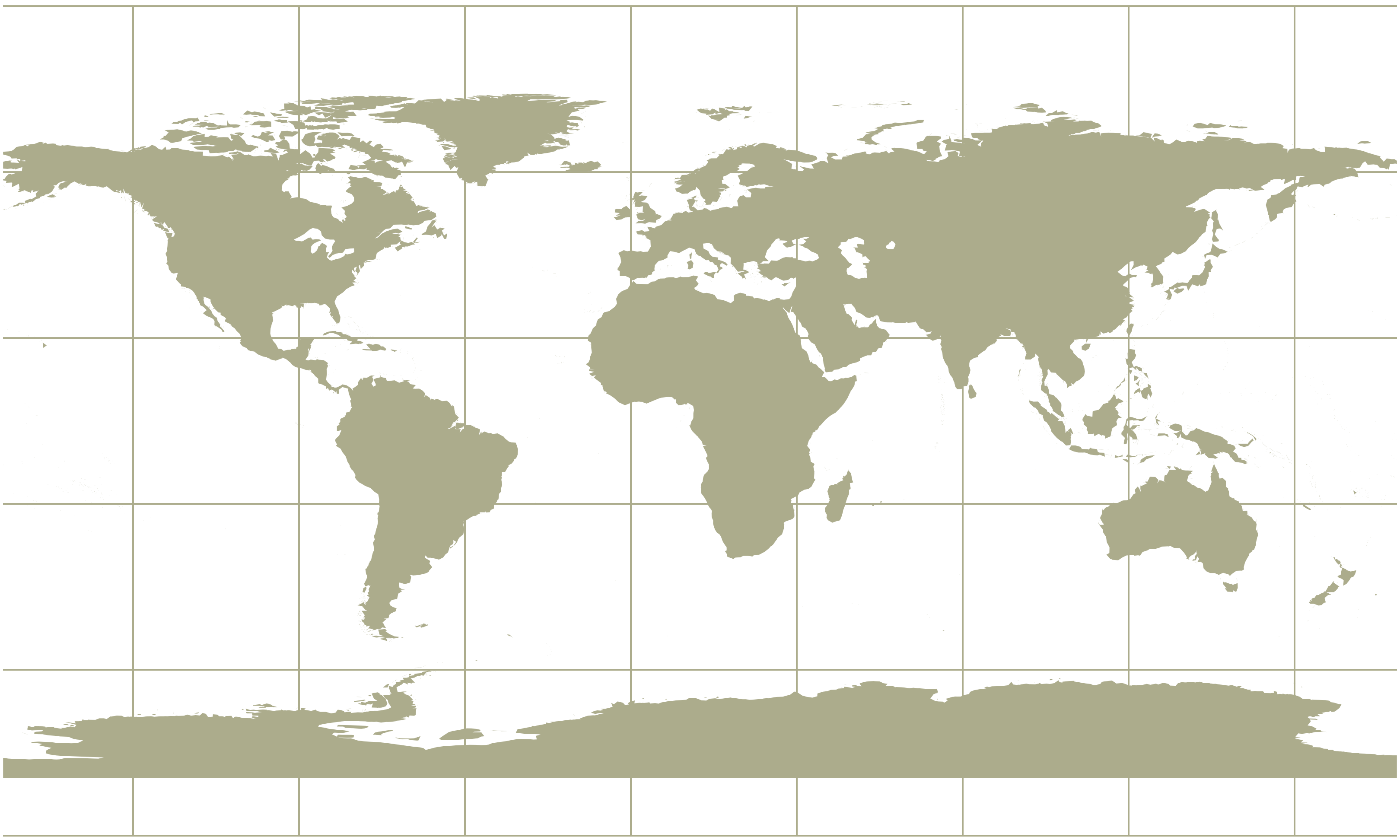
World Economic Situation and Prospects 2015



United Nations
New York, 2015

Chapter I
Global economic outlook

Prospects for the world economy in 2015–2016

Global growth prospects

Moderate global growth continues amid challenges and risks

The global economy continued to expand during 2014 at a moderate and uneven pace, as the prolonged recovery process from the global financial crisis was still saddled with unfinished post-crisis adjustments. Global recovery was also hampered by some new challenges, including a number of unexpected shocks, such as the heightened geopolitical conflicts in various areas of the world. Growth of world gross product (WGP) is estimated to be 2.6 per cent in 2014, marginally better than the growth of 2.5 per cent registered in 2013, but lower than the 2.9 per cent projected in *World economic situation and prospects as of mid-2014*.[1] In the outlook period, premised on a set of assumptions (box I.1) and subject to a number of uncertainties and downside risks (see the section on uncertainties and risks), the global economy is expected to strengthen in the following two years, with WGP projected to grow by 3.1 and 3.3 per cent in 2015 and 2016, respectively (figure I.1 and table I.1).

Most economies have shifted to a lower growth path

Six years after the global financial crisis, gross domestic product (GDP) growth for a majority of the world economies has shifted to a noticeably lower path compared to pre-crisis levels. Excluding the three years from 2008–2010, which featured, respectively, the eruption of the financial crisis, the Great Recession and the policy-driven rebound,

Figure I.1
Growth of world gross product, 2008–2016[a]

Source: UN/DESA.

a Growth rate for 2014 is partially estimated; rates for 2015 and 2016 are forecast.

1 United Nations, "World economic situation and prospects as of mid-2014 (E/2014/70)", available from http://www.un.org/en/development/desa/policy/publications/ecosoc/e_2014_70_wesp_mid.pdf.

Table I.1
Growth of world output, 2008–2016

Annual percentage change	2008-2011[a]	2012	2013[b]	2014[b]	2015[c]	2016[c]	Change from WESP 2014 forecast[d] 2014	2015
World	**1.9**	**2.4**	**2.5**	**2.6**	**3.1**	**3.3**	**-0.4**	**-0.2**
Developed economies	**0.1**	**1.1**	**1.2**	**1.6**	**2.1**	**2.3**	**-0.3**	**-0.3**
United States of America	0.2	2.3	2.2	2.3	2.8	3.1	-0.2	-0.4
Japan	-0.7	1.5	1.5	0.4	1.2	1.1	-1.1	0.0
European Union	-0.1	-0.4	0.0	1.3	1.7	2.0	-0.1	-0.2
EU-15	-0.2	-0.5	-0.1	1.2	1.5	1.9	-0.2	-0.3
New EU members	1.2	0.7	1.1	2.6	2.9	3.3	0.5	0.2
Euro area	-0.2	-0.8	-0.5	0.8	1.3	1.7	-0.3	-0.3
Other European countries	0.7	1.9	1.4	1.4	2.2	2.3	-1.2	-0.7
Other developed countries	1.5	2.6	2.2	2.6	2.6	2.6	0.0	-0.3
Economies in transition	**1.9**	**3.3**	**2.0**	**0.8**	**1.1**	**2.1**	**-2.5**	**-2.9**
South-Eastern Europe	1.6	-0.9	2.4	0.7	2.7	3.0	-1.9	-0.4
Commonwealth of Independent States and Georgia	1.9	3.5	2.0	0.8	1.1	2.1	-2.6	-2.9
Russian Federation	1.4	3.4	1.3	0.5	0.2	1.2	-2.4	-3.4
Developing economies	**5.6**	**4.8**	**4.8**	**4.3**	**4.8**	**5.1**	**-0.8**	**-0.5**
Africa	3.5	5.6	3.5	3.5	4.6	4.9	-1.2	-0.4
North Africa	1.8	6.6	1.4	1.6	3.9	4.3	-1.7	-0.4
East Africa	6.2	6.1	6.3	6.5	6.8	6.6	0.1	0.3
Central Africa	3.9	5.3	2.2	4.3	4.7	5.0	-0.4	0.7
West Africa	5.9	6.9	7.0	5.9	6.2	6.1	-1.0	-0.5
Nigeria	6.4	6.7	7.3	5.8	6.1	5.9	-1.1	-0.6
Southern Africa	3.3	3.4	3.0	2.9	3.6	4.1	-1.2	-0.8
South Africa	2.2	2.5	1.9	2.0	2.7	3.3	-1.3	-1.0
East and South Asia	7.2	5.6	5.9	5.9	6.0	6.0	0.0	0.0
East Asia	7.4	6.3	6.4	6.1	6.1	6.0	-0.1	0.0
China	9.6	7.7	7.7	7.3	7.0	6.8	-0.2	-0.3
South Asia	6.2	2.9	4.1	4.9	5.4	5.7	0.3	0.2
India	7.3	4.7	5.0	5.4	5.9	6.3	0.1	0.2
Western Asia	4.3	4.5	4.0	2.9	3.7	4.3	-1.4	-0.2
Latin America and the Caribbean	3.2	2.7	2.6	1.3	2.4	3.1	-2.3	-1.9
South America	3.8	2.2	2.8	0.7	1.9	2.8	-2.7	-2.2
Brazil	3.7	1.0	2.3	0.3	1.5	2.4	-2.7	-2.7
Mexico and Central America	1.6	4.2	1.8	2.6	3.5	3.8	-1.4	-1.2
Mexico	1.4	4.0	1.4	2.4	3.4	3.8	-1.6	-1.4
Caribbean	2.5	2.8	3.0	3.8	3.8	3.8	0.5	0.0
By level of development								
High-income countries	0.4	1.4	1.4	1.7	2.2	2.4	-0.4	-0.3
Upper-middle-income countries	5.7	4.9	4.9	4.3	4.8	5.2	-1.0	-0.6
Lower-middle-income countries	5.6	4.8	5.2	4.6	5.3	5.7	-0.4	-0.2
Low-income countries	5.7	4.9	4.9	4.4	4.9	5.3	-1.7	-1.2
Least developed countries	5.6	5.0	5.3	5.3	5.7	5.9	-0.3	0.1
Memorandum items								
World trade[e]	2.5	2.5	3.0	3.4	4.5	4.9	-1.3	-0.7
World output growth with PPP-based weights	2.7	2.9	3.0	3.1	3.5	3.8	-0.5	-0.5

Source: UN/DESA.

a Average percentage change.

b Actual or most recent estimates.

c Forecast, based in part on Project LINK and baseline projections of the UN/DESA World Economic Forecasting Model.

d See United Nations *World Economic Situation and Prospects 2014*.

e Average of exports and imports of goods and services.

Box I.1

Major assumptions for the baseline forecast

This box summarizes key assumptions underlying the baseline forecast for various important factors, including monetary and fiscal policies for major economies, exchange rates for major currencies, international prices of oil and other primary commodities. Policy assumptions for other countries can be found in the text of the regional outlook.

Monetary policy

The Federal Reserve of the United States (Fed) is assumed to gradually normalize the stance of monetary policy during 2015–2016, from the extremely accommodative "anti-crisis" mode to a more neutral position. It is assumed that the federal funds interest rate will remain within the range of 0.00 to 0.25 per cent until mid-2015. The Fed will then start to raise interest rates gradually in the third quarter of 2015 with the federal funds interest rate reaching 2.75 per cent by the end of 2016. It is also assumed that the Fed will maintain the assets acquired under the past quantitative easing policy on its balance sheet by reinvesting the matured principle through the end of 2015. After that point, the Fed will reduce the size of its balance sheet by letting the assets mature.

The European Central Bank (ECB) is assumed to keep its policy interest rates at their current levels through mid-2016, followed by a series of gradual increases. The ECB is expected to extend its existing programme of providing unlimited short-term liquidity via its main refinancing operations until at least 2016. It is also following through by implementing three new programmes: the targeted longer-term refinancing operations and the asset-backed securities and covered bond purchase programmes. In total, these three programmes are expected to add close to one trillion euro to the ECB balance sheet so that it would return to the level prevailing in 2012, about three trillion euro.

The Bank of Japan (BoJ) is assumed to continue its Quantitative and Qualitative Monetary Easing programme until April 2016, although the strength of the programme may be reduced gradually. The policy rate of the BoJ is also assumed to stay within the range of 0.0 to 0.1 per cent until the end of 2016.

The People's Bank of China is expected to maintain its current monetary policy approach, which largely relies on short-term quantitative measures and targeted adjustments of liquidity. Overall, monetary conditions are expected to be neutral in 2015–2016.

Fiscal policy

Fiscal policy in the United States of America is expected to remain restrictive, but less severe than in 2014. Real federal government spending is forecast to decline by less than 1 per cent in 2015–2016. It is also assumed that the debt ceiling will be increased during the forecasting period.

In the euro area, fiscal policy in the majority of economies will continue to focus on reducing fiscal imbalances, but the degree of consolidation will be less onerous than in the past few years. The debt crisis countries will continue their adjustment programmes, and any shortfalls due to growth underruns will not be made up; rather, the timetable for achieving targets will be extended. It is also assumed that no countries will ask for formal assistance under the European Stability Mechanism.

In Japan, the focus continues to be on improving the budget situation. The original plan was to implement the second part of the consumption tax increase—raising the tax rate from 8 to 10 per cent— in October 2015, but the Government announced in November 2014 that it will postpone the tax increase for 18 months.

China is expected to maintain its current fiscal policy stance, which is based on robust expenditure growth and targeted easing measures to offset weaknesses. Accounting for recently adopted tightening measures on extrabudgetary activities, the overall fiscal policy stance has become more restrictive than the official budget figures suggest.

