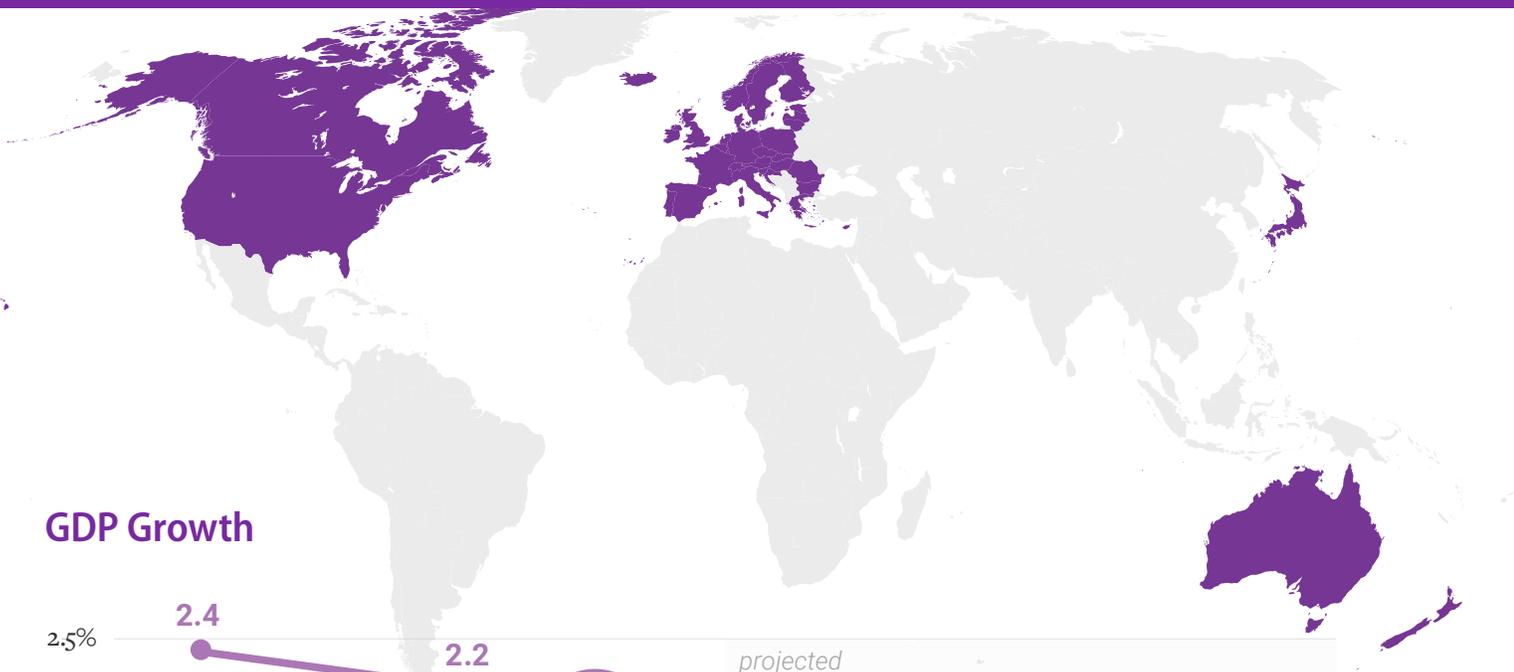


World Economic Situation and Prospects

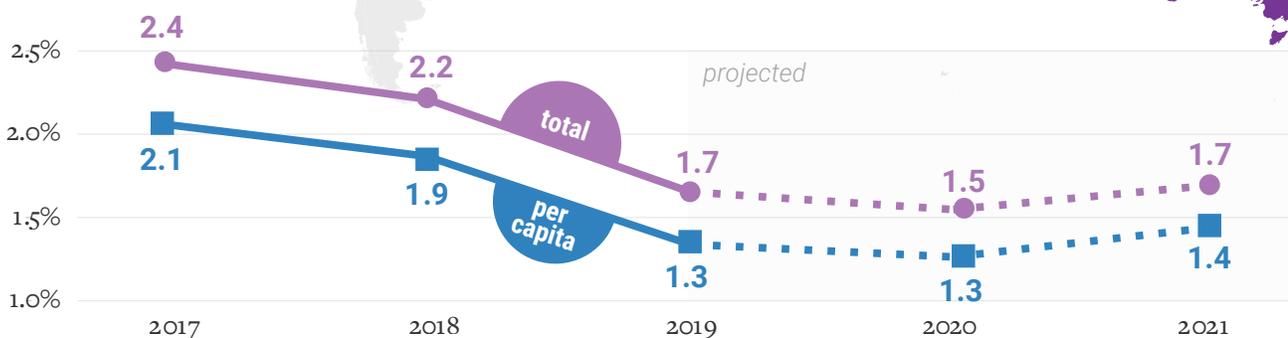


United Nations
New York, 2020

Developed economies

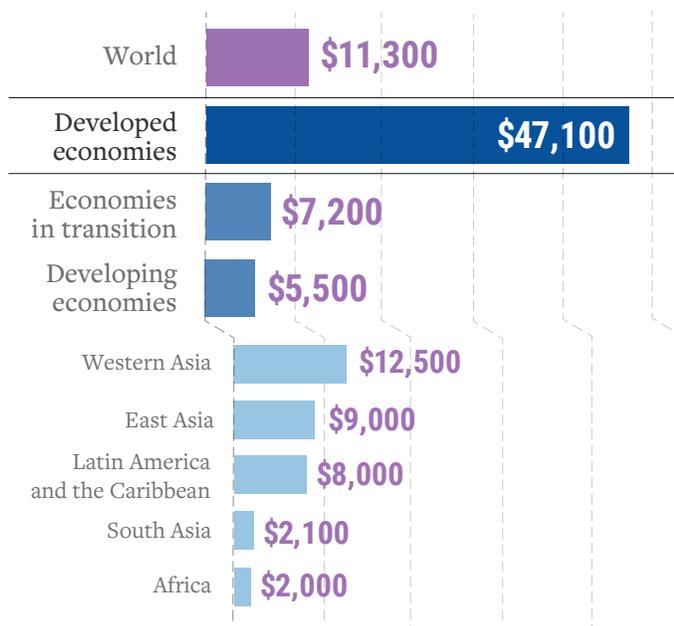


GDP Growth



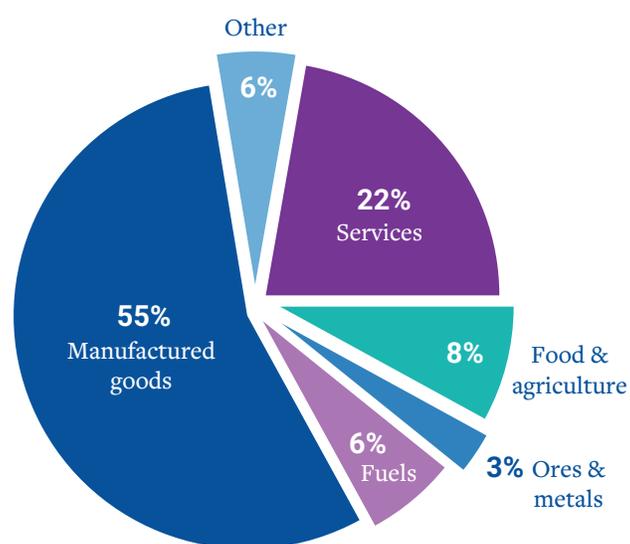
GDP per capita

2019



Export Structure

2018



The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations. The map represents countries and/or territories or parts thereof for which data is available and/or analysed in *World Economic Situation and Prospects 2020*. The shaded areas therefore do not necessarily overlap entirely with the delimitation of their frontiers or boundaries.

Chapter III

Regional developments and outlook

Developed economies

- Headwinds from global trade tensions are affecting investment in Europe and North America.
- Capacity constraints and labour market shortages are evident in many developed economies, including Canada, Germany, Japan and the United States.
- Deteriorating economic prospects have prompted monetary easing in Australia, Europe, New Zealand and the United States.

United States: trade tensions take an increasing toll on investment

Economic activity in the United States has decelerated, largely reflecting the toll on investment of prolonged trade policy uncertainty and the impact of tariffs on specific sectors. At the same time, the effects of fiscal stimulus measures introduced in 2018 are fading; a lower global oil price has discouraged investment in the fossil fuel industry; and residential investment remains weak, partly reflecting labour shortages in the construction sector. Muted inflationary pressures and the deepening of trade disputes over the course of 2019 prompted a reversal in the monetary policy stance of the United States Federal Reserve. The target range for the federal funds rate was reduced by a cumulative 75 basis points in the second half of the year, while the Federal Reserve balance sheet was also allowed to rise; between September and November 2019, the central bank's balance sheet increased by over 7 per cent, reversing declines in the first eight months of the year. GDP growth is estimated to have moderated to 2.2 per cent in 2019, and a further slowdown towards 1.7 per cent is forecast for 2020. Even as trade tensions ease along some fronts, the potential for setbacks are high, and firms and households are expected to remain cautious.

