World Economic Situation and Prospects

Monthly Briefing Note to the Secretary-General

No. 3 **UN/DESA** 1 December 2008

Summary

This edition of the Monthly Briefing presents the highlights of the global economic outlook as in chapter one of the ***World Economic Situation and Prospects (WESP) 2009***, which was launched on 1 December 2008 in Doha, Qatar.

Global issues

A synchronized global downturn in economic growth in 2009

The world economy is now mired in the most severe financial crisis since the Great Depression. According to the United Nations baseline forecast, world gross product (WGP) is expected to grow only by 1.0 per cent in 2009, a sharp deceleration from the 2.5 per cent growth estimated for 2008 and well below the more robust growth in previous years (table 1). Given world population growth of 1.2 per cent, this means income per capita for the world as a whole is expected to decline in 2009.

Table 1: Growth of world output, 2003-2009

Annual percentage change

	2003	2004	2005	2006	2007	2008[a]	2009[b] Basline	2009[b] Pessimistic scenario	2009[b] Optimistic scenario
World output[c]	**2.7**	**4.0**	**3.5**	**4.0**	**3.8**	**2.5**	**1.0**	**-0.4**	**1.6**
of which:									
Developed economies	1.8	3.0	2.4	2.9	2.5	1.1	-0.5	-1.5	0.2
United States	2.5	3.6	2.9	2.8	2.0	1.2	-1.0	-1.9	-0.5
Euro zone	0.8	2.1	1.7	2.8	2.6	1.1	-0.7	-1.5	0.3
Japan	1.4	2.7	1.9	2.4	2.1	0.4	-0.3	-0.6	0.5
Economies in transition	7.3	7.6	6.5	7.8	8.3	6.9	4.8	2.7	6.1
Developing economies	5.2	7.1	6.8	7.1	7.2	5.9	4.6	2.7	5.1
China	10.0	10.1	10.4	11.6	11.9	9.1	8.4	7.0	8.9
India	7.3	7.1	11.5	7.3	8.9	7.5	7.0	4.7	7.1
Brazil	1.1	5.7	2.9	3.7	5.4	5.1	2.9	0.5	3.0
Mexico	1.4	4.2	3.0	4.8	3.2	2.0	0.7	-1.2	1.5
of which:									
Least developed countries	5.2	7.2	7.9	7.7	7.8	6.4	5.1	2.0	6.1
Memo item:									
World trade	5.6	11.2	8.0	8.8	6.3	4.4	2.1	-3.1	3.1
World output growth with PPP-based weights	3.6	4.9	4.5	4.9	4.9	3.7	2.3	1.3	3.0

Source: UN/DESA.

a Partly estimated.
b Forecasts, based in part on Project LINK.
c 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.

Developed economies are leading the global downturn, with the majority of them having been in recession throughout the second half of 2008. Meanwhile, through international trade and finance channels, the weakness has spread rapidly to developing countries and the economies in transition, causing a synchronized global downturn in the outlook for 2009. Such a globally synchronized slowdown may be the first of its kind in the post-war era.

The vast majority of countries are experiencing a sharp reversal in the robust growth registered during the period 2002-2007. For example, among the 160 economies in the world for which data are available, the number of economies that had an annual growth in gross domestic product (GDP) per capita of 3 per cent or higher is estimated to have dropped from 106 in 2007 to 83 in 2008, and this number is expected to decline further, to 52, in 2009. Among the 107 developing countries, this number is estimated to have dropped from 70 in 2007 to 57 in 2008, and is forecast to decline further in 2009 to 29. This trend suggests a significant setback in the progress made in poverty reduction in many developing countries over the past few years. The prospects for the least developed countries (LDCs), which generally registered a very positive growth performance on average over the past several years, are also deteriorating rapidly.

The employment situation is expected to deteriorate in most regions during 2009 and much of the employment gains achieved over the past years could be lost because of the global economic slowdown. Employment began to change course in many economies in the second half of 2008, with unemployment rising rapidly in some economies (the United States, for instance), as lower consumption, production and trade started to have an adverse impact on the demand for labour. The employment situation worldwide is expected to deteriorate more significantly in 2009.

