Development Policy and Analysis Division ◆ Department of Economic and Social Affairs

World Economic Situation and Prospects

Monthly Briefing

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Summary

- Global employment remains a challenge
- United States Federal Reserve faces challenges in adjusting its monetary policy
- Financial markets in emerging economies stabilized

Global issues

Employment growth is a major challenge for both developed and developing economies

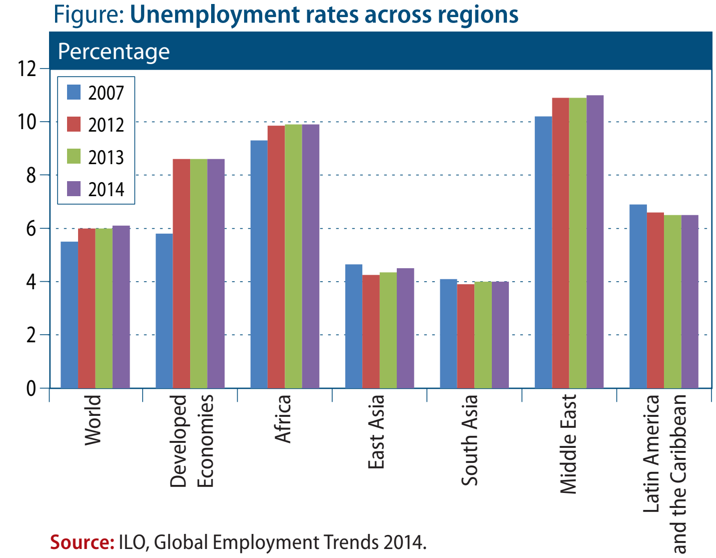
The preliminary estimates for employment and unemployment, prepared by the International Labour Organization (ILO), show that labour markets have been affected by the slow recovery in 2013. Globally, employment grew by 1.4 per cent in 2013—similar to the 2012 expansion, but stubbornly slower than the growth of pre-crisis years. As a result, the global jobs gap (measuring the number of current jobs lost in comparison with the pre-crisis trend) widened further to 62 million in 2013. Across regions, employment growth slowed down in all except South Asia and North Africa. The 2013 global unemployment rate of 6 per cent is unchanged when compared with 2012. In absolute terms, 4.9 million new individuals joined the cohort of unemployed people in 2013.

Across regions and countries, the impact of the economic crisis on the incidence of unemployment has been varied. In member countries of the Organization for Economic Cooperation and Development (OECD), for instance, the average unemployment rate (harmonized rate) was 7.9 per cent in the second quarter of 2013. However, in Austria, Japan, Norway, Republic of Korea, and Switzerland, the unemployment rate was below 5 per cent, while in at least ten countries the unemployment rate was above 10 per cent. The highest unemployment rates in the OECD were in Greece and Spain, at 27.9 and 26.5 per cent, respectively. Many countries from the European Union (EU) embarked on fiscal consolidation, which led to lower public services provision, less coverage for jobless persons, and higher levels of poverty. Among developing regions, the highest unemployment rates are currently in North Africa and the Middle East, above 12 and 10 per cent, respectively, without any progress relative to 2012. In other developing regions, unemployment rates are relatively low, even lower than prior to the crisis (see figure). The main challenge though, across developing countries, is still the level of informal employment, which reaches on average between 40 per cent and 50 per cent in Africa, Asia, and Latin America and the Caribbean.

In addition to high unemployment levels, the depth and length of labour market imbalances is leading to long-term and structural unemployment, becoming more than a mere cyclical issue. Since the beginning of the crisis, long-term unemployment has increased in many countries. In OECD countries, between 2007 and mid-2013, the share of people unemployed for one year or more as a percentage of total unemployment has increased by as much as 30 percentage points in Ireland, while it increased by more than 15 percentage points in Greece and the United States of America. As a percentage of total unemployment, the long-term unemployed account for 60 per cent in Greece, Ireland, and Slovakia, and 40 per cent in Germany and Poland. Such high levels of long-term unemployment increase the risk of higher structural unemployment. The long-term unemployed face progressive loss of skills and psychological barriers leading to re-employment difficulties. As long-term unemployment increases, labour force participation declines, owing to the significant number of discouraged workers dropping out of the labour force; this also masks real unemployment rates. The ILO has estimated that about 23 million people could be categorized as discouraged workers in 2013. These workers may not join the labour market until employment creation accelerates.