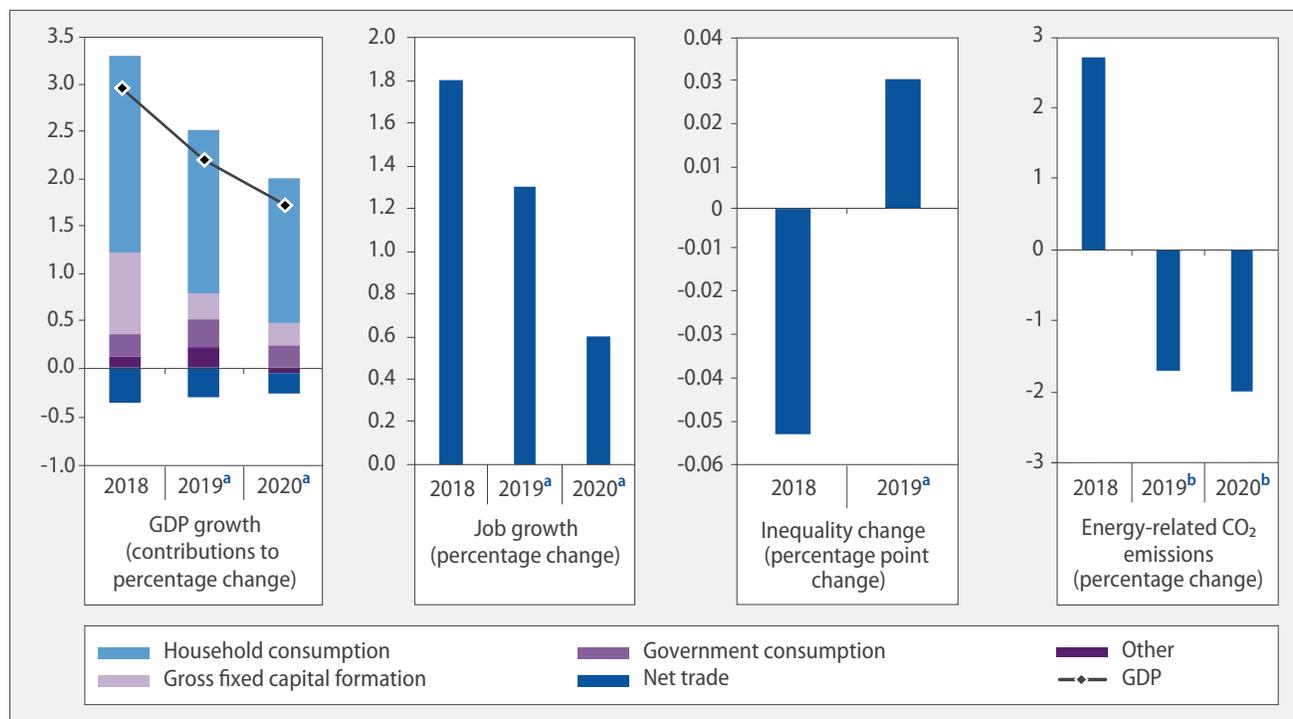
As trade tensions between the United States and its major trading partners continued to intensify, export volumes contracted by an estimated 1.2 per cent in 2019, while in value terms trade between the United States and China plummeted by over 13 per cent in the first nine months of 2019 in comparison with the same period a year earlier. Although China and the United States have reached agreements in some areas, a comprehensive agreement will require progress on many fronts, addressing issues that have yet to be tackled in depth, and there is a risk that trade tensions may re-escalate going forward. Tensions with trading partners in the European Union are also elevated in connection with issues surrounding agricultural access, tariffs imposed in response to the Airbus subsidy ruling, and repeated threats to impose tariffs on automobiles imported from the European Union.

Business confidence has been on a steady downward trend since the escalation of trade disputes in August 2018. Manufacturing production fell by 2.5 per cent in the first nine months of 2019, with a particularly sharp decline in the production of motor vehicles. While China has suspended the additional tariffs imposed on automobiles made in the

Policy uncertainty will continue to weigh on economic activity

Trade between the United States and China has plummeted by over 13 per cent

Figure III.1
Key indicators for the United States



Sources: UN DESA, United States Bureau of Labor Statistics, and United States Energy Information Administration.

Notes: Inequality is measured as the ratio of usual weekly earnings of the highest 10 per cent of earners to the lowest 10 per cent of earners.

^a UN DESA estimates and forecasts.

^b Estimates and forecasts from United States Energy Information Administration (2019).

United States, the industry is heavily impacted by tariffs imposed on imports of car parts into the United States from China, as well as by steel tariffs that raise input costs across the industry. One of the stated aims of recent trade measures is to increase investment in the domestic car industry, but to date production figures show little evidence of this boost. Recent negotiations also focus on increasing exports of agricultural goods from the United States to China. According to the United States Department of Agriculture, the soybean sector, in particular, has suffered from tariff hikes, with an estimated 60 per cent decline in exports to China between 2017 and 2019. However, removing these tariffs and resuming the purchase of agricultural products will not be sufficient to regain lost exports, as demand for soybeans in China has also fallen off steeply as a result of the outbreak of African swine fever and its impact on demand for animal feed.

