Executive summary

Prospects for global macroeconomic development

As headwinds from the global financial crisis subside, policymakers have more scope to tackle longer-term issues that hold back sustainable development

The last decade has been punctuated by a series of broad-based economic crises and negative shocks, starting with the global financial crisis of 2008–2009, followed by the European sovereign debt crisis of 2010–2012 and the global commodity price realignments of 2014–2016. As these crises and the persistent headwinds that accompanied them subside, the world economy has strengthened, offering greater scope to reorient policy towards longer-term issues that hold back progress along the economic, social and environmental dimensions of sustainable development.

In 2017, global economic growth is estimated to have reached 3.0 per cent, a significant acceleration compared to growth of just 2.4 per cent in 2016, and the highest rate of global growth recorded since 2011. Labour market indicators continue to improve in a broad spectrum of countries, and roughly two-thirds of countries worldwide experienced stronger growth in 2017 than in the previous year. At the global level, growth is expected to remain steady at 3.0 per cent in 2018 and 2019.

Stronger economic activity has not been shared evenly across countries and regions

The recent acceleration in world gross product growth stems predominantly from firmer growth in several developed economies, although East and South Asia remain the world's most dynamic regions. Cyclical improvements in Argentina, Brazil, Nigeria and the Russian Federation, as these economies emerge from recession, also explain roughly a third of the rise in the rate of global growth between 2016 and 2017. But recent economic gains remain unevenly distributed across countries and regions, and many parts of the world have yet to regain a healthy rate of growth. Economic prospects for many commodity exporters remain challenging, underscoring the vulnerability to boom and bust cycles in countries that are overly reliant on a small number of natural resources. Moreover, the longer-term potential of the global economy carries a scar from the extended period of weak investment and low productivity growth that followed the global financial crisis.

Investment conditions have improved, but elevated policy uncertainty and rising levels of debt may prevent a more widespread investment rebound

Conditions for investment have generally improved, amid low financial volatility, reduced banking sector fragilities, recovery in some commodity sectors and a more solid global macroeconomic outlook. Financing costs generally remain low, and spreads have narrowed in many emerging markets, reflecting a decline in risk premia. This has supported rising capital flows to emerging markets, including a rise in cross-border lending, and stronger credit growth in both developed and developing economies.

Improved conditions have supported a modest revival in productive investment in some large economies. Gross fixed capital formation accounted for roughly 60 per cent of the acceleration in global economic activity in 2017. This improvement is relative to a very low starting point, following two years of exceptionally weak investment growth, and a prolonged episode of lacklustre global investment overall. A firmer and more broad-based rebound in investment activity, which is needed to support stronger productivity growth and accelerate progress towards the Sustainable Development Goals, may be deterred by elevated levels of trade policy uncertainty, considerable uncertainties regarding the impact of balance sheet adjustment in major central banks, as well as rising debt and a build-up of longer-term financial fragilities.

Rebound in world trade could face a setback if protectionist tendencies increase

Global trade rebounded in 2017. In the first eight months of the year, world merchandise trade grew at its fastest pace in the post-crisis period. The rebound springs predominantly from stronger import demand in East Asia, as domestic demand picked up in the region, supported by accommodative policy measures. In several major developed economies, imports of capital goods have rebounded, as firms respond to improving conditions for investment.

Recent course adjustments in major trade relationships, such as the United Kingdom of Great Britain and Northern Ireland's decision to withdraw from the European Union and the United States of America's decisions to renegotiate the North American Free Trade Agreement and to reassess the terms of its other existing trade agreements, have raised concerns over a potential escalation in trade barriers and disputes. These could be amplified if met by retaliatory measures by other countries. An increasingly restrictive trade environment may hinder medium-term growth prospects, given the mutually