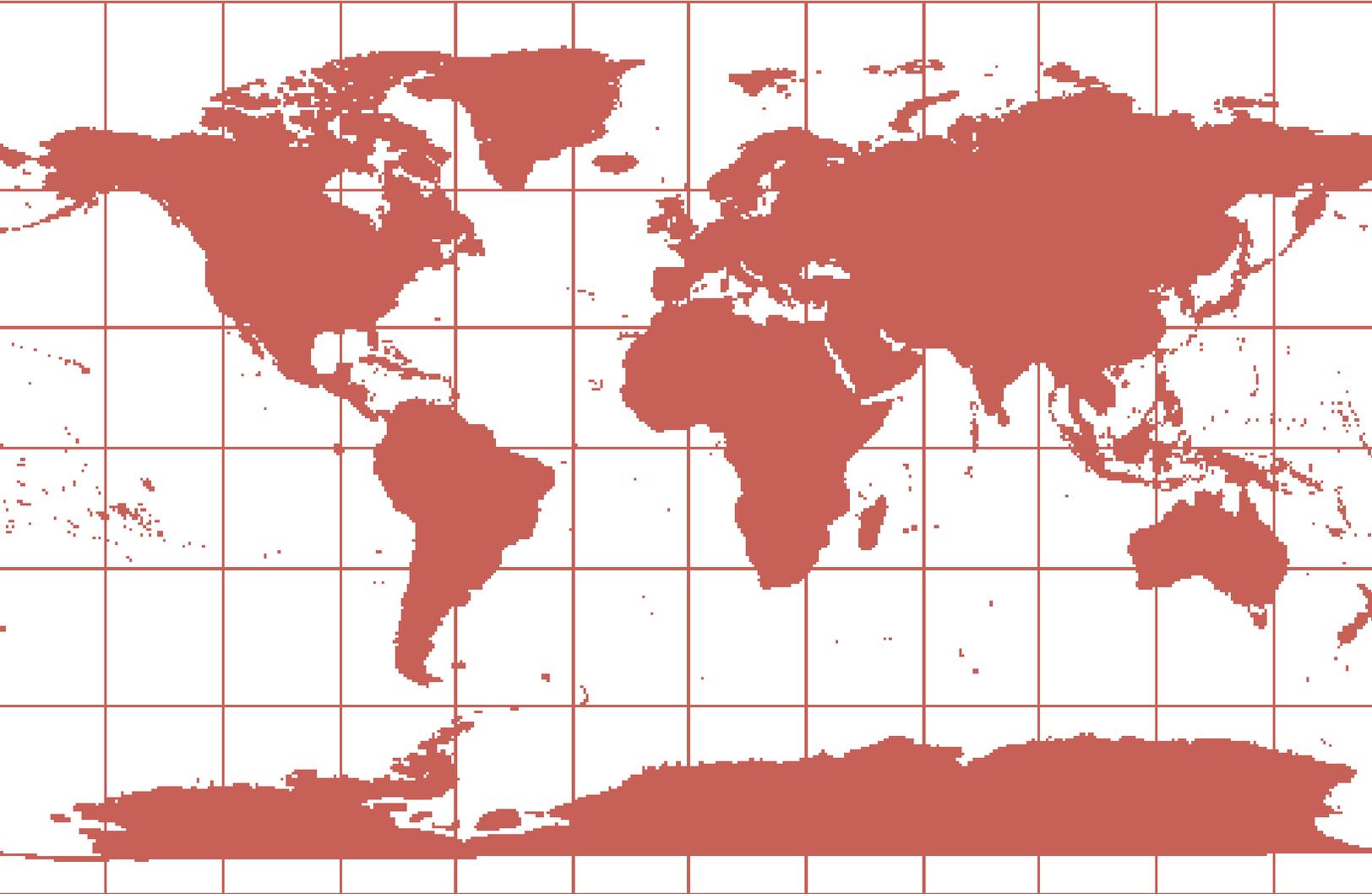


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World Economic Situation and Prospects 2018

Update as of mid-2018*



United Nations
New York, 2018

* *The present document updates World Economic Situation and Prospects 2018 (United Nations publication, Sales No. E.18.II.C.2), released in December 2017.*

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Update as of mid-2018*

Summary

Short-term prospects for the world economy have continued to improve. World gross product is expected to expand by 3.2 per cent in both 2018 and 2019, marking an upward revision from forecasts released in December 2017. The recent improvement reflects a further uptick in the growth outlook for developed economies in 2018, on the strength of accelerating wage growth, broadly favourable investment conditions, and the short-term impact of a fiscal stimulus package in the United States. Higher levels of energy and metal prices are also supporting a gradual recovery in many commodity-exporting countries.

However, the improvement in economic growth has been accompanied by an increase in downside risks, including a rise in the probability of trade conflicts between major economies; increased uncertainty regarding the pace of monetary policy adjustment in developed economies; high and increasing levels of debt; and greater geopolitical tensions.

The current economic picture has important implications for progress towards the Sustainable Development Goals. The continued improvement in global macroeconomic conditions offers an opportunity to raise living standards on a broad scale. However, this also requires policies aimed at reducing inequality, to ensure that economic gains are widely shared. The recent acceleration in economic growth also bears an environmental cost. Global energy-related CO₂ emissions increased in 2017, partly as a result of accelerating global economic growth. Current efforts to decouple GDP growth and emissions growth are insufficient to meet the objectives of the Paris Agreement. In the area of trade, policymakers face an increasing tendency to move away from the multilateral framework.

* The present document updates *World Economic Situation and Prospects 2018* (United Nations publication, Sales No. E.18.II.C.2), released in December 2017.

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I. Global macroeconomic trends

Global overview

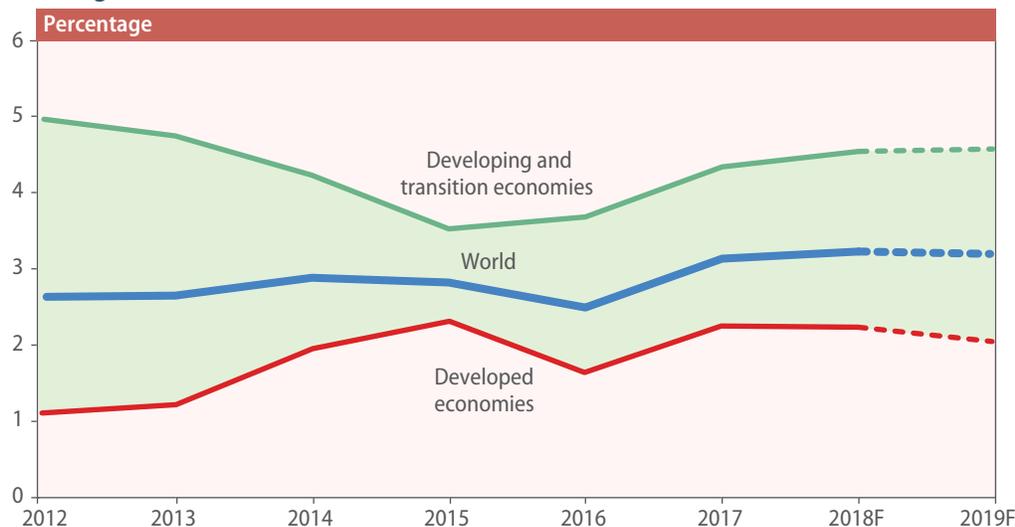
Short-term prospects for the global economy have improved further

The World Economic Situation and Prospects (WESP) 2018 noted that the world economy had strengthened. Over the last several months, short-term prospects for the world economy have continued to improve. World gross product is expected to expand by 3.2 per cent in both 2018 and 2019 (table I and figure I), marking an upward revision from forecasts released in December 2017. The recent improvement reflects a further uptick in the growth outlook for developed economies in 2018, on the strength of accelerating wage growth, broadly favourable investment conditions, and the short-term impact of a fiscal stimulus package in the United States of America. World trade growth has accelerated, reflecting a widespread revival of demand. Many commodity-exporting countries will also benefit from the higher level of energy and metal prices. While the modest rise in global commodity prices will exert some upward pressure on inflation in many countries, inflationary pressures remain contained across most developed and developing regions.