While tariffs have increased selected prices in the United States, inflation has drifted below the Federal Reserve target of 2 per cent since late 2018 despite some upward pressure on wages from the extremely low unemployment rate. Subdued inflation is largely a reflection of movements in the oil price. Headline inflation is more sensitive to oil price dynamics in the United States than in most other developed economies, partly as a result of lower levels of taxation on gasoline and other carbon-intensive inputs and consumables.

The consumer price inflation rate (excluding energy) has remained steady at 1.6–2.2 per cent for several years, inching up to 2.3 per cent in the second half of 2019.

Investment in the United States is also increasingly sensitive to the oil price, reflecting the short-term nature of investment activity in the shale industry, which now accounts for over 60 per cent of United States oil and gas production. In 2018, the oil price rose by 30 per cent, which was associated with a 24 per cent rise in investment in mining exploration, shafts and wells. In the first three quarters of 2019, the oil price was 10 per cent lower than a year earlier, and investment in mining exploration, shafts and wells declined by 5 per cent. This shift alone accounted for roughly 30 per cent of the slowdown in non-residential private investment growth in 2019.

The important role of the fossil fuel sector in the economy acts as an obstacle to more rapid progress towards environmental goals. While the majority of states have passed legislation requiring greater use of renewable energy by electric power plants, progress towards a cleaner energy mix is lagging behind most of Europe, and there has been a steady unwinding of environmental regulation over the last few years.¹ Nonetheless, total energy-related carbon emissions are estimated to have declined by 1.7 per cent in 2019, offsetting much of the rise seen in 2018 (see figure III.1). The improvement largely reflects a 5 per cent decline in summer cooling degree days, which were exceptionally high in 2018 (United States Energy Information Administration, 2019).

Despite the recent deceleration in growth, labour markets appear relatively strong, with the unemployment rate at its lowest level since 1969 and the ratio of workers to the total population of prime-age adults (aged 25 to 54) at its pre-recession high of 80.3 per cent. Poverty levels in the United States are closely correlated with job creation, and the steep decline in unemployment since 2010 has pulled a significant number of people out of poverty. However, sufficient social protection is failing to reach those at the very bottom of the income distribution, for whom the standard of living has deteriorated further over the past decade. The number of households living on less than \$15,000 a year has increased by more than 1 million since 2007.

Job quality is also uneven, and inequality remains a significant obstacle to a higher sense of well-being in the United States. After-tax income inequality in the United States is the highest among the developed economies and has continued to rise steadily since the mid-1970s. Following modest improvement in 2018, inequality—as measured by the ratio of usual weekly earnings of the highest 10 per cent of earners to the lowest 10 per cent of earners—increased in 2019 (see figure III.1). Inequalities in health and access to quality health care are also stark, with significant disparities according to race, ethnicity and educational background. The share of the population with no form of health insurance began to rise again in 2018 following several years of improvement, suggesting that health inequalities may widen further.

As the stimulus from the 2017 Tax Cuts and Jobs Act dissipates and consumer confidence is increasingly affected by economic uncertainty, household consumption growth is expected to slow. Government spending will also remain moderate. Higher discretionary funding limits for 2020 and 2021 that were established in the Bipartisan Budget Act of 2019 offer some scope for higher spending, including on defence and disaster preparedness and relief, which acts as a small upside risk to current short-term forecasts.

Inflation and investment in the United States are sensitive to oil price movements

The number of households living in deep poverty has risen...

... and inequality continues to increase

¹ See, for example, Climate Deregulation Tracker, Sabin Center for Climate Change Law, Columbia Law School, Columbia University Earth Institute (<https://climate.law.columbia.edu/climate-deregulation-tracker>).