Exchange rates among major currencies

The dollar/euro exchange rate is assumed to average 1.34 in 2014 and to continue to depreciate, averaging 1.25 in 2015 and 1.21 in 2016.

The yen/dollar exchange rate is assumed to average 104.1 in 2014 and then 107.5 in 2015 and 105.5 in 2016.

The renminbi/dollar exchange rate is assumed to be 6.15 CNY/dollar in 2014 and 6.10 in 2015 and 6.05 in 2016.

Oil price

The Brent oil price is expected to average $102 per barrel (pb) in 2014. In 2015 and 2016, it is assumed to be $92 pb and $96 pb, respectively.

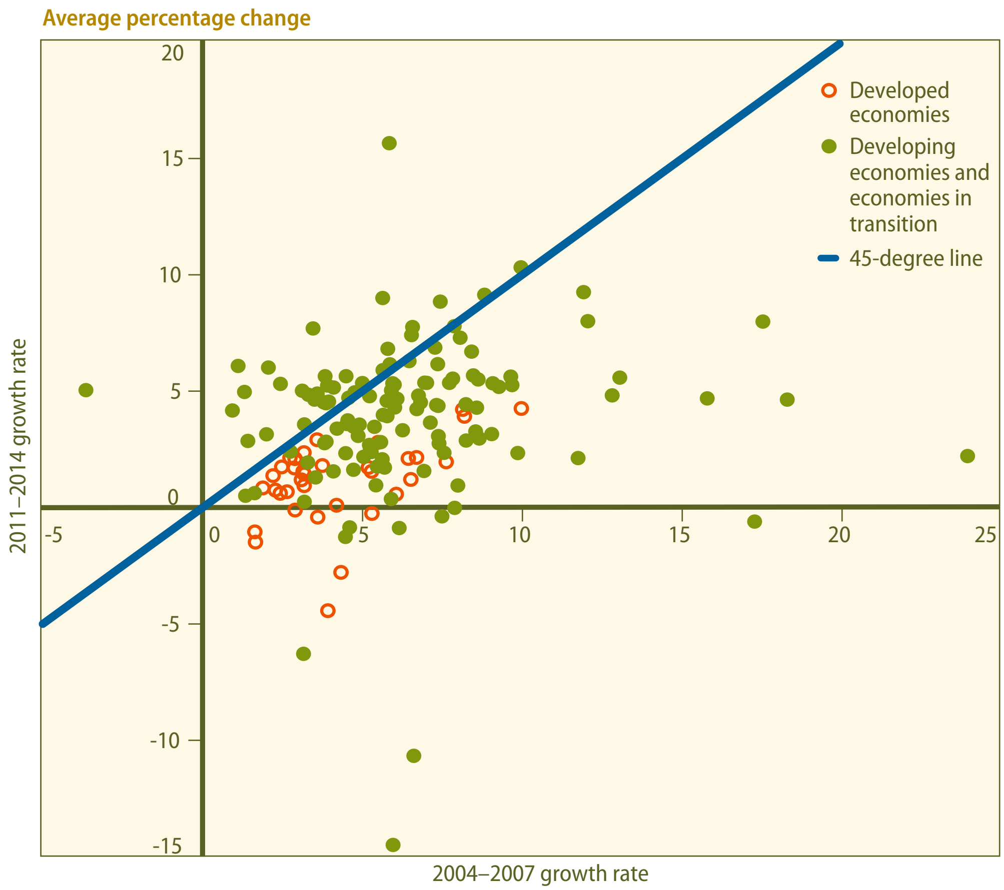
Source: UN/DESA.

four fifths of the world economies have seen lower average growth in 2011–2014 than in 2004–2007 (figure I.2). At issue is whether such a shift to a lower path of growth in most countries will become entrenched for a long period. According to some pessimistic views, major developed economies are highly likely to be entrapped in secular stagnation (see also box IV.1 in chapter 4), while policymakers in China have indeed taken growth of 7.0–7.5 per cent as the new normal for the Chinese economy, compared with the average growth of 10 per cent that China achieved in the previous three decades. Many other large emerging economies, particularly those outside of Asia, have also seen a much slower growth trajectory in recent years as domestic weaknesses interact with challenging international conditions.

Quarterly growth rates of developed countries have been volatile

A salient feature for major developed countries during 2014 has been the erratic movements in their quarterly GDP growth rates. For example, the economy of the United States of America oscillated from a decline of 2.1 per cent in the first quarter of 2014 to an increase of 4.6 per cent in the second quarter, while at the same time the economy of Japan swung from growth of 6.7 per cent to a contraction by 7.3 per cent. For the year as a whole, all major developed economies in North America, Europe and developed Asia have indeed aligned on an upward growth trajectory for the first time since 2011. Although the discrepancy in the growth rates of these economies has narrowed from the previous year (figure I.3), the growth picture remains diverse: while the United States has managed to

Figure I.2
Growth performance: pre-crisis (2004–2007) vs. post-crisis (2011–2014)



Source: UN/DESA.

maintain an annual growth rate above 2 per cent in 2014, the economic situation in Europe is precarious, particularly in the euro area, where growth is exceptionally weak, with some countries close to or already in recession. Meanwhile, in Japan, momentum generated by the fiscal stimulus package and monetary easing introduced in 2013 has receded. In the baseline outlook, further improvement is expected for developed countries, with growth projected to be 2.1 and 2.3 per cent for 2015 and 2016, respectively, compared with the 1.6 per cent estimated for 2014. However, downside risks remain significant, especially in the euro area and Japan, which have seen renewed weakness in 2014.

Developing countries and economies in transition have seen more divergent growth

Growth rates in developing countries and economies in transition have become more divergent during 2014 (figure I.4), as a sharp deceleration occurred in a number of large emerging economies, particularly in Latin America and the Commonwealth of Independent States (CIS). A number of these economies have encountered various country-specific challenges, including structural imbalances, infrastructural bottlenecks, increased financial risks and ineffective macroeconomic management, as well as geopolitical and political tensions. In contrast, East Asia, including China, managed to register relatively robust growth, while India led South Asia to a moderate strengthening. In the baseline outlook, developing countries as a group are expected to grow at 4.8 and 5.1 per cent in 2015 and 2016, respectively, up from the 4.3 per cent estimated for 2014. Growth in the least developed countries (LDCs) is expected to continue exceeding the global average, at 5.7 per cent in 2015 and 5.9 per cent in 2016 (box I.2). The economies in transition as a group are expected to grow at 1.1 per cent and 2.1 per cent in 2015 and 2016, respectively, up from the 0.8 per cent estimated for 2014. As in the case of developed economies, the risks to this baseline outlook are mainly on the downside. Many developing countries and economies in transition appear vulnerable to a tightening of global financial conditions and to the risk of a sharper-than-expected slowdown in major emerging economies, as well as a further aggravation of geopolitical tensions and an escalation of the Ebola epidemic.

The United States will see stronger growth

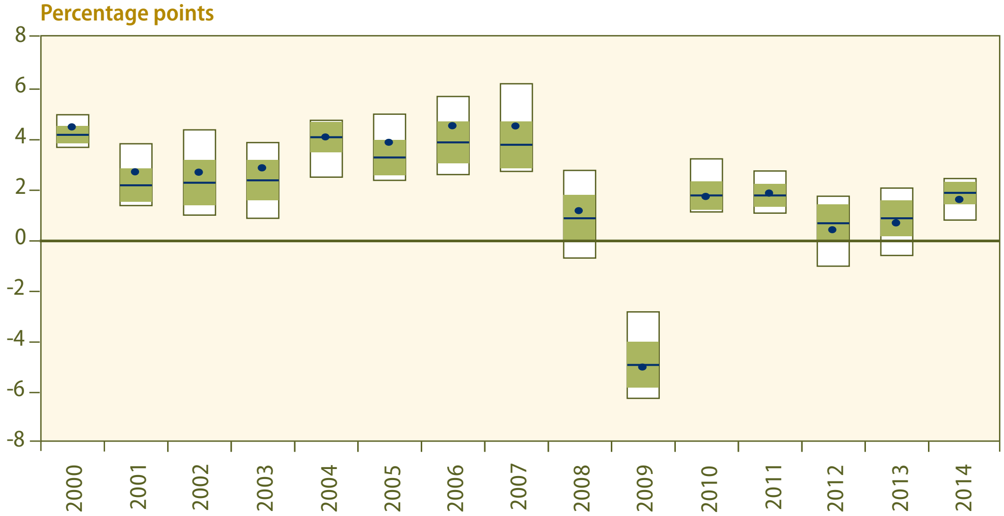
Among the developed economies, the economy of the United States, after some erratic fluctuation in 2014, is expected to improve in 2015 and 2016, with GDP projected to expand by 2.8 and 3.1 per cent respectively, compared with an estimate of 2.3 per cent for 2014. While an increase in business investment will be the major driver, household consumption is also expected to strengthen, along with continued improvement in employment. The fiscal drag on growth is expected to remain, but with much milder intensity than in previous years. The policy interest rates are set to rise gradually after mid-2015, but the monetary policy stance will continue to be accommodative. The contribution from the external sector will be limited, as export growth is expected to be curbed by the strong appreciation of the dollar. The risks for the economy are mainly associated with the possibility of sizeable volatility in financial markets in response to the normalization of monetary policy, leading to adverse effects on the real economy.

A slight improvement in growth is expected in Western Europe

Western Europe continues to struggle. In the EU-15,[2] GDP growth is estimated to be only 1.2 per cent in 2014, with a slight pickup to 1.5 per cent and 1.9 per cent in 2015 and 2016, respectively. The region is held back by the travails of the euro area, where the level

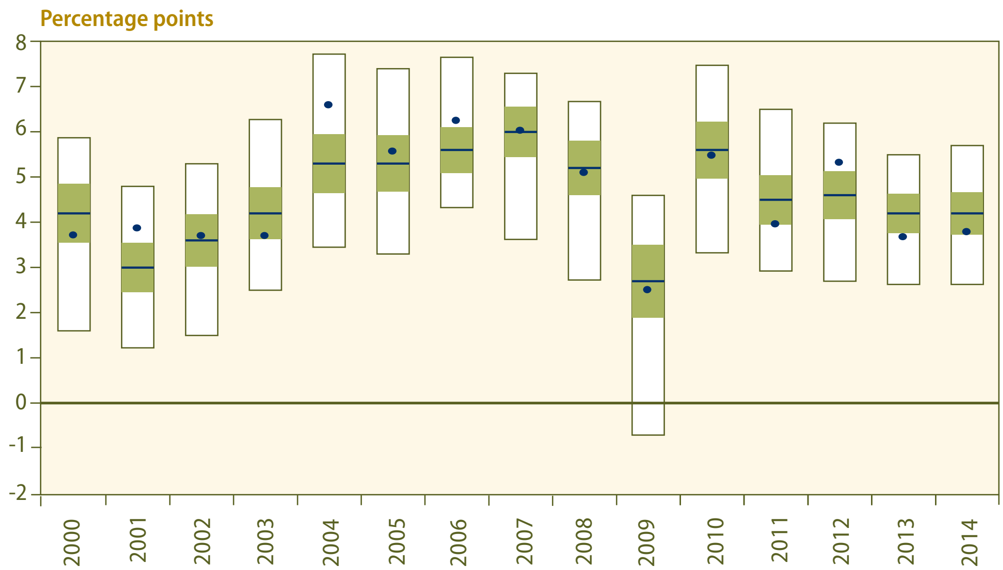
2 The EU-15 refers to the 15 countries that were members of the European Union (EU) prior to the accession of the new member States on 1 May 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom of Great Britain and Northern Ireland.

Figure I.3
Distribution of growth rates for developed economies



Source: UN/DESA.
Note: The boxplots show the distribution of GDP growth rates among developed countries between the first and third quartiles, that is within the middle 50 per cent of the data. The wider a box, the more divergent are the growth rates. The horizontal line in the box represents the median, the symbol indicates the mean. The shading indicates a confidence interval at 95 percent for the median.

Figure I.4
Distribution of growth rates for developing economies



Source: UN/DESA.
Note: The boxplots show the distribution of GDP growth rates among developing countries between the first and third quartiles, that is within the middle 50 per cent of the data. The wider a box, the more divergent are the growth rates. The horizontal line in the box represents the median, the symbol indicates the mean. The shading indicates a confidence interval at 95 percent for the median.

of GDP has yet to regain its pre-recession peak. Unemployment remains extremely high in many countries in the region and headline inflation is at alarmingly low levels. In the large economies, Italy is expected to contract for the third consecutive year and France has stagnated, while Germany started the year strongly, but has since slowed significantly. There is a ray of hope in that some of the crisis countries have resumed growth. Spain resumed positive growth in mid-2013 and has been strengthening since; Ireland and Portugal have

Box I.2

Prospects for the least developed countries

Growth in the economies of the least developed countries (LDCs) will continue to exceed the global average, with an expected acceleration from 5.3 per cent in 2014 to 5.7 per cent in 2015 and 5.9 per cent in 2016. Major drivers for this performance will be an anticipated improving external environment, which helps underpin growth through trade and financial flows; continued strong investment in infrastructure and natural resource projects; and, in some cases, the reconstruction after conflicts or natural disasters. Despite this positive headline performance, meaningful economic and social development remains a challenge for many LDCs, given a number of factors including: the often low starting point for growth; institutional shortfalls; the exposure to numerous risks, including public health crises such as the recent Ebola epidemic, or adverse weather patterns; and the lack of basic services and infrastructure despite, in some cases, significant public financial resources from commodity exports.