But risks to the outlook are building

However, in parallel with the improvement in economic growth we have seen a rise in risks to the economic outlook, including a rise in the probability of trade conflicts between major economies; increased uncertainty regarding the pace of monetary policy adjustment

Figure I
GDP growth



Source: UN/DESA.

Table I
Growth of world output, 2016–2019

| | Annual percentage change | | | | Change from World Economic Situation and Prospects 2018 forecast ^a | |
|--|--------------------------|-------------------|-------------------|-------------------|---|------|
| | 2016 | 2017 ^b | 2018 ^c | 2019 ^c | 2018 | 2019 |
| World | 2.5 | 3.1 | 3.2 | 3.2 | 0.2 | 0.1 |
| Developed economies | 1.6 | 2.3 | 2.2 | 2.1 | 0.2 | 0.2 |
| United States of America | 1.5 | 2.3 | 2.5 | 2.3 | 0.4 | 0.2 |
| Japan | 0.9 | 1.7 | 1.6 | 1.5 | 0.4 | 0.5 |
| European Union | 2.0 | 2.4 | 2.2 | 2.0 | 0.1 | 0.0 |
| EU-15 | 1.9 | 2.2 | 2.0 | 1.8 | 0.1 | 0.0 |
| EU-13 | 3.1 | 4.6 | 3.9 | 3.6 | 0.2 | 0.1 |
| Euro area | 1.8 | 2.3 | 2.1 | 1.9 | 0.1 | 0.1 |
| Other developed countries | 1.9 | 2.4 | 2.3 | 2.3 | -0.1 | 0.1 |
| Economies in transition | 0.3 | 2.0 | 2.1 | 2.2 | -0.1 | -0.2 |
| South-Eastern Europe | 3.0 | 2.2 | 3.0 | 3.4 | -0.1 | 0.1 |
| Commonwealth of Independent States and Georgia | 0.2 | 2.0 | 2.1 | 2.1 | -0.1 | -0.2 |
| Russian Federation | -0.2 | 1.5 | 1.7 | 1.7 | -0.2 | -0.2 |
| Developing economies | 4.0 | 4.6 | 4.8 | 4.8 | 0.1 | 0.0 |
| Africa | 1.6 | 3.7 | 3.6 | 3.9 | 0.1 | 0.2 |
| North Africa | 2.7 | 6.6 | 4.5 | 4.8 | 0.3 | 0.6 |
| East Africa | 5.5 | 5.7 | 6.0 | 6.1 | 0.2 | -0.1 |
| Central Africa | -1.0 | -0.1 | 1.8 | 2.8 | -0.2 | 0.3 |
| West Africa | 0.2 | 2.2 | 3.5 | 3.4 | 0.2 | 0.0 |
| Southern Africa | 0.7 | 1.4 | 1.9 | 2.3 | -0.4 | -0.2 |
| East and South Asia | 6.1 | 6.0 | 5.9 | 5.9 | 0.1 | 0.0 |
| East Asia | 5.7 | 6.1 | 5.8 | 5.7 | 0.0 | 0.0 |
| China | 6.7 | 6.9 | 6.5 | 6.3 | 0.0 | 0.0 |
| South Asia | 8.0 | 6.0 | 6.6 | 6.8 | 0.2 | -0.1 |
| India ^d | 7.1 | 6.7 | 7.5 | 7.6 | 0.3 | 0.2 |
| Western Asia | 3.2 | 3.0 | 3.3 | 2.7 | 0.9 | 0.0 |
| Latin America and the Caribbean | -0.9 | 1.0 | 2.1 | 2.5 | 0.0 | 0.0 |
| South America | -2.4 | 0.6 | 1.9 | 2.5 | 0.0 | 0.0 |
| Brazil | -3.5 | 1.0 | 2.4 | 2.7 | 0.4 | 0.2 |
| Mexico and Central America | 3.0 | 2.3 | 2.5 | 2.6 | -0.1 | 0.0 |
| Caribbean | -0.5 | 0.3 | 2.0 | 2.2 | 0.2 | 0.3 |
| Least developed countries | 3.9 | 4.7 | 5.2 | 5.5 | -0.1 | 0.0 |
| Memorandum items: | | | | | | |
| World trade ^e | 2.4 | 4.3 | 3.8 | 3.8 | 0.3 | 0.2 |
| World output growth with purchasing power parity-based weights | 3.2 | 3.7 | 3.9 | 3.8 | 0.2 | 0.1 |

Source: UN/DESA.

^a Adjusted to 2012 prices.

^b Partly estimated.

^c Forecast, based in part on Project LINK.

^d Fiscal year basis.

^e Includes goods and services.

in the United States; high and increasing levels of debt; elevated asset valuations, which may in some cases indicate underpriced risk; and an undercurrent of geopolitical tensions, including in the Korean Peninsula, Middle East, the South-China Sea and in Ukraine.

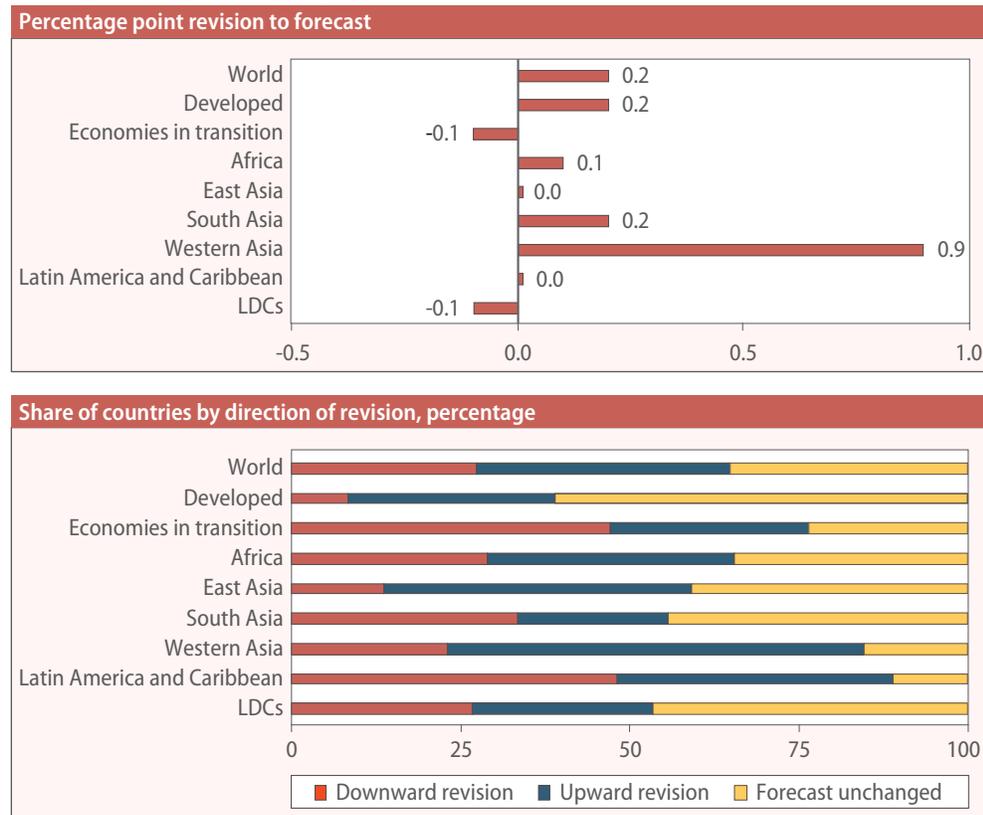
Some regions are lagging behind in the global upturn

Forecasts for GDP growth in 2018 have been revised upward in nearly 40 per cent of countries since December (figure II). This compares to downward revisions in about 25 per cent of countries. Some countries and regions are not sharing in the global cyclical upturn, in many cases reflecting structural impediments to development. In per capita terms, output is expected to decline in Central and in Southern Africa this year. Forecasts for the economies in transition and for the least developed countries (LDCs) have been revised marginally downward for 2018. For the economies in transition, the downward revision predominantly reflects rising geopolitical tensions between the Russian Federation and several countries. In the case of the LDCs, weaker growth prospects are largely driven by a deteriorating situation in Yemen.

