Global issues

Prolonged period of slow global growth amid significant uncertainties

The World Economic Situation and Prospects (WESP) 2017, launched on January 17, states that the world economy continues to face significant uncertainties and downside risks over changes in the international policy environment, unconventional monetary policy, debt overhang in emerging economies and volatile financial flows. According to the report, the world economy has yet to emerge from the period of slow growth. The world economy is estimated to have expanded by just 2.2 per cent in 2016, the slowest rate of growth since the Great Recession of 2009 (Figure 1). The previously anticipated recovery in global growth toward the pre-crisis trend failed to materialize. A modest global recovery is expected over the next two years, with world gross product forecast to grow by 2.7 per cent in 2017 and 2.9 per cent in 2018. The report underscores that the projected recovery is more an indication of economic stabilization than a signal of a robust and sustained revival of global demand.

Self-perpetuating cycle of slow growth

The report warns that the prolonged episode of weak global growth could be self-perpetuating, through the linkages of weak investment, dwindling trade, flagging productivity and low income growth (Figure 2).

Summary

- According to the World Economic Situation and Prospects (WESP) 2017, the world economy remains trapped in a prolonged period of slow growth
- Weak investment is a major cause of the slowdown in global growth
- East Asia and South Asia remain the world’s most dynamic regions

Many economies have experienced a marked downturn in private and public investment in recent years. Governments – particularly in commodity-exporting countries – have curtailed much-needed public investment in infrastructure and social services, in response to sharp revenue losses. The resulting weak demand for capital goods has contributed to the slowdown in trade growth. World trade volumes expanded by just 1.2 per cent in
2016, the third-lowest rate in the past 30 years. At the same time, labour productivity growth has slowed markedly in most developed economies and in many large developing and transition economies. The slow productivity growth has in turn weakened wage growth, which has held back aggregate demand.

**Developing countries as the main drivers of growth**

The report projects that developing countries will continue to be the main drivers of global growth, accounting for about 60 per cent of the growth of world gross product in 2016-2018. East and South Asia remain the world’s most dynamic regions, benefiting from robust domestic demand and supportive macroeconomic policies. As commodity prices trend higher, commodity-exporting economies are likely to see some recovery in growth. On the other hand, growth in the developed economies is expected to improve only slightly in 2017, with headwinds arising from weak investment and policy uncertainty.

*WESP 2017* warns that gross domestic product (GDP) growth in the least developed countries (LDCs) is projected to remain well below the Sustainable Development Goals (SDGs) target of at least 7 per cent. Under the current growth trajectory and assuming no decline in income inequality, nearly 35 per cent of the population in LDCs may remain in extreme poverty by 2030. The report also discusses some positive developments related to environmental sustainability. The level of global carbon emissions has stalled for two consecutive years. This reflects the declining energy intensity of economic activities and the rising share of renewables in the energy structure, but also slower economic growth in some major emitters.

**Calling for more effective policy mix**

*WESP 2017* cautions that many countries continue to depend excessively on monetary policy to support growth. It calls for policy measures that move beyond demand management, stressing the importance of investment in technological change and efficiency gains. Concerted policy efforts are crucial to revive investment and foster a recovery in productivity that will result in stronger global growth. In particular, the report proposes more investments in key areas, such as research and development, education, and infrastructure. These measures need to be fully integrated with structural reforms that target the various aspects of sustainable development, including poverty, inequality and climate change. The report emphasizes that global policy cooperation and coordination are crucial to achieve further and equitable economic gains in trade and investment, to expedite clean technology transfer, to raise climate finance, to strengthen international tax cooperation and to address the challenges posed by large movements of refugees and migrants.

**Developed economies**

**United States: shifting direction of policy**

GDP in the United States of America increased by 1.6 per cent in 2016, marginally faster than the estimate of 1.5 per cent reported in the *WESP 2017*. The accumulation of non-farm inventories made a strong positive contribution to GDP growth in the final quarter of the year, and will support more solid growth in 2017. However, business fixed investment remains soft, and may be further restrained in the short term by uncertainty regarding the impact of announced and forthcoming policy changes that are being introduced by the new Administration.