Global inflation is expected to decelerate significantly in the outlook for 2009, with the risk for deflation increasing in some economies. Surging prices of oil and food boosted global inflation in 2008, leaving consumer price inflation at its highest level in a decade. Inflation was markedly higher in developing economies and economies in transition than in the developed economies. In the second half of 2008, however, inflationary pressures dissipated rapidly following the steep fall in world commodity prices (despite the lag in the pass-through effect from international to domestic prices) and weakening demand worldwide. The projected economic downturn is expected to weaken inflationary pressures further in 2009, creating ample space for policymakers to focus on staving off sharp downfalls in economic growth.

The international economic environment for developing countries is deteriorating

External financing costs for emerging market economies have surged since September 2008, as measured by the spreads implied by the Emerging Markets Bond Index (EMBI). Unlike in recent years where the spread varied significantly across regions and countries as an indication that investors were differentiating between country-specific risks, the latest surge has been uniform, suggesting that contagion and a general aversion to investing in emerging markets have taken hold among investors. Spreads are expected to remain high in 2009.

Private capital inflows to emerging market economies were relatively robust in the first half of 2008, but have dropped sharply since the third quarter of 2008. Declines in bank lending and portfolio equity inflows explain most of the drop. By contrast, foreign direct investment (FDI) inflows to these countries remained relatively stable, with a decline of about 10 per cent estimated for 2008 compared to the record highs of 2007. In the outlook for 2009, capital inflows to emerging market economies are projected to drop further. A continued deleveraging in the large financial institutions of developed countries and the eroded confidence of international investors are likely to limit portfolio inflows to emerging market economies, while the pro-cyclical nature of FDI flows will also imply a slowdown in FDI along with weakening growth prospects for emerging market economies.

The *outflow of capital* from emerging to developed market economies continued to be larger than the inflow. On balance, emerging market economies continue to be net lenders to the rest of the world, financing the external deficits of the United States and other developed economies.

The total value of the *official foreign-exchange reserves* of developing countries reached about $3.1 trillion in 2007, and that amount rose further in the first half of 2008. Nevertheless, a significant deceleration in the pace of reserve accumulation has been reported for many developing countries amid the intensification of the global financial crisis. In the outlook, the foreign reserves of developing countries are expected to stagnate or even decline in some cases, as more of these countries will experience a weakening of their current and/or capital accounts.

Prices of oil and non-oil primary commodities have also shown strong fluctuations during 2008, largely driven by financial factors as well as shifts in the balance between supply and demand. The prices of most commodities rose sharply in the first half of 2008, continuing a multi-year upward trend that began in 2003. Food prices, especially the price of rice, surged the most in early 2008, leading to a food crisis in some 40 developing countries. Oil prices also soared by about 50 per cent in the first half of the year. However, these trends reversed sharply in mid-2008. Oil prices plummeted by more than 60 per cent from their peak levels from July to November. The prices of other commodities, including basic grains, have also declined significantly. In the outlook, most of these prices are expected to remain volatile along with the moderation in global demand, but further cuts in the supply of oil, as already indicated by the Organization of Petroleum Exporting Countries (OPEC), may help to stabilize oil prices.

Policy challenges

In response to the heightened systemic risks of the financial crisis and the rapid downturn in global economic growth, policymakers worldwide have scaled up their policy stance. In October 2008, the United States and several European economies adopted a number of emergency policy packages totaling about $4 trillion and aimed at unfreezing credit and money markets by recapitalizing banks with public funds, guaranteeing bank lending and insuring bank deposits.[1]

In addition, more countries have recently adopted policy measures to stimulate the real economy. For example, China has announced a large-scale fiscal stimulus plan of $586 billion (or 15 per cent of China's GDP), to be implemented during 2009 and 2010, to strengthen domestic demand through public spending on infrastructure and social welfare. Australia, the Republic of Korea, and Japan have also announced fiscal stimulus packages.

Many countries are still hesitant to move quickly on fiscal stimulus packages, fearing possible negative repercussions in the medium run from a further widening of fiscal deficits, which are already ballooning as a result of the emergency fiscal measures to recapitalize financial institutions and the effect of automatic stabilizers. However, the severity of the financial crisis calls for policy actions that are commensurate with the scale of the problem and should thus go well beyond any normal range of budgetary considerations.

The scope for a counter-cyclical policy stance will vary greatly across developing countries. Ideally, the counter-cyclical fiscal stimuli should be combined with the needs for achieving the long-run development goals, which require considerable resources for public investments in areas such as infrastructure, food production, education and health, and renewable energy sources.