GDP growth in the LDCs is estimated to reach 5.2 per cent in 2018 and 5.5 per cent in 2019, continuing a steady acceleration in growth since 2015. While some large LDCs are growing at an average annual rate of 7 per cent, including Bangladesh, Cambodia, Ethiopia, Myanmar and the United Republic of Tanzania, many small

Figure II

Forecast revisions for GDP growth in 2018



Source: Current UN/DESA forecasts compared to forecasts reported in WESP 2018.

island developing States (SIDS) and conflict-affected countries remain well below this Sustainable Development Goal (SDG) target. Per capita economic growth in LDCs is steadily rising, although at levels insufficient to eradicate extreme poverty: longer-term growth projections point to 35 per cent of the population in LDCs remaining in extreme poverty by 2030.¹ Changing this outcome would require both faster GDP growth and a significant reduction in income inequality.

Rising risks heighten need to tackle development barriers

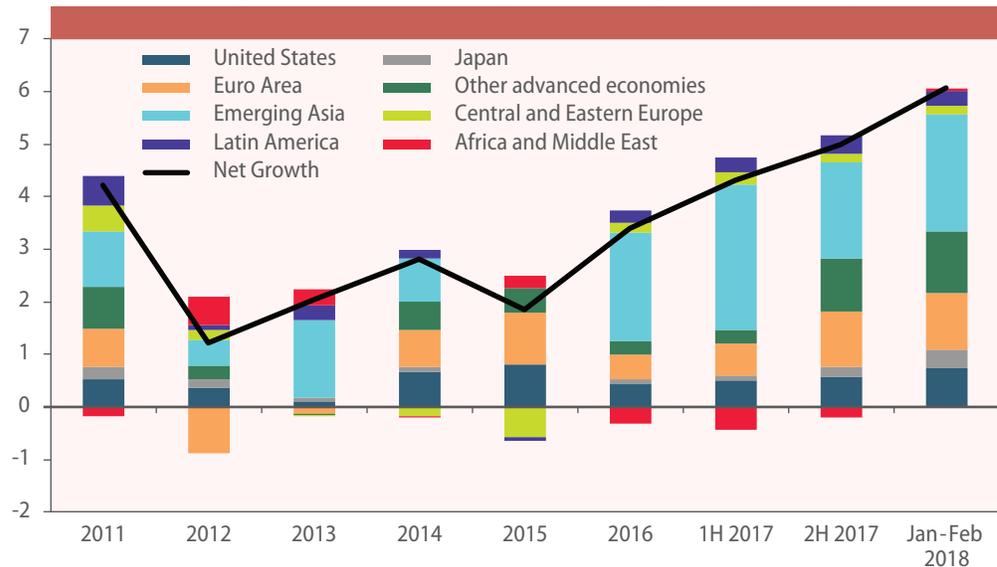
As emphasized in the *WESP 2018*, the improvement in macroeconomic conditions offers policymakers greater scope to address some of the deep-rooted barriers that hamper progress towards the SDGs. This includes, for example, accelerating the process of economic diversification; tackling high and/or rising levels of inequality; supporting essential investment; and strengthening institutions and governance to build a more transparent and dynamic business environment. The ongoing rise in economic risks makes this challenge all the more imperative, to build resilience in advance of any forthcoming economic shocks.

World trade growth has accelerated

In the first two months of 2018, growth in the volume of world merchandise trade strengthened further (figure III), in tandem with the continued improvement in global manufacturing output. All regions contributed positively to global import demand for the first time in several years, reflecting a broad-based revival of demand. This was driven in part by the ongoing recovery in investment activity in the developed economies, and solid domestic demand in East Asia, particularly in China. Strong global demand for

Figure III

Contribution to global merchandise import volume growth (year-on-year)



Source: UN/DESA based on data from CPB Netherlands Bureau for Economic Policy Analysis. Regional groupings are not strictly comparable to those in the WESP, but are illustrative of regional tendencies.

¹ WESP 2017, pp. 25-27.

electronics has also boosted intra-regional trade activity in East Asia, given the region's deep integration into the industry's global production networks.

Leading indicators in many developed and developing countries point to solid, albeit more moderate, trade momentum in the subsequent months of 2018. Following growth of 4.3 per cent in 2017, the volume of global trade in goods and services is projected to moderate slightly, but continue expanding at a relatively robust pace of 3.8 per cent in 2018 and 2019. There are, however, significant downside risks to these forecasts given the increasing number of trade policy uncertainties and disputes among major economies, as discussed further below.

Terms of trade gains for energy and metal exporters

The strong recovery in global import demand continues to push up energy and metal prices. The price of Brent crude averaged \$68 per barrel in the first four months of 2018 compared to \$54 per barrel in 2017. Metal prices are projected to continue recovering in 2018, driven by robust industrial production, particularly in China. Agricultural prices are projected to remain stable, but are prone to localized spikes related to drought and conflict in parts of Western Asia and Africa.

Global financial conditions remain largely favourable

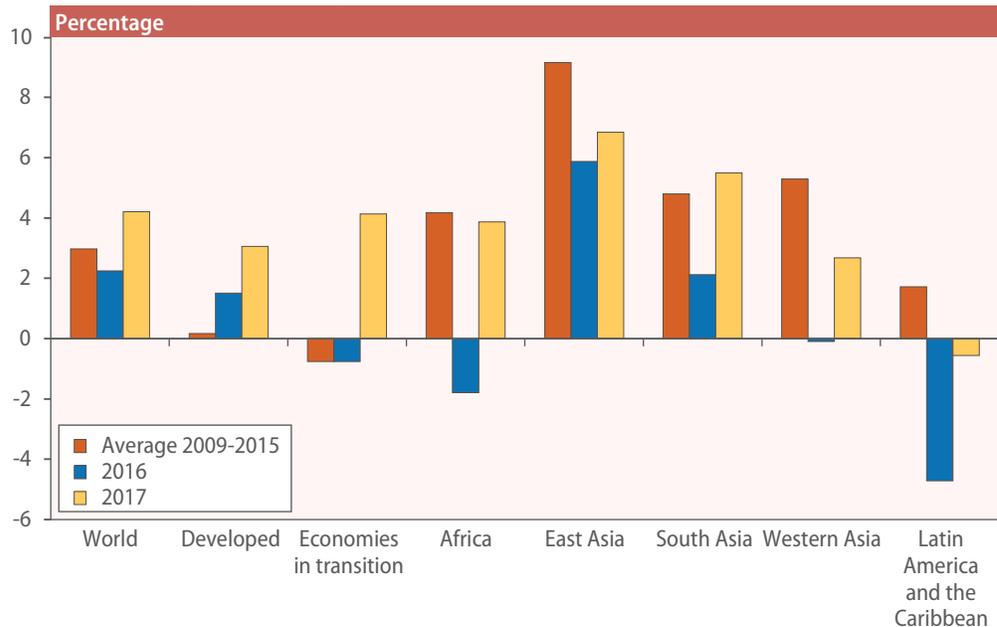
Global financial conditions remain broadly favourable, amid the still largely loose monetary policy stances among major central banks, high market liquidity and generally well-capitalized banking systems in developed economies. Despite some rise in volatility, global stock market sentiment and expectations for corporate earnings are largely positive, and cross-border bank lending continues to recover. Meanwhile, equity and bond flows to emerging economies have improved, after the visible slump observed in 2015 and 2016. This has helped maintain relatively low borrowing costs and spreads.

Investment growth accelerating from a low starting point

Against this backdrop, investment conditions have improved since early 2017, and investment growth accounted for more than three-quarters of the acceleration in global economic activity in 2017. In particular, private non-residential investment growth in developed countries has been more robust: machinery and equipment investment accelerated in a number of large economies in 2017, including Canada, France, Germany, Japan, Spain and the United States. Yet, the recent improvement follows an extended period of relatively weak investment growth since the global financial crisis (figure IV).

The recent performance of investment is more heterogeneous in developing and transition economies. Investment demand has been more vigorous in East Asia, for example in Indonesia, Malaysia and the Philippines, amid robust trade growth, accelerating manufacturing production and public infrastructure outlays. There are also improvements on the investment outlook in some commodity-dependent economies such as Brazil, Chile, Nigeria, Peru and the Russian Federation, as prices of key commodities have moved upward. In many low-income countries, where the marginal return to any investment tends to be relatively high, the level of investment appears to be insufficient to achieve a more sustained and inclusive growth, especially in parts of Africa. Moreover, investment remains highly concentrated in extractive industries, rather than laying foundations for a more diversified economy.

Figure IV
Investment growth by region



Source: UN/DESA estimates.