Within a wide range of performances, the highest growth rate among LDCs in 2015 is forecast for the Democratic Republic of the Congo. Major factors are a mining sector that is strengthening from investment in new capacities, infrastructure investment, and higher agricultural output due in part to better access to inputs. Similar dynamics are also playing out in other LDC forecasts for 2015. For example, in Ethiopia, the agricultural sector will underpin growth by 7.5 per cent, while in the United Republic of Tanzania, natural resource investment, notably in the gas sector, will lead to an economic expansion by 7.2 per cent. In Bangladesh, the economy will continue its multi-year streak of solid growth of more than 6 per cent in 2015 and 2016, driven by strong external demand for textile products and robust domestic demand.

By contrast, numerous LDCs face particularly pronounced growth challenges. The Ebola crisis (see box IV.3 in chapter IV) has taken a severe humanitarian toll in Guinea, Liberia and Sierra Leone and created a significant drag on economic growth. Even in the absence of an exceptional crisis, all three countries feature weak and strained public health systems, creating high vulnerability to crisis scenarios. Meanwhile, Equatorial Guinea will register a contraction of its economy by 1.6 per cent in 2015, which will mark the third consecutive year of declining gross domestic product (GDP). Falling oil output combined with lower oil prices is crimping other sectors of the economy, such as construction, with the lack of any positive offsetting factors, thus highlighting the vagaries of an overreliance on the natural resource sector. In Yemen, growth of GDP is estimated to have decreased by more than half to 2.1 per cent in 2014, with a moderate acceleration in growth to 3.7 per cent expected in 2015. Political instability has led to disruptions in oil output, reducing oil revenues by about one third in the first half of 2014. The non-oil sector has performed better, but still below potential, owing to the general instability.

Taken together, despite the overall solid headline growth picture for LDCs, the underlying situation and performance of many LDCs underscore numerous pressing problems and the need to reinforce effective policy measures in this regard. First, countries with strong reliance on resource-extracting industries need to further strengthen their efforts to diversify their economic structure and thus reduce their vulnerability to external shocks. This is especially relevant in the context of the decline in oil prices as well as the price of various other commodities. Effective policies in this respect, both in terms of funding and expertise, include the promotion of higher-value-added activities, the support of small and medium-sized enterprises and investment in better education programmes. Second, as illustrated by the Ebola outbreak, any meaningful and lasting development progress requires as a foundation the sufficient and stable provision of basic public services. This includes, first and foremost, not only a functioning health-care system, but also sufficient energy supply and viable transportation linkages. Last, the international community should redouble its efforts to deliver on the commitment of financial and other types of assistance to the LDCs.

Source: UN/DESA.

also returned to positive growth, but all three recoveries remain extremely fragile. The only example of more robust growth is outside the euro area in the United Kingdom of Great Britain and Northern Ireland.

Domestic demand will increasingly drive growth in the new EU member States

The recovery in the new European Union (EU) member States gained further ground in 2014, thanks to recovering domestic demand, the gradual abandonment of fiscal austerity and a turnaround in the inventory cycle. While the region is confronted with a difficult external environment as prospects for the core euro area countries are downgraded, domestic demand is becoming an increasingly important driver of growth. Although household foreign-exchange-denominated debt still remains a major macroeconomic problem in some of the new EU members, private consumption is expected to strengthen in the outlook period and investment is benefiting from the expansion in public sector projects. Inflation in the region hit record lows in 2014, thanks to lower food and energy prices; it is estimated to have been negative in a number of countries and is expected to remain very low in 2015. Labour markets continued to improve, although progress was very uneven across the countries. In those with flexible currencies, interest rates were reduced to record lows and in 2015, monetary policy should remain accommodative. However, as deleveraging by foreign banks continues (although at a diminishing rate), the recovery in credit markets lags. The aggregate GDP of the new EU member States is expected to grow by 2.9 per cent in 2015 and 3.3 per cent in 2016, compared with an estimate of 2.6 per cent in 2014.

Private consumption constrained by higher taxes will weigh on Japan's growth

Japan is estimated to grow by only 0.4 per cent in 2014, technically falling into a recession in the second and third quarters. The drop in private consumption caused by the higher consumption tax is the main reason for the slowdown. Quantitative easing introduced in 2013 has predictably raised inflation expectations and the central bank further strengthened this policy in late-2014. Exports are expected to eventually benefit from the depreciation of the Japanese yen triggered by the monetary easing, while the planned cut in corporate taxes will support fixed investment. The growth rate is predicted to be 1.2 per cent in 2015 and 1.1 per cent in 2016.

Regarding other developed countries, GDP in Canada is estimated to register growth of 2.3 per cent in 2014 and is projected to grow by 2.6 per cent and 2.8 per cent in 2015 and 2016, respectively. Exports will likely expand at a robust pace and support growth. However, household indebtedness remains a concern and improvement in the labour market has been slow. GDP in Australia is estimated to grow by 3.0 per cent in 2014, before receding to 2.4 per cent and 2.3 per cent in 2015 and 2016, respectively. Exports and fixed investment in large natural resource projects will provide support for continued growth, while the slow improvement in the labour market will be a limiting factor. New Zealand became the first developed country to tighten its monetary policy stance after the Great Recession. GDP is estimated to grow by 3.0 per cent in 2014 and 3.3 per cent in 2015, with the solid expansion of investment in fixed structures as an important contributor.

Africa's growth will be driven by private consumption and investment

Among the developing countries, Africa's overall growth momentum is set to continue, with GDP growth expected to accelerate from 3.5 per cent in 2014 to 4.6 per cent in 2015 and 4.9 per cent in 2016. Growth in private consumption and investment are expected to remain the key drivers of GDP growth across all five subregions and all economic groupings. Net exports will continue to moderately pull down growth. Inflation in Africa will remain flat, at an average of 6.9 in 2015, in the light of moderating global prices for commodities, food, oil and industrial imports as well as prudent monetary policies. Fiscal balances will remain negative, owing to infrastructure spending, public wage bills and social sector projects. A number of internal and external risks remain, such as a continued slow recovery in the developed countries, a slowdown in China, tighter global financial conditions, the Ebola outbreak, political instability, terrorism and weather-related shocks.

East Asia will remain the fastest-growing region

East Asia remains the world's fastest-growing region, with GDP growth estimated at 6.1 per cent in 2014. In the outlook period, the region is projected to see stable growth of 6.1 per cent in 2015 and 6.0 per cent in 2016. China's transition to more moderate growth is expected to be partly offset by higher growth in other economies, where investment and exports will likely strengthen as activity in developed countries improves. Household consumption is expected to remain strong in most economies, supported by mild inflation, robust labour markets and generally low real interest rates, even as monetary conditions will likely become less accommodative, in line with the normalization of monetary policy in the United States. Fiscal policy is expected to remain mildly supportive of growth and most countries have sufficient space to provide additional stimulus, if necessary. The key downside risks for East Asia are related to the upcoming tightening of global liquidity conditions, which could result in weaker growth of domestic consumption and investment, and to a sharper-than-expected slowdown of the Chinese economy.

Stronger domestic demand will underpin growth in South Asia

Economic growth in South Asia is set to gradually pick up from an estimated 4.9 per cent in 2014 to 5.4 per cent in 2015 and 5.7 per cent in 2016. While the recovery will be led by India, which accounts for about 70 per cent of regional output, other economies such as Bangladesh and the Islamic Republic of Iran are also projected to see stronger growth in the forecast period. Along with robust external demand, growth is expected to be underpinned by a moderate strengthening of domestic consumption and investment as countries benefit from improved macroeconomic conditions. With international oil prices declining, inflation has further eased across the region. If this trend continues, some central banks may have room to ease monetary policy. At the same time, several countries, notably India, are likely to make progress in implementing economic policy reforms, thus providing support to business and consumer confidence. There are, however, significant downside risks for the region due to the continuing fragility of the global economy and considerable country-specific weaknesses, including political instability and the agricultural dependency on the monsoon.

Economic growth in Western Asia will moderately increase, with serious downside risks

Lower oil prices and armed conflicts in Iraq, Gaza and the Syrian Arab Republic hampered economic growth in Western Asia throughout 2014. The external environment was also not conducive to growth for non-oil exporting countries, given the relatively subdued economic growth in many developed economies. On the domestic front, the Cooperation Council for the Arab States of the Gulf (GCC) partially offset weaker external demand for oil by increasing fiscal spending, whereas other countries, such as Turkey, had to implement restrictive policies, either to limit their fiscal deficit or to avoid further depreciation of the national currency and inflation pressures. As a result, GDP growth has slowed to 2.9 per cent in 2014 from 4.0 per cent in 2013. During the forecast period, the aggregate economic situation is expected to pick up, although with only relatively modest GDP growth compared to previous years. Domestic demand will remain strong in GCC members, stimulated by ongoing public investment in infrastructure. Turkey will benefit from stronger external demand, provided that the depreciation of the national currency will continue to help the export sector, with GDP projected to grow by 3.7 per cent in 2015 and 4.3 per cent in 2016. The downside risks notably include any possible further fallout from the conflicts in Iraq and the Syrian Arab Republic. Moreover, should the Brent oil price come down to a level below $70 per barrel, it would hurt business confidence significantly in GCC countries.

Latin America and the Caribbean will see an uptick in growth

Economic growth in Latin America and the Caribbean is projected to moderately improve from a meagre 1.3 per cent in 2014 to 2.4 per cent in 2015 and 3.1 per cent in 2016, albeit to varying degrees across countries and with significant risks to the downside. Investment demand is estimated to recover from the current sharp slowdown, as large public investment projects are expected to be implemented in countries such as Brazil, Chile and Mexico. Accommodative monetary policy is also expected to support economic activity in some countries. On the external front, a sustained recovery in the United States will continue to benefit the economies of Mexico and Central America through the trade, tourism and remittances channels. The downside risks are related to a larger-than-expected growth decline in China, further reductions in commodity prices and the potential financial spillovers from the normalization of the monetary policy stance in the United States.

Geopolitical tensions weigh on growth in the CIS

Among the economies in transition, growth in the CIS slowed down sharply in 2014. The geopolitical tensions in the region resulted in a difficult external environment with high levels of uncertainty. Economic activity in the Russian Federation came to a standstill, which also lowered growth prospects for other economies in the region. In Ukraine, a severe output contraction followed years of sluggish expansion. Smaller CIS economies were affected by a contraction in the inflow of remittances. The prospects for 2015 are weak: near-zero growth is expected in the Russian Federation as the high cost of capital will deter private investment, and the possibility of deeper recession exists in Ukraine. However, some of the Central Asian energy exporters will continue to see strong growth. Inflation in the CIS accelerated in 2014, as currency depreciations created price pressures in many countries, including in the Russian Federation. Despite the slowdown in economic activity, the unemployment rate in the Russian Federation reached historical lows during the year. By contrast, labour market conditions worsened in Ukraine and in lower-income Central Asian countries. The aggregate GDP growth of the CIS and Georgia is expected to strengthen only modestly to 1.1 per cent in 2015 and 2.1 per cent in 2016, compared with the estimate of 0.8 per cent for 2014.

Post-flood reconstruction and infrastructure investment will underpin growth in South-Eastern Europe

After returning to growth in 2013, overall economic activity in South-Eastern Europe slowed down in 2014, as significant floods in May caused severe damage in Bosnia and Herzegovina and Serbia. As a result, the economy of Serbia contracted in 2014. Economic performance in the rest of the region modestly improved. External demand remained the main driver of growth in early 2014. After contracting for two years, domestic demand also modestly recovered, with the notable exception of Serbia. Infrastructure, tourism and energy projects have supported economic expansion in the region. Growth is expected to pick up in 2015, boosted by reconstruction work in flood-affected areas and planned infrastructure projects, although high unemployment, ongoing fiscal adjustments and elevated indebtedness will constrain the speed of economic expansion. The aggregate GDP of South-Eastern Europe is expected to grow by 2.7 per cent and 3.0 per cent in 2015 and 2016, respectively, compared with the estimate of 0.7 per cent in 2014.

Employment trends

Labour market conditions remain challenging

The global employment situation remains a key policy challenge, as GDP growth continued to be modest and below potential in many parts of the world. Globally, employment is estimated to have grown by 1.4 per cent in 2014, similar to the pace in 2013, but still lower than the 1.7 per cent rate in pre-crisis years. As a result, unemployment figures remain historically high in some regions, even though they appear to have stopped rising. The overall labour market situation is, however, more complex and challenging if a wider range of indicators are taken into consideration, such as labour force participation, long-term unemployment, wage levels (box I.3), involuntary part-time work and informality.

Job creation is lacking in developed economies

In developed economies, the job recovery has been insufficient to recuperate the losses from the financial crisis. The employment rate (employment-to-population ratio) declined significantly after the financial crisis in developed economies and remains below the pre-crisis level, with the exception of Japan.