In 2014, as macroeconomic conditions are expected to improve only moderately, significant changes in global employment and unemployment rates are not expected. First, developed economies should perform better economically, but they also face high economic uncertainties, which may delay investment and hiring decisions. Second, economic growth is expected to slow down in emerging economies, which may also affect labour market trends.

Figure: **Unemployment rates across regions**



Source: ILO, Global Employment Trends 2014.

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Against this background, in OECD countries, employment creation is expected to continue to grow moderately, by about 0.9 per cent in 2014, slightly better than the 0.6 per cent in 2013, while the unemployment rate is projected to remain practically unchanged, drifting down to about 7.8 per cent by the end of 2014. This is still high unemployment compared to the pre-crisis rate of 5.6 per cent in 2007. Among OECD countries, labour market conditions are expected to improve faster in the United States, where the unemployment rate is projected to decline from 7.4 per cent in 2013 to 6.5 per cent by the end of 2014. In the euro area, as output growth is projected to pick up only slowly, net job growth will likely resume slowly as well and the unemployment rate may remain relatively high—about 12 per cent—without deviating much from the 2013 rate. In Japan, the unemployment rate is also expected to remain relatively stable in 2014 at about 4 per cent, partly helped by a labour force that is declining owing to retirement. In emerging and developing economies, labour markets are expected to remain relatively stable as well, with no improvements and perhaps a moderate increase in unemployment figures.

The slow progress in reducing unemployment in developed economies and an eventual slowdown in employment creation in developing countries will remain a major concern for policymakers. In addition to concerted efforts made by several countries to address the labour market crisis, additional policy action is required both at the macro and micro levels. At the macroeconomic level, a better coordination of monetary and fiscal policies will be essential in order to minimize economic uncertainties for the private sector, to stimulate investment, and to foster employment opportunities. At the same time, more concrete labour market policies are needed to minimize the negative impact of labour reallocation across sectors and to tackle long-term unemployment. Adequate unemployment benefit schemes, coupled with reemployment strategies, such as training activities, must be developed.

Developed economies

The United States: challenges to adjusting monetary policy

The Federal Reserve of the United States (Fed) has relied on three major monetary policy instruments in the aftermath of the financial crisis: 1) maintaining the federal funds rate at zero, 2) purchasing large amounts of long-terms assets (the so-called quantitative easing), and 3) providing "forward guidance" for financial markets on the expected trajectory of the federal funds rate in the future. As the economy recovers, the Fed is challenged with adjusting the stance of these policy instruments in a way that will continue to provide sufficient support for the recovery, yet avoid sowing the seeds of asset bubbles and inflation for the future.

Since January 2014, the Fed has been tapering its monthly purchases of long-term assets. At the most recent Federal Open Market Committee meeting in March, the Fed decided that it would continue to slow its purchases of long-term assets at a pace of $55 billion per month starting in April, $10 billion less than the pace of the previous months. At this pace, the Fed asset purchase programme is expected to end in the third quarter of 2014.

Meanwhile, the Fed has also modified its forward guidance. Previously, the guidance read that the Fed was supposed to keep the federal funds rate at exceptionally low levels, as long as the unemployment rate remained above 6.5 per cent or the projected inflation rate for the following two years remained below 2.5 per cent. The new forward guidance reads that it will be appropriate to maintain the current federal funds target rate range for a considerable time after ending the asset purchase programme, especially if projected inflation continues to run below the 2.5 percent. With this guidance, the federal funds rate is expected to stay at the current level until mid-2015, even if the unemployment rate is anticipated to drift down to 6.5 per cent in mid-2014

Developed Asia: New Zealand changes monetary policy stance

The Reserve Bank of New Zealand increased its policy rate by 25 basis points to 2.75 per cent on 13 March. This is the first adjustment since it lowered the rate to the recent level three years ago. The key triggers for this decision are potential inflation pressure and the booming housing market.