A number of executive orders and presidential memos have already shifted the direction of the United States policy in the arenas of trade, immigration, healthcare and regulation. Some of these changes may have far-reaching implications for the economic, social and environmental dimensions of sustainable development. The United States has withdrawn from the Trans-Pacific Partnership (TPP), an agreement under negotiation with Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Viet Nam, which goes beyond trade to include a wide spectrum of issues in areas such as investment, e-commerce, intellectual property, government procurement and regulatory coherence. The Administration has also clearly indicated an intention to renegotiate the North American Free Trade Agreement (NAFTA), which has governed trade relations among Canada, Mexico and the United States since 1994. These policies may impact not only investment decisions but also the volume of international trade. Other policy changes may impact international policy coordination efforts that address, for example, the challenge of large movements of refugees and migrants.

The direction of fiscal policy in the United States remains unclear. The new Administration may propose an expansion of infrastructure investment and significant tax cuts, especially for corporations. A rise in infrastructure spending could raise growth prospects for 2018, but may also entail a large increase in the federal deficit. Other potential policy initiatives, such as the introduction of import tariffs and other protective measures, could raise inflation and slow economic growth, especially if other countries respond with retaliatory measures.

**Japan: policy easing supports short-term prospects**

Short-term economic prospects for Japan benefit from the additional fiscal and monetary easing measures introduced in 2016. However, the longer-term prospects remain constrained by the large overhang of government debt, an ageing population, a slowdown in productivity growth and entrenched deflationary expectations.

Nationwide consumer price inflation in Japan averaged -0.1 per cent in 2016. The significant drag on the overall price level from low oil prices dissipated towards the end of the year. Nevertheless, the strong yen and weak wage growth will continue to exert downward pressure on inflation. Forecasts reported in the *WESP 2017* project inflation will reach 0.6 per cent in 2017, and will remain below the central bank’s target of 2 per cent in 2018.

The Japanese Government introduced a new fiscal stimulus package in August 2016, including 4.6 trillion yen additional spending for the current fiscal year and the postponement to October 2019 of the consumption tax increase planned for April 2017. The stimulus package amounts to 28.1 trillion yen, making it the third-largest ever implemented. It is expected to give a strong boost to government investment spending in 2017, which is forecast to contribute roughly 0.4 percentage points to GDP growth.

The rise in government investment in Japan will partially compensate for the persistently weak private sector non-residential investment, as export-oriented firms remain under pressure from the strong yen and sharp slowdown in global trade. Residential investment, on the other hand, has rebounded. Housing starts have been supported by Japan’s negative interest rates, which have
allowed home-loan rates to fall to an all-time low. With monetary policy expected to remain accommodative for the foreseeable future, the housing sector is expected to strengthen further.

**Europe: economic activity in Western Europe will remain subdued**

Economic activity in Western Europe will remain subdued, with growth expected to stay at 1.8 per cent in the European Union (EU) for 2016-2018. This implies a downward revision compared to the previous forecast, primarily due to the negative impact from Brexit. On the upside, domestic demand will continue to support growth, as low inflation rates and lower unemployment in some countries bolster private consumption, while the expansive monetary policy stance supports business investment. At the same time, several factors will continue to prevent a more vibrant economic revival across the region. These include the major uncertainty stemming from Brexit, which has already dented business investment in some key sectors both in the United Kingdom and its major European trading partners. In addition, structural issues such as a need for labour market reforms impede the development of small- and medium-sized companies in several countries. Unemployment still remains high in several countries, with negative effects on overall growth. High public and private debt levels constrain investment in some countries and lingering balance sheet problems in the banking sector put a drag on the proper functioning of the banking system. A number of risk factors could affect this baseline forecast, notably further negative fallout from Brexit, more severe problems in the banking sector, a recurrence of the debt crisis in Greece and policy uncertainties related to forthcoming elections in numerous countries including France, Germany and the Netherlands in 2017.

In the **EU member States from Eastern Europe and the Baltics region**, economic growth remains on a higher trajectory than in the EU-15 as the countries continue to catch up through capital accumulation and productivity growth. However, the pace of economic expansion slowed slightly to 3 per cent in 2016, following the robust investment cycle of 2014-2015 driven by the expedited absorption of the remaining 2007-2013 EU funds.