The overall decline in employment rates since the beginning of the financial crisis is explained by weak labour demand, but also by structural factors and lower labour force participation. A case in point is the United States, where the labour force participation rate is near its lowest level in the past 10 years due to population ageing, an increase in skills upgrading and a higher number of discouraged workers.

Employment has been improving slowly in developed economies, although significant challenges remain. While the unemployment rate in the United States has decreased to below 6 per cent, the unemployment rate in the euro area remains elevated, with several economies in the euro area featuring extremely high unemployment. In addition, youth unemployment rates remain high in several European countries, with 53 per cent in Spain, 44 per cent in Italy and 35 per cent in Portugal, for example.

Long-term unemployment has become a more severe problem

During the Great Recession, the duration of unemployment has been abnormally prolonged in many developed and developing economies (figure I.5), bringing long-term unemployment rates to record highs, including among youth. In the Organization for Economic Cooperation and Development (OECD) countries as a whole in the last quarter of 2013, one third of unemployed individuals had been out of work for 12 months or more. This equals 16.7 million people, or twice as many as before the financial crisis. Even in countries where unemployment rates have improved or remain low, long-term unemployment remains persistently high. For instance, in the second quarter of 2014 in the United States, the share of long-term unemployed in total unemployment was 23.6 per cent, still more than double the figure prior to the financial crisis; in the euro area, the share of long-term unemployed reached as high as 62 per cent in Italy and Ireland.

Employment growth slowed in developing countries and economies in transition

In developing countries and economies in transition, the employment situation has not improved considerably either, with economic expansion decelerating in many economies. However, there have been noticeable improvements in some countries since the beginning of the financial crisis, including in some larger emerging economies. For example, Argentina, Brazil, Indonesia, the Russian Federation, Saudi Arabia and Turkey have recorded higher employment rates in 2014 than in 2007.

Despite slower employment growth, the unemployment rates have remained relatively stable since 2013, partially owing to a level of labour force growth in East Asia, South Asia and Latin America and the Caribbean that is lower than pre-crisis levels. In general, slower labour force growth can be attributed to ageing of the economically active population and to more young people enrolling in longer educational programmes. The highest unemployment rates of 2013 continue to be in North Africa and Western Asia, which registered 12.2 per cent and 10.9 per cent, respectively. In both cases, the unemployment rates remain higher than pre-crisis rates, and they are not expected to improve during the forecast period owing to extremely high structural unemployment, particularly among youth, and several armed conflicts that will require longer-term solutions.

Conversely, reported unemployment rates remained low across much of East Asia and South Asia in 2013, at 4.5 per cent and 4.0 per cent, respectively. Nevertheless, the unemployment rate in East Asia has been rising since the onset of the financial crisis, from 3.8 per cent in 2007, while the employment rate remains below the pre-crisis level, confirming relatively slow employment growth.

In the CIS and South-Eastern Europe, unemployment rates remain relatively high in general, with an average of about 8.2 per cent in 2013 and alarmingly high unemploy-

Box I.3

Wages remain weak in Organization for Economic Cooperation and Development countries

In addition to slower employment growth and higher unemployment rates, wages and earnings were also significantly affected by the financial crisis. During the period 2010–2013, the annualized real wage growth was about -0.1 per cent in the euro area, about 0.2 per cent in the United States of America and -0.1 per cent in Japan. When unemployment increases, wages and earnings normally decrease, and these adjustments in the labour market could eventually restore demand for labour and reduce unemployment. However, during the Great Recession, hourly wage adjustments were much more severe than in previous crises. Real wages have fallen faster for every percentage point of increase in unemployment than in the past, exacerbating social distress, depressing aggregate demand and curbing economic recovery and employment growth. In addition, wage growth has also been slow during the recovery period, particularly in the United States, prolonging the economic burden on lower-income workers.

According to an Organization for Economic Cooperation and Development (OECD) study for European economies,[a] in the absence of a minimum wage, income of newly hired workers fell about 3 per cent for every percentage point of increase in the unemployment rate. As wages are the main source of income for the majority of households, many face the challenge of poverty—especially low-skilled workers, whose real wage growth declined more dramatically than others. In the United States, for instance, the share of working poor in the overall working population increased from about 5 per cent in 2007 to about 7 per cent in 2012.

The fall in wages is not only a cyclical issue, but a long-term trend aggravated by the financial crisis. The gap between wage growth and productivity growth has widened. Real wages, which had been flat for a decade in many developed economies, decreased in the aftermath of the financial crisis, leading to an increase in the number of working poor and higher levels of income inequality.

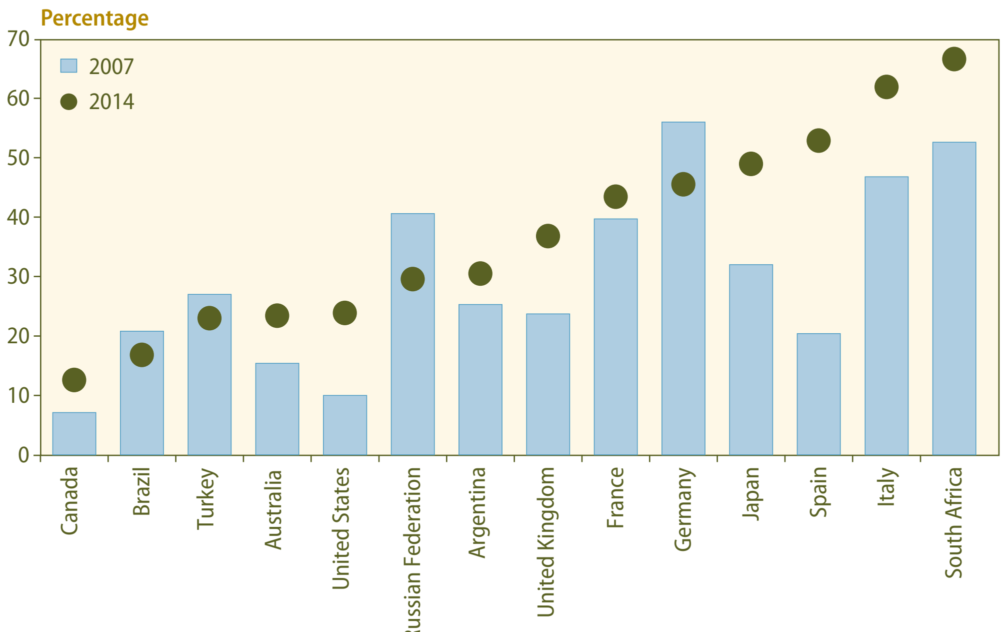
Some evidence in the OECD study shows that introducing or increasing minimum wages are effective measures to curb working poverty and income inequality, while supporting aggregate demand. Such initiatives may also help to increase labour force participation. The main challenge, however, is to set the minimum wage at a proper level so that it does not reduce employment opportunities for those unemployed.

a Organization for Economic Cooperation and Development, *OECD Employment Outlook 2014*, Paris.

Source: UN/DESA.

Figure I.5

Share of long-term unemployed within the total unemployed population in major economies



Source: OECD and ILO databases.

Note: Long-term unemployment refers to persons unemployed for one year or longer.

ment rates in most of South-Eastern Europe. Nevertheless, the unemployment rate was at historical lows in the Russian Federation, at 5.1 per cent in the first quarter of 2014, 0.2 percentage points lower than the previous year.

In many developing countries, the unemployment rate is, however, only a limited indicator to assess labour market conditions, given the high prevalence of informal and vulnerable employment. According to International Labour Organization (ILO) estimations, informal employment is widespread in Africa, Asia and Latin America and the Caribbean, with a cross-country average between 40 and 50 per cent. But significantly higher informality rates can be found in many economies, particularly in South and South-East Asia, reaching in some cases as high as 90 per cent of total employment. In India, for instance, despite some progress in reducing the share of workers in the informal sector, they still represented 82.2 per cent of the labour force in 2011–2012. In addition to informality, gender gaps in earnings and the employment rate are still widespread in many parts of the developing world, especially where informality is more pronounced. For instance, the participation rate of women in the labour force is below 40 per cent in almost all countries in South Asia, whereas for men, it tends to be about 75 per cent.

Inflation outlook

While global inflation remains subdued, the spectrum ranges from deflation risks in the euro area to high inflation in some developing countries

Global inflation remains tame, although inflation rates are still elevated in about a dozen developing countries and economies in transition, and some developed economies in the euro area are facing the risk of deflation. For the outlook period, global average inflation is projected to stay close to the level observed in the past two years, which was about 3 per cent. However, the trends at the subregional level vary. While average inflation for developed economies is estimated to have increased from 1.3 per cent in 2013 to 1.5 per cent in 2014 (mainly owing to the higher inflation in Japan), inflation in the EU is estimated to have decreased from 1.5 per cent in 2013 to 0.7 per cent in 2014 because of the sizeable output gap, the weakness of the recovery, and the strength of regional currencies until mid-2014. A fall into deflation is considered a downside risk for several euro area countries; if persistent, deflation may lead to greater reluctance by households and businesses to increase their current spending, thus weakening aggregate demand.

The average inflation rate for the economies in transition is estimated to have increased by 1.8 percentage points in 2014, with the increase in average inflation in the CIS countries more than offsetting the 3 percentage-point drop in inflation in the South-Eastern European countries. The significant depreciation of currencies for many CIS members played an important role in the acceleration of inflation in 2014. Regional inflation is predicted to be 8.1 per cent in 2014, but will decline to 7.4 per cent and 5.7 per cent in 2015 and 2016, respectively.

Average inflation for developing economies will fall slowly over the outlook period. In Africa, inflation will decline to 6.8 per cent in 2016, owing to increasingly prudent monetary policies as well as moderating import prices. While inflation for East Asia will stay near the recent levels of 2–3 per cent over the outlook period, a pronounced decrease is forecast for South Asia due to falling inflation in almost all countries, especially in India and the Islamic Republic of Iran. Regional average inflation for South Asia is projected to decrease gradually from 14.7 per cent in 2013 to 7.2 per cent in 2016. In Western Asia, inflationary pressures have been well contained, with the exception of the Syrian Arab Republic, Turkey and Yemen. Those three countries are expected to face close to or higher than 10 per cent inflation over the outlook period and push the regional inflation rate from 4.4 per cent in 2013 up to 5.3 per cent in 2016. In Latin America and the Caribbean, aggregate regional inflation has increased in 2014, driven by Argentina and Venezuela (Bolivarian Republic of), but it is expected to recede moderately to 8.8 per cent in 2015.

Trends in international trade and finance[3]

International prices of primary commodities

Primary commodity prices will remain subdued

International prices of primary commodities have been on a downward trend in the past two years, and no measurable upturn is projected for 2015–2016.

The Brent oil price is projected to decline in 2015–2016 from the average price in 2014, as the gap between demand growth and supply growth is expected to continue. Oil demand growth has been slowing down throughout 2014, following sluggish economic growth in key economies, including Western Europe and Japan. In addition, weaker-than-expected GDP growth in China has also weighed on weaker demand, particularly during the second quarter of 2014. As a result, growth in oil demand was at its lowest level in more than two years. In 2015–2016, increasing demand in the United States is expected to partially offset the weaker demand from other developed economies. However, global demand growth for crude oil should continue at a moderate pace.

Non-oil commodity markets strengthened slightly during the first quarter of 2014, led by a surge in food prices, but eased thereafter. The Non-oil Nominal Commodity Price Index of UNCTAD[4] increased from 245 points in January to 252 points in March 2014 and decreased afterwards by 3 per cent to reach 244 points in August. The average value of the index over the period of January–August was about 6 per cent lower than a year ago, but remains high relative to its long-term trend of the past decades. Compared to 2013, major commodity groups registered an overall decline in their prices, with the exception of tropical beverages, which increased.

International trade flows

Trade growth will increase moderately

Slow and uneven recovery in major developed countries and moderated growth in developing countries have led to sluggish trade growth in the past few years. World trade is estimated to have expanded by 3.4 per cent in 2014, still well below pre-crisis trends. In the forecast period, trade growth is expected to pick up moderately along with improvement in global output, rising to 4.5 per cent in 2015 and 4.9 per cent in 2016.

Developed countries are expected to see some improvement in trade growth, with export growth rising from 3.5 per cent in 2014 to 4.4 per cent in 2015. Import growth will also progress at a similar rate. Further improvement is expected in 2016. In the United States, export growth has been strong in 2014, but will be restrained by the appreciation of the dollar in 2015 and 2016. Further stabilization in Western Europe will boost export

3 See also chapter II on international trade and chapter III on international finance.

4 The UNCTAD Non-oil Nominal Commodity Price Index covers these subgroups of commodities: food, tropical beverages, vegetable oilseeds and oils, agricultural raw materials, and minerals, ores and metals.

growth somewhat, although the deprecation of the euro may limit import growth in the euro area. Japan's exports are expected to grow moderately, partly owing to a weaker yen.

Exports of the CIS have been heavily affected by geopolitical tensions in the region and the global oil market. Export volumes for the region are estimated to register close to zero growth for 2014 and are expected to rise only moderately over the forecast period. Import growth will fare worse, falling by 3.4 per cent in 2014 and rising only slightly over the forecast period.