Canada: fossil-fuel subsidies undermine carbon pricing efforts

Global trade uncertainty has driven a sharp contraction in business investment

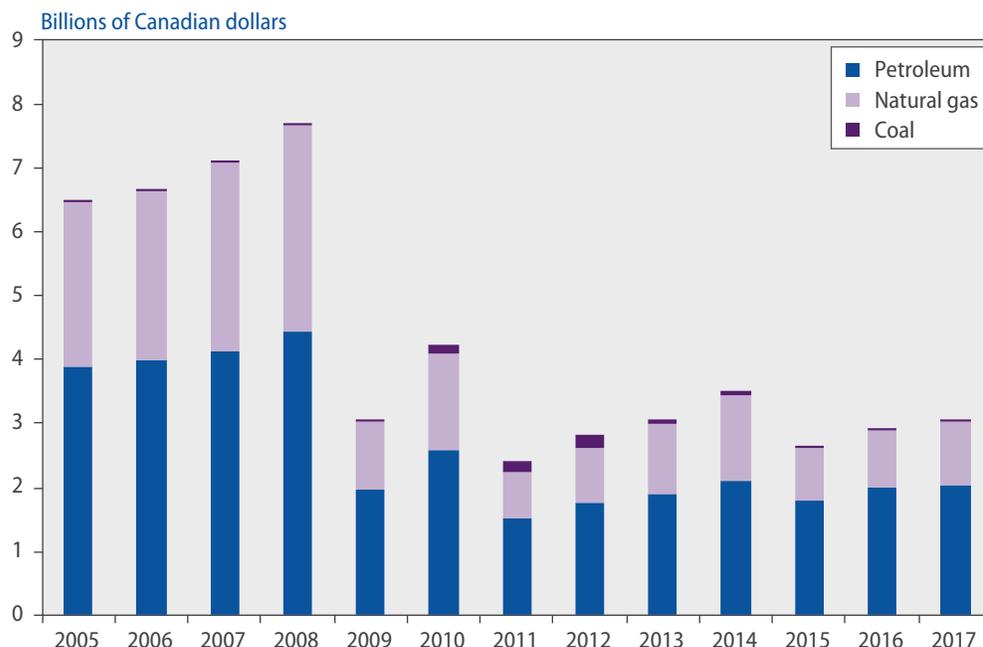
GDP growth in Canada slowed to an estimated 1.5 per cent in 2019 as global trade uncertainty and weak demand from the United States, the country's most important export market, delivered a sharp contraction in business investment. In an environment of heightened risk and uncertainty, GDP growth is forecast to remain below potential at 1.5 per cent in 2020.

The successful renegotiation of the United States-Mexico-Canada Agreement (USMCA) eases some downside risks for the Canadian economy. However, until the agreement is ratified by all parties, a resurgence of global trade tensions will remain a critical concern. Inflation in Canada remains close to the central bank target of 2 per cent; as a result, the Bank of Canada did not follow the global trend of greater monetary accommodation in 2019. The Bank's Governing Council remains open to interest rate cuts in 2020 if economic conditions deteriorate further and will carefully monitor developments in the exchange rate and labour markets. While the unemployment rate is near an historical low, with many companies reporting a shortage of skilled workers, persistent economic weakness in energy-producing regions has contributed to extended layoffs.

Fossil-fuel subsidies are at odds with the national carbon tax

Canada has set ambitious targets to meet emission commitments under the Paris Agreement. In 2019, the federal Government established a national carbon tax² as part of the Pan-Canadian Framework on Clean Growth and Climate Change. While this marks a decisive step, the federal Government and individual provinces continue to provide various types of subsidies to the fossil-fuel industry, which remains an important sector of the Canadian economy (see figure III.2). These subsidies, which include tax breaks, reduced

Figure III.2
Total support for fossil fuels in Canada by fuel type



Source: OECD Inventory of Support Measures for Fossil Fuels.

² Provinces that did not introduce their own carbon pricing plan by 2019 received a federally mandated carbon tax.

royalty rates, and R&D support programmes, conflict with the incentives and targets of the carbon tax. Removing this double standard would accelerate progress towards the country's 2030 Agenda targets.

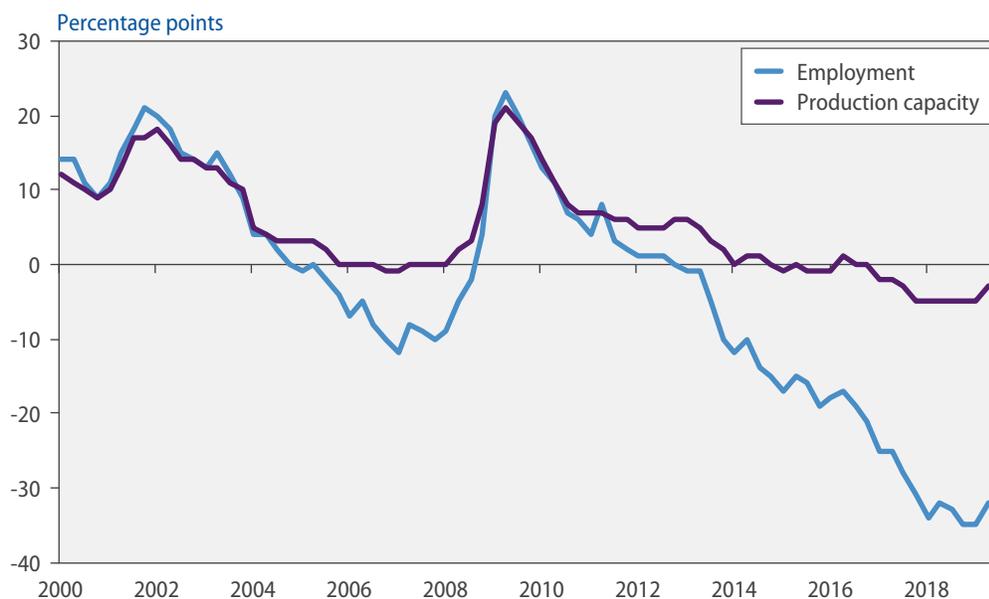
Japan: resilient investment sustains growth against weakening consumption and exports

