Monthly Briefing
World Economic Situation and Prospects

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Summary[1]

- World economic prospects for 2013 only slightly improving
- Uncertainties and risks looming
- More proactive and concerted policy actions needed

Global issues

Global macroeconomic prospects

Five years after the eruption of the global financial crisis, the world economy is still struggling to recover. According to the United Nations *World Economic Situation and Prospects 2013*, growth of world gross product is forecast to reach 2.4 per cent in 2013 in the baseline estimates, only a slight improvement from the estimated growth of 2.2 per cent for 2012 (figure 1). Weaknesses in the major developed economies are at the root of the continued global economic woes. Most of them have been dragged into a downward spiral by the problems of sovereign debt, banking fragility, fiscal tightening and high unemployment. Several European economies and Japan are already in their second recession in just a few years, and their outlook remains grim. The economy of the United States also weakened notably during 2012 and the growth prospects for 2013 remain sluggish.

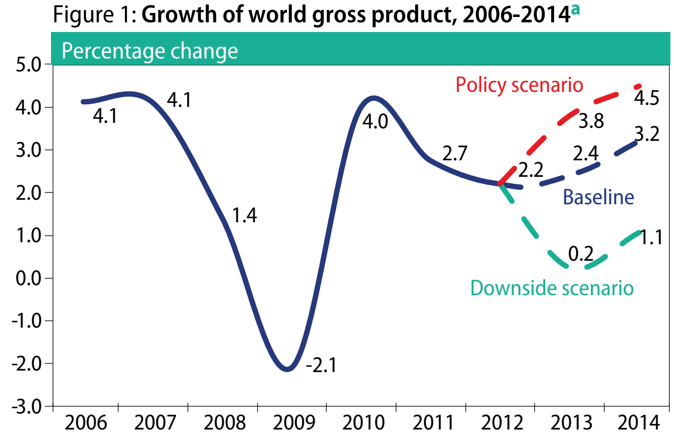
A number of emerging economies, such as Brazil, China and India, which managed to recover rapidly earlier in the aftermath of the global financial crisis, experienced a significant slowdown in 2012. Some of this is due to spillover effects from the economic woes of the developed countries, through weaker trade flows and heightened volatility in capital flows and commodity prices. Some of these emerging economies are also faced with unbalanced and unsustainable structural problems in their domestic economy. Growth for developing countries is forecast to be 5.1 per cent in 2013, marginally better than the 4.7 per cent of 2012.

Global unemployment remains very high, particularly among developed economies, with the situation in Europe being the most challenging. In many developing countries, the shares of working poor and vulnerable jobs remain high, with high youth unemployment and gender disparities in employment a key policy concern.

Major economic risks

The report has identified three major economic risks for the global economy in 2013. The potential impact of these risks could be substantial, prompting a downside scenario for the global economy (figures 1 and 2).

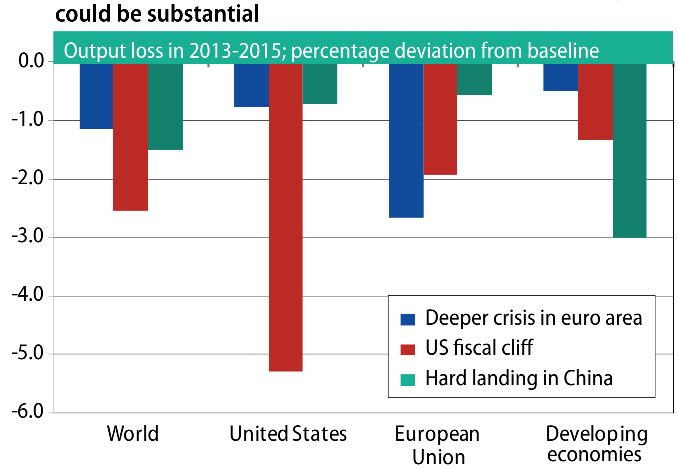
Figure 1: **Growth of world gross product, 2006-2014[a]**



Source: UN/DESA.

a Growth rate for 2012 is partially estimated. Estimates for 2013 and 2014 are forecasts. See "Uncertainties and risks" section for a discussion of the downside scenario and Box I.3 for a discussion of the policy scenario.