Macroeconomic policy stance

Monetary policy normalization in developed economies progressing gradually

In the developed economies, the process of monetary policy adjustment is expected to continue at a measured pace, as inflation remains close to or below most central bank targets. The deflationary pressures that posed a key policy concern in 2015-2016 have subsided. In response to stronger growth and labour market conditions, a few central banks have recently signalled a slightly faster pace of monetary adjustment and balance sheet normalization going forward.

In March, the United States Federal Reserve (Fed), raised the target range for the federal funds rate by 25 basis points to 1.5 – 1.75 per cent, maintaining its expectations for two further rate hikes in 2018. At the same time, it lifted its projections to three hikes in 2019. The European Central Bank (ECB) recently dropped an explicit commitment to purchase additional assets should economic activity deteriorate. This follows its decision in 2017 to reduce the amount of its monthly asset purchases. However, the ECB reiterated that interest rates will remain at the current near-zero levels for an extended period. Meanwhile, the Bank of England signalled a further rate hike in 2018. By contrast, the Bank of Japan is expected to maintain its ultra-loose monetary policy stance, reflecting a continued divergence in the magnitude and timing of monetary policy adjustments among the developed countries.

Many developing and transition economies may reduce monetary accommodation

In the majority of developing economies and economies in transition, monetary policy is likely to remain supportive of growth, amid benign inflationary pressures and heightened uncertainty in the external environment. However, a growing number of countries are expected to gradually reduce their degree of monetary accommodation. The prolonged accommodative monetary conditions have contributed to a build-up of debt in several countries, posing a growing policy challenge for central banks.

In early 2018, a few large commodity exporters, including Argentina, Brazil, Colombia, the Russian Federation, South Africa and Zambia lowered interest rates further to support the nascent economic recovery. As growth stabilizes, however, the monetary easing cycle in most of these economies is projected to come to an end. Among the commodity importing economies, several central banks in East and South Asia, including China, the Republic of Korea, Malaysia and Pakistan, raised interest rates in 2017 and 2018. Given high external uncertainty, however, central banks are expected to remain cautious. For several countries, particularly in the African region, monetary policy remains tight, given weakened domestic currencies and elevated inflation rates.

Procyclical fiscal policy expansion in the United States

Against the backdrop of a synchronized upturn in economic activity, most developed country Governments have adopted a broadly neutral fiscal policy stance for 2018-19. The main exception is the United States. Recently-passed budget changes are expected to provide a boost to economic growth in the near term, while significantly increasing the public deficit and debt over the medium term (see discussion in Part II). With the economy being close to full employment, the fiscal expansion is highly procyclical. Such an increase in debt is unusual outside a recession, leaving fiscal policy with far less room to respond to the next economic downturn.

Fiscal balances in Europe have improved but debt levels remain high

Fiscal policy in the European Union (EU), by contrast, is expected to have a neutral impact on growth in 2018-19 after many countries moved away from austerity in recent years. Across the region, stronger GDP growth and significant labour market gains have driven cyclical improvements in budget balances, by boosting tax revenues and reducing welfare expenditures. While almost all European countries are projected to record a primary balance surplus in 2019, the region's aggregate debt-to-GDP ratio remains high and is expected to decline only slowly.

Fiscal pressures ease for commodity exporters

Higher commodity prices and a gradual recovery in GDP growth are expected to ease fiscal pressures in many developing and transition economies, including major commodity exporters such as Brazil, the Russian Federation and Saudi Arabia. General government balances will nonetheless remain in deficit, and debt-to-GDP ratios are expected to rise further in many African, Latin American and Western Asian economies. Fiscal policy

will thus remain relatively tight in the forecast period. In East and South Asia, fiscal policy remains supportive of growth, focusing on infrastructure spending and expansion of social welfare systems. Fiscal deficits in the region are expected to remain broadly stable. In China, the budget deficit target has been reduced from 3 per cent of GDP in 2017 to 2.6 per cent in 2018, the first targeted decline in several years. Further discussion on regional policy developments is included in Part II.

Risks to the outlook

The baseline forecast presented in this report, which represents the most likely trajectory for the global economy, points to further improvement in short-term prospects. Nonetheless, there are significant downside risks to the outlook, with the potential to reverse recent improvements.

Escalation of trade policy disputes

Trade tensions among many of the world's largest economies have been building. Major trade agreements such as NAFTA have undergone prolonged renegotiation, and a range of tariff and trade barriers have been put forward by major economies. In addition to these measures taken outside the auspices of the World Trade Organization (WTO), an increasing number of disputes have been raised within the WTO in recent months, including cases involving Australia, Canada, China, India, Pakistan, the Republic of Korea, the Russian Federation, Ukraine, the United Arab Emirates, the United States and Viet Nam. A move towards a more fragmented international trade landscape could reverse recent improvement in the global economy. Were trade barriers and disputes to escalate sharply, this has the potential to sharply slow trade and investment in the short term, and hamper medium-term global growth, particularly given the deep linkages between trade, investment and productivity growth.

The direct impact of measures that have been introduced and proposed in recent months, including proposed tariffs on \$50 billion worth of exports from China and from the United States (equivalent to 0.2-0.4 per cent of GDP in each country), would be relatively modest at the macroeconomic level. The baseline forecast presented in this report sees world trade growth slowing modestly in 2018, but remaining relatively robust at 3.8 per cent, under an assumption that trade tensions do not escalate significantly from current levels and global spillovers remain contained. Under an alternative scenario, where trade tensions and barriers were instead to spiral over the course of 2018, through widespread retaliations and extensive disruption to global value chains, this could trigger a sharp drop in global investment and trade. For example, a shock to investment and trade equivalent to roughly half the losses seen during the global financial crisis could bring world trade growth to a halt and slow world gross product growth to 1.8 per cent in 2019, compared to baseline projections for growth of 3.2 per cent.²

Financial risks building

While global financial conditions remain relatively conducive for investment, financial risks have also been building in recent years. The prolonged period of abundant global liquidity and low borrowing costs has not translated into a sustained, widespread and

² WESP Monthly Briefing No. 114, May 2018.

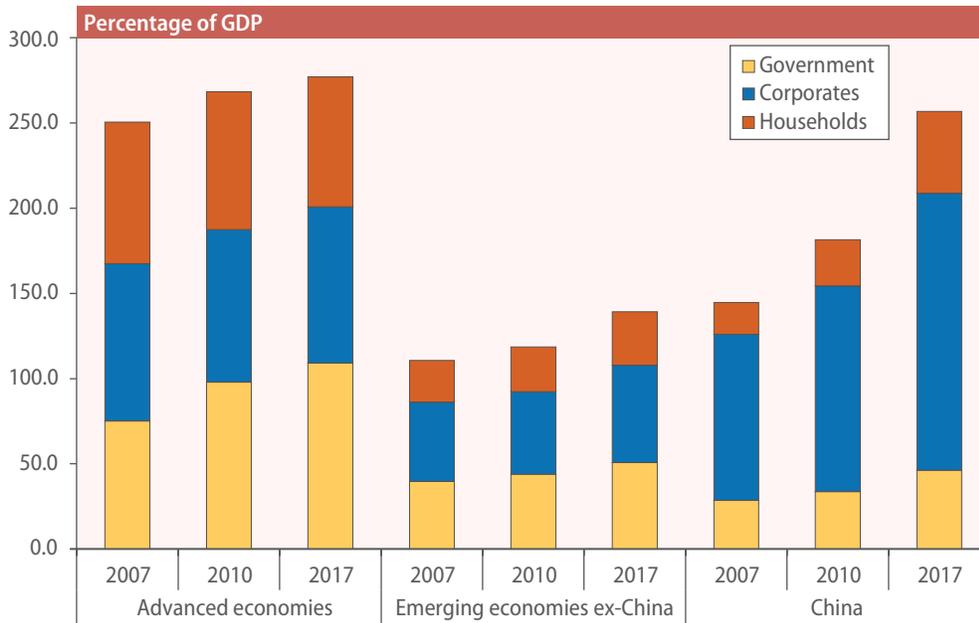
robust recovery of investment. On the contrary, it has mostly encouraged the issuance of debt securities, merger and acquisitions strategies, and rising corporate buybacks. This has been associated with a significant rise in financial asset valuations, and a substantial increase in debt levels across regions. Global stock markets volatility increased in early 2018, acting as a reminder that the vulnerabilities that have built up in many emerging economies leave them exposed to spikes in risk aversion, a disorderly tightening of global liquidity conditions, and sudden capital withdrawal.