Growth of exports in developing countries is expected to increase from 3.9 per cent in 2014 to 4.6 per cent in 2015 and 5.5 per cent in 2016, while growth of imports will expand even more rapidly from 3.8 per cent in 2014 to 5.3 per cent in 2015 and 6.0 per cent in 2016.

International capital inflows to emerging economies

Capital inflows to emerging economies have declined moderately

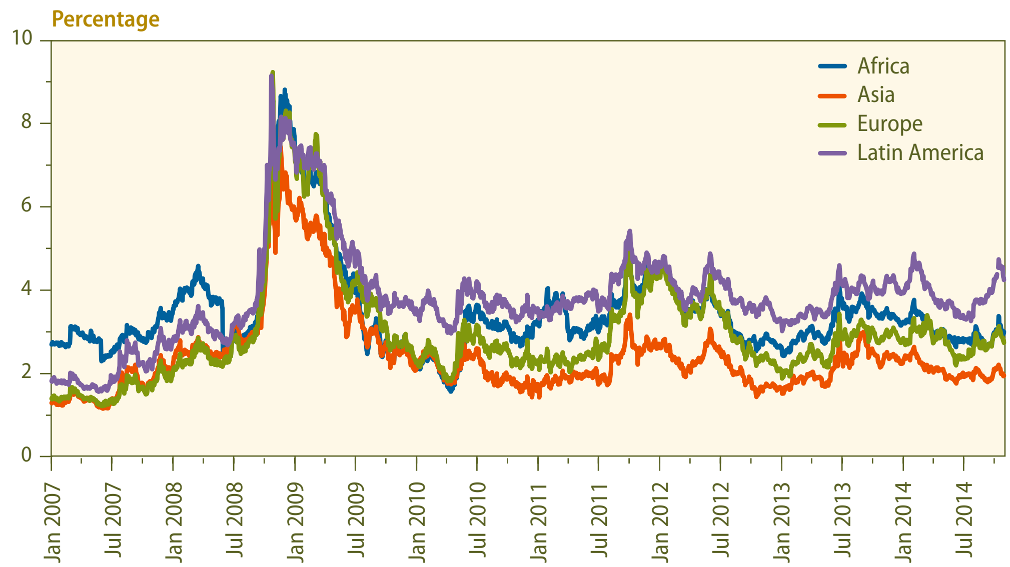
Net private capital inflows to emerging economies have been on a moderate downturn since 2013, triggered by the Fed tapering its quantitative easing programme, the deterioration in the growth prospects for these economies and escalated geopolitical tensions. In 2014, net private inflows to this group of economies are estimated to have declined by about 6.0 per cent from 2013, to a level of $1,160 billion, compared with the recent peak of $1,256 billion in 2012.[5] However, this decline is mainly explained by capital flight from the Russian Federation, amid a weak economic situation and escalating geopolitical tensions. In other emerging markets, capital inflows rebounded after a sharp contraction in early 2014, albeit to varying degrees and with significant fluctuations. Meanwhile, external borrowing costs continue to be relatively low for most developing regions (figure I.6). Despite this recent trend, the risks for abrupt adjustments and increased volatility driven by changes in investor sentiment remain high.

Among different types of capital flows, portfolio equity inflows rebounded significantly in 2014 from a sharp decline in 2013, reaching about $140 billion, driven by a renewed search for yield. By mid-2014, these flows increased significantly to Asia and Latin America, including countries such as Brazil, India, Indonesia and Mexico, but also to other markets such as South Africa and Turkey. By contrast, portfolio debt inflows continued to decline in 2014, to a level of $310 billion from $390 billion in 2013. Despite the decline over the past two years, debt inflows are noticeably higher than the pre-crisis peak levels. Moreover, the partial recovery of bond flows by mid-2014, after the sharp reduction in January and February, resulted in a reduction in external financing costs in some developing regions, like Asia and Africa.

Foreign direct investment (FDI) inflows have remained the most stable and relevant source of financing for developing countries. FDI maintains a relatively solid path across regions, standing at about $550 billion for the past three years and accounting for about half of the total net inflows to emerging economies. In addition, the importance of emerging economies and developing countries regarding FDI outflows continues to increase. In

5 The data and definition of private capital inflows in this section are based on Institute of International Finance, "Capital flows to emerging market economies", IIF Research Note, 2 October 2014.

Figure I.6
Yield spreads on developing economies' bonds, January 2007–October 2014



Source: JPMorgan Chase.

2013, these economies reached a record of $460 billion in FDI outflows, which constitutes about 39 per cent of global FDI outflows.[6]

Across different regions, emerging economies in Asia continue to receive the bulk of net capital inflows, accounting for about 60 per cent of the total in 2014, increasing from 51 per cent in 2013, with China alone absorbing some $500 billion. Emerging economies in Latin America accounted for 24 per cent, Africa and Western Asia combined for 8 per cent, and emerging economies in Europe for 7 per cent.

Capital flows will remain flat in 2015 and increase slightly in 2016

The outlook for capital inflows to emerging economies and developing countries remains moderately positive. Overall, net capital inflows are projected to stay at the same level in 2015 and slightly increase in 2016. However, abrupt changes in investor sentiment regarding geopolitical tensions, ongoing monetary policy shifts in the United States, and further divergence of the monetary policy stances of the major central banks might significantly affect portfolio flows. As was also illustrated towards the middle of 2013, a retrenchment in capital flows can have widespread impacts, especially in emerging economies, on exchange rates, foreign reserves, bond yields and equity prices.[7] Economic fundamentals seem to provide little insulation in this regard, and the magnitude of the short-term impacts appears to depend more strongly on the size of national financial markets. A sudden stop in capital inflows also stands to significantly affect growth, for example, through a tightening of bank lending.

6 UNCTAD, "Investment by South TNCs reached a record level", Global Investment Trends Monitor, No. 16 (28 April 2014).

7 Barry Eichengreen and Poonam Gupta, "Tapering talk: the impact of expectations of reduced Federal Reserve security purchases on emerging markets", World Bank Policy Research Working Paper, No. 6754 (December 2013), Washington, D. C.

Exchange rates

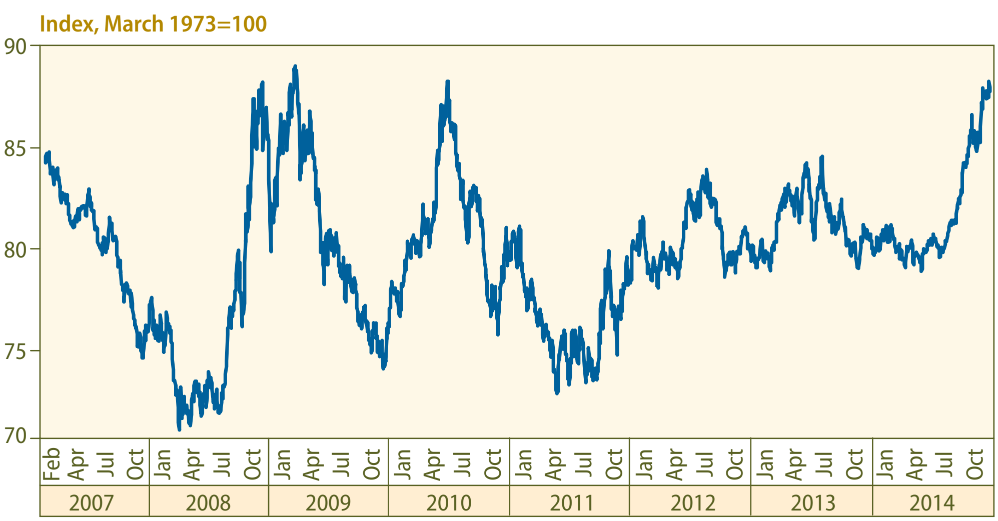
The United States dollar appreciated substantially

Starting in the third quarter of 2014, the dominant trend on foreign exchange markets has been the appreciation of the United States dollar. This trend has been fuelled by expectations that the Fed's monetary policy stance would increasingly diverge from that of other major central banks, notably the ECB and BoJ. The recent dollar strength has been broadly based, with considerable gains against the euro, the Japanese yen, the pound sterling and most emerging market currencies. The dollar index, which measures the value of the dollar relative to a basket of six developed-economy currencies, reached a four-year high in November 2014 (figure I.7).[8]

Against the euro, the dollar gained more than 10 per cent between May and November, climbing from 1.39 to 1.25 dollar/euro, after trading in a fairly narrow range in early 2014. The strong adjustment since May 2014 reflects a growing divergence in the economic performance and the monetary policies between the two areas. Faced with a slumping euro area economy and the threat of deflation, the ECB has taken additional steps to loosen monetary policy, including a further reduction of its main policy rates and the expansion of unconventional policies. The Fed, by contrast, ended its quantitative easing programme in October 2014 and appears set to increase interest rates by mid-2015, amid robust growth prospects and positive labour market trends. As this divergence is expected to continue in the forecast period, the dollar is assumed to strengthen further against the euro, although much more slowly than in the third quarter of 2014.

The dollar also appreciated notably against the Japanese yen in the third quarter of 2014, moving from 101 yen/dollar in July to a seven-year high of 115 yen/dollar in November. As with the euro area, this appreciation largely reflects different monetary policy paths, as the BoJ expanded its quantitative and qualitative easing programme in late October

Figure I.7
United States dollar index, February 2007–November 2014



Source: UN/DESA, based on data from http://www.Investing.com (accessed on 25 November 2014).
Note: A rising index indicates an appreciation of the United States dollar.

8 The basket of currencies includes the euro, the Japanese yen, the pound sterling, the Canadian dollar, the Swedish krona and the Swiss franc.

2014. The yen is expected to stay relatively weak in 2015 before appreciating slightly in 2016 as the BoJ starts to normalize its monetary policy.

With few exceptions, emerging-market currencies also weakened notably against the dollar in the third quarter of 2014, while remaining fairly stable against the euro and the yen. This follows a moderate strengthening against developed-economy currencies between February and June, when capital flows to emerging economies recovered amid relatively benign global financial conditions. The recent slide against the dollar reflects not only expectations of monetary policy tightening in the United States, but also renewed concerns over the short-term outlook for some emerging economies. In several countries—Brazil, the Russian Federation, South Africa and Turkey, for example—the growth forecasts for 2014 and 2015 have been revised downward sharply in the face of weak domestic demand, geopolitical tensions and falling commodity prices. Some of these economies also continue to record considerable external imbalances, including large current-account deficits, and appear vulnerable to a sudden shift in market sentiment or a tightening of global financial conditions. These factors will continue to weigh on emerging-economy currencies in the outlook period, although, given diverging macroeconomic trends, significant cross-country differences are expected.

The renminbi appreciated against the dollar

In contrast to most other emerging economy currencies, the Chinese renminbi appreciated against the dollar between May and early November, following a significant depreciation in early 2014. The People's Bank of China is expected to keep the average value of the renminbi relatively stable during the forecast period in a bid to maintain competitiveness and support growth.

Global imbalances

Global imbalances narrowed slightly

The size of global current-account imbalances narrowed slightly in 2014 as their pattern remained largely unchanged (figure I.8). The sum of the absolute values of current-account balances is estimated at about 3.5 per cent of WGP, down from a peak of 5.6 per cent in 2006.[9] A significant part of this narrowing appears to be driven by weaker demand in many economies since the global financial crisis along with a decline in potential output.[10] Moreover, several of the major contributors to the pre-crisis imbalances, including China and Japan on the surplus side and the United States and the euro area's peripheral countries on the deficit side, have seen structural shifts that tended to push their economies towards external balance.

The United States still has by far the largest current-account deficit in the world. For 2014, the deficit is estimated at $430 billion, slightly up from 2013. As a share of domestic GDP, the deficit stood at 2.5 per cent, well below the peak of 6.0 per cent registered in 2006. By contrast, China's surplus in 2014 remained the same as in 2013, at about 1.9 per cent of GDP, compared to 10.1 per cent in 2007, whereas the surpluses of fuel-exporting countries in Western Asia, such as Saudi Arabia and the United Arab Emirates, further declined, owing to lower oil prices. Germany, which has replaced China as the largest individual surplus country in the world, continued to see a significant current-account surplus

9 The total imbalances depicted in figure I.8 are smaller than the total (global) sum of current-account balances because some groups, such as the rest of the world, the EU without Germany, and East Asia without China, include both deficit and surplus countries.