In Japan, households have anticipated the higher consumption tax, effective on 1 April, by increasing their purchase of durable goods. Month-over-month growth in retail sales increased substantially in January and February of 2014. On the other hand, the frontloading in the housing sector has faded out; housing construction has declined significantly in January and February as well. Macroeconomic indicators show that the economic situation has been stable. Industrial output for the first two months of 2014 has been about 9 per cent higher than one year ago, in spite of the harsh winter storms that have disrupted production and transportation substantially. Japan's labour market has maintained the recovering trend. The employment level has been about 0.6 per cent higher than one year ago for the first two months of the year, bringing down the unemployment rate to 3.6 per cent. At the end of 2013, the inflation rate trended up, closer to the target of 2.0 per cent, reaching 1.6 per cent in November and December 2013. Since then, however, inflation slowed down to 1.4 and 1.5 per cent in January and February 2014, respectively.

Western Europe: inflation dips again

Inflation decelerated in the euro area to 0.5 per cent (year over year) in March, down from 0.7 per cent in February. This is the lowest rate of inflation since November 2009, raising again the spectre of deflation. The dip was largely due to calendar effects from the temporary rise in prices during Easter 2013, and so should be reversed in April of this year, but inflation still remains exceptionally low. Despite this alarm signal from the price side, sentiment in the euro area remains positive. The European Commission's economic sentiment indicator for the euro area increased again in March, led by a strong increase in consumer confidence, a result widely shared across the region. The Markit Purchasing Manager's Index dipped slightly but remained above the level demarking expansion from contraction for the ninth consecutive month. These results are consistent with positive growth going forward. Growth will remain subdued, however, and it is not expected to lead to improved performance in labour markets, where the rate of unemployment for the euro area remained stuck at 12 per cent in February.

The new EU members: gradual recovery and low inflation

Economic activity in the new EU member States continued to strengthen in February, albeit unevenly. In Poland, industrial output expanded more than 5.0 per cent year on year and retail sales strengthened, increasing by 6.9 per cent year on year, reflecting the broad-based nature of the recovery. By contrast, the economy of Croatia has yet to reach a turnaround point. The crisis in Ukraine may adversely affect the region through weaker exports and capital outflows, but so far its impact has been limited.

Inflation in the region remains low, as February consumer prices increased on an annual basis by only 0.2 per cent in the Czech Republic, 0.1 per cent in Hungary, and 0.7 per cent in Poland, while falling in Croatia and Slovakia (where the stronger euro led to cheaper imports). Low inflation is accompanied by loose monetary policies. The Czech National Bank asserted its commitment to maintain a weak currency for at least a year. The Hungarian National Bank lowered its base rate in March by 10 basis points to another record low of 2.6 per cent, despite some weakening of the currency versus the euro in mid-March over the crisis in Ukraine.

In February, the labour market improved slightly in Poland, but the employment situation continued to deteriorate in Croatia, where the unemployment rate reached 22.7 per cent. Several companies outsourced their production from Croatia to the neighbouring countries after losing tariff-free access to the markets of those countries when Croatia joined the EU and abandoned the Central European Free Trade Agreement.

Economies in transition

CIS: the impact of the crisis in Ukraine is already visible

The economic performance of many large CIS economies remains disappointing and has been impacted by the recent political standoff around Ukraine. In February, the GDP of the Russian Federation grew by a meagre 0.3 per cent year on year. Following the Crimea crisis, the possibility of introducing economic sanctions against the country has led to accelerated capital outflows, which may reach $70 billion for the first quarter of 2014, more than in all of 2013. In mid-March, the stock market plunged and the currency depreciated dramatically. The weaker currency further spurred inflation, from 6.2 per cent in February to possibly 7.0 per cent in March. The credit rating agencies Standard and Poor's and Fitch downgraded the country's credit outlook for long-term foreign currency sovereign debt from stable to negative, while Fitch also downgraded the outlook for 15 banks in the Russian Federation (10 foreign owned among them). The weaker currency may affect the purchasing power of remittances sent by migrant workers from other CIS countries. In Ukraine, the complex political situation took its economic toll, with an industrial production index of 95.6 per cent in January-February compared with the same period of 2013. The Government is aiming to conclude a deal with the IMF to avert a balance of payments crisis, which is also a precondition of receiving financial aid from the United States and the EU. A preliminary deal was reached with the Fund on a $14-$18 billion loan, subject to serious fiscal austerity measures, such as increases in natural gas tariffs for households.

