World Economic Situation and Prospects 2011

Press Release

High unemployment, fiscal tightening and risk of currency wars threaten global recovery – UN Report

Greater risks for renewed instability in financial markets

The recovery of the world economy has started to lose momentum since the middle of 2010, and all indicators point at weaker global economic growth, according to a new United Nations report. The UN expects that the world economy will expand by 3.1 per cent in 2011 and 3.5 per cent in 2012 – far from sufficient to enable recovering the jobs lost because of the crisis.

In the release of its annual report, the *World Economic Situation and Prospects 2011* (WESP), the United Nations emphasizes that the outlook remains uncertain and surrounded by serious downside risks. The cooperative spirit among major economies is waning, which has debilitated the effectiveness of responses to the crisis. Uncoordinated monetary responses, in particular, have become a source of turbulence and uncertainty in financial markets. The recovery may suffer further setbacks if some of the downside risks materialize, in which case a double-dip recession is looming for Europe, Japan and the United States. WESP 2011 says that in the short run more fiscal stimulus will be needed to reinvigorate the recovery, but that it will need to be better coordinated with monetary policies and reoriented to provide stronger support to employment generation and facilitate a sustainable rebalancing of the global economy. This cannot be done without better international policy coordination.

Among developed economies, the United States has been on the mend from its longest and deepest recession since World War II. Yet, the pace of recovery has been the weakest in the country's post-recession experience. At 2.6 per cent in 2010, growth is expected to moderate further to 2.2 per cent in 2011 before improving slightly to 2.8 per cent in 2012, according to the report. This pace will not make much of a dent in unemployment rates, and recovering the jobs lost during the crisis would take at least another four years.

The growth prospects for Europe and Japan are even dimmer, the report says. Assuming continued, albeit moderate, recovery in Germany, GDP growth in the Euro area is forecast to virtually stagnate at 1.3 per cent in 2011 and 1.7 per cent in 2012. Growth in 2010 was 1.6 per cent.

Some countries in Europe will see even less growth, especially where drastic fiscal austerity and continued high unemployment rates are draining domestic demand. This is especially the case in Greece, Ireland, Portugal and Spain, which are entrapped in sovereign debt distress. Their economies will either remain in recession or stagnate in the near term. Japan's initially strong rebound, fuelled by net export growth, started to falter in the course of 2010. Challenged by persistent deflation and elevated public debt, the economy is expected to grow by a meagre 1.1 per cent in 2011 and 1.4 per cent in 2012.

Among the economies in transition, GDP of the Commonwealth of Independent States (CIS) and Georgia rebounded by about 4 per cent on average in 2010, up from the deep contraction of more than 7 per cent in 2009. In 2011 and 2012, the pace of recovery in South-Eastern Europe is expected to be rather slow.

Developing countries continue to drive the global recovery, but their output growth is also expected to moderate to 6.0 per cent during 2011-2012, down from 7.0 per cent in 2010, because of the slowdown in the advanced countries and phasing out of stimulus measures. *Developing Asia*, led by China and India, continues to show the strongest growth performance, but some moderation (to around 7 per cent) is expected in 2011 and 2012.

Growth in *Latin America* is projected to remain relatively strong at around 4.0 per cent, though less robust than the GDP growth of 5.6 per cent estimated for 2010. Brazil, the engine of regional growth, continues with strong domestic demand to boost export growth of neighbouring countries. The sub-region also benefits from strengthened economic ties with the emerging economies in Asia.

The economic recovery in the *Middle East* and other countries in *Western Asia* is also expected to moderate from 5.5 per cent in 2010 to 4.7 per cent in 2011 and 4.4 per cent in 2012. At this pace, the average annual output growth will be lower than the pre-crisis rate.

Economic recovery has been solid in most of *Africa*. The rebound is expected to push through at about 5 per cent per year in 2011 and 2012, but this is well below potential and conditions vary across the region. The economies in East Africa are showing strong growth, but several of the poorest countries, especially those in the Sahel, have suffered from droughts and conditions of insecurity, which is causing hunger and hampering the recovery of their economies.

