World Economic Situation and Prospects

Monthly Briefing

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Summary

- Financial markets upbeat; real economies sluggish
- Subdued global growth in 2013 and moderate pick-up expected for 2014
- Unemployment remains a key policy challenge
- Short-term risks have diminished but not disappeared; new medium-term risks emerge

Global issues

Global growth remains below potential

Despite improved global financial conditions and signs of reduced short-term risks, the world economy continues to expand at a subdued pace. After markedly slower growth over the past two years, global economic activity is expected to slowly gain momentum in the second half of 2013, but growth will still remain below potential. Near-term downside risks remain to the recovery.

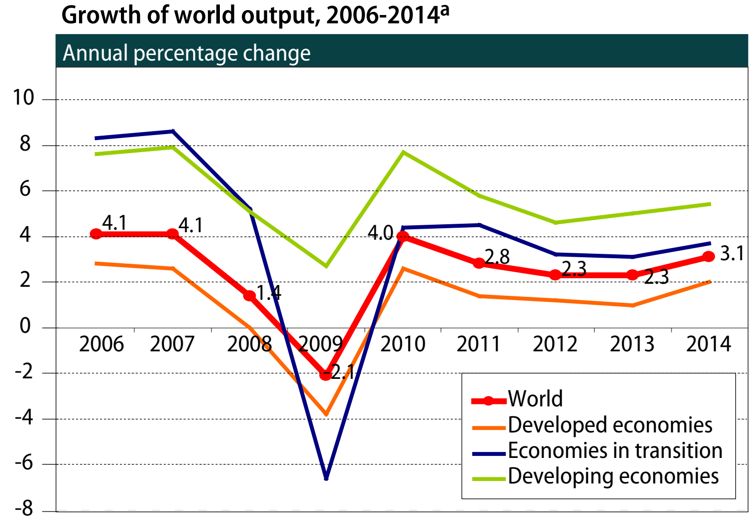
The baseline outlook presented by UN/DESA in the *World Economic Situation and Prospects 2013: Update as of Mid-2013* shows a downward revision in estimates of the world gross product (WGP), which is expected to grow 2.3 per cent in 2013, the same pace as in 2012, before gradually strengthening to 3.1 per cent in 2014.

Since late 2012, several new policy initiatives in major developed economies have somewhat muted systemic risks and helped stabilize consumer, business and investor confidence, but with very limited impacts on growth and job creation. As a result, the unemployment situation remains a key concern in developed countries. In March 2013, average unemployment in the euro area reached a new all-time high of 12.1 per cent and is forecast to increase further in 2014. In the United States, the unemployment rate has fallen, partly due to a significant decline in the labour force, but the level of 7.6 per cent in March 2013 is still high by historical standards. Further improvements are expected in the outlook period, with US unemployment forecast to average 7 per cent in 2014.

Growth in developing countries and economies in transition slowed but remain strong and higher than developed economies. In response to the economic slowdown in 2012, many large emerging economies adopted more expansionary monetary and—to a lesser extent—fiscal policies to strengthen domestic demand. This, along with a slight upturn in external demand, should provide a lift to economic activity in 2013. Nevertheless, the pick-up in growth will be slower than previously estimated as many large emerging economies face significant structural challenges. The least developed countries (LDCs) are projected to see faster growth in 2013 than in the past two years. However, with commodity demand moderating and Official Development Assistance (ODA) falling, the pace of expansion in LDCs will still be notably slower than during the 2004-2008 period.

The short-term risks associated with the situation in the euro area, the fiscal adjustments in the United States and the economic slowdown in large developing countries have diminished, but not disappeared. At the same time, new medium-term risks have emerged, including possible adverse effects of unconventional monetary measures in developed economies on global financial stability. These risks have the potential to once again derail the feeble global recovery. The priority for policy makers worldwide should therefore be to support a robust and balanced global recovery, with a focus on promoting job creation. International policy coordination needs to be enhanced to mitigate negative policy spillovers, curb protectionism, promote cooperation in reforming the international financial system, and ensure sufficient resource flows to developing economies, and in particular the least

Growth of world output, 2006-2014[a]



Source: UN/DESA.
a Estimates for 2013 and 2014 are forcasts.