In Japan, real GDP growth is estimated at 0.7 per cent for 2019 and is forecast to remain below 1 per cent in 2020 for the third year in a row. The country's weak economic performance reflects weak external demand; domestic demand has remained more resilient. Slowing demand from China, in particular, has impacted exports of the automobile and electronics sectors. Although corporate profits are in decline as a result of sluggish export earnings, capital investments remain firm, particularly in software, information technology and R&D. Private consumption has been constrained by declining real wages and a hike in the consumption tax rate in October 2019. A modest acceleration in GDP growth to 1.3 per cent is expected for 2021 as the impact of the consumption tax rise dissipates and real wages stabilize. However, the slowing growth of other East Asian economies, especially China, will continue to act as a drag on the Japanese economy.

The decline in average real wages in 2019 occurred despite a further tightening in the labour market. In August, the unemployment rate fell to 2.2 per cent for the first time in 27 years, and the quarterly Tankan survey revealed continuing labour shortages (see figure III.3); however, this has yet to put significant upward pressure on wages. Weak inflationary pressures overall partly reflect spare capacity in the business sector. The Tankan survey indicates that the utilization of capital equipment of business enterprises is well below capacity limits. Consumer price inflation declined to 0.7 per cent in 2019, and a similar rate is forecast for 2020; while a modest rise to 1.3 per cent is projected for 2021, the goal of meeting the Bank of Japan's inflation target of 2 per cent soon is becoming increasingly elusive.

Labour shortages reported by firms

Figure III.3
Diffusion indices on employment and production capacity in Japan



Source: Bank of Japan, Tankan survey.

Note: Figures are for all enterprises. Negative values indicate a shortage of labour or production capacity in the majority of businesses. Diffusion indices measure the difference between the share of enterprises identifying "excessive" employment or capacity minus the share reporting "insufficient" employment or capacity.

Monetary policy focuses on yield curve control

The Bank of Japan continues to maintain a set of unconventional monetary easing measures known as Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control (YCC). The rate of asset expansion under QQE has decelerated from an average of 17 per cent in 2017 to just 3 per cent year-on-year in September 2019. The year-on-year growth rate of the broad money stock (M2) decelerated from the 2017 average of 4 per cent to 2.4 per cent in September 2019. The focus of monetary policy has now shifted to the YCC component, as the Bank of Japan is actively involved in controlling the yield curve of Japanese Government Bonds (JGBs). YCC is aimed at maintaining the short-term interest rate at -0.1 per cent, the yield on 10-year JGBs at zero per cent, and long-term interest rates at a positive value.

Substantial appreciation of the yen remains the principal downside risk

As the interest rate differentials with other major currencies are narrowing, the Japanese yen is projected to appreciate. An abrupt and rapid appreciation of the yen remains the main downside risk for the Japanese economy. The deflationary effects of a stronger currency would erode fragile business confidence and deter the investment that is currently sustaining domestic demand.

The fiscal stance has tightened, as the Government is committed to lowering its debt dependency. Structural reforms have focused fiscal expenditures on areas such as the expansion of social protection systems. The expansion of childcare services is a priority, as the lack of such services deters a significant number of (mainly female) single parents from pursuing decent employment opportunities.

Australia and New Zealand: expansionary policies underpin economic growth

Mineral and fuel sectors lead export growth in Australia

The Government of Australia has shifted to a more expansionary fiscal stance, thanks to an improved fiscal position; coupled with a more expansionary monetary stance, this is offsetting weaknesses elsewhere in the economy. Real GDP growth is estimated to have dropped to 1.8 per cent in 2019 from 2.7 per cent the previous year, but the Australian economy is projected to grow by 2.1 per cent in 2020 and 2.2 per cent in 2021. Private consumption and residential investments are constrained by the weakness in residential property prices, which have been declining in Sydney and Melbourne, and have yet to show signs of recovery. Wage growth also remains sluggish, in part reflecting an increase in labour force participation, which has expanded the pool of jobseekers. With weak wage growth and subdued private sector demand, consumer price inflation dropped to 1.6 per cent in 2019. Export performance has been mixed. A surge in the price of iron ore in the first half of 2019 supported export revenue from the mineral and fuel sectors, but wheat exports have declined as a result of severe drought in eastern Australia. Weaker demand from China is expected to weigh on the economy in the near term.

