4.5 per cent and 3.4 per cent, respectively. In the outlook period, several countries, including Austria and Germany, will increase fiscal spending to integrate a large number of migrants. However, fiscal policy space will remain limited in the EU as a whole, with the aggregate debt-to-GDP ratio standing at 86 per cent, and Belgium, Cyprus, France, Greece, Italy, Portugal and Spain exhibiting debt-to-GDP ratios of close to or in excess of 100 per cent. In the United Kingdom, fiscal policy will remain under pressure from the effects created by the decision to leave the EU.

Among developing countries and economies in transition, the fiscal policy stance in many commodity exporters will remain relatively tight.
CIS: Despite some uptick in commodity prices in 2016–2017, energy-exporters in the CIS continue to face tight budget constraints, even though privatization proceeds partially mitigated the revenue shortfall. Stronger than anticipated growth and the higher oil price allowed for some additional fiscal spending in the Russian Federation in 2017, but in 2018–2019 fiscal expenditure should decline in nominal terms according to budget plans. In Kazakhstan, additional funds were allocated to the budget in 2017, largely for supporting the banking sector through purchases of non-performing assets. In both countries, new fiscal frameworks, lowering the dependency on oil revenues, have been introduced. In Turkmenistan, numerous state subsidies were removed in 2017. The budget will be consolidated following recent spending on large infrastructure projects. A more supportive fiscal stance is expected in Uzbekistan, utilizing the accumulated wealth fund. Among the energy importers, IMF programmes place restrictions on fiscal policy in Ukraine and in a number of other countries. In Belarus, fiscal space is constrained by external debt repayments, although the recent aid from the Russian Federation alleviates some pressure. In Tajikistan, the need to bail out the banking sector places additional burden on the budget. A number of CIS countries were able to place Eurobonds in 2017, including Ukraine, which returned to international capital markets.

South-Eastern Europe: In South-Eastern Europe, fiscal consolidation remains a priority to address public debt levels; Albania and Serbia have undergone tangible fiscal adjustment. In the former Yugoslav Republic of Macedonia and Montenegro, by contrast, significant public spending on infrastructure projects is expected to continue in the near-term.

Africa: Firming commodity prices have eased fiscal pressures in economies throughout the continent. However, in the outlook period, fiscal policy stances are expected to remain tight in most countries, as fiscal consolidation efforts continue. Under the IMF’s Extended Fund Facility (EFF) arrangement, Côte d’Ivoire, Egypt, Gabon and Tunisia are projected to implement measures to reduce their budget deficits. Importantly, fiscal revenues could come under stress should the upward trend in commodity prices come to a halt or reverse, as observed during the first half of 2017.

East Asia: Given limited room for further monetary easing and elevated risks in the external outlook, fiscal policy in the East Asian economies is likely to play a more active role in supporting domestic economic activity. In 2017, several countries including China, the Philippines, the Republic of Korea, Taiwan Province of China and Thailand announced a range of fiscal and pro-growth measures, including accelerating infrastructure investment, improving access to finance for small and medium enterprises, and enhancing corporate tax incentives. China is expected to continue pursuing a proactive fiscal policy stance, as ongoing structural reform measures to reduce overcapacity in the heavy industries and to rein in financial risks dampen growth.

South Asia: Fiscal policies are officially in a moderately tight stance in most economies. However, as in previous years, the actual fiscal stances are expected to be more expansionary in most economies, especially in relation to key social areas and public investments. Thus, budget deficits will likely remain high, but manageable, in the outlook period. Some economies, notably India, are implementing tax reforms to strengthen their tax revenues, but further efforts are needed to significantly improve the capacity to implement countercyclical policies across the region.

Western Asia: Despite the recent recovery in oil prices, fiscal authorities in Co-operation Council for the Arab States of the Gulf (GCC) economies are expected to remain cautious against loosening the policy stances. Some GCC economies are expected to introduce the value-added tax by the end of 2018. Fiscal consolidation efforts are projected
to continue in Iraq, Jordan, Lebanon and Turkey. The fiscal policy stance is likely to be accommodative in Israel given its strong fiscal position.

**Latin America and the Caribbean:** The fiscal accounts of many Latin American and Caribbean countries deteriorated significantly over the past few years. South America’s commodity exporters, in particular, have seen sharp increases in fiscal deficits that have resulted in higher public debt-to-GDP ratios. In response, many of the region’s governments have implemented fiscal adjustment measures. The pace and pattern of these consolidation programmes have differed notably across countries. In general, governments have pursued a gradual approach to minimize the negative impact on economic activity. In some cases, such as in Colombia, Ecuador, Mexico and Peru, capital expenditures were reduced, contributing to a decline in potential output. Despite these adjustment measures, primary balances have remained below debt-stabilizing levels. The ongoing consolidation needs imply that fiscal policy will likely remain relatively tight in the outlook period. However, higher commodity prices and improved growth prospects could boost government revenues and help ease the fiscal pressures.

**Exchange rates**

The dollar/euro exchange rate is assumed to average 1.129 in 2017, 1.154 in 2018 and 1.151 in 2019 (figure I.A.6).

The yen/dollar exchange rate is assumed to average 111.28 in 2017, 113.37 in 2018 and 114.79 in 2019.

The renminbi/dollar exchange rate is assumed to average 6.74 CNY/dollar in 2017, 6.59 in 2018 and 6.65 in 2018.

**Figure I.A.6**  
*Major currency exchange rates: recent trends and assumptions*

![Index, January 2013=1](image)

Sources: IMF Exchange Rate Query Tool and UN/DESA forecast assumptions.