The economy of Belarus also continued a negative trend in early 2014, with GDP shrinking by 1.6 per cent in January-February, and inflation reaching 15.3 per cent, the highest rate in the CIS. The economy of Azerbaijan also slowed down, with GDP at factor cost growing at only 1.6 per cent in January-February. In Armenia, the central bank reduced its main policy rate in February, expecting inflation to taper later in the year. In Kazakhstan, following devaluation of the currency, the Government decided to adjust the budget for 2014 and to increase oil export duties.

South-Eastern Europe: industrial output is strengthening

Industrial output in the region continued to expand in early 2014, aided by the recovery in key export markets. In February, industry grew by 6.7 per cent year on year in Bosnia and Herzegovina, 6.4 per cent year on year in the former Yugoslav Republic of Macedonia, and 1.1 per cent year on year in Serbia. For the purpose of budget support, Serbia obtained a $1 billion loan from the United Arab Emirates in March.

Developing economies

Africa: sharp contraction in South Africa's current-account deficit

South Africa's current-account deficit fell to 36 billion rand—or 4.1 per cent of GDP—in the fourth quarter, compared to 61.3 billion rand—or 7.1 per cent of GDP—in the previous quarter. One main driver for this was the sharp fall in imports in light of the weaker rand, which reduced the trade deficit by more than two thirds. Tanzania's current-account deficit was up 34.7 per cent in January, year on year, to 17 per cent of GDP owing to higher oil imports and lower gold exports. The current-account deficit in Kenya was down to 8.3 per cent of GDP for 2013, from 10.5 per cent in 2012, driven by rising remittances and increasing services exports. The merchandise trade balance moved further into deficit as revenues from coffee and raw materials fell. Tea export revenues were up slightly as prices fell but production increased. Tourism revenues were down 16.7 per cent on election fears in the first half of the year and terrorism fears in the latter half of the year. In Ghana, inflation increased to 14.0 per cent in February, from 13.8 per cent in January, underpinned by reductions in utility subsidies.

Oil production in Libya is estimated to be down almost 90 per cent from last year's peak of 1.4 million barrels per day, as protests and strikes continue to cut output. The Central Bank of Libya was recently forced to extend a $2 billion loan to the Government as Parliament has been unable to agree on a budget for 2014 and falling oil revenues have cut into government finances.

In Botswana and South Africa, sufficient power supply remains a major challenge, with the economies being hit by blackouts or supply rationing. In the Democratic Republic of the Congo (DRC) mining companies were told to halt any expansion plans in Katanga province that require more power owing to a severe lack of spare capacity in the province. The World Bank and the African Development Bank have pledged grants—$73 million and $33 million, respectively—to fund technical studies to expand the major Inga hydroelectric dam in DRC. The dam could provide enough power to more than cover peak load needs there, but construction would take considerable resources and is unlikely to be completed in the near future.

Denmark, the Netherlands, Sweden and the World Bank have cut aid or loans going to Uganda by $118 million, after a law imposing harsh penalties for homosexuality was enacted. This has put modest pressure on the exchange rate as aid is a significant source of foreign exchange.

East Asia: growth target in China maintained at 7.5 per cent

At the annual National People's Congress, the Chinese Government set the real GDP growth target for 2014 at about 7.5 per cent, the same level as in 2013. Authorities outlined Government priorities, which include creating a sufficient number of jobs, strengthening environmental protection, addressing financial risks and, more broadly, raising the quality and returns of economic development. The Government will target the creation of 10 million more urban jobs in 2014 and aims to ensure that the registered urban unemployment rate does not rise above 4.6 per cent. The target for consumer price inflation remained constant at 3.5 per cent; year-on-year inflation is currently running at about 2.5 per cent. In March, the People's Bank of China announced a doubling of the renminbi's daily trading band against the dollar. The exchange rate will now be allowed to rise or fall 2 per cent (instead of 1 per cent) from the daily reference rate.