Business sentiment appears pessimistic in New Zealand, but export growth remains resilient

In New Zealand, real GDP growth is estimated at 2.6 per cent for 2019 and projected to be 2.9 per cent in 2020 and 2.8 per cent in 2021. The mild acceleration into 2020 reflects a policy-led expansion in domestic demand. As in Australia, developments in the real estate sector continue to subdue private sector spending. Business sentiment has turned increasingly pessimistic. While export growth has thus far remained resilient, there are growing concerns regarding demand from East Asia, the country's major export destination. Consumer price inflation remains low, estimated at 1.4 per cent in 2019, allowing space for monetary easing. A series of policy interest rate cuts in 2019 is expected to give some relief to the real estate sector and boost business confidence. Moreover, the fiscal

stance is expected to be mildly expansionary since a more flexible debt target was adopted in the 2019 budget.

Europe: external conditions, policy uncertainty and structural changes take a toll on growth

The European Union is expected to see only limited growth of 1.6 per cent in 2020 and 1.7 per cent in 2021. Against the backdrop of heightened global trade tensions, exporters face numerous challenges, including tariffs, weaker or delayed demand, and having to make corporate decisions under greater policy uncertainty. In addition, structural challenges and changes in significant sectors such as the car industry put long-established business models in doubt and create the need for companies and policymakers to develop new economic paradigms. As these factors will suppress the contribution of exports to economic performance, domestic demand will remain the mainstay of growth. Lower unemployment, solid wage gains and additional monetary stimulus on top of the already supportive monetary stance will underpin solid household consumption. The very accommodative monetary policy stance will continue to drive investment in domestically oriented sectors such as residential construction, creating positive knock-on effects for many small and medium-sized companies.

The outlook for Europe remains subject to numerous risks and challenges that could lead to a significant slowdown in growth. First, an escalation of trade tensions could have a considerable impact on European exporters, affecting not only direct exports but also exports from foreign production sites—including, for example, various models produced by European car manufacturers in the United States for export to China.

Second, some aspects of the exit of the United Kingdom from the European Union remain unresolved. While the baseline forecast assumes that an orderly withdrawal of the United Kingdom from the European Union will be concluded during the transition period, a disorderly exit would open the field to a host of negative consequences across the real economy and financial markets. With the modalities of the exit unclear and limited information regarding the nature and structure of the legal and economic relations of the United Kingdom with the European Union and the rest of the world after the exit, corporate investment decisions have already become subject to tremendous political uncertainty.

A third risk stems from monetary policy. After a brief period of starting to move away from a very accommodative policy stance, the ECB has again reversed course by providing even more stimulus, driven by persistently low inflation and global economic challenges. This will increase the potential for a run-up in asset prices, with associated risks to financial stability. It also leaves little scope for additional monetary easing in the event of an economic crisis.

In many cases, it is difficult to distinguish between cyclical developments in regional growth performance and more fundamental issues such as structural disruptions in certain economic sectors as a result of policy or technological change. Germany, the largest economy in the region, is a case in point. After solid growth momentum in 2017, the economy slowed significantly in the second half of 2018 and in 2019, in tandem with rising global trade tensions and significant headwinds for the important automotive sector. The car industry struggled to adjust to stricter emissions tests and had to deal with the fallout from the diesel emissions scandal. Combined with an increasing policy focus on climate change and air quality, both at the national level and in numerous German cities where legal battles

Trade tensions and Brexit constitute significant downside risks

Germany has experienced a structural disruption to its car industry

emerged over outright bans on certain types of cars, this pressured car manufacturers to fundamentally question their business models. As a result, the automotive sector has seen a drastic reorientation, culminating in major long-term investment programmes to create mainly electric-based product portfolios and a redefinition of corporate missions. A number of car manufacturers now emphasize their role as mobility companies encompassing areas such as autonomous driving technologies and the operation of car-sharing platforms.

The external headwinds and structural change stand in contrast to strong domestic fundamentals. Private consumption in Germany will remain buoyant because of low unemployment, rising wages and low interest rates. The same applies to investment. While some companies have become more cautious regarding investment related to external demand, this will be more than offset by investment needs to address capacity constraints, skill shortages and technological change. In the baseline forecast, which assumes no further escalation in trade tensions and an orderly exit of the United Kingdom from the European Union, Germany will see higher but still only moderate growth of 1.3 and 1.4 per cent in 2020 and 2021, respectively.

Negative fundamentals inhibit growth in Italy

France experienced a dip in growth in 2019 due to the more negative external environment, but private consumption and investment will underpin a projected expansion of 1.5 per cent in 2020 and 1.6 per cent in 2021. High capacity-utilization rates and recent reforms that impact the business environment, including changes to the tax code, will spur investment. Italy, by contrast, faces a more challenging outlook. Growth remained barely positive in 2019, as the more negative external conditions were compounded by domestic political and policy uncertainties. As the impact of some of these uncertainties eases, the economy will track the uptick in growth in the other large economies in the region, with a projected expansion of 0.6 per cent in 2020 and 0.7 per cent in 2021. However, negative fundamentals such as high sovereign debt, a complex regulatory system and a weak banking sector will continue to inhibit economic activity.