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developed countries. The *World Economic Situation and Prospects 2013: Update as of Mid-2013* discusses further the recent developments related to these risks and key policy issues for the global economy.

Developed economies

The United States: financial markets foreseeing the phasing-out of QE

The economy of the United States registered moderate growth in the first quarter of 2013, after stagnating at the end of 2012. There have been measureable improvements including substantial gains in equity prices, a notable recovery in the housing market, and moderate growth in employment. The Federal Reserve Bank (Fed) continues its accommodative monetary stance and is purchasing long-term securities despite debates over the implications. On the fiscal side, Congress's agreement to permanently maintain lower income tax rates for a majority of households is positive but the activation of the automatic government spending cuts in March 2013 is expected to weigh down the economy for the rest of the year. There are concerns that this may restrain the fledgling recovery in private consumption and business investment. In the outlook, GDP growth is forecast at 1.9 per cent in 2013, a few percentage points below 2012, but it will gain momentum to 2.6 per cent in 2014 as financial market and consumption spending strengthens. The recent appreciation of the dollar against other currencies may however slow down the export growth. The perception that quantitative easing may be phased out earlier than originally expected has likely triggered the jump of bond yields and the exchange rate of the dollar.

Japan: long-run effects of monetary easing uncertain

After expanding by 2 per cent in 2012, Japan's GDP is projected to grow by 1.3 per cent in 2013 and 1.6 per cent in 2014. In early 2013, the Japanese Government introduced a bold stimulus package composed of a supplemental budget that increases central government spending by about 2.2 per cent of GDP and a new round of monetary easing by the Bank of Japan (BoJ). The BoJ's new policy attempts to propel the annual consumer price inflation rate to 2 per cent within two years by significantly increasing its purchases of Japanese government bonds and other securities. By pushing down the yields for long-term securities through these purchases and formally adopting inflation targeting, the BoJ seeks to move up inflation expectations, encouraging consumption and investment. Consumer price inflation is expected to turn positive and reach 0.3 per cent in 2013 and 1.5 per cent in 2014. The average unemployment rate is projected to decline from 4.4 per cent in 2012 to 4.0 per cent in 2013, mainly owing to the continued decrease in the labour force. The recent sharp depreciation of the yen will contribute to a moderate recovery in exports in 2013 and 2014. The volatility in the bond and equity markets in the second half of May has raised concerns about the ultimate impacts of the new monetary policies.

Western Europe: poor outlook amid continuing recession

Western Europe remains mired in recession. GDP fell sharply for most countries in the fourth quarter of 2012, and the trend persisted in the first quarter of 2013 despite an improvement in confidence While activity is expected to pick up in the second half of the year, the low growth carry over and low momentum are expected to lead to yet another year of weak or negative growth. In the euro area, GDP is expected to decline 0.4 per cent in 2013 after falling by 0.7 per cent in 2012. Only a small increase of 1.1 per cent is expected for 2014. There remains considerable diversity in the euro area performance. Among the large economies, Germany is expected to grow by 0.6 per cent in 2013 while the United Kingdom will grow by 0.7 per cent, but France is expected to register no growth, and Italy and Spain to contract by 1.5 and 1.7 per cent, respectively. The other crisis countries (except Ireland) are expected to experience far worse contractions. Growth is held back by fiscal austerity programs in many countries in the region, fragile banking systems, the contagion effects of low confidence caused by the sovereign debt crisis, low extra-regional and exceptionally low intra-regional demand, as well as structural problems, such as a lack of competitiveness, inflexible labour markets, and institutional deficiencies in public administration.

New EU members: growth in the near-term to remain subdued

The new EU member States in Central and Eastern Europe will continue to see subdued performance. Growth of aggregate GDP of the region is forecast to accelerate from 0.8 per cent in 2012 to 1.1 per cent in 2013 which may pick up to 2.2 per cent in 2014. Three countries, the Czech Republic, Hungary and Slovenia, entered a recession in 2012, and the Slovenian economy may shrink even further in 2013. The protracted weakness in the euro area will drag down exports of the new EU members and foreign direct investment (FDI) inflows. Liquidity measures of the European Central Bank eased pressure on the parent banks from the EU-15 (which provide a large share of the lending in the region through local subsidiaries); however, banks still continue cross-border deleveraging and private credit would remain constrained despite loose monetary policy. Domestic demand remains subdued owing to weak labour markets, stagnant real wages and fiscal austerity. Growth in the biggest economy in the region, Poland, is expected to decelerate further to 2 per cent in 2013. For the smaller, export-oriented economies in Central Europe, near-zero growth is projected, while the economies of the Baltic States may expand at an average rate of about 3 per cent.