In Viet Nam, the central bank cut its main policy rates in a bid to boost growth at a time when inflation has fallen well below the target range of 6.0-6.5 per cent. In March, consumer price inflation declined to a multi-year low of 4.4 per cent year on year as prices of food, housing and construction materials eased. Economic growth slowed to 5 per cent in the first quarter of 2014, down from 6 per cent in the previous quarter. Activity has been held back by weak lending as banks continue to struggle with bad debt.

South Asia: Sri Lanka records rapid and broad-based growth

Sri Lanka continues to be the fastest-growing economy in the region. In the fourth quarter of 2013, GDP increased by a stronger-than-expected 8.2 per cent year on year. Full-year growth reached 7.3 per cent, up from 6.3 per cent in 2012. The strength in the fourth quarter was broad-based, with all sectors—agriculture, industry and services—posting rapid growth. Industrial production increased by 10.7 per cent year on year, driven by manufacturing output and construction.

The Pakistani rupee appreciated sharply against the dollar in recent weeks, gaining almost 7 per cent between March 1 and March 25. In 2013, the rupee lost about 9 per cent against the dollar. The recent turnaround can be attributed to a significant increase in capital inflows from bilateral and multilateral sources. These inflows have helped Pakistan's central bank rebuild its foreign-exchange reserves. Confidence in the rupee has also been supported by considerable improvement in the macroeconomic situation. Over the past few quarters, inflationary pressures have moderated, manufacturing activity has gained strength and the fiscal deficit has declined significantly. The improvement has been acknowledged by the IMF, which, in late March, approved the disbursement of the third tranche (worth $555.6 million) of the $6.7 billion loan agreement with Pakistan.

Western Asia: economic growth is expected to slow down in Turkey

As the external financing climate becomes tighter, several countries have had to introduce new monetary measures to help adjusting their current-account balances and to stabilize local financial markets. In Turkey, for instance, the central bank increased interest rates aggressively in February (see monthly briefing 64), which stabilized financial markets during the past month. In addition, the exchange rate started to recover and is now trading against the euro at levels close to those of December. Although these measures are expected to translate into positive outcomes for the current account as well (imports slowed down significantly since the beginning of the year, for instance), economic growth is now expected to slow in 2014. In GCC countries, as oil exports slow down, new measures to boost economic growth are being introduced. In March, Kuwait approved a new regulation allowing foreign banks to open several branches in the country. Previously, foreign banks could only open one branch in Kuwait and this new measure could potentially boost credit growth, which has been very weak. However, if improvements are not also made on the demand side, and with more viable projects, the real impact of this measure will be limited.

Latin America and the Caribbean: manufacturing output remains subdued

By early 2014, the manufacturing sector in Latin America continues to be subdued, remaining as a lack-lustre engine to economic growth. In the first two months of the year, manufacturing output in Argentina decreased by 1.8 per cent year on year. In January, the manufacturing production index in Brazil also fell by 2.4 per cent year on year—continuing the negative trend observed in December when the index decreased by 2.5 per cent—while in Colombia it increased by only 0.1 per cent, after an accumulated reduction of 1.6 per cent for the previous twelve months. In addition, Chilean manufacturing output in January decreased by 0.5 per cent with respect to the previous month and 1.4 per cent year on year. In the same month, and with a relatively better performance, the manufacturing production in Mexico increased by 2.5 per cent, lifted by the recent pickup in economic activity in the United States. Still, the Mexican manufacturing sector continues to be restrained, and is only expected to strengthen slowly during the second half of 2014.

In February and March, the Central Bank of Chile eased its monetary policy by successively reducing interest rates by 500 basis points to 4.0 per cent, despite the tapering of quantitative easing in the United States. The monetary stimulus came on the back of increasing signs of a significant slowdown in economic activity and relatively contained inflation. By contrast, inflation in Brazil shows signs of persistence, despite the tightening monetary cycle that began in mid-2013. The consumer price index increased by 0.73 per cent in March—similar to the variation registered in February of 0.7 per cent—leading to a relatively high cumulative variation of 5.9 per cent in the last twelve months. These recent developments are increasing the pressure on the Central Bank of Brazil to continue raising interest rates, which might further affect the already subdued economic activity.