



**2008 ECOSOC High-level Policy Dialogue with the trade and financial
Institutions – New York, 30 June 2008, 11 a.m. – 1 p.m.**

Informal Note

***Executive Summary of WESP Mid-2008: World Economic Situation and Prospects
2008-9***

In the wake of a turbulent economic environment, the world economy is teetering on the brink of a severe global economic downturn. The deepening credit crisis in major developed market economies, triggered by the continuing housing slump, the declining value of the United States dollar vis-à-vis other major currencies, persisting global imbalances, and soaring oil and non-oil commodity prices all pose considerable risks to economic growth in both developed and developing economies.

In the face of these uncertainties, the United Nations' baseline forecast for world economic growth has been revised downward in line with the pessimistic scenario of the *World Economic Situation and Prospects 2008* published in January. The growth of world gross product is expected to decline markedly in 2008 to 1.8 per cent in 2008, down from 3.8 per cent in 2007 with the weakness likely extending into 2009 as further deterioration in the housing and financial sectors of the United States is expected to continue to be a major drag on the world economy (see Table 1). In Western Europe and Japan strong growth in 2007, is expected to slow in the outlook as consumer demand weakens and the slowdown in the United States places additional pressure on exports.

In the developing economies and the economies in transition the contagion effects of the sub-prime mortgage market turmoil have so far been limited and a great many economies in these regions have experienced strong growth in the past few years due to high oil and non-oil commodity prices. However the steeply rising prices of food and energy are compounding the sluggish global economic environment for oil and food importers and weakening growth prospects in some economies such as India. Additionally, a moderate slowdown is expected in China due to strong trade ties with the United States and other industrial economies. As the downturn in the United States protracts, more adverse impact should be anticipated and growth in developing countries is expected to weaken from 7.3 per cent in 2007 to 5.0 per cent in 2008 and 4.8 per cent in 2009.

Yet, even with this gloomy scenario, the downside risks remain stark. In a not yet likely, but not improbable pessimistic scenario of a much more protracted downturn in the United States and continued international financial turmoil, the world economy could well come to a virtual standstill. Additionally, the unfolding food crisis, which is not only a grave humanitarian issue, but also a serious threat to social and political stability in some developing economies, is endangering the achievement of the millennium development goals (MDGs) and reversing some of the progress towards those goals made so far.

The international economic environment for developing economies and economies in transition has become less favourable with the deterioration of the financial crisis originating from the sub-prime debacle in the United States. Volatility in international trade and finance has increased since the beginning of 2008, particularly of international commodity and equity prices and yield spreads. Growth of world trade decelerated, slowing from 7.2 per cent in 2007 to 4.7 per cent in early 2008 due to weak import demand from the United States, which accounts for about 15 per cent of the world total. Many developing countries benefited from high commodity prices over the past five years, but net importers of energy and food commodities are suffering adverse terms-of-trade effects as food prices, which increased considerably in 2008 have become a threat to the poor and to the prosperity and social stability of many developing countries.

The employment situation has remained resilient across most developed economies. However, with economic growth slowing, unemployment is expected to rise in 2008 and 2009. Labour market conditions have already begun to weaken in the United States and in some of the developing economies where employment gains have slowed or started to recede. In East and South Asia there has been little or no change in the employment situation and the outlook suggests a deteriorating trend due to growth moderation. In Latin America, the trend in labour market improvements has stagnated and unemployment will probably increase slightly or remain constant as economic activity slows.

Headline inflation has been markedly affected by the rise in commodity prices, especially since the second half of 2007. In addition to the continued rise in oil prices, world food commodity prices increased substantially. In developing countries, where about half of the consumer basket of goods consists of food products, increases in global food prices have had significant inflationary effects. Other factors putting pressure on inflation are excess capacity utilization and higher wages. In addition, many countries face the dilemma of choosing between controlling inflation or stimulating the economy through looser monetary and fiscal policies. Thus, global inflation is expected to accelerate in 2008 but slow in the baseline outlook for 2009 as aggregate demand continues to be weak.

Policy challenges

Such a tenuous economic environment carries with it serious challenges for the global economy. In the baseline forecast there is the expectation that the proposed policy stimuli in the United States will be inadequate, resulting in a recession that will have adverse spill-over effects on the rest of the world. In the pessimistic scenario, the unravelling of household indebtedness in the United States and a number of developed economies such as the United Kingdom, Spain, and Australia, may turn into much greater financial instability. In such a case, all developed regions will experience a recession of some degree while growth in developing countries will be strongly affected through both trade and financial channels. Meanwhile, the

massive global imbalances remain a serious concern as any disorderly unwinding would have drastic implications for global trade and finance.

Macroeconomic policy makers worldwide face enormous challenges in addressing these difficulties. Previous *World Economic Situation and Prospects* reports have repeatedly stressed the need for multilaterally concerted action as a means of reducing global imbalances while avoiding an economic downturn. While there has been some progress towards global rebalancing and a significant realignment of exchange rates, the risks associated with a visible worsening of the world economic situation have heightened. Consequently, a more aggressive expansion of demand in the rest of the world is needed to counterbalance the contraction in the United States. In addition multilateral actions are also needed to alleviate constraints in the supply and adequate distribution of food and other primary commodities.

In dealing with the food crisis, short and long term issues need to be addressed. In the short term additional food and monetary aid is necessary to alleviate the humanitarian and food emergency needs. In addition, increasing agricultural productivity through investments in water supply, infrastructure, improved seeds and fertilizers, education, and agricultural research and development is essential not only to deal with the present food crisis, but to address the persistent longer term problem of widespread rural poverty—by improving access of producers to agricultural land, affordable inputs, and infrastructure. This would entail making agriculture a priority at both the national and international levels.