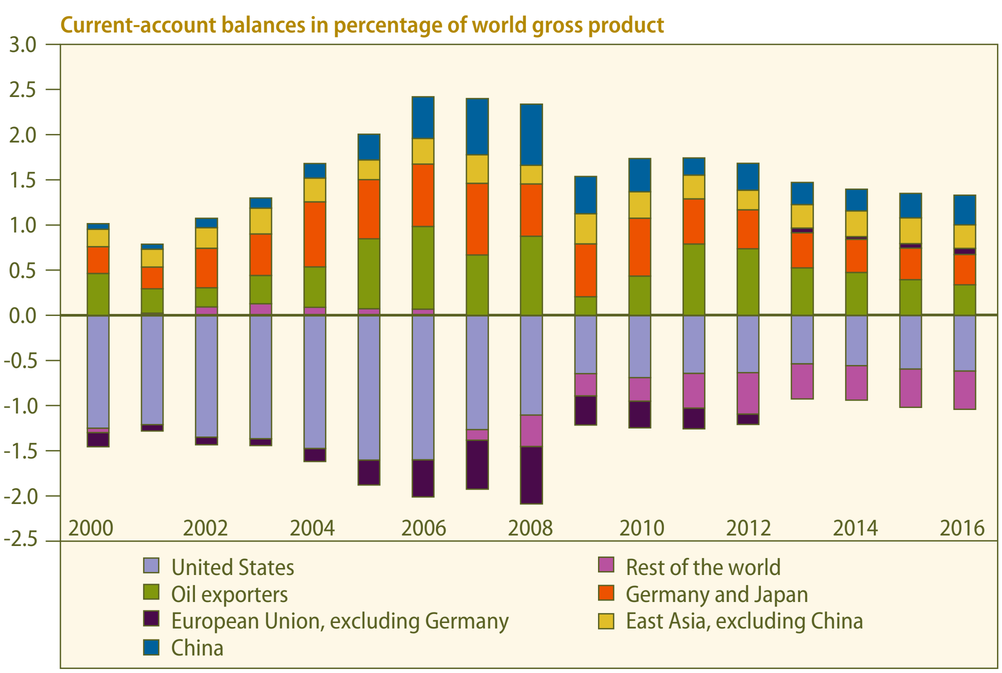
10 See IMF, *World Economic Outlook: Legacies, Clouds, Uncertainties*, October 2014, chap. 4.

in 2014 as exports continued to outpace imports. Germany's current-account-to-GDP ratio for 2014 is estimated at about 7 per cent, exceeding the European Commission's early warning threshold of 6 per cent.[11] Japan, by contrast, recorded only a very small surplus of about 0.2 per cent of GDP, despite the weakening of the yen against the dollar.

New patterns in the global imbalances

In the outlook period, the total size of global imbalances, relative to WGP, is projected to remain fairly constant. From a global perspective, the magnitude of current-account imbalances does not appear to pose an imminent threat to the stability of the world economy. Nonetheless, there are important problems associated with the current pattern of imbalances and the ongoing adjustment processes. On the one hand, Europe's shift from a current-account deficit prior to the global financial crisis to a significant surplus in recent years has largely been the result of weak internal demand. This reflects deep recession in the euro area's peripheral economies, and a heavy reliance by northern countries, including Germany, on exports for growth. Due to a lack of investment at home, the region has become the world's largest capital exporter. This is exerting a considerable deflationary impact on the world economy at a time when global demand is still slacking. On the other hand, the ongoing high current-account deficits in some large emerging economies, such as Brazil, Indonesia, South Africa and Turkey, remain a concern, particularly in light of fickle short-term international capital flows and an upcoming normalization of United States monetary policy. A sudden change in market sentiment, similar to the experience of mid-2013, could trigger a painful adjustment process in the countries with large external deficits, through tighter monetary conditions and weaker aggregate demand.

Figure I.8
Global imbalances, 2000–2016



Source: UN/DESA, based on IMF World Economic Outlook, October 2014. Data for 2015–2016 are forecast.

11 Germany recently undertook a major revision of the national accounts. This has resulted in an upward shift in the level of GDP and, accordingly, in a reduction of the current-account-to-GDP ratio. The number cited here is from the data before the revision.

Risks and uncertainties in the global economy

Risks associated with the normalization of United States interest rates

The uncertainty associated with the normalization of monetary policy by the Fed can be captured in three different scenarios.[12] While the assumption for the baseline outlook as delineated above is a smooth process of interest-rate normalization, any unexpected changes in GDP growth, employment creation, inflation or other circumstances can trigger a deviation from the assumed interest-rate path. This, in turn, would lead to the sudden repricing of financial assets, higher volatility and possibly to global spillovers. In one scenario, higher inflation or financial bubble concerns would lead to a more rapid increase in the policy interest rate. Together with a rise in term premia, this would drive up credit spreads, accompanied by an increase in volatility and significant repercussions for global financial markets. By contrast, in another scenario, a renewed slowdown in growth prompts a delay in interest-rate hikes. This would set off higher volatility and possibly lead to additional financial instability risks in the light of asset pricing that is based for an even longer time on abundant liquidity rather than on economic fundamentals.

Any deviation from the expected interest-rate path could have major effects on financial markets…

Any deviation from the policy interest-rate path expected by financial markets could have major ramifications in financial markets. One reason for this is the decrease in market liquidity for corporate bonds due to a retrenchment of market-making banks. As a result, any sell-off in bond markets caused by an upward revision of interest-rate expectations would lead to a more pronounced fall in bond prices, higher yields and higher borrowing costs. A further reason lies in the increased role of financial actors that feature a higher redemption risk, such as mutual funds and exchange-traded funds. These actors, together with households, have seen a continuous increase in their share as holders of corporate bonds, while the share of insurance and pension funds has decreased.

…with spillover effects to other economies

A faster-than-expected normalization of interest rates in the United States can also create significant international spillover effects, especially a drying up of liquidity in emerging economies and an increase in bond yields. Historically, the yields on 10-year government bonds across advanced and major developing economies have exhibited a high degree of correlation, especially during phases of rising interest rates in the United States. The direction of causation typically flows from the United States to the other markets, with the term premium being the major adjustment component. This observation is especially relevant in the current context, with other central banks like the ECB remaining committed to a loose monetary policy stance. While this will keep expected short-term interest rates low, a cascading term-premium shock would still be likely to put upward pressure on long-term yields. Many emerging economies also remain vulnerable to the fallout from rising global interest rates. While certain economic fundamentals such as currency reserve ratios are overall in better condition than in the past, various factors have increased emerging markets' vulnerability, particularly to higher global interest rates. This includes, for example, rising levels of foreign-currency-denominated debt, particularly short-term debt in a number of cases.

12 See more detailed discussion in IMF, *Global Financial Stability Report: Risk Taking, Liquidity, and Shadow Banking: Curbing Excess While Promoting Growth,* October 2014; and *Global Financial Stability Report: Moving from Liquidity to Growth-Driven Markets*, April 2014.

Remaining fragilities in the euro area

The recovery in the euro area remains precarious

The euro area sovereign debt crisis has subsided dramatically since the European Central Bank (ECB) announced its Outright Monetary Transactions facility in August 2012. It has yet to be activated, but its mere existence has broken the negative feedback loop between weak banks and weak government fiscal positions. Sovereign-bond spreads have narrowed significantly and some of the crisis countries have seen an improvement in their debt ratings.

However, while the sense of crisis has dissipated, significant risks remain. The banking sector remains under stress. Lending conditions remain fragmented across the region, with firms in periphery countries, particularly small and medium-sized enterprises (SMEs), starved of credit. The recent Asset Quality Review and stress tests performed by the ECB and the European Banking Authority revealed that the capital shortfall was at the lower end of expectations and was manageable, thus eliminating a major source of tension in recent months. But it also revealed that the majority of problems were in periphery country banks.

The most significant risk, however, is the precarious nature of the euro area recovery. The underlying growth momentum in the region has decelerated to the point where an exogenous event could lead to a return to recession. The current tensions in Ukraine and resulting sanctions have already had a serious negative impact on activity and confidence. The weak state of the recovery is characterized by continued low levels of private investment, extremely high unemployment in many countries—which becomes more entrenched as the ranks of the long-term unemployed increase—and by dangerously low inflation, which could turn to Japan-style deflation. Aside from being exceptionally difficult to exit, deflation would also increase real government debt burdens and perhaps reignite the debt crisis as fiscal targets become increasingly difficult to achieve.

Vulnerabilities in emerging economies

Many large emerging economies continue to face a challenging macroeconomic environment, as weaknesses in their domestic economies interact with external financial vulnerabilities. Although the baseline forecast projects a moderate growth recovery in 2015 and 2016 for almost all emerging economies—including Brazil, India, Indonesia, Mexico, the Russian Federation, South Africa and Turkey—and only a slight moderation in China, there are significant risks of a further slowdown or a prolonged period of weak growth. A broad-based downturn in emerging economies, particularly a sharp slowdown in China, would not only weigh on growth in smaller developing countries and economies in transition, but could also derail the fragile recovery in developed countries, particularly in the struggling euro area.

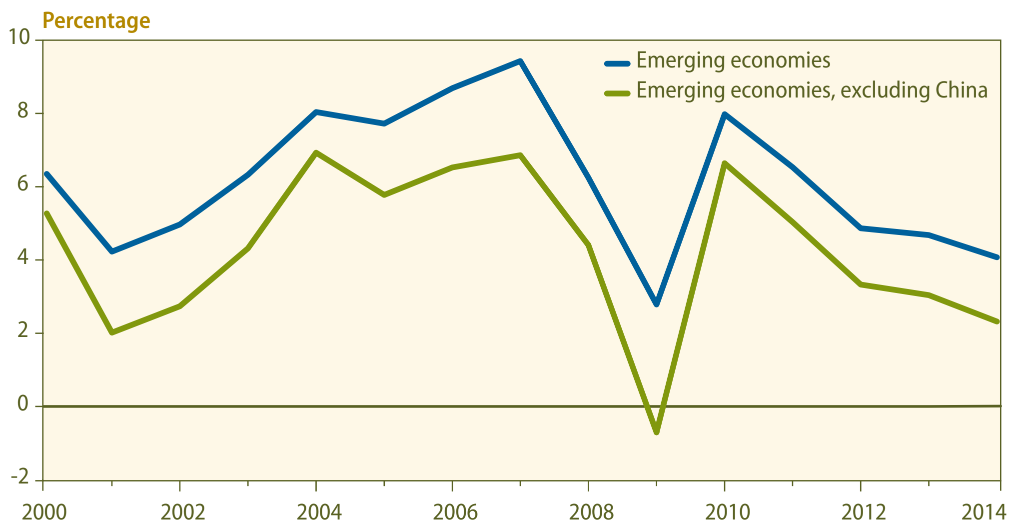
The possible interaction between weaker growth and tighter financing conditions presents a risk

At present, the main risk for many emerging economies arises from the potential for negative feedback loops between weak activity in the real sector, reversals of capital inflows and a tightening of domestic financial conditions amid an expected rise in the interest rates in the United States. The financial turmoil episodes of mid-2013 and early 2014 illustrated the dynamics of such feedback loops and underlined the policy dilemma some of the countries are facing. During these episodes, global investors reallocated their portfolios amid a reassessment of the Fed's monetary tightening path, concerns over global growth, higher uncertainty and country-specific shocks.[13] This resulted in strong portfolio capital reversals and rapidly depreciating currencies in emerging economies, particularly those with large external financing needs and macroeconomic imbalances, such as Brazil, Indonesia, South Africa and Turkey. Faced with significant downward pressure on domestic asset prices and currencies, the central banks in these countries hiked interest rates even as economic growth slowed. These moves, while helping to stabilize financial markets, have further slowed down activity in the real sector. During the course of 2014, the growth projections have been lowered sharply for Brazil, South Africa and Turkey and marginally for Indonesia.

Geopolitical tensions (especially the conflict between the Russian Federation and Ukraine), the weaker-than-expected performance of developed economies, and the growth moderation in China have also negatively impacted real activity in emerging economies over the past year. Contrary to expectations at the beginning of the year, average GDP growth in a group of 18 emerging economies declined further in 2014 to 4.1 per cent, down from 4.7 per cent in 2013 (figure I.9).[14] The current pace is less than half the rate recorded in the period 2004–2007, when these countries grew at an annual average rate of 8.5 per cent. When China is excluded, the slowdown is even more pronounced, indicating the magnitude of the recent slump. Without China, emerging market growth in 2014 averaged only 2.3 per cent, compared to 6.5 per cent in 2004–2007.

Much of the recent downturn in emerging economies outside Asia can be attributed to weak growth in investment and in total factor productivity. In many countries, investment in fixed capital has slowed considerably since 2011 even as global financial conditions remained unusually loose. As a result, the contributions of gross fixed investment to GDP

Figure I.9
Annual GDP growth in emerging economies, 2000–2014[a]



Source: UN/DESA.
a Growth rate for 2014 is partially estimated.

13 Changes in market expectations about the path of monetary tightening in the United States of America were the main factor behind the turbulence in mid-2013, whereas country-specific shocks, such as an unexpected devaluation in Argentina and a deterioration of the geopolitical situation around Ukraine, played the major role in early 2014.

14 The 18 emerging economies analyzed here are: Argentina, Brazil, Chile, China, Colombia, India, Indonesia, Malaysia, Mexico, Peru, the Philippines, Poland, the Russian Federation, South Africa, Thailand, Turkey, Ukraine and Venezuela (Bolivarian Republic of).

growth in most emerging economies outside Asia have been low or negative in the past two years. Investment-to-GDP ratios have remained below 20 per cent in several economies, such as Argentina, Brazil, South Africa and Turkey. Growth in total factor productivity fell to the lowest level in two decades in 2013, indicating increased challenges for emerging economies to achieve technological progress and efficiency gains. Given the expected normalization of monetary policy in the United States, it is likely that emerging markets will see a tightening of financial conditions in the forecast period. In the absence of a new reform push, this may further weaken real investment growth, particularly in the private sector. A key question in this regard is the degree to which the upcoming increase in United States interest rates will affect borrowing costs in emerging economies.