Figure 2: **Impact of downside risks on the world economy could be substantial**



Source: UN/DESA, based on simulations using the World Economic Forecasting Model.

1 This special issue covers the highlights of the *World Economic Situation and Prospects 2013*, launched on 17 January 2013.

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(1) Further deterioration of the crisis in the euro area. A number of new policy initiatives announced in late 2012, including the outright monetary transaction programme (OMT) of the European Central Bank, the establishment of the permanent European Stability Mechanism (ESM) and the agreement to form a banking union, have all reduced market tensions to some extent and represent moves in the right direction to resolve the crisis. However, these measures are not sufficient to boost economic demand in the short run and the implementation itself will have significant uncertainties.

(2) "Fiscal cliff" for the United States. At the time the report was published, it was uncertain whether the United States Congress could reach an agreement to avoid the fiscal cliff. The fiscal cliff did occur technically but only for a couple of days; Congress managed to arrange a deal to set the income tax rates for 99 per cent of U.S. families at 2012 levels, but let the payroll tax holiday expire. However, as Congress could not resolve the issue of spending cuts, they postponed any resolution on that issue along with the pending issue of the debt ceiling—both of which pose significant risks.

(3) A risk of a "hard landing" for some large emerging economies. Brazil's growth has dropped from 7.5 per cent in 2010 to 1.3 per cent in 2012, while India's growth dropped below its potential and China's growth also weakened notably. Risks remain for further slowing in these economies, should the external conditions continue to deteriorate and domestic policy responses lapse.

Policy challenges

The report calls for more forceful and concerted policy actions at both national and international levels to mitigate the major risks as defined above. Fiscal policy should become more supportive of jobs creation and green growth, and more equitable. Regulatory reforms of the financial sector should also be accelerated. In addition, sufficient resources should be made available to developing countries to accelerate progress towards the achievement of the Millennium Development Goals, particularly for the least developed countries.

The report presented a possible alternative policy scenario in which job creation and green-growth measures are also compatible with medium-term reduction of public debt ratios and benign global rebalancing (figure 1).

Developed economies

The United States: a prolonged sluggishness

The economy of the United States continues to struggle in the aftermath of the sub-prime mortgage crisis of six years ago. Per capita income and employment levels are still below those reached before the crisis. In early 2012, there were signs of a more robust recovery, but faded later in the year. While a full-blown fiscal cliff has been averted, significant uncertainties remain about the debt ceiling and fiscal sustainability in the long run. On the positive side, nascent signs of a recovery in the beleaguered housing sector form a bright spot amid the clouds. Also, additional policy support comes in the form of the new round of quantitative easing launched by the Federal Reserve, which committed to monetary easing until the unemployment rate drops to 6.5 per cent or projected inflation reaches 2.5 per cent. In the outlook, gross domestic product (GDP) growth is forecast to be 1.7 per cent in 2013, lower than the already anaemic pace of 2.1 per cent estimated for 2012.

Developed Asia and the Pacific: weak export performance dragged down growth in Japan

Japan's economy made a ragged recovery in 2012, strong in the first quarter, but back into recession in the second half, with a meagre 1.5 per cent for the annual GDP. Japan's economy is expected to climb out of the recession, but growth was originally expected to remain weak at 0.6 per cent in 2013 and 0.8 per cent in 2014 before the Government announced a new stimulus package of 2 per cent of GDP after the report was published.

The more than 20 per cent decline of real net exports in both 2011 and 2012 has had a strong, economy-wide impact. Deflationary conditions still prevailed in 2012 and are expected to persist in the outlook. The Bank of Japan is expected to keep the policy rate near zero, with inflation targeting at 1 per cent and expanding the size of the quantitative easing. It has also started a new scheme to encourage the banks to provide new loans to the private sector by providing very cheap funds to depository institutions.

Western Europe: the debt crisis and its reverberations continue to depress the region

The euro area sovereign debt crisis and attendant fiscal austerity programs remain the dominant forces depressing growth. When combined with slowing external demand and high oil prices, these events have led to recession in the euro area and in many regional economies. GDP is expected to decline by 0.5 per cent in the euro area in 2012 and is expected to reach only 0.3 per cent in 2013, strengthening marginally to 1.4 per cent in 2014.