To stimulate strong and sustained demand in the global economy, an internationally coordinated reflation programme consisting of both fiscal and monetary stimuli should be considered, which would compensate for the ongoing adjustments in the United States. Such coordinated policies initiated in surplus countries will increase net export demand from the United States and contribute to a smoother global adjustment. In addition, improved liquidity provision mechanisms at low conditionality for low income, food and energy importing countries should also be part of the global stimulus to help consolidate gains achieved in many developing regions over the last few years.

The restoration of confidence and effective functioning of credit and financial markets requires consideration of credit injections into productive sectors as well as households under severe stress. The most important and lasting reforms, however, have to be towards meaningful improvements in the regulatory framework of financial markets. Likewise, a revision of the international system of payments and reserves towards a multi-reserve currency is necessary. The current system is not sustainable because for countries to accumulate international reserves the main issuer country has to run deficits.

Suggested key questions:

- (1) In light of the current world food crisis and the outlook for continued increased food demand, what are the specific strategies needed to safeguard world food security?
- (2) Given the current global environment of rising inflation and weakening consumer demand, how can policymakers at the national level better balance inflation control with much needed economic stimulus.
- (3) What instruments are necessary for regulators to limit the harmful effects of financial excesses? To what extent can national and international regulatory frameworks be modified to better assess risk build-up in financial markets?

Table 1: Growth of world output, baseline and optimistic scenarios, 2003-2009

| | 2003 | 2004 | 2005 | 2006 | 2007 | Baseline | | Optimistic Scenario | | Pessimistic Scenario | |
|---|-------|------|------|------|------|----------|------|---------------------|------|----------------------|------|
| | | | | | | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 |
| World Output Growth | 2.7 | 4.0 | 3.5 | 3.9 | 3.8 | 1.8 | 2.1 | 2.8 | 2.9 | 0.8 | 1.4 |
| Developed economies | 1.9 | 3.0 | 2.4 | 2.8 | 2.5 | 0.6 | 0.9 | 1.4 | 1.6 | -0.3 | 0.7 |
| United States | 2.5 | 3.6 | 3.1 | 2.9 | 2.2 | -0.2 | 0.2 | 1.0 | 1.2 | -1.3 | 0.3 |
| Euro zone | 0.8 | 2.0 | 1.5 | 2.8 | 2.6 | 1.1 | 1.2 | 1.7 | 1.7 | 0.4 | 0.9 |
| Japan | 1.4 | 2.7 | 1.9 | 2.2 | 2.1 | 0.9 | 1.2 | 1.3 | 1.5 | 0.3 | 0.9 |
| Economies in transition | 7.2 | 7.6 | 6.6 | 7.9 | 8.4 | 6.4 | 6.1 | 7.3 | 6.6 | 4.5 | 3.0 |
| Developing economies | 5.2 | 7.0 | 6.7 | 7.1 | 7.3 | 5.0 | 4.8 | 6.3 | 6.0 | 3.5 | 3.3 |
| Africa | 4.6 | 5.0 | 5.3 | 5.6 | 5.8 | 4.9 | 4.6 | 6.2 | 6.1 | 2.2 | 1.1 |
| East and South Asia | 6.9 | 7.6 | 7.9 | 8.1 | 8.5 | 5.9 | 5.7 | 7.3 | 6.9 | 5.0 | 5.5 |
| Western Asia | 4.7 | 6.8 | 6.6 | 5.9 | 5.2 | 4.0 | 4.1 | 5.4 | 5.1 | 2.9 | 1.7 |
| Latin America and the Caribbean | 2.2 | 6.2 | 4.8 | 5.7 | 5.7 | 3.1 | 2.6 | 4.2 | 4.0 | -0.3 | 0.9 |
| <i>Memo: Least developed countries</i> | 6.6 | 7.9 | 8.5 | 8.2 | 6.5 | 5.2 | 6.4 | 6.8 | 6.3 | 3.3 | 2.5 |
| World trade growth (volume) | 5.8 | 10.7 | 7.0 | 9.9 | 7.2 | 4.7 | 5.1 | 6.0 | 6.1 | 2.5 | 4.5 |
| US dollar exchange-rate index (annual percentage change) | -12.3 | -8.2 | -1.9 | -1.5 | -5.6 | -15.0 | 0.0 | -10.0 | 2.0 | -11.5 | -9.2 |
| Interest rate on 10-year US Treasury notes | 4.0 | 4.3 | 4.3 | 4.8 | 4.6 | 3.7 | 5.2 | 3.4 | 3.7 | - | - |
| United States current-account balance (billion US dollars) | -522 | -640 | -755 | -811 | -739 | -636 | -544 | -666 | -605 | -562 | -418 |

Source: UN/DESA

Note: The three scenarios mainly differ regarding assumptions on the housing market in the United States and financial market parameters. The baseline assumes the average housing price will decline by 15 per cent in 2008 and remain stable in 2009. The optimistic scenario assumes the price will decline 10 per cent in 2008 and increase marginally in 2009, while in the pessimistic scenario similar price declines will occur in the United States, as well as other developed economies in 2008, with more moderate declines in 2009. The baseline further assumes that financial sector problems will deteriorate further as net lending to the private sector will decline until the beginning of 2009. In contrast, in the optimistic scenario it is assumed the declines will hit bottom in the first quarter of 2008, with a recovery thereafter. The pessimistic scenario assumes that net lending to the private sector will come to a standstill in 2008, with some recovery in 2009