Private-sector debt in many emerging economies has increased significantly

While fixed capital formation has remained subdued in recent years, many emerging economies have registered considerable credit growth, with increased leverage in the household and the corporate sector. Corporate sector debt as a share of GDP is particularly high in some faster-growing East Asian countries, such as China and Malaysia, but also elevated in many less dynamic economies, including Brazil, the Russian Federation, South Africa and Turkey. Preliminary evidence suggests that part of the new borrowing has been used for more speculative activities, as indicated by a marked increase in corporate cash holdings.[15] Rising interest rates, along with weakening earnings in the context of slowing economic growth, could put considerable pressure on corporate balance sheets. China's high and rapidly rising level of total debt poses a substantial risk factor, although almost all of the debt is held domestically and the country is partly insulated from changes to global financial conditions.

An additional risk factor for several emerging economies, including Brazil, Colombia, Indonesia, Peru, South Africa and Turkey, are persistently large current-account deficits. According to recent projections, full-year current-account deficits in 2014 are expected to be about 3.5 per cent in Brazil and Indonesia, 4.0 per cent in Colombia, 5.0 per cent in Peru and close to 6.0 per cent in South Africa and Turkey. Among the economies with large external financing needs, those with weak economic fundamentals and large open capital markets appear to be most vulnerable to a tightening of global financing conditions and further portfolio reallocation.

Geopolitical tensions and risks

Geopolitical tensions remain a major downside risk for the economic outlook. In addition to the severe human toll, the crises in Iraq, Libya, the Syrian Arab Republic and Ukraine have already had pronounced economic impacts at the national and subregional levels, although the global economic effect has so far been relatively limited. A major reason for the limited global impact thus far is that global oil markets remained on an even footing, with any actual or feared conflict-related decline in oil supplies being offset by oil production increases, notably in the United States. Nevertheless, the world economy remains at risk to experience a more pronounced slowdown that could be caused by subregional economic weakness due to conflict and sanctions feeding into a broader global impact. A further risk lies in a drastic fall in oil output and exports by any of the major oil-exporting countries, which may set off a sharp adjustment in financial markets' risk perception, leading to higher risk premia and an increase in market volatility across different asset classes.

15 See Michael Chui, Ingo Fender and Vladyslav Sushko, "Risks related to EME corporate balance sheets: the role of leverage and currency mismatch", BIS Quarterly Review, September 2014.

The crisis in Ukraine has major regional macroeconomic repercussions

The crisis in Ukraine has led to several rounds of sanctions between the Russian Federation and leading OECD economies. Over the course of 2014, those countries have introduced a series of increasingly tough sanctions against the Russian economy, affecting the defence, finance and energy sectors by restricting exports of arms, double-use technology and certain equipment for the oil industry, and by curbing access of Russian banks and companies to international capital markets. The measures have already imposed a serious toll on the Russian economy through worsening business sentiment and an outflow of capital, and have triggered a reciprocal response. In August of 2014, the Government of the Russian Federation decided to impose counter-sanctions against those countries—most notably imposing a one-year ban on imports of their food products, despite the fact that switching to alternative suppliers may imply high transaction costs and lead to higher inflation, which currently poses a serious macroeconomic threat to the Russian economy.

Weaker Russian import demand has already affected a number of EU economies, as the Russian market absorbs almost 5 per cent of the euro area's exports. The slowdown in the German economy in the second quarter is partially explained by lower exports of automotive components to the Russian Federation. Moreover, the restriction on supplying deep-water drilling equipment to sanctioned Russian companies affected Germany's producers. Financial difficulties experienced by the sanctioned oil companies will limit their investment plans and, consequently, sales of construction materials to those companies. Some countries, such as the Baltic States and Finland, will lose transit revenue. Globally, the tourism industry will suffer from the depreciation of the Russian currency.

The Russian ban on food imports, in turn, will mostly hurt those countries which are strongly exposed to trade with the Russian Federation, not only through direct losses by the agricultural sector, but also their consequential effects. Total EU food exports to the Russian market amount to approximately $11 billion annually. The forgone food exports would impact the entire logistics sector (including transport), put pressure on the states' budgets to compensate for farmers' losses, put banks exposed to agricultural borrowers at risk by increasing the number of non-performing loans, and constrain credit extended to farmers. For some East European countries (especially the Baltic States and Poland) and also for Finland and Norway, the Russian Federation absorbs a significant share of their food exports. For Poland, fruit and vegetable exports to the Russian Federation provided revenue of about $1 billion last year.

The loss of the Russian market may also have a multiplier effect on the region, through weaker aggregate demand in the affected countries, resulting from significant intraregional trade links. Although the EU members will be able to file a compensation claim with the EU, and the European Commission in late August announced support measures for dairy exporters and fruit and vegetable farmers, full coverage of losses is not likely. Nevertheless, at the macroeconomic level, the impact of the Russian food import ban still remains to be seen. By contrast, some countries, among them Argentina, Brazil, Serbia and Turkey, as well as some CIS economies, may benefit from the current situation, becoming alternative food product suppliers to the Russian Federation.

The situation in Iraq, Libya and the Syrian Arab Republic remains a major source of uncertainty

The conflict situations in Iraq, Libya and the Syrian Arab Republic have created considerable uncertainty in the oil market. In 2013, Iraq's oil production constituted 3.7 per cent of total world oil production, while Libya provided 1.1 per cent of global output. But despite the ongoing conflicts in these countries, crude oil prices actually declined, in contrast to similar episodes in the past that saw sharp increases in crude oil prices. This price behaviour is linked to the oil output trend in other oil producers, especially the United

States. Oil production there jumped by 12.5 per cent in 2013, following an increase by 13.0 per cent in the previous year. The United States oil output level in 2013 came close to that of the Russian Federation, which was surpassed only by Saudi Arabia. Taken together, this has increased the resilience of the global oil market to any crisis scenarios. However, a major downside risk remains the possible sudden and drastic stoppage of exports by a major supplier country. While such a scenario could eventually be compensated for by existing slack in global oil markets, the immediate reaction of financial markets could be severe, with possible negative repercussions for real economic activity as well.[16]

The Ebola outbreak has not only taken a severe human toll, but has also had major economic repercussions

A further risk to the outlook lies in the future development of the Ebola epidemic. The current outbreak of the disease is the largest since the virus was first discovered in 1976, with the number of cases and deaths in this outbreak exceeding those of all previous outbreaks combined. In August of 2014, the World Health Organization declared the outbreak an international public health emergency; in September, the United Nations Security Council declared the epidemic a threat to international peace and security. The first cases of the current outbreak were identified in March 2014 and the majority of cases have so far occurred in three West African countries, namely Guinea, Liberia and Sierra Leone. The occurrence of the outbreak and the difficulties in addressing it have been underpinned by the weak health systems in these countries, both in terms of human and physical resources. In addition to the severe human toll the disease has taken, it has also imposed major economic costs in the affected countries through disruptions to travel and trade.

Policy challenges

Fiscal policy stance

Fiscal consolidation will continue in developed economies

For major developed economies, including Japan, which earlier resorted to a fiscal stimulus, fiscal policy in 2014 was dominated by pursuing the goal of fiscal consolidation, both on the revenue and on the expenditure side. Consequently, the average size of the budget deficit in developed economies is expected to decline further in 2014. The implications of those consolidation policies for economic growth may not be so straightforward to assess, but in general they should have a mildly contractionary impact. In the outlook for 2015, fiscal tightening in most of the developed economies is likely to continue; but, since the most drastic post-crisis austerity measures have already been implemented, the countries should face less fiscal drag, unless the cyclical position of those economies deteriorates dramatically and undermines public revenues.

In the United States, several years of fiscal austerity noticeably reduced the size of the federal budget deficit (by approximately one half between 2010 and 2013) and improved public accounts at the state and local government level. Although the federal budget squeeze is expected to continue in 2015 (despite the increase in the public debt ceiling, agreed in February 2014), spending at the state and local government level may increase. Thus, the total impact of fiscal policy on growth may be largely neutral. Nevertheless, the long-term sustainability of the entitlement programmes is being questioned repeatedly and their reforms will remain on the agenda, although the sharp political divisions will most likely prevent reaching any consensus in the near term.

16 Oil market data is from BP Statistical Review of World Energy, June 2014, p. 8.

In the EU, where fiscal accounts has been severely damaged by the loss of tax income during the economic downturn, by countercyclical spending, and by bailouts of the banking system, fiscal consolidation has been progressing slowly, with only slight improvements in the fiscal positions of many countries. In some large economies, such as France, the Government mostly relied on tax increases. In 2014, many of the EU members are expected to violate the provision of the Stability and Growth Pact that stipulates a deficit limit of 3 per cent of GDP. In early October, the Government of France announced that it will shift its target date of complying with the 3 per cent threshold to 2017, two years beyond its initial target. The overall efficiency of the austerity measures in the periphery euro area countries is being debated; however, in these countries deficits have been reduced significantly and the prospective issuance of Eurobonds should mitigate near-term fiscal risks and promote greater fiscal discipline in the EU.

In Japan, the large fiscal stimulus enacted in 2013 has led to a swelling of the budget deficit to about 10 per cent of GDP. The public debt-to-GDP ratio, at over 220 per cent, has already been among the highest in developed countries and may be unsustainable in the long run. However, supportive factors include the fact that most debt is held domestically, the borrowing costs are currently low, and the real interest rate became negative after the monetary stimulus. Additionally, the consumption tax increases enacted in 2014 and planned for 2015 should gradually reduce the deficit.

In developing countries and economies in transition, fiscal developments in 2014 varied. Their budget deficits and public debt levels are generally lower than in developed economies. As commodity prices still remained weak, public revenues for a number of commodity exporters continued to underperform. In China, the fiscal deficit moderately expanded. Against the backdrop of the high indebtedness of local governments, spending by the central Government is likely to increase in the future.

The refinancing of external debt could pose challenges for developing countries

Despite comparatively low public debt levels, a more cautious attitude towards sovereign borrowing may be recommended for many developing countries. Refinancing external debt could prove to be costly should there be a sharp change of investor appetite for emerging markets, a weakening of the exchange rate, or higher levels of benchmark interest rates. However, the increasing inequality in many emerging economies will necessitate fiscal spending aimed at narrowing income gaps and promoting social mobility.

Monetary policy stance

The direction of monetary policies has become more divergent among different economies in the world. While some countries are in a position to raise interest rates, others intend to reduce interest rates, reflecting a diverse economic situation and different country-specific challenges facing different economies.

Monetary policy remained accommodative in developed economies

Major developed economy central banks continued to maintain accommodative monetary policy stances in 2014 against the backdrop of a weak recovery, deflationary pressures and limited support from the fiscal side. At its most recent meeting in September, the Fed decided to maintain the federal funds rate within the current range of 0.00–0.25 per cent for a “considerable time” after ending the asset-purchasing programme, especially if projected inflation continues to run below 2.0 per cent and inflation expectations remain well anchored.

In forward guidance issued in July, the ECB announced that interest rates would remain at present or lower levels for an extended period of time, given the subdued outlook for inflation in the medium-term, broad-based weakness in the real economy and weak monetary transmission. In September, in line with its forward guidance, the ECB kept the interest rates on refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.05 per cent, 0.30 per cent and -0.20 per cent, respectively. In mid-October, the ECB will start buying covered bonds and asset-backed securities, which are expected to add 1.1 trillion euros to its balance sheet. The new round of asset purchases is expected to boost lending to SMEs, a priority sector for the ECB, to stimulate employment and growth in the euro area economies.

At its meeting in October, the Bank of England (BoE) kept the policy rate unchanged at 0.5 per cent and the asset-purchasing programme at 375 billion pounds. In its first forward guidance in August 2013, the BoE had signalled that it would leave interest rates unchanged at 0.5 per cent at least until the unemployment rate fell to 7.0 per cent. However, as unemployment fell below 7.0 per cent by April 2014, the BoE maintained that there was still room for non-inflationary growth in the economy before it needed to raise interest rates and that the increases in interest rates are likely to be gradual and limited.

The BoJ continued its Quantitative and Qualitative Monetary Easing Programme, as inflation remained well below the 2 per cent target. On 31 October 2014, the BoJ announced that it will increase the monetary base at an annual pace of about 80 trillion yen and purchase Japanese government bonds at an annual rate of about 80 trillion yen, with an average remaining maturity of about seven years. The BoJ kept its policy rate below 0.10 per cent; it has remained at this level since 2009.

Emerging economies featured more divergent monetary policy stances

In contrast to developed economies, developing- and emerging-economy central banks demonstrated considerable divergence in their monetary policy operations. The People's Bank of China cut its benchmark interest rate in November 2014, after previously reducing the short-term repo rate twice during 2014 in order to inject liquidity into the banking system. It also cut the reserve requirements for banks that lend to SMEs and rural sectors of the economy. On the other hand, the Central Bank of Brazil increased its policy rate three times during 2014 amid concerns about rising inflation. The central banks of India and South Africa raised interest rates during the first half of 2014, largely to stem capital outflows and prevent depreciation of their exchange rates, while the central bank of Indonesia has kept its policy rate unchanged at 7.5 per cent since November 2013 and the central bank of Turkey cut the policy rate by 50 basis points in May 2014.

