World Economic Situation and Prospects 2016
Executive summary

Prospects for global macroeconomic development

The world economy stumbled in 2015

The world gross product is projected to grow by a mere 2.4 per cent in 2015, a significant downward revision from the 2.8 per cent forecast in the *World Economic Situation and Prospects as of mid-2015*. More than seven years after the global financial crisis, policymakers around the world still face enormous challenges in stimulating investment and reviving global growth. The world economy has been held back by several major headwinds: persistent macroeconomic uncertainties and volatility; low commodity prices and declining trade flows; rising volatility in exchange rates and capital flows; stagnant investment and diminishing productivity growth; and a continued disconnect between finance and real sector activities. A modest improvement is expected to start next year, with global growth reaching 2.9 per cent and 3.2 per cent in 2016 and 2017, respectively. The anticipated timing and pace of normalization of the United States monetary policy stance is expected to reduce some policy uncertainties, while preventing excessive volatility in exchange rates and asset prices. While the normalization will eventually lead to higher borrowing costs, rising interest rates should encourage firms to increase investments in the short run. The improvement in global growth is also predicated on easing of downward pressures on commodity prices, which should encourage new investments and lift growth, particularly in commodity-dependent economies.

The developed economies are expected to contribute more to global growth

Growth in developed economies is expected to continue gaining momentum in 2016, surpassing 2 per cent for the first time since 2010. In developing and transition economies, growth slowed in 2015 to its weakest pace since the global financial crisis amid sharply lower commodity prices, large capital outflows and increased financial market volatility. Growth is projected to reach 4.3 per cent in 2016 and 4.8 per cent in 2017, up from an estimated 3.8 per cent in 2015. Despite the slowdown in China, East and South Asia will remain the world’s fastest-growing regions, with many of the region’s commodity-importing economies benefiting from low prices for oil, metals and food. GDP growth in the least developed countries is expected to rebound from 4.5 per cent in 2015 to 5.6 per cent growth in 2016, but will fall short of the Sustainable Development Goal target of at least 7 per cent GDP growth per annum in the near term. While developing countries have been the locomotive of global growth since the financial crisis, the developed economies, particularly the United States of America, are expected to contribute more to global growth during the forecast period.
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**Low inflation persists in developed economies, while volatility of inflation and growth remains high**

Amid persistent output gaps, declining commodity prices and weak aggregate demand, global inflation is at its lowest level since 2009. In developed-market economies, annual inflation in 2015 is expected to average just 0.3 per cent. Ultra-loose monetary conditions have so far prevented deflation from becoming entrenched in the developed countries. However, low inflation has been associated with higher levels of volatility in inflation, growth, investment and consumption in a majority of large developed and developing countries and economies in transition. Significant currency depreciations have offset the disinflationary pressures in several developing economies. The Brazilian real and the Russian rouble have recorded large depreciations, and both countries remain mired in severe economic downturns, accompanied by elevated inflation.

**The economic slowdown hurts labour markets**

Unemployment is on the rise in many developing and transition economies, especially in South America, while it remains stubbornly high in countries such as South Africa. At the same time, labour force participation rates, especially among women and youth, have been declining, and job insecurity has become more widespread, amid a shift from salaried work to self-employment. The declining employment intensity of growth in many countries, coupled with stagnant real wages, poses a challenge to promoting inclusive and sustainable economic growth, employment and decent work for all.

**Investment experienced sharp and broad-based deceleration**

Growth rates of fixed capital formation have registered sharp declines in a majority of developed and developing economies since 2014, including negative investment growth in nine economies. The weak aggregate demand, falling commodity prices and persistent policy uncertainties constrained investment growth during 2014-2015. A modest pickup in investment is expected, provided commodity prices do not slide down further and the anticipated normalization of the United States monetary stance reduces policy uncertainties. However, coordinated efforts are still needed at national and international levels to ensure that financial sectors effectively intermediate savings and liquidity and also stimulate fixed investments.

**Reducing poverty and emission levels will require concerted policy efforts**

The broad slowdown in economic growth in many developing economies and generally weak wage growth will restrain progress in poverty reduction in the near term. Further progress in poverty reduction will rely heavily on policies to reduce inequality, such as investment in education, health and infrastructure, and stronger social safety nets. Global energy-related carbon emissions experienced no growth in 2014 for the first time in 20 years, with the exception of 2009 when the global economy contracted, suggesting that a delinking of economic growth and carbon emission growth is possible with appropriate policies and adequate investment. Low-carbon energy sources now account for over 50 per cent of new energy consumption worldwide.
International trade and financial flows

The commodity price decline has had significant adverse effects on trade flows and public finance

The terms-of-trade of commodity exporters have deteriorated significantly, limiting their ability to demand goods and services from the rest of the world. Current-account balances of commodity exporters have deteriorated, and given the net outflow of capital from many commodity-dependent economies, countries have been forced to either draw down international reserves or cut back imports. This has had second order effects on trade in non-commodity-exporting economies, compounding longer-term trends, such as the slower expansion of global value chains and limited progress in multilateral trade negotiations, which weigh on the volume of global trade. The commodity price declines and exchange-rate realignments have also had a significant impact on fiscal balances, particularly in the commodity-dependent developing and transition economies. The sharp decline in the headline value of global trade, however, is largely attributable to the deterioration of commodity prices and appreciation of the dollar. Trade volumes have recorded a more moderate deceleration, reflecting a widening divergence between the value and volume of global trade.