High and rising levels of debt not fully backed by productive assets

Elevated, and in some cases still rising, levels of debt, is a prominent feature of the global economy. Public and private debt levels remain at historically high levels in many developed economies, and both household and corporate debt is higher than before the global financial crisis. In emerging economies³, the debt-to-GDP ratio (all credit to non-financial sector) has increased from 139 per cent in 2010 to nearly 200 per cent in 2017. Non-financial sector debt in China increased from 180 to over 250 per cent of GDP (figure V). Debt levels in Latin America also increased visibly, for example in Brazil (from 125 to 145 per cent) and Mexico (from 56 to 77 per cent). In many of these economies, a significant part of this rise in debt has been channelled towards real estate and financial assets rather than productive capital. The extent to which corporate debt is not backed by productive assets poses a source of financial risk, which in some economies has potential for significant spillovers to the world economy.

Figure V

Breakdown of non-financial sector debt of advanced and emerging economies



Source: BIS Total Credit Statistics.

³ Figures refer to definition used by the Bank of International Settlements
https://www.bis.org/statistics/tables_f.pdf.

In response to the building financial risks, policymakers face the challenge of enhancing resilience to external shocks, and in some cases curbing credit growth and managing the pace of private sector deleveraging. If deleveraging occurs too rapidly, it risks sparking banking sector stress, corporate bankruptcies, or sudden asset price adjustments. Many emerging economies have improved their macroeconomic management, and are better prepared to make use of a wider policy toolkit through monetary, fiscal, exchange rate and macro-prudential policies, as well as capital account management measures. Yet, it is crucial to also implement appropriate policies to encourage an adequate level, and composition, of productive investments, in order to promote productivity gains and lift potential growth in the medium term.

Uncertainty regarding monetary policy adjustment in the United States

While monetary policy adjustment in developed economies is progressing at a gradual pace, the procyclical nature of fiscal policy in the United States has increased uncertainty around the pace of adjustment, and increased the probability of a more rapid withdrawal of monetary stimulus. This uncertainty increases the risk of global financial market volatility. Many developing countries are exposed to associated risks, especially where the rise in debt in recent years reflects significant amounts of dollar-denominated debt. The prospects of tighter liquidity conditions and potential spikes in risk aversion expose emerging economies to higher borrowing costs, depreciation of domestic currencies and a decline in equity prices. This could adversely impact banking and corporate sector balance sheets as well as the capacity to roll over debt. Furthermore, the corporate sector will face a heavy debt servicing schedule in the next few years, especially in the case of a sudden appreciation of the US dollar. The effects on real economic activity have potential to be large, through a sharp slowdown in investment, higher inflation or fiscal adjustment measures.

II. Economic outlook by region

Developed economies

The economy of the **United States** is operating at or close to full capacity. The unemployment rate has dropped to 4.1 per cent, which is below most estimates of its long-run equilibrium level; the ratio of job openings to job seekers is at its highest level since at least 2000; and rising capacity utilization rates have supported a rebound of investment in equipment.

While activity moderated slightly in the first quarter of 2018, prospects for the year remain firm, buoyed by major fiscal stimulus measures introduced in the Tax Cuts and Jobs Act of December 2017 and Bipartisan Budget Act of 2018. GDP growth is expected to reach 2.5 per cent in 2018 and 2.3 per cent in 2019. Average income tax rates have dropped by 2 percentage points this year, which will sustain steady household spending. However, after-tax wage inequality is expected to continue to rise, as higher income households reap a greater share of tax cuts.

A steep decline in the corporate tax rate will continue to support investment in the near term. The Budget also includes additional federal spending amounting to 1 per cent of GDP in 2018-2019. These stimulus measures will allow the federal deficit to widen from 3.5 per cent of GDP in 2017 to about 5 per cent by 2019, and government debt will continue to rise relative to GDP for the next decade. The aggressive fiscal expansion, at a

point when the economy is operating near full capacity, coupled with potential upward pressure on inflation from import tariffs, may accelerate the pace of interest rate rises by the Fed.

In **Canada**, the economy registered exceptional growth of 3 per cent in 2017, driven by fiscal stimulus measures and strong gains in housing wealth. Looking ahead, economic activity is expected to expand at a more moderate, but healthy pace of 2-2.2 per cent in 2018-2019. Elevated uncertainty surrounding the ongoing renegotiation of NAFTA will restrain the recovery in investment in the near term.

In **Japan**, the GDP growth forecast for 2018 has been revised upwards from 1.2 per cent to 1.6 per cent, reflecting improvements in both external and domestic demand. Domestic demand is supported by rising corporate profits and tightening labour market conditions. This should support a gradual increase in real wages, which will in turn exert some upward pressure on consumer prices in 2018. The potential for a sharp appreciation of the Japanese yen poses a key downside risk to the economy.

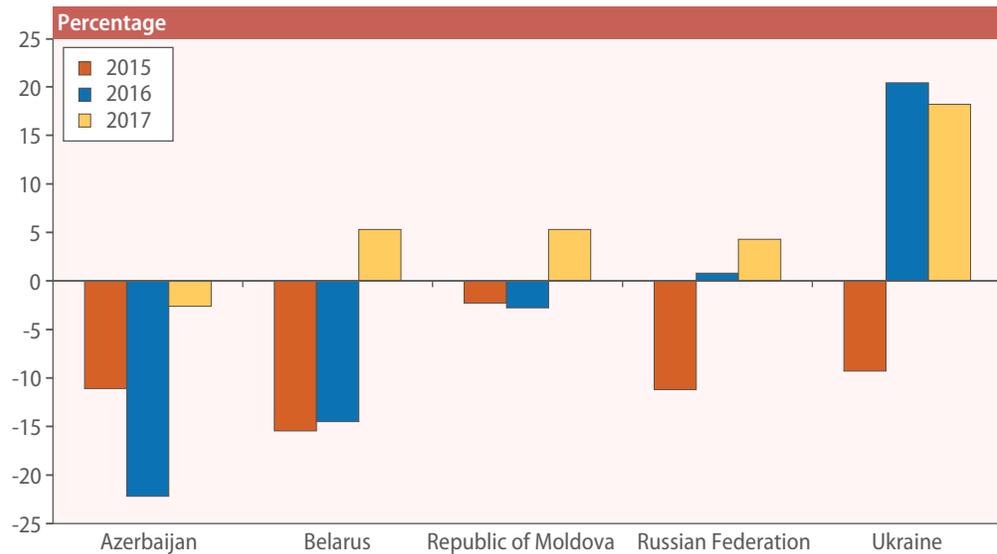
The growth outlook for **Europe** remains robust, but downside risks are high. The euro area is projected to expand by 2.1 per cent this year and 1.9 per cent in 2019, a marginal upward revision compared to the previous forecast. Strong private consumption growth is underpinned by dynamic labour market conditions and rising disposable incomes. Business investment and construction activity will also be supported by the loose monetary policy stance of the ECB. However, downside risks to the region's outlook have increased. Amid rising trade tensions among major economies, various product groups have become the subject of new or changed tariff regimes. A widening of trade restrictions would pose a significant risk, especially to the export-reliant European economies. As the United Kingdom of Great Britain and Northern Ireland prepares to leave the EU, the transition phase will entail significant uncertainty, particularly over future trade relations between the two parties. This increases the risk of businesses diverting investments away from the United Kingdom. The ECB faces the challenge of designing and communicating a normalization of its monetary policy stance, both in terms of its asset purchases and the policy rate, which could become an additional source of financial market volatility.

Growth in the EU members from Eastern Europe and the Baltics is expected to remain above the EU average, driven by robust export performance and infrastructure spending, which has been boosted by a surge in inflows of EU funds. However, rising debt burdens and the potential buildup of housing bubbles pose medium-term challenges.

Economies in transition

The energy-exporting economies of the **Commonwealth of Independent States** (CIS) are expected to maintain a positive growth trajectory in 2018 and 2019, supported by higher oil prices and prudent macroeconomic policies. The Russian Federation exited recession in 2017, amid stronger private consumption and a moderate rebound in fixed investment, buoyed by preparations for the FIFA 2018 World Cup. In early 2018, low inflationary pressures, a stable domestic currency, and the planned increase in public sector wages laid foundations for a further impetus to consumer spending. However, the intensification of geopolitical tensions and the introduction of additional economic sanctions have subsequently complicated activities of Russian companies and have put downward pressure on the currency. This may spur inflation and curb consumer spending, restraining growth to 1.7 per cent in 2018. In Kazakhstan, growth may exceed 3 per cent, driven by rising oil output and investment in transport infrastructure.