Challenges in managing the normalization of monetary policy

Both the end of quantitative easing by the Fed in October 2014 and the forthcoming normalization of its policy interest rate assumed in the baseline forecast hold significant risks and uncertainties for the economic outlook. These relate to the design of the exit strategy, its timing, and how it is perceived by financial markets. The potential difficulties that can arise in this context already became clear in the spring of 2013, when the announcement by the Fed of its intention to taper its bond purchases set off a fall in the price of various financial assets and a spike in financial market volatility.

As the Fed has ended its quantitative easing (i.e., bond purchases), the focus has increasingly moved to the future trajectory of the policy interest rate. As outlined in the assumptions for the baseline forecast, the first interest-rate hike is expected in the third quarter of 2015, with further gradual increases bringing the policy rate to 2.75 per cent by the end of 2016. This projection is linked to the guidance given by the Fed that it will maintain the current near-zero level of interest rates for a considerable time after the end of the asset-purchasing programme, provided that inflation remains low.

The actual path of the policy interest rate will depend on a number of factors, particularly the emerging macroeconomic picture, in terms of unemployment and inflation, and concerns about financial stability risks. Interest rates will also be a major determinant not just of macroeconomic performance, but also the extent of financial stability risks and global spillovers. Policymakers face the challenge of determining the optimal magnitude and timing of interest-rate changes while dealing with a difficult trade-off: delaying the policy tightening could reinforce any asset mispricing and financial stability risks, while an unwarranted quick tightening could weaken the still fragile economic growth picture.

Complex macroeconomic data can complicate monetary policy

The difficulty of designing the optimal monetary policy path stems in large part from the uncertain nature of macroeconomic data. A case in point is the unemployment rate in the United States, which has fallen from a peak of 10 per cent in 2010 to below 6 per cent. However, at the same time, the percentage of employees working part-time but preferring to work full-time remains elevated, indicating significant underemployment. In addition, the labour force participation rate has decreased, meaning that more people have simply stopped looking for a job. This raises two issues for monetary policymakers. First, there is the need to consider a broader unemployment variable that adjusts the nominal unemployment rate for involuntary part-time work and for the decrease in the labour-force participation rate. Second, if the drop in the participation rate is cyclical, monetary policy can be a potent means for reducing the participation gap by letting the unemployment rate fall below its long-term natural rate. This would help in bringing people back into the job market, which would have the side effect of reducing (to a point) any inflation pressure from the undershooting of the unemployment rate.[17] However, an opposite argument can be made that a large part of the decline in the participation rate is actually structural, due, for example, to the ageing of the population;[18] in this case, targeting the participation rate with monetary policy would be inadequate and create upward wage pressures and inflation.

Policy challenges for strengthening employment and improving working conditions

As discussed earlier, employment rates, in comparison with pre-crisis levels, are still relatively low in many economies, requiring more supportive macroeconomic policies to foster employment creation. At the same time, long-term unemployment has increased and labour market conditions—wages in particular— have deteriorated, requiring more active labour market policies.

Macroeconomic policies and structural measures need to target employment creation

To date, macroeconomic policies in many developed economies have been uncoordinated and only had a limited impact on job creation. While expansionary monetary policies in developed economies may have averted otherwise larger falls in employment, they cannot directly stimulate employment growth. Moreover, fiscal austerity in many developed economies and, more recently, in some emerging economies, has led to a weak demand in the short run; further, economic uncertainty has deterred private investment

17 Christopher Erceg and Andrew Levin, "Labour force participation and monetary policy in the wake of the great recession", IMF Working Paper, WP/13/245, July 2013, p. 4.

18 Stephanie Aaronson, and others, "Labour force participation: recent developments and future prospects", Brookings Papers on Economic Activity, Fall 2014.

and perpetuated a vicious cycle of weak labour demand and constrained private consumption. Therefore, the main challenge for policymakers in many countries is to implement fiscal strategies that are more supportive of output growth and employment creation. On the monetary side, access to credit for SMEs will continue to be an essential tool, as they play a significant role in job creation. There is also the need to adequately coordinate monetary and fiscal policies to foster employment creation. On the structural side, policymakers in a number of countries need to create an environment that is more amenable to the creation of businesses and jobs—by streamlining administrative procedures, for example.

Specific labour market policies are also required to address the various challenges

In addition to macroeconomic policies, specific labour market policies are also required in order to effectively address current challenges. This includes wage growth policies (box I.3), which would also help to support aggregate demand. Such policies are especially relevant as consumer demand has been constrained not only as a result of the financial crisis, but also because of a long-term decline of the labour share in total income. In addition, policymakers should minimize individual losses caused by structural economic changes, such as automation. Governments therefore need to find the right balance between recent labour market flexibility initiatives, which are expected to create more dynamic labour markets, and guaranteeing decent working conditions. In developed economies, in-work benefits and tax credits for low-paid workers have been efficient in limiting the risk of working poverty. In many developing countries, greater diversification of the economic structure and development of higher value-added sectors are needed to promote productivity and reduce unemployment and underemployment, as well as to increase formal employment. This can be achieved through more proactive industrial and innovation policies. Social protection programmes implemented in many emerging economies also recently proved to be effective in improving labour market conditions and supporting aggregate demand.

Concrete policies are needed to address long-term unemployment

Long-term unemployment remains another major challenge for policymakers, including in countries where unemployment figures appear to have declined faster in recent years. Long-term unemployment, as discussed earlier, leads to the depreciation of human capital, negative health effects and higher risks of aggravating structural unemployment. Ultimately, it will limit a country's economic growth potential and require extended social programmes, straining budget resources. Because the long-term unemployed remain progressively on the margins of labour markets, wages can rise as the short-term unemployed cohort shrinks. Lower short-term unemployment could thereby lift inflation and push central banks to reverse their expansionary monetary policy by raising interest rates, which would aggravate job prospects for the long-term unemployed.

Concrete labour market policies to tackle long-term unemployment must be implemented, as conventional policies to stimulate aggregate demand will not be sufficient to reintegrate those trapped in extended joblessness. Empirical evidence[19] shows that long-term unemployment often leads to discrimination from employers, worker discouragement or skills depreciation. As a result, the long-term unemployed tend to leave the labour market altogether, mainly because they are discouraged by the relatively low prospects of finding a job. This is particularly evident for workers who are suffering from a chronic skill mismatch due to technological changes or industrial geographical reallocation, who therefore do not possess the skills required to reintegrate into today's labour market.

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19 Alan B. Krueger, Judd Cramer and David Cho, "Are the long term unemployed on the margins of the labor market?", Brookings Papers on Economic Activity, Spring 2014.

In many cases, Governments should extend unemployment benefit schemes to minimize individual losses for those who face higher risk of long-term unemployment and poverty. In order to create incentives for individuals to continue seeking employment while benefiting from unemployment benefits, Governments could introduce a myriad of additional policies. Unemployment benefits, for instance, should be coupled with active labour market policies. Specific lessons from developed economies with lower unemployment rates during the crisis indicate that activation strategies for unemployed individuals should include job search assistance and training programmes, as well as institutional reforms to better coordinate unemployment schemes with employment services. However, in the aftermath of the financial crisis, many Governments face limited resources to ensure such adequate employment services.

Policy challenges in promoting international trade

At the ninth Ministerial Conference of the World Trade Organization (WTO), held in Bali in December 2013, agreements were reached on trade facilitation, agriculture, a package of decisions related to the LDCs, and a monitoring system on special and differential treatment provisions.

Among these agreements was the Trade Facilitation Agreement, the first multilateral agreement concluded in the WTO since its creation in 1995. The Agreement is expected to possibly induce a reduction in business costs equivalent to as much as 15 per cent of present costs and to raise global exports by as much as $1 trillion, in the most optimistic scenario.[20] In Africa, for example, a significant reduction in transaction costs may not only enhance Africa's trade with the rest of the world, but also support regional integration. However, a key WTO member failed to ratify the agreement by the deadline of 31 July 2014.

The agreements reached in Bali only encompassed a limited and least controversial subset of the issues of the Doha Round. WTO ministers were instructed to prepare, by December 2014, a clearly defined work programme to conclude the Doha Round.

There is recognition that tough issues lie ahead, particularly concerning industrial goods, services and agriculture, which are crucial for many developing countries. The list of unresolved issues contains many possible stumbling blocks. Even decisions in the package that are binding will require time and commitment from the parties in order to have a positive effect on international trade.

The multilateral trading system is becoming more fragmented

Since the Doha Round started more than a decade ago, the landscape of international trade and political order has changed considerably. For instance, the number of bilateral and regional trade agreements has increased substantially. Some of the multi-country agreements currently under negotiation, such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, might have a major impact on international trade, but developing-country considerations may not be taken into account in those negotiations. The multilateral trading system is faced with the danger of fragmentation. Bali has renewed the trust in the WTO, but it also reinforced views on the difficulty in achieving ambitious reforms at the multilateral level. This poses a challenge to the entire multilateral approach to development cooperation.

20 See Organization for Economic Cooperation and Development, "The WTO Trade Facilitation Agreement: potential impact on trade costs", Paris, February 2014.

International policy coordination and cooperation

In order to mitigate the risks and meet challenges as discussed above, it is imperative that international policy coordination is strengthened. In particular, macroeconomic policies worldwide should be aligned towards supporting robust and balanced growth, creating productive jobs, and maintaining economic and financial stability in the long run. Meanwhile, international policy coordination and cooperation is equally important for such areas as defusing geopolitical tensions and addressing wider health crises, as illustrated by the recent Ebola pandemic.

The new initiative of the Group of Twenty (G20) to raise their collective GDP by 2018 by more than 2 per cent above the trajectory projected in 2013 is positive for the global economy. The call by the International Monetary Fund (IMF) and the World Bank to increase global investment in infrastructure, including energy, is also very timely and will not only stimulate short-term growth and employment, but also lift long-term potential growth. However, broader international policy coordination is also needed to boost growth in the majority of developing countries, especially LDCs. In this regard, the international community should accelerate its concerted efforts to deliver on the official development assistance (ODA) commitment to the LDCs. ODA flows rebounded by 6.0 per cent in 2013 from the decline in 2011 and 2012, reaching a record level, but are still far below the United Nations target of 0.7 per cent of gross national income of the donor countries.

Despite some progress, further efforts are needed in reforming international financial regulation

The international community has taken important steps to strengthen the resilience of the financial sector through regulatory reform. These reforms attempt to reduce the risk of future crises, but should balance the need for greater stability with ensuring sufficient access to financing, particularly for sustainable development. To date, reforms have focused on regulation of the banking sector. Further progress is needed on other aspects of the international regulatory agenda, including addressing shadow banking and systemically important institutions that are considered too big to fail. There is also a need for stronger cross-border resolution regimes with fair burden-sharing. The development and implementation of international financial regulation would also benefit from greater representation of and participation by developing countries.

Progress continues to be made on international cooperation in tax matters. There is important ongoing work in this area in several international forums, including the OECD, the G20 and the United Nations system. Some steps have been taken, for example, against base erosion and profit-shifting, and towards developing a widely applicable system of automatic exchange of tax information between countries. In all areas of international tax cooperation, it will be critically important to ensure that the developing world, and in particular the poorest countries, are able to participate in, and benefit from, new developments. Domestic resource mobilization will be central to raising resources to finance sustainable development. Measures which aim to support the developing world in mobilising more domestic resources for development, such as through capacity-building, are critically important and have high development paybacks.

Timely implementation of the 2010 IMF quota and governance reforms would have been an important first step towards bolstering the credibility, legitimacy and effectiveness of the institution. Rapid adoption of the 2010 IMF reforms will pave the way for the next round of quota and voice reforms. Successful completion of further reforms will boost the coherence and stability of the global financial system. Additionally, United Nations Member States agreed in April 2010 that the next round of World Bank governance reforms in 2015 should move the institution towards equitable voting power and protect the voting power of the smallest poor countries. Agreement should be reached on these reforms in a timely fashion.

It is imperative to ensure a seamless transition from the MDGs to the SDGs

It also is crucial to enhance international policy coordination and cooperation in the global efforts to promote sustainable development. The United Nations Member States are formulating an ambitious and transformative post-2015 development agenda. The broad contours of this agenda are becoming clear, with an especially strong commitment to end poverty and ensure sustainable development for all. The Open Working Group of the General Assembly on Sustainable Development Goals (SDGs), initiated by the United Nations Conference on Sustainable Development (Rio+20), has proposed a set of 17 goals and 169 associated targets. While poverty eradication will remain at its core, the post-2015 development agenda is aimed at integrating the economic, social and environmental dimensions of sustainable development. It is generally agreed that the agenda should be firmly anchored in the values and principles as enshrined in the United Nations Charter and complete the unfinished business of the Millennium Development Goals (MDGs), while meeting the new challenges the world is facing, such as climate change. In addition, the Intergovernmental Committee of Experts on Sustainable Development Financing, established in the follow-up to the Rio+20 Conference, has delivered its report[21] proposing options for a sustainable development financing strategy. As the target date of the MDGs is approaching, it is imperative for the international community to ensure a seamless transition from the MDGs to the SDGs in 2015.

21 United Nations, "Report of the Intergovernmental Committee of Experts on Sustainable Development Financing (A/69/315)", available from http://sustainabledevelopment.un.org/index.php?menu=1558.