Table I.1
Growth of world output, 2006–2012

Annual percentage change								Change from United Nations forecast of June 20 10c	
	2006	2007	2008	2009	2010a	2011b	2012b	2010	2011
World outputd	4.0	3.9	1.6	-2.0	3.6	3.1	3.5	0.6	-0.1
of which:									
Developed economies	2.8	2.5	0.1	-3.5	2.3	1.9	2.3	0.4	-0.2
Euro zone	3.0	2.8	0.5	-4.1	1.6	1.3	1.7	0.7	-0.2
Japan	2.0	2.4	-1.2	-5.2	2.7	1.1	1.4	1.4	-0.2
United Kingdom	2.8	2.7	-0.1	-4.9	1.8	2.1	2.6	0.7	-0.2
United States	2.7	1.9	0.0	-2.6	2.6	2.2	2.8	-0.3	-0.3
Economies in transition	8.3	8.6	5.2	-6.7	3.8	4.0	4.2	-0.1	0.6
Russian Federation	8.2	8.5	5.2	-7.9	3.9	3.7	3.9	-0.4	0.7
Developing economies	7.3	7.6	5.4	2.4	7.1	6.0	6.1	1.2	0.2
Africa	5.9	6.1	5.0	2.3	4.7	5.0	5.1	0.0	-0.3
Nigeria	6.2	7.0	6.0	7.0	7.1	6.5	5.8	0.6	-0.5
South Africa	5.6	5.5	3.7	-1.8	2.6	3.2	3.2	-0.1	-0.3
East and South Asia	8.6	9.3	6.2	5.1	8.4	7.1	7.3	1.3	0.2
China	11.6	13.0	9.6	9.1	10.1	8.9	9.0	0.9	0.1
India	9.6	9.4	7.5	6.7	8.4	8.2	8.4	0.5	0.1
Western Asia	6.1	5.1	4.4	-1.0	5.5	4.7	4.4	1.3	0.6
Israel	5.7	5.4	4.2	0.8	4.0	3.5	3.0	1.1	0.4
Turkey	6.9	4.7	0.7	-4.7	7.4	4.6	5.0	3.9	1.3
Latin America and the Caribbean	5.6	5.6	4.0	-2.1	5.6	4.1	4.3	1.6	0.2
Brazil	4.0	6.1	5.1	-0.2	7.6	4.5	5.2	1.8	-1.1
Mexico	4.9	3.3	1.5	-6.5	5.0	3.4	3.5	1.5	0.6
of which:									
Least developed countries	7.6	8.1	6.7	4.0	5.2	5.5	5.7	-0.4	-0.1
Memorandum items:									
World tradee	9.3	7.2	2.7	-11.4	10.5	6.6	6.5	..	..
World output growth with PPP-based weights	5.1	5.2	2.7	-0.8	4.5	4.0	4.4	0.6	0.0

Source: UN/DESA.

a Partly estimated.

b Forecasts, based in part on Project LINK and baseline projections of the United Nations World Economic Forecasting Model.

c See *World economic situation and prospects as of mid-2010* (E/2010/73), available from http://www.un.org/esa/policy/wess/wesp2010files/ wesp1 0update.pdf.

d Calculated as a weighted average of individual country growth rates of gross domestic product (GDP), where weights are based on GDP in 2005 prices and exchange rates.

e Includes trade in goods and non-factor services. Previous WESP reports reported growth of merchandise trade only.

High unemployment is the Achilles heel for the recovery

The UN report says that the lack of employment growth is the weakest link of the economic recovery. Between 2007 and the end of 2009, at least 30 million jobs were lost worldwide as a result of the global financial crisis. As more governments embark on fiscal austerity, the prospects for a fast recovery of employment look even gloomier.

In 2010, employment conditions in the United States seemed to be improving earlier in the year, but started to falter later as the recovery decelerated and state and local governments started to lay off workers. The unemployment rate may increase to 10 per cent in early 2011, up from 9.6 per cent in the third quarter of 2010. All projections indicate that it will take several years for the unemployment rate to return to its pre-crisis level.

In the Euro area, despite improvements in Germany's job market, the average unemployment rate has continued to drift upward, reaching 10.1 per cent in 2010, from 7.5 per cent before the crisis. In Spain, the unemployment rate more than doubled to 20.5 per cent. It also increased dramatically in Ireland, reaching 14.9 per cent in 2010, and other countries in the region. WESP predicts that unemployment in Europe will decline at a snail's pace. In Japan, labour market conditions improved marginally during 2010, but the unemployment rate is expected to remain above 5 per cent in 2011.

Worldwide, unemployment and underemployment rates are very high among young people (aged 15 to 24). At the end of 2009, with an estimated 81 million unemployed young people, the global youth unemployment rate stood at 13.0 per cent -- a 0.9 percentage point increase from 2008.