Financial market volatility has increased significantly

The steady decline in global commodity prices, including a dramatic drop in the oil price, reflects a combination of ample supply and slowing demand. Demand from China plays a key role in price swings for metals, in particular, as the country accounts for almost half of global metal consumption. The combination of commodity price adjustments and capital outflows has been associated with sharp exchange-rate realignments and heightened volatility in foreign-exchange markets.

Strengthening the multilateral trading system will allow countries to better exploit the benefits of trade

International trade is an important determinant of global growth and development. At the global level, there remains considerable untapped potential to exploit the benefits of international trade. A universal, non-discriminatory multilateral trading system is a central element for harvesting this potential. However, the Doha Round has made limited progress in the last fifteen years. At the same time, there has been an increasing prevalence of new-generation regional trade agreements (RTAs). Mega-RTAs can diminish incentives for universal negotiations, and may have adverse effects on countries not included in the RTA, especially developing countries. The Trans-Pacific Partnership (TPP) is the first mega RTA completed, and creates a market of 800 million people with over 40 per cent of the world gross product. Non-TPP members, however, may be impacted by diversion of trade and investment towards TPP member countries. This highlights the importance of enhancing coherence between RTAs and the multilateral trading system so they can support and sustain an enabling development environment.
Finance for sustainable development

Addis Ababa Action Agenda establishes a financing framework for the 2030 Agenda for Sustainable Development

A primary role of the international financial system is to channel savings to productive uses and investment in order to deliver sustainable economic growth. As such, it critically underpins the implementation of the 2030 Agenda for Sustainable Development. While the financing requirements to achieve the sustainable development agenda are extremely large, global public and private savings would be sufficient if the financial system were to effectively intermediate flows in line with sustainable development objectives. However, international finance is currently neither stable nor efficient in allocating credit where it is needed for sustained and inclusive growth, and credit is generally not channelled with social outcomes or environmental sustainability in mind. The Addis Ababa Action Agenda (AAAA) establishes a new global framework for financing sustainable development that aligns all financing flows and international and domestic policies with economic, social and environmental priorities.

Achieving the 2030 Agenda for Sustainable Development will put significant demands on public budgets and capacities in developing countries

The mobilization and effective use of public resources will remain critical for achieving sustainable development. This will require additional and more effective international public finance, including official development assistance (ODA), South-South cooperation and other official flows. To supplement existing public funds, there is also an important role for multilateral, regional and national development banks, especially as private resources are currently not being effectively channelled in this direction. Tax evasion, tax avoidance and illicit financial flows have become a major difficulty in efficient resource mobilization. This can be improved by increased efforts towards international tax cooperation.

All stakeholders need to contribute and remain accountable for their commitments, including Member States, the private sector, civil society and other actors, in implementing the AAAA for sustainable development. The role of the annual Financing for Development Forum—the dedicated follow-up process for monitoring the implementation of the AAAA—will be crucial.

Policy challenges and the way forward

Policymakers need to prepare for a tightening of global financial conditions

In developed economies, central banks shouldered most of the responsibility for supporting growth during the post-crisis period, which has led to an unprecedented level of monetary accommodation in recent years. As the economic conditions in the United States have improved, the United States Federal Reserve has clearly signalled its intention to begin raising the policy rate, after seven years of near-zero interest rates. This is likely to reduce policy uncertainties on the one hand, although the pace and sequence of anticipated interest rate
increases remain unknown. On the other hand, the increase in the policy rate is expected to have significant spillovers, exacerbate capital outflows from developing countries, and tighten financial conditions worldwide.

**Policy challenges are likely to intensify in the short run**

Policymakers worldwide will need to make concerted efforts to reduce uncertainty and financial volatility, striking a delicate balance between their objectives for achieving sustainable economic growth and maintaining financial stability. The response to a tightening of global financial conditions will require a variety of policy tools, including macroprudential instruments, targeted monetary measures and a more accommodative fiscal stance. The challenge for developing countries is likely to be more acute, given that corporate debt in these economies—often denominated in the United States dollar—has risen sharply since the global financial crisis. These economies are thus left exposed to exchange-rate risk and rising debt-servicing costs as global financial conditions tighten. Policymakers will need to increasingly rely on macroprudential tools to prevent rapid deleveraging, redirect finance to real sector activities, and minimize financial stability risks.

**More targeted, effective and coordinated policy efforts are needed to ensure inclusive and sustainable economic growth**

Stimulating inclusive growth in the near term and fostering long-term sustainable development require more effective policy coordination at the national, regional and global levels. It will be critical for policymakers to ensure that the financial sector facilitates and stimulates long-term, productive investment, breaking the vicious cycle of weak aggregate demand, under-investment, low productivity and the below-potential growth performance of the world economy. While reducing excessive reliance on monetary policy measures, policymakers will need to increasingly undertake targeted fiscal measures to stimulate aggregate demand, investment and growth. Well-designed and targeted labour market strategies can complement fiscal policies to reinvigorate productivity, employment generation and output growth. Coordinated policy efforts in economic, social and environmental dimensions will be crucial for realizing the 2030 Agenda for Sustainable Development.