At least five economies are now in technical recession. GDP in Italy is expected to decline by 2.4 per cent in 2012 and 0.3 per cent in 2013 and in Spain by 1.6 per cent and 1.4 per cent, respectively. The other countries in recession are Cyprus Greece and Portugal.

Not all economies are equally affected, however. Germany's economy is expected to grow by 0.8 per cent in 2012, with a marginal rise to 1.0 per cent in 2013, but France is expected to reach only 0.1 per cent in 2012 and 0.3 per cent in 2013. In the United Kingdom, GDP is expected to contract by 0.3 per cent for the year in 2012, with only a slight rebound to 1.2 per cent expected for 2013.

New EU members: continuing to muddle through

The tenuous economic recovery that emerged in the new European Union (EU) member States in 2010 has continued to weaken throughout 2012. Although some countries of the region started the year with solid first quarter economic results, the ongoing troubles in the euro area have led to a visible deterioration of the region's economic prospects. Some of the new EU members, such as the Czech Republic, Hungary and Slovenia, saw negative annual economic growth. Most of the fiscal space the new EU members possessed has been significantly constrained. Aggregate GDP of the new EU members expanded by 1.2 per cent in 2012 and growth will accelerate to a still moderate rate of 2.0 per cent in 2013 amid numerous uncertainties and risks.

Economies in Transition

CIS and Georgia: growth slows down

GDP in the Commonwealth of Independent States (CIS) and Georgia increased by 3.8 per cent in 2012 (down from 4.8 per cent in 2011) and growth is expected to remain at a similar level in 2013, well below potential. Economic performance has weakened in most countries, including the largest economy, the Russian Federation, which remains a major influence on the others. The region remains exposed to a worsening of the global situation, particularly in Europe, its main economic partner.

The unemployment rate reached historical lows in the Russian Federation. Continued income growth, favourable labour market dynamics and declining inflation have provided impetus to domestic demand through the region. In Azerbaijan, the oil sector stabilized after last year's large fall in output, although the non-hydrocarbon economy remained the main source of economic dynamism. In Ukraine, the poor performance of export-oriented industrial branches was compounded by the problems of the agricultural sector. The accession of the Russian Federation to the World Trade Organization in 2012 may generate some additional positive growth impulses in the long term.

South-Eastern Europe: another year of economic stagnation

Real economic activity in South-Eastern Europe in 2012 remained below that achieved in 2008 before the onset of global financial crisis. After a very weak recovery in 2010 and 2011, aggregate GDP declined by 0.6 percent in 2012, and is forecast to recover only modestly, by 1.2 per cent in 2013, owing to weakness in both external and internal demand. Exceedingly high rates of unemployment that persisted even before the global crisis are expected to continue for several more years.

In 2012, spring floods and summer droughts and forest fires destroyed crops and physical infrastructure throughout the region. Foreign direct investment inflows remain depressed at about half their level prior to the crisis, leading to low growth and high unemployment, as well as weak gowth prospects in the future. The major risks to the forecast are to the downside because of the region's strong financial, trade and remittances linkages with some of the most troubled countries of the EU, such as Greece and Italy.

Developing economies

Africa: a robust growth pattern amid many challenges

Africa's economic growth (excluding Libya) will see a rebound to 4.5 per cent in 2013 compared to 3.4 per cent in 2012. The upward trend is expected to continue in 2014, with growth reaching 5.0 per cent. Key factors underpinning Africa's strong growth prospects include solid growth in oil-exporting countries supported by increased oil production and continued high prices as well as increased fiscal expenditure, especially on infrastructure. Other growth factors such as increasing domestic demand associated with rising incomes and urbanization will help reduce vulnerability to external shocks.

Despite the positive growth picture, the employment situation remains a major problem across the region, both in terms of the level of employment as well as the quality of jobs that are generated. On average, inflation rates will recede moderately across the region, while fiscal budgets will remain under pressure on a number of fronts. Also, the lack of adequate infrastructure will require significant investments, while extremely low coverage of social security and high unemployment levels will create continuing pressure to initiate new spending to address at least some of the urgent welfare problems. Aid flows to Africa are expected to stabilize or even decline in 2013 and 2014 because of the global economic slowdown and fiscal difficulties in many donor countries.