Figure VI
Real investment dynamics in selected CIS economies



Sources: National statistics offices and central banks. Data for 2017 is preliminary.

Among the CIS energy-importers, Ukraine expanded by 2.5 per cent in 2017, supported by a solid upturn in investment (figure VI). Growth is projected to remain relatively stable in the outlook period, provided external financial assistance continues. Nevertheless, a possible downscaling of the Russian natural gas transit presents a moderate downside risk to growth in 2019. In early 2018, remittance flows to the smaller CIS countries in Central Asia and the Caucasus remained robust, bolstering private spending, although the weakening of the Russian rouble presents a risk. Going forward, the Central Asian countries should also benefit from the implementation of the “Belt and Road” initiative. Aggregate GDP of the CIS and Georgia is expected to increase by 2.1 per cent in 2018 and 2019.

The outlook for **South-Eastern Europe** is generally favorable, with aggregate GDP expected to expand by 3.0 per cent in 2018 and 3.4 per cent in 2019, supported by investment and exports.

Developing countries

Asia

The short-term growth outlook for **East Asia** remains robust, with regional GDP projected to expand at a steady pace of 5.8 per cent in 2018 and 5.7 per cent in 2019. Growth in the region will be underpinned by resilient private consumption and public investment, as well as the ongoing improvement in external demand.

In China, growth is expected to remain solid, supported by robust consumer spending and supportive fiscal policies. Amid ongoing structural reforms, growth in the Chinese economy is projected to gradually moderate from 6.9 per cent in 2017 to 6.5 per cent in 2018 and 6.3 per cent in 2019. While ongoing efforts to address financial vulnerabilities will contribute to more sustainable medium-term growth, the authorities face the policy challenge of ensuring that associated deleveraging does not derail growth in the short term.

Most other economies in the region are expected to experience stable GDP growth in the outlook period. Private consumption will remain the key driver of growth, supported by healthy job creation, low interest rates and modest inflationary pressures. In addition, consumer spending in the Republic of Korea, Myanmar and Thailand will be further boosted by an increase in minimum wages in 2018. Growth in many countries, including Indonesia, the Philippines and Thailand, will also be supported by large infrastructure projects, which will help to alleviate structural bottlenecks and boost productivity growth in the medium term.

Downside risks to the region's growth outlook have increased. A more restrictive global trade environment would have a significant negative effect on East Asia, given the region's high trade openness and extensive global production networks. Meanwhile, geopolitical tensions in the Korean Peninsula could also affect investor sentiments and regional financial markets. In addition, high corporate debt will continue to weigh on investment prospects in several countries.

The macroeconomic outlook in **South Asia** remains favourable, amid robust domestic demand, strong infrastructure investment and moderately accommodative monetary policies. GDP growth is expected to strengthen to 6.6 per cent in 2018 and 6.8 per cent in 2019, following an expansion of 6.0 per cent in 2017. Regional inflation is anticipated to remain stable and at relatively low levels. This positive outlook provides an enabling environment for most countries in the region to make further progress in addressing the vast development challenges across economic, social and environmental dimensions. Deeper reforms, such as strengthening fiscal accounts and tackling the region's large infrastructure gaps, are also needed to boost productivity gains and unleash the region's growth potential. Downside risks faced by the economies in South Asia include setbacks on the reform agenda, heightened regional geopolitical tensions, or a sharp rise in oil prices.

Among the major economies, growth in India is gaining momentum, underpinned by robust private consumption, a slightly more supportive fiscal stance and benefits from past reforms. GDP growth is expected to climb to 7.5 and 7.6 per cent in fiscal years 2017/18 and 2018/19, respectively. Although capital spending has shown signs of revival, a more widespread and sustained recovery in private investment remains a crucial challenge. Meanwhile, the economic situation in the Islamic Republic of Iran is expected to become more challenging in the near term, due to the re-imposition of trade, investment and financial sanctions by the United States. In addition, structural weaknesses of the Iranian economy due to prolonged periods of under-investment will continue to constrain economic activity in the medium term. Among the smaller economies in the region, Pakistan's growth is accelerating due to vigorous investment and the gradual recovery of exports. Meanwhile, the Bangladesh economy is set to continue expanding by more than 7.0 per cent per annum in the near term, amid robust fixed investment and a broadly accommodative monetary policy. The fiscal stance remains prudent, striking a delicate balance between consolidation efforts and advancing large infrastructure projects.

The forecast for GDP growth in **Western Asia** for 2018 has been revised upwards from 2.3 per cent to 3.3 per cent, reflecting a stronger growth projection for Turkey. Economic growth in Turkey accelerated in the second half of 2017, on the strength of recovering domestic demand and stabilising balance-of-payments. Growth in Israel remains robust, with low inflation and strengthening external demand. Meanwhile, the member States of the Gulf Cooperation Council (GCC), namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, are also expanding at a faster pace. The non-oil sector of the GCC countries has been growing steadily, supported by moderate demand growth in the public sector with the recovery in oil revenues. Monetary stances of

the GCC countries have been tightened in line with the Fed. However, financing costs in the GCC countries remain relatively stable, and credit has continued to expand.

In Jordan and Lebanon, domestic demand growth remains weak, amid moderate inflation. Fiscal stances in these countries are likely to be tightened as part of reform plans linked to support from international donors. Despite ongoing armed conflicts, more signs of economic stabilisation have been observed in Iraq and Syria. An improvement in the security situation is supporting the Iraqi economy. By contrast, economic recovery in Syria is subject to its fragile balance-of-payments situation and economic sanctions. The crisis in Yemen remains dire, amid an escalation of conflict, deteriorating food security and deteriorating balance-of-payments conditions.

Africa

In Africa, the region is forecast to grow by 3.6 per cent in 2018 and 3.9 per cent in 2019, marking an upward revision since December. The improvement largely reflects stronger prospects in some of the region's largest economies, such as Nigeria and Egypt. Per capita income growth, however, remains very weak, estimated at 1.1-1.3 per cent in 2018-2019, and insufficient to significantly alleviate poverty in the absence of dramatic declines in income inequality.

Growth in Nigeria remains subdued, but recent improvement reflects terms-of-trade gains, recovering oil production, greater foreign exchange availability and more solid non-oil growth, driving the upward revision to the forecast for West Africa. North Africa is benefitting from lower inflation in countries such as Egypt and Libya. However, ongoing political instability and security issues continue to hinder prospects for the Libyan economy. Growth prospects have improved for 2018 in East Africa, as continued recovery from droughts and new manufacturing infrastructure spur growth in Ethiopia. In Central Africa, fiscal consolidation and lower oil production are projected to constrain growth in 2018. The outlook for Southern Africa remains challenging. However, growth in South Africa is expected to accelerate modestly this year, as a result of stronger household consumption and improving investor confidence.

Average inflation in Africa remains on a downward trend, reflecting more stable exchange rates and lower food price inflation. This will allow monetary authorities in the region to cut interest rates to support economic activity, especially in East and Southern Africa. However, among the fuel exporters, monetary policy is likely to remain tight.

Fiscal deficits should narrow slightly in aggregate, driven by spending cuts and concerns over rising levels of public debt. African sovereigns are attracting record demand, as they tap international markets to take advantage of relatively low rates and strong demand from investors, before policy-tightening by the Fed drives up borrowing costs.

Latin America and the Caribbean

Against a backdrop of robust global growth and higher commodity prices, the recovery in Latin America and the Caribbean is expected to gain momentum in 2018-19. Following growth of 1.0 per cent in 2017, the region is projected to expand by 2.1 per cent in 2018 and 2.5 per cent in 2019. The upturn in economic activity is projected to be broad-based. Except for the Bolivarian Republic of Venezuela, which has entered its fifth year of recession, all countries are expected to record positive growth during the forecast period. The pickup in growth will be driven by strengthening private sector demand,

especially in South America's commodity-exporting countries. Private consumption and investment will be underpinned by modest inflationary pressures, low interest rates and, in some cases, improved confidence. While the easing cycle in countries such as Brazil, Colombia and Peru, is expected to come to an end, monetary policy will generally remain accommodative. Moreover, labour markets have shown signs of improvement. In many countries, the unemployment rate has edged lower over the past year, with employment in the manufacturing sector starting to recover. Higher commodity prices and the moderate recovery in growth have helped ease fiscal pressures, particularly in the region's metals and agricultural exporters. However, in many cases primary balances remain below debt-stabilizing levels, implying a further need for fiscal consolidation.