**Economies in transition**

**CIS economies tentatively stabilize, while growth in South-Eastern Europe accelerates**

The Commonwealth of Independent States (CIS) region has entered a period of tentative stabilization in 2016 and is expected to return to modest growth in 2017. The aggregate GDP of the CIS and Georgia is projected to expand by only 1.4 per cent in 2017, with a slight pick-up to 2.0 per cent forecast for 2018. Domestic demand in the region remains weak and investment shrunk in most countries in 2016. Relatively low commodity prices, persistent geopolitical tensions and structural factors constrain growth prospects. The ongoing fiscal adjustment in the energy-exporters is also restraining demand. Although monetary policy was generally eased in 2016, interest rates in larger economies remain relatively high.

The continuing international sanctions against the Russian Federation weigh on business sentiment and investment prospects. The Russian economy, along with other CIS energy exporters, is expected to remain on a low-growth track. Import-substitution policies and a weaker currency have supported the agriculture and the chemical industries. However, the strengthening of the Russian rouble in early 2017 may pose certain risks.

In the region’s smaller countries, falling remittances from the Russian Federation have depressed incomes since 2015. However, some modest recovery was observed in Kyrgyzstan in 2016. On the other hand, stronger links with China within the framework of the “Belt and Road” initiative should support the Central Asian economies and produce positive spillover effects.

The risks to the outlook are mostly on the downside, as the recovery of commodity prices is expected to be limited and the region remains dependent on primary commodities and low-tech exports. The banking system, despite some progress toward financial stability, remains fragile. Geopolitical risks are also undermining confidence and business sentiment in the region.

In **South-Eastern Europe**, economic activity gained further strength in 2016, driven by the strong pick-up in Serbia. The improved performance largely reflects domestic factors, including strong public investment in 2016 and improved labour markets that supported private consumption. The region’s GDP growth is projected to strengthen from an estimated 2.6 per cent in 2016 to 3.1 per cent in 2017 and 3.3 per cent in 2018. Inflationary pressures remained very low, with inflation projected to accelerate modestly in 2017 as energy prices strengthen. The region remains closely linked with the EU and highly dependent on external financing.

**Developing economies**

**Africa: growth to recover moderately amid challenges**

Following a sharp growth deceleration in 2016, the African region is expected to recover moderately this year. There is, however, a marked divergence in the growth prospects across the region. The projected increase in global commodity prices will ease fiscal and external pressures for the commodity exporters. Nevertheless, given that global commodity prices are expected to remain well below pre-2014 levels, a strong growth rebound appears unlikely in the highly commodity-dependent economies such as Algeria, Angola and Nigeria. In contrast, the growth outlook is more favourable for countries in the East African Community, including Ethiopia, Kenya and the United Republic of Tanzania, as well as the Western African economies of Côte d’Ivoire, Ghana and Senegal. Growth in these economies will continue to be driven by robust private consumption and large infrastructure projects.

Yet, the growth outlook for Africa is faced with several external and domestic risks. On the external front, this includes a renewed downturn in global commodity prices, a sharper-than-expected growth moderation in China and high uncertainty in the international policy environment. On the domestic front, an escalation of security concerns and political unrest in several African countries would adversely affect investment and disrupt economic activity. In addition, highly agriculture-dependent economies remain highly susceptible to weather-related shocks.

**East Asia: domestic demand continues to drive positive near-term outlook amid weak export performance**

East Asia’s economy is estimated to have grown by 5.5 per cent in 2016, with a marginal pick-up to 5.6 per cent projected for both 2017 and 2018. Private consumption and public investment...
continue to drive growth. However, export growth of the region remained exceptionally weak in 2016. This has negatively affected consumer sentiment, resulting in weaker household spending in several economies. While overall fiscal balances have recently worsened in some countries, the relatively low public debt levels mean that there is still room for fiscal expansion. However, existing estimates of fiscal multipliers show that the effectiveness of fiscal spending varies significantly across economies. In this light, economies would have to identify the most effective means of fiscal intervention to maximize its positive impact on growth.

While East Asia’s economic outlook remains stronger than that of other regions, risks for East Asia tilt to the downside. Factors that could drive faster economic growth in 2017, such as stronger demand in developed economies, higher global commodity prices and rising infrastructure investment are subject to considerable uncertainty. A downside risk to growth is posed by the high and rising corporate and household debt in several countries, including China, which could further add to Governments’ contingent liabilities and curb their engagement in supportive fiscal measures. The surge of international bond issuance in East Asia in January 2017 indicates an ongoing strong appetite for debt across the region.