Uncertainties surrounding Brexit dampen business activity in the United Kingdom

In the United Kingdom, the intended exit from the European Union and the absence of relevant procedural specifics and details have created a political situation that leaves economic decisions by firms subject to the highest degree of uncertainty; businesses in the United Kingdom essentially do not know what market they will be operating within in a few weeks or months. The lower value of the pound sterling is reflecting this uncertainty, and while this provides some support for exporters, import prices have increased. Even more problematic is the looming disruption to supply chains. Membership in the European Union allows the free passage of production inputs and half-finished products across borders, in many cases numerous times before becoming a finished product. The mere possibility of a disorderly exit from the European Union is making this notion of market integration obsolete, forcing companies to reconsider their investment plans. Based on the assumption of an orderly exit from the European Union, the economy of the United Kingdom is projected to expand by 1.2 per cent in 2020 and 1.8 per cent in 2021, with significant downside risks in the case of a disorderly exit.

Rapid growth in EU-11 countries supports convergence in income levels within the European Union

EU-11 countries³ are expected to register GDP growth rates well above the European Union average for the period 2019–2021, which will facilitate their gradual convergence towards the more advanced economies of the European Union. Several countries are expected to achieve growth rates exceeding 4 per cent in 2019 (in Hungary, growth may approach 5 per cent); unemployment rates in the EU-11 have dropped to record lows and real wages have soared, stimulating private consumption. Many projects funded under

³ Defined here as countries that have joined the European Union since 2004, with the exceptions of Cyprus and Malta: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

the 2014–2020 European Union budget cycle are still in progress and should further support economic expansion over the forecast horizon. However, the external environment is becoming challenging; structural challenges in the automotive industry will weigh on production and exports, and financing from the 2021–2027 Multiannual Financial Framework of the European Union is expected to contract.

Monetary policy in the euro area has undergone a sharp reversal. Before the spike in international trade tensions and signs of a global growth slowdown, the ECB had signaled that it was beginning to move away from its historically loose policy stance; this included halting asset purchases, which had become a core element of the adopted non-standard policy measures. With decelerating growth rates and inflation remaining below its target of just under 2 per cent, the ECB decided in September of 2019 to reverse course again by providing further monetary stimulus in addition to an already very accommodative policy stance. The announced measures included reducing the deposit rate for banks from -0.4 to -0.5 per cent while maintaining the main refinancing rate at zero per cent and the marginal lending facility rate at 0.25 per cent; the restart of net purchases under the asset purchase programme at a monthly pace of 20 billion euros; and the forward guidance that interest rates will remain at their present or lower levels until inflation has moved closer to the policy target, dropping the previous reference to the first half of 2020.

While the adjusted ECB policy stance offers short-term support to offset some global and internal policy uncertainties, it also poses some risks and potential policy challenges. The ECB has increased its demand for sovereign and corporate bonds. This compounds a problem that has increasingly cropped up in the course of this strategy: the ECB has set limits on the share of individual bond issues it will purchase, and under these guidelines it may eventually run out of bonds to buy. Having the ECB as a major buyer in the market also means that the added demand is driving bond prices up further, with the intended effect (from the ECB perspective) of reducing yields. This has already suppressed yields in bond markets (see figure III.4), to the point that at times all debt issued by Germany

Monetary policy has reversed course towards renewed stimulus

ECB asset purchases face a number of potential pitfalls

Figure III.4
Yield on euro area 10-year government bonds



Source: European Central Bank.

Note: Figure is based on daily data on AAA-rated euro area central government bonds.

has traded with negative yields across all maturities, making investors search for yield elsewhere. The consequences of this include the run-up in stock market prices, the boom in real estate markets, and stronger demand in riskier parts of international debt markets. This brings with it the risk of a sudden bursting of a bubble of artificially inflated asset prices. Critics of quantitative easing have also raised legal concerns that this policy constitutes a form of financing fiscal budgets, reducing incentives for fiscal efficiency, as the central bank stands as the sovereign bond buyer of last resort. The monetary policy stance also raises questions of how to deal with the next crisis. If a pronounced economic crisis were to materialize, with sharp declines in growth and employment, the scope for effective further monetary easing would be increasingly constrained.

Low or negative interest rates offer opportunities for targeted public investment increases in some countries

High levels of public debt relative to GDP continue to constrain the fiscal position in many countries in Europe, including Belgium, Greece and Italy. However, zero or negative borrowing costs in countries such as Germany offer scope to increase investment in areas such as digital infrastructure, public transportation and large-scale renewable energy technologies, boosting long-term productivity and promoting green-growth initiatives while also allowing a relatively prudent fiscal stance to be maintained. Stronger fiscal support in countries that retain some fiscal space would ease the pressure for further monetary easing and alleviate associated risks.