Despite the projected recovery, Latin America and the Caribbean's rate of expansion during the forecast period is expected to remain well below the 1991-2012 average of 3.2 per cent. The weak performance of investment and productivity in recent years has raised concerns over a decline in potential growth that could hamper progress towards the SDGs. Moreover, forecast risks remain tilted to the downside. An escalation of global trade tensions would negatively affect South America's commodity exporters and Central American and Caribbean countries with close ties to the United States. In addition, prolonged uncertainty over NAFTA renegotiations could weaken the outlook for Mexico's economy.

III. Key policy challenges

Unilateral trade measures challenge the multilateral trading system

There has been a significant increase in trade tensions among the world's largest economies, highlighting the risk of a significant negative fallout for global trade. The United States Government initiated a sweeping review of existing trade deals in 2017. Following a series of investigations, including those related to national security⁴ and the acts, policies, and practices of the Government of China related to technology transfer, intellectual property, and innovation,⁵ the United States has proposed a series of measures aimed at protecting domestic industries from perceived security concerns or imbalances in market access. In the first quarter of 2018, the United States imposed new tariffs on a range of products, including steel and aluminium for security reasons, and washing machines and solar panel cells as safeguard measures. The United States also announced plans to impose a 25 per cent tariff on imports of more than 1,000 products from China, worth approximately \$50 billion. In response to these measures, major trading partners have been drawing up plans for retaliatory measures, and at the same time all parties are seeking solutions to the disputes at the WTO. While the situation remains in flux amid ongoing negotiations, it nonetheless constitutes a clear move away from unambiguous support for the multilateral trading system.

⁴ U.S. Department of Commerce. January 11, 2018. "The Effect of Imports of Steel on the National Security".

⁵ Government Publishing Office. August 24, 2017. "Federal Register", Volume 82, No. 163.

WTO agreements include specific provisions to allow differential treatment for developing and developed economies in trade agreements, in order to support the development dimension of the trading system. The agreements also include provisions for countries to charge additional import duties to compensate for damage caused by “unfair” trading practices, a clause used to justify some of the recently-proposed measures. Nonetheless, a fundamental principle of the WTO is moving towards lower trade barriers between countries, as a means of encouraging trade.

The use of tariffs and trade barriers is often seen as a way to protect domestic industries and employment against external competition. In many circumstances, however, these moves can prove self-defeating. Assessing the macroeconomic impact of a single tariff requires an understanding of both the direct impact on the targeted sector and the indirect impacts elsewhere in the economy. For instance, a tariff on steel may preserve or create jobs within the steelmaking industry, as domestic firms are better able to compete with lower-cost producers abroad. This depends on the ability of domestic suppliers to expand production. The tariff also has an indirect impact on downstream steel-consuming industries and consumers more broadly. For the steel-consuming industries, the tariff raises production costs and may squeeze firm profits, potentially leading to job losses or lower wages in these industries. In addition, higher steel prices feed to the broader macroeconomy through higher consumer prices, dampening overall household demand.

The net impact of any tariff on the macroeconomy will depend on the relative magnitudes of these channels, as well as on spillovers and reactions in the rest of the world. Introducing a tariff in a large country would be expected to put downward pressure on international prices of the targeted product. For example, a tariff on steel in the United States may reduce demand for imported steel, and further aggravate the supply glut of steel in global markets. Trade restrictive measures can also disrupt the intricate global and regional production networks that have evolved under existing policy, with potentially large impacts on many smaller developing countries integrated into those supply chains. In addition, tariffs may provoke retaliatory measures by other countries, which may constrain exports and increase uncertainty, with a negative impact on business confidence and investment. On the other hand, in some cases, trade diversion may benefit countries exempt from the new barriers. For example, a tariff on soybean exports from the United States to China could increase Chinese demand for soybeans from other countries, such as Brazil.

A further increase in trade barriers and retaliatory measures would mark a step back from the global efforts to revitalize a global partnership for sustainable development through progress towards building a universal, rules-based, open, non-discriminatory and equitable multilateral trading system, undermining some of the basic objectives of the WTO.

High inequality constrains inclusive growth

The continued improvement in global macroeconomic conditions offers an opportunity to raise living standards on a broad scale, especially in developing regions. However, stronger economic growth in itself is not sufficient to ensure that these gains are widely shared. As recognized in SDG 10, reduced inequality – both within and among countries – is a key factor for inclusive growth and shared prosperity. Moreover, many other SDG goals and

targets related to poverty, health or education are directly or indirectly linked to the issue of inequality.

The relationship between income inequality and growth at the country level is complex, with country-specific factors such as the size of the economy, the level of development and the institutional and political environment playing a major role. Empirical evidence has increasingly suggested that high levels of inequality hinder economic growth.^{6/7} High income inequality is often associated with social tensions and political instability, which in turn can hamper growth-supporting investment. Inequality can also hinder human capital accumulation and social mobility, affecting both the short-term and medium-term economic prospects of a country. High levels of inequality are also often linked to disproportionate political influence by certain interest groups, resulting in market concentration and lack of competition, which in turn hampers productivity growth.

As widely documented, most developed and developing countries saw income inequality rise significantly throughout the 1980s and 1990s. In many cases, levels of inequality – measured for example by Gini coefficients or the income shares of the top 10 per cent – reached post-World War II highs. The increase in overall inequality can be attributed to both declining labour shares of income and rising wage inequality. Numerous factors contributed to these trends. Chief among them were moves towards privatization, liberalization and deregulation; skill-biased technological change; shifts towards less progressive tax systems; weakening of labour market institutions; and a decline in public capital. Widening income inequality – while not universal – prevailed across all major regions during this period.

The picture has become more mixed since the early 2000s, including the period since the global financial crisis of 2008. Inequality continued to rise in most developed economies, especially crisis-affected European countries that saw sharp increases in unemployment and severe austerity measures. In most developing countries, especially in Latin America and parts of Africa, inequality remains at extraordinarily high levels, holding back productivity and growth. However, recent data have shown some modest improvement in inequality trends. As illustrated in figure VII, in most developing and transition economies for which recent data are available, Gini coefficients were lower in 2014-15 than in 2005-08. Similarly, the income share held by the highest 10 per cent declined slightly in most of these economies during this period, while in two out of three countries, mean incomes grew faster for the bottom 40 per cent than for the total population from 2008 to 2013.⁸ In part, these gains may be temporary cyclical reactions to the global financial crisis (for example a temporary decline in the capital income share).⁹ However, in some cases the positive trends reflect more structural longer-term changes. Latin America and the Caribbean, the region with the most uneven distribution of income, has made significant progress in reducing inequality in the past 15-20 years. Four factors contributed to the observed reduction in Gini coefficients across the region: first, a relative increase of