**South Asia: positive economic outlook supported by robust private consumption**

South Asia is the fastest-growing developing region and its economic outlook remains largely positive, benefiting from robust private consumption, a modest pick-up in investment and the continuing implementation of domestic reforms. Macroeconomic policies have also played a positive role: monetary policy continues to support economic activity, while the fiscal policy stance displays some flexibility despite remaining moderately tight. The positive economic outlook will likely enable further progress in labour market indicators and poverty reduction, albeit gradual and moderate. Among the largest countries, India has positioned itself as the most dynamic emerging economy. Despite the negative short-term effects of the so-called demonetization policy, India’s economy is projected to expand at a robust pace in 2017, driven by strong private consumption and slight pick-up in investment demand. The outlook for the Islamic Republic of Iran is strengthening visibly, due to the strong expansion of oil production and exports, increasing business confidence and a surge in foreign investments. In Pakistan, growth is also projected to remain robust at above 5 per cent, driven by strong consumption, rising investment and a supportive monetary policy stance.

Despite the favourable outlook, South Asian economies face several downside risks. The reform agenda could experience setbacks in some countries, while political instabilities might dampen investment prospects. Heightened regional geopolitical tensions could also weigh on the outlook. For instance, intra-regional trade facilitation and integration projects could experience delays and obstacles, while large investments on connectivity infrastructure may face institutional uncertainty.

**Western Asia: subdued growth amid continuing macroeconomic adjustments**

The economic outlook for Western Asia remains weak and turbulent amid macroeconomic adjustments in oil-dependent economies, ongoing conflicts and long-lasting geopolitical concerns. In 2016, regional GDP growth declined to an estimated 2.1 per cent, mainly due to deteriorating economic conditions in the countries of the Cooperation Council for the Arab States of the Gulf (GCC). In these economies, lower oil prices have seriously affected investment and government budgets, prompting Governments to undertake major reforms towards fiscal austerity. While non-oil exporting economies exhibited a more heterogeneous outlook, military conflicts and geopolitical tensions continue to curb investment and restrain economic activity.

Among GCC countries, economic activity in Saudi Arabia is expected to remain subdued in 2017, amid fiscal austerity and restrained investment. The economies of Bahrain, Oman and the United Arab Emirates are also projected to remain on a modest growth path in 2017. Among the more diversified countries, the Turkish economy is projected to expand at a solid rate as domestic demand remains resilient. In the Syrian Arab Republic and Yemen, the economies are in a perilous state due to intensifying armed conflicts and severe foreign exchange shortages.

Against this backdrop, regional labour markets have deteriorated recently due to both economic and non-economic factors. Unemployment rates have risen, while job creation has been hampered by the economic slowdowns. Conflicts have caused large-scale unemployment in Iraq, the Syrian Arab Republic and Yemen, with some negative spillover effects to the labour markets of Jordan, Lebanon and Turkey. The region’s labour markets continue to be affected by high structural unemployment, particularly among the youth, and a widespread lack of decent work.

**Latin America and the Caribbean: return to positive growth in 2017, but strong external and internal headwinds persist**

After contracting for two consecutive years, the economy of Latin America and the Caribbean is expected to return to positive growth in 2017. The region’s aggregate GDP is projected to grow by 1.3 per cent in 2017 and by 2.1 per cent in 2018, following an estimated decline of 1.0 per cent in 2016. While the region continues to face significant internal and external headwinds, economic growth is forecast to gradually pick up in most countries. The modest recovery is expected to be supported by an improvement in external demand, an increase in commodity prices, and some monetary easing in South America amid lower inflation.

South America’s two largest economies, Argentina and Brazil, are expected to emerge from recession in 2017, but the recovery will likely be shallow as unemployment, fiscal consolidation and indebtedness weigh on demand. Mexico is projected to see only modest growth in 2017/18 amid restrictive monetary and fiscal policies and uncertainty over future US trade policies. While Central America and the Caribbean will likely continue to outperform South America in terms of growth, the economic situation and prospects vary widely across countries.

The region’s economic prospects are subject to significant downside risks, including a sharper-than-expected deceleration in China, the adoption of protectionist measures in the United States and renewed financial market turbulences. The subdued medium-term outlook poses a threat to the social achievements of the past decade and could significantly complicate the region’s path towards the realization of the SDGs.