Furthermore, to ensure sufficient stimulus at the global level, it is desirable to coordinate the fiscal stimulus packages internationally. Internationally coordinated policy action among both the deficit and the surplus countries is also critical for achieving a benign adjustment of the global imbalances.

Central banks in a number of countries have continued to reduce interest rates on a large scale, along with other unorthodox monetary measures to ease the credit crunch. For example, in late November, the Fed of the United States adopted another plan of $800 billion to buy debts related to home mortgages and consumer loans, in a new attempt to unfreeze consumer credit markets more directly.

On the other hand, a large number of developing countries and the economies in transition have not been easing monetary policy so far over concerns of inflationary pressures and currency depreciation. Most Latin American economies and many economies in transition, as well as several Asian developing countries, have either further increased policy interest rates or kept them constant in late 2008.

Meanwhile, a growing number of economies have approached the IMF for support, including Hungary, Iceland, Pakistan, Serbia and Ukraine.

1 For more details, see the Monthly Briefing Note of October 2008.

Regional issues

Developed economies

The economy of the *United States* is expected to contract by 1.0 per cent in the baseline scenario for 2009. The most severe credit crunch since the Great Depression has turned a housing sector-led slowdown into a full-scale retrenchment of households and businesses, affecting the economy at large. All policy measures adopted so far may eventually stabilize financial markets, but they came too late to prevent a recession in the real economy.

Japan's economy is in a recession, which is expected to linger into 2009. While the direct losses from the global financial crisis have been contained so far, the indirect effects are becoming increasingly significant, including those caused by weakening external demand as well as the appreciation of the yen.

Since September 2008, the global credit crunch has transformed a sharp slowdown in *Western Europe* into a full-fledged recession and the major European economies have technically entered a recession. Having lost all growth momentum, GDP is expected to contract further in the first half of 2009, with little likelihood of a recovery in the second half, leaving a negative growth rate for the year as a whole.

Following several years of buoyant economic expansion throughout the entire region, the *new EU members* exhibited divergent growth patterns in 2008, including a sharp slowdown in the Baltic states. Domestic demand is weakening in response to higher credit costs and accelerated inflation, and export growth is also likely to decline. Growth is expected to weaken and inflation to moderate in 2009.

The economies in transition

Growth of the members of the *Commonwealth of Independent States* (CIS) is heading for a marked slowdown in 2009, largely dragged down by the impact of the global recession and falling commodity prices on the largest economies of the region such as Kazakhstan, the Russian Federation and Ukraine. A slowdown in business investment and, to a lesser degree, in household consumption will be felt throughout the region. The smaller CIS economies will likely be affected by declining worker remittances and FDI inflows. There will be significant adverse effects of a domestic credit squeeze and increased costs of external financing on the real economy of the region, despite some recently adopted offsetting policy measures.

In *South-Eastern Europe*, growth in 2008 continued to be largely driven by domestic demand, underpinned by rising real wages and the lasting credit boom, as well as by strong FDI inflows. With the global financial crisis, these growth factors have started to lose momentum. In view of weak demand in the main export markets, it is unlikely that the region will be able to switch to a more export-oriented pattern of economic growth in the short-run. Therefore, a further moderation of economic growth is expected in 2009.

Developing economies

Growth in *Africa* is expected to decelerate in 2009, as the contagion effects of the global economic slowdown spread throughout the region and inflationary pressures continue to dampen consumer demand.

Growth in *East Asia* is expected to decline notably in 2009, as exports will decelerate significantly. Some economies in the region will also experience sizeable financial losses as a result of their relatively high exposure to global financial markets. An outflow of capital from this region will further intensify the difficulties experienced by the local financial institutions.

South Asia is experiencing a broad-based slowdown in economic growth, including the industrial sector and the service sector, as a result of the negative impact of higher costs and the global financial turmoil.

Growth in *Western Asia* is anticipated to slow significantly in 2009, to the lowest rate in seven years. The region will register a sharp decline in export revenues as average annual oil prices are expected to drop.

Economic growth in *Latin America and the Caribbean* is expected to slow markedly in 2009, with the key drag being the fall in commodity prices. In addition, domestic credit is expected to tighten in many economies.