East Asia: weak demand for exports weighs on economic activity; growth expected to pick up moderately in 2013

Sluggish demand in developed economies and a sharper-than-expected slowdown in China weighed on economic activity in East Asia in 2012. The region's GDP expanded by 5.8 per cent, down from 7.1 per cent in 2011. Economic growth in China slowed to a decade-low of 7.7 per cent in 2012. The region's higher-income and export-dependent economies —Hong Kong Special Administrative Region of China, the Republic of Korea, Singapore and Taiwan Province of China— saw a particularly sharp drop-off in GDP growth in the face of weakening global demand. In contrast, solid growth was found in Indonesia, Malaysia, the Philippines and Thailand, where robust consumption and investment demand largely offset lower net exports.

In the outlook, GDP growth in the region is forecast to pick up to 6.2 per cent in 2013 and 6.5 per cent in 2014. Even though economic fundamentals remain strong, the risks are tilted to the downside. A further deterioration of the debt crisis in Europe and a sharp deceleration in the pace of growth in China remain the major risks.

South Asia: regional growth slowed to a decade low in 2012; moderate recovery expected in 2013

Economic growth in South Asia slowed further in 2012, as internal and external headwinds persisted. After growing by 6.1 per cent in 2011, the region's GDP expanded by only 4.4 per cent in 2012, the slowest pace in a decade. Persistent high inflation, political uncertainties, and transport and energy constraints weighed on household consumption and business investment. Exports were negatively affected by the slowdown in key international markets. India's economy grew by 5.5 per cent in 2012, down from more than 9.0 per cent in 2010 and 6.9 per cent in 2011. In Bangladesh and Sri Lanka, economic conditions have remained largely favourable. However, the scope for macroeconomic policies to support growth is limited as inflation continues to be elevated and fiscal deficits are large.

In the outlook, regional growth is expected to accelerate moderately, but well below potential. Led by a gradual recovery in India, economic activity in South Asia is projected to increase by 5.1 per cent in 2013 and 5.7 per cent in 2014. Downside risks to the outlook for South Asia are related to the continued weakness of the global macroeconomic environment and to regional and domestic vulnerabilities.

Western Asia: weaker though divergent growth

Economic performance in Western Asia strongly diverged in 2012. Most oil-exporting countries experiencing robust though decelerating growth, supported by record-high oil revenues and government spending, but economic activity weakened sharply in oil-importing countries, burdened by higher import bills, declining external demand and shrinking policy space. The divergence is expected to continue in 2013. GDP growth in the region is estimated to have declined from 6.7 per cent in 2011 to 3.3 per cent in 2012 and is forecast to stagnate in 2013. Fiscal policy in Western Asia was affected by temporary and permanent increases in public expenditures in the wake of the Arab Spring. While medium-run fiscal balances remain strong in many Gulf countries, policy buffers became even more limited in oil-importing countries, except in Israel and Turkey.

In the outlook, Western Asia faces several downside risks. The price of oil could rise abruptly in the case of renewed social unrest or international tensions and exacerbate existing current-account and fiscal imbalances. Oil-exporting countries could suffer as well in the case of a renewed global downturn and an oil oversupply, which would depress oil prices over a longer period of time.

Latin America and the Caribbean: slowdown in 2012 and moderate acceleration in 2013

During 2012, economic conditions deteriorated as the stagnation in the developed world and the slowdown in China affected exports from the region, especially in South America. Some countries faced domestic problems in promoting growth, such as Argentina and Brazil. GDP growth decelerated to 3.1 per cent in 2012, from 4.3 per cent in 2011 and 6.0 per cent in 2010. Despite the slowdown, labour market and inflation indicators continued to reflect a good performance.

The region is expected to see a modest acceleration in growth to 3.9 per cent in 2013. This is closely tied to the performance of the Brazilian economy, which is expected to expand by 4.0 per cent. Nevertheless, the outlook is vulnerable to several risks. A more pronounced slowdown in the euro area would affect South America more strongly. A worsening scenario in the United States would most strongly affect the Caribbean, Central America and Mexico through export, tourism and workers' remittances channels. Finally, a hard landing in China would seriously affect the countries in South America that are heavily reliant on primary commodity exports.