Economies in transition

CIS and Georgia: economic performance in the area will remain diverse

Economic performance in the countries of the Commonwealth of Independent States (CIS) and Georgia is expected to remain diverse in 2013. The aggregate GDP of CIS and Georgia is projected to expand by 3.2 per cent in 2013, down from 3.5 per cent in 2012. Provided the global economic environment gradually improves, growth is forecast to strengthen to 3.9 per cent in 2014. Economic growth in the Russian Federation, which strongly impacts its CIS neighbours through trade, FDI and remittance flows, is expected to slow down further from 3.4 per cent in 2012 to 2.9 per cent in 2013 in the face of challenging global conditions. Domestic demand is also slowing in response to weaker confidence and moderate inflation. Growth is expected to remain low in Belarus and Ukraine. While global liquidity has facilitated access by the CIS countries to financial markets, Ukraine, which faces significant foreign debt repayments in 2013, may still need balance of payments support from the International Monetary Fund. Growth may slightly accelerate in Azerbaijan, driven mostly by the non-energy sector. The countries of Central Asia will continue to register high growth rates on the back of strong export revenues and fiscal spending. In Kazakhstan, growth may accelerate thanks to the development of a new major Caspian Sea oil field. Economic activity in Armenia, Georgia, Kyrgyzstan, Republic of Moldova, Tajikistan and Uzbekistan will continue to be supported by remittances from migrant workers.

South-Eastern Europe: both external and domestic conditions constrain the recovery

The countries of South-Eastern Europe will see another year of meagre economic performance in 2013, after several economies entered into recession in 2012. The aggregate GDP of South-Eastern Europe, which contracted by 1.2 per cent in 2012, will expand by only 0.9 per cent in 2013, with a mild strengthening to 1.9 per cent forecast for 2014. The weak performance reflects unfavourable external conditions and feeble domestic demand. The ongoing weakness in Greece, Italy and Slovenia, which are important export destinations and sources of FDI and remittances for South-Eastern Europe, remains a drag on the region's near-term prospects. High unemployment and stagnant wages, coupled with deleveraging by businesses and households and a lack of lending growth, continue to suppress private consumption and investment. The region's economies have limited policy space, as they are trying to rebuild fiscal buffers, and monetary policies are constrained by formal and informal pegs to the euro. Strong exposure to the Greek banking sector remains a particular risk for the region.

Developing economies

Growth for Africa revised slightly lower, but still relatively strong

Africa is expected to grow by 4.6 per cent this year and 5.1 per cent in 2014. This implies a very moderate downward revision by 0.2 percentage points for the current year mostly owing to the negative impact of the fall in the export demand from developed economies. Over the forecast horizon, growth drivers include further increases in output in the natural resources sector, which underpins rising fiscal expenditure, especially on infrastructure projects. Looking ahead, Africa's trade and investment ties with emerging and developing economies are expected to intensify. Across the region, rising incomes and urbanization are supporting growth of domestic demand, which helps to reduce the exposure to external economic shocks. As a consequence, increasing diversification, for example into services will continue to create a more solid growth profile. However, high levels of poverty and unemployment continue to constitute a major policy challenge in many countries. Average inflation is forecast to moderate further, based on lower food prices and slightly moderating oil prices. Risks to the outlook include a more severe global economic slowdown with negative impacts on trade, tourism and remittances; a more pronounced negative effect of the fiscal problems in developed countries on ODA flows; and adverse weather conditions.