High unemployment will constrain household consumption recovery, which in turn will drag output growth. WESP points out that below-potential output growth, in turn, will constrain employment growth. The longer this vicious cycle lasts, the higher the risk of "cyclical" unemployment becoming "structural", further impairing long term economic growth potential.

The UN report also provides evidence that workers in developing countries and economies in transition have also been severely affected by the crisis, though the impact in terms of job losses emerged later and was much more short-lived than in developed countries. Indeed, employment started to rebound from the second half of 2009 and, by the end of the first quarter of 2010, unemployment rates had already fallen back to pre-crisis levels in a number of developing countries. Yet, despite the rebound in employment in parts of the world, the global economy still needs to create at least another 22 million new jobs in order to return to the pre-crisis level of global employment. At the current speed of the recovery, this would take at least five years to achieve.

Increased exchange rate instability

WESP 2011 says that a much weaker recovery of the world economy is far from a remote possibility. Besides the lack of job creation, especially in advanced economies, volatility in currency markets is generating additional macroeconomic uncertainty which could further jeopardize the recovery. In a more pessimistic scenario of greater uncertainty and no change in policies, the UN predicts that Europe could well see a double-dip recession, while the economies of the United States and Japan might virtually stagnate and possibly also fall back into recession during 2011. This would also significantly lower growth prospects for developing countries (by almost 1 percentage point).

Tensions over currencies have emerged in part as a result of uncoordinated expansionary monetary policies, essentially consisting of more money printing. The stronger quantitative easing in the United States has put downward pressure on the dollar, causing ripples in currency markets worldwide. The quantitative easing is to lower interest rates and stimulate investment. The UN says this will not be very effective as long as financial systems are still clogged and hence not channelling much money to finance productive investments. Instead, more capital is flowing to emerging and other developing countries, in search of higher profitability. As a result of these developments, the Euro and the yen have appreciated against the dollar, as have the currencies of emerging market economies. This has led to interventions in currency markets and introduction of capital controls in a number of markets. The report says that heightened tensions over currency and trade could well trigger renewed turmoil in financial markets, jeopardizing the recovery.

Five challenges for sustainable recovery

These potentially damaging spillover effects of national policies once again highlight the need for strengthened international policy coordination, according to the report. Unfortunately, during 2010 the cooperative spirit among policymakers in the major economies has been waning. “Avoiding a double-dip recession and moving towards a more balanced and sustainable global recovery would require addressing at least five related major policy challenges”, said *Rob Vos*, who led the team of UN economists that prepared the report.

The first is to provide additional fiscal stimulus, by using the ample fiscal space that, according to WESP 2011, is still available in many countries. Such fiscal action should be adequately coordinated among the major economies to ensure a reinvigoration of global growth that will also provide external demand for those economies which have exhausted their fiscal space. The present shift towards severe fiscal austerity measures in developed economies could well trigger a spiral of pro-cyclical fiscal adjustment, the UN report argues, with the result that that fiscal consolidation will turn out to be self-defeating on a global scale.

The second challenge is to redesign fiscal stimulus and other economic policies to lend a stronger orientation towards measures that directly support job growth, reduce income inequality and strengthen sustainable production capacity on the supply side.

The third challenge, the UN report stresses, is to find greater synergy between fiscal and monetary stimulus, while counteracting damaging international spillover effects in the form of increased currency tensions and volatile short-term capital flows. This will require reaching agreement about the magnitude, speed and timing of quantitative easing policies within a broader framework of targets to redress the global imbalances. It will also require deeper reforms of financial regulation, including for managing cross-border capital flows, and in the global reserve system, reducing dependence on the US dollar.

The fourth challenge is to ensure that sufficient and stable development finance is made available for developing countries with limited fiscal space and large developmental deficits, including resources for achieving the Millennium Development Goals and investing in sustainable and resilient growth.
The fifth challenge is to find ways to come to credible and effective policy coordination among major economies. The UN report says it is urgent in this regard to make the G20 framework for sustainable global rebalancing more specific and concrete. In this sense, establishing concrete “current-account target zones” could be a meaningful way forward, if it is part of a broader package aiming at addressing all of these challenges.

For interviews or to obtain more information, contact Newton Kanhema, tel 1-212-963-5602, e-mail kanhema@un.org, UN Department of Public Information

http://www.un.org/esa/policy/wess/wesp.html

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