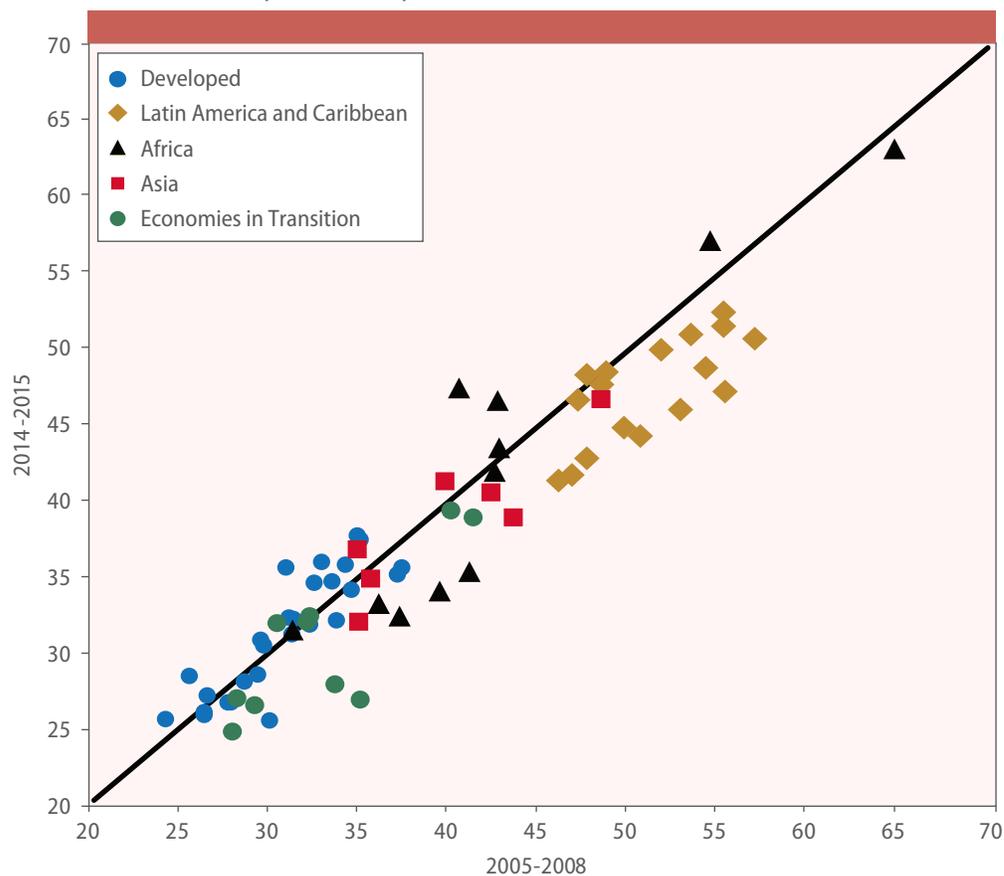
⁶ Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides (2014). Redistribution, Inequality and Growth. IMF Staff Discussion Note.

⁷ This contrasts with some theoretical literature of the 20th century, which viewed higher inequality as an incentive to increase work and education efforts or as a factor encouraging higher rates of domestic savings.

⁸ World Bank (2016), Poverty and Shared Prosperity, Taking on Inequality.

⁹ IMF, *World Economic Outlook*, April 2017.

Figure VII
Gini coefficient, 2005-2008, and 2014-2015



Source: World Bank and CEIC data.

Note: Figure includes a subset of countries in each region for which data is available; a higher value of the Gini coefficient indicates a higher level of inequality.

the labour income of poor workers, partly as a result of higher minimum wages; second, an increase in average schooling of adults; third, an increase in government transfers to households in the form of targeted social programs; and fourth, a demographic dividend, with an increase in the share of working-age people.¹⁰

In East Asia, the last decade has also seen more policy efforts geared towards addressing income inequality. Such measures include the implementation of large infrastructure plans, which generated jobs for low-skilled and migrant workers; the review of minimum wage policies; the introduction of cash handouts for the poor; and the strengthening of pension systems. In the former centrally planned economies of Central and Eastern Europe and the CIS, inequality also declined in the aftermath of the global financial crisis, after increasing sharply during the economic transition of the 1990s and early 2000s.

Levels of inequality remain high in many developing countries. However, recent positive experiences illustrate the role institutions and policies play in promoting a

¹⁰ Inter-American Development Bank (2016). Social Pulse in Latin America and the Caribbean 2016: Realities & Perspectives <https://publications.iadb.org/handle/11319/7863>

more equitable distribution of the gains from growth. The current benign global economic environment presents an opportunity to accelerate progress in this direction.

Economic growth and the environment

The recent acceleration in economic growth also bears an environmental cost. In contrast to what is required, global energy-related carbon dioxide (CO₂) emissions increased 1.4 per cent in 2017, according to the International Energy Agency (IEA), due to the acceleration of global economic growth, relatively low cost of fossil fuels and weaker energy efficiency efforts. At this rate, the IEA warns, current efforts to combat climate change are insufficient to meet the objectives of the Paris Agreement.

According to NASA, 2017 was the second hottest year on record; the hottest was 2016.¹¹ Global temperatures have followed a rapid warming trend for the last 40 years. The planet's average surface temperature has risen about 1°C during the last century, attributed largely to the accumulation of CO₂ and other human-made greenhouse gas (GHG) emissions in the atmosphere. According to the International Panel of Climate Change (IPCC), global temperature change will likely range from 4.0°C to 6.1°C relative to pre-industrial levels by 2100 in a scenario of no meaningful action to mitigate GHG emissions growth.¹² It is the stated goal of the Paris Agreement to limit this increase in global average temperature to well below 2°C.

As temperatures rise, evidence points to slower growth of per capita output in countries with relatively high average temperature, which include most low-income countries.¹³ Potential channels of transmission include shifting rainfall patterns that may move the locations of arable farmland;¹⁴ rising sea levels, which threaten SIDS in particular, as well as some of the world's most valuable infrastructure and sizable populations; and increased frequency and intensity of extreme weather events. Damage through these channels will impact agricultural production, labour productivity in more weather-dependent sectors, capital accumulation and human health, spurring large-scale migrations of people. Natural disasters already cause the highest numbers of new internal displacements each year: in 2016, new displacements due to disasters were 3.5 times higher than those due to conflict and violence.¹⁵

While recent evidence points to progress in decoupling emissions growth from GDP growth in some developed economies,¹⁶ it is still manifestly insufficient. The rate of global energy efficiency gains has been slowing since 2015, reaching 1.7 per cent in 2017 – half the rate required to remain on track with the Paris Agreement.¹⁷ Low fossil-fuel prices and changes to energy policies lie behind the slowdown. Reforming fossil fuel subsidies and taxation could speed the rate of energy efficiency gains, and may be more easily implemented while fossil fuel prices are low.

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- 11 <https://climate.nasa.gov/news/2671/long-term-warming-trend-continued-in-2017-nasa-noaa/>
 - 12 <http://www.ipcc.ch/report/ar5/wg1/>
 - 13 IMF, *World Economic Outlook*, October 2017.
 - 14 <http://www.ipcc.ch/report/ar5/syr/>
 - 15 <http://www.internal-displacement.org/library/publications/2017/2017-global-report-on-internal-displacement>
 - 16 Gail Cohen, João Tovar Jalles, Prakash Loungani, and Ricardo Marto (2018). *The Long-Run Decoupling of Emissions and Output: Evidence from the Largest Emitters*. IMF Working Paper.
 - 17 <http://www.iea.org/geco/>

Development and deployment of new technologies such as wind, solar, electric vehicles and battery storage also remains crucially important. Renewables accounted for 61 per cent of all newly-installed net power capacity in 2017; solar alone accounted for 38 per cent. This was supported in part by falling costs for solar electricity and wind power, allowing some projects to become economically viable. But the pace of energy transition must accelerate further still.

Thanks to intensified plans for renewables and electric vehicles deployment, the IEA forecasts emissions growth of just 0.4 per cent per year between 2016 and 2040 (compared to an average annual growth of 2.2 per cent between 2000 and 2016). The current share of renewables in global power generation is thought to have prevented the emission of 1.8Gt of CO₂, or 5.5 per cent of total carbon emissions in 2017. However, this progress still falls short of the need to reach peak levels of emissions as soon as possible and rapid reductions thereafter.

Renewable energy accounts for only 19 per cent of global power capacity and 12.1 per cent of global power generation (17 per cent including large hydro), despite the recent high share of newly-installed capacity. If the pace of power transition were to continue at this rate, as a conservative estimate it would take at least 55 years for the share of renewables in total capacity to reach 50 per cent. In this context, achieving the target of the Paris Agreement poses an immense challenge.

Developing countries continue to commit more investment in renewables than developed economies, with notable investment surges in countries such as Egypt, Mexico and United Arab Emirates. Since 2004, renewables investment has changed from originating predominantly from Europe to a dominance by China, especially in 2017. At 45 per cent of global new renewables investment, China remains the world's largest investor.

Near-term challenges to renewable energy include coping with higher borrowing costs and less policy support, and integrating renewable energy generation capacity into the electricity grid. While solar and wind generating costs are decreasing, securing finance may become more difficult and expensive in the near-term, as world interest rates rise and as the withdrawal of government-backed price support affects the attractiveness of projects.

For further information,
see <http://www.un.org/en/development/desa/policy/wesp/index.shtml>

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