East Asia: growth projected to pick up slightly

Economic growth in East Asia is projected to pick up slightly in the outlook period, following the marked slowdown since mid-2011. The region's GDP is forecast to expand by 6.1 per cent in 2013 and 6.3 per cent in 2014, up from 5.9 per cent in 2012. The mild upturn is expected to be underpinned by robust growth in domestic demand and a gradual recovery in exports amid slowly improving global conditions. In most economies, domestic demand will be supported by stable labour market conditions, strong household income growth, and accommodative monetary policies. China's economy has likely shifted to a lower but more sustainable and balanced growth trajectory, with full-year growth in 2013 projected at 7.8 per cent, the same pace as in 2012. The region's high export-oriented economies are expected to see a mild recovery, in line with a pick-up in global demand, but growth will remain well below potential. In Indonesia, Malaysia, the Philippines and Thailand, growth is expected to remain fairly robust owing to buoyant consumption and investment demand. Average consumer price inflation is forecast to accelerate only slightly to 3.1 per cent in 2013 as further weakening of global commodity prices helps curb upward pressures.

South Asia: moderate upturn in growth expected; major structural challenges remain

After experiencing a sharp slowdown over the past two years, South Asia is expected to see a moderate recovery. The region's GDP is projected to expand by 4.7 per cent in 2013 and by 5.4 per cent in 2014. The recovery will be based on an upturn in private demand following the recent easing of monetary policy, and a gradual strengthening of exports amid slowly improving global conditions. Structural factors such as stubbornly high inflation, large fiscal deficits, political uncertainties, fragile security conditions, and transport and energy constraints will keep investment and growth below potential. In India, growth is likely to have bottomed out, but the recovery will be slower than previously expected, with economic activity forecast to expand by 5.5 per cent in 2013 and 6.1 per cent in 2014, up from 5.1 per cent in 2012. The rest of the region continues to be characterized by stark differences in economic performance, with growth in 2013 projected to range from -0.3 per cent in the Islamic Republic of Iran to more than 6 per cent in Bangladesh and Sri Lanka. Monetary and fiscal policy space is constrained by persistently high consumer price inflation and large budget deficits of more than 5 per cent of GDP in most economies.

Western Asia's economic growth forecast to rise slightly

Economic growth in Western Asia decelerated in the second half of 2012, owing mainly to weakening external demand, especially from the euro area. Most oil-exporting countries increasingly relied on their weakly diversified non-oil sector as a source of economic growth. Economic activity also decelerated in oil-importing countries, burdened by high import bills, slackening demand and shrinking policy space. Turkey and Israel were particularly affected by the deteriorating external environment and experienced a significant drop in full-year growth. Economic growth in the region is expected to increase slightly from 3.1 per cent in 2012 to 3.4 per cent in 2013 following gas production in Israel and rebounding private demand in Turkey. Assuming a gradual recovery in the developed economies, regional economic growth is forecast to accelerate to 3.8 per cent in 2014. Several Gulf Cooperation Council (GCC) countries scaled back their oil production during the last quarter of 2012 to absorb excess supply in the market and support high prices. In most GCC countries, ongoing large public expenditures in both the oil and non-oil sectors is supporting investment and consumption. The civil war in the Syrian Arab Republic continues to weigh on the risk perception of the region, especially regarding neighbouring countries. In Jordan and Lebanon, trade, tourism and investment have remained subdued.

Latin America and the Caribbean: growth acceleration is expected

Economic growth in Latin America and the Caribbean is expected to accelerate from 3.0 per cent in 2012 to 3.6 per cent in 2013 and 4.2 per cent in 2014. This will be driven mainly by a strengthening of domestic demand, in particular investment spending. In Mexico and Central America, economic activity is projected to expand by 3.9 per cent in 2013, a pace similar to the past few years. In South America, growth will strengthen to 3.5 per cent in 2013 as the economies of Argentina and Brazil gradually gain momentum. Brazil is expected to grow by 3.0 per cent, driven by a rebound in investment demand following monetary policy loosening and reductions in energy costs and payroll taxes. Additionally, Brazil removed the financial transaction tax (entry tax) on capital inflows. The Caribbean is expected to expand by 3.0 per cent in 2013, 0.5 percentage points higher than in 2012. Across the region, domestic demand continues to be supported by robust labour markets, most notably in South America and Mexico. The regional unemployment rate declined to a multi-year low of 6.4 per cent in 2012 and is likely to remain low in the short term. The inflation outlook is fairly stable, although inflation is expected to accelerate somewhat in 2013 amid more accommodative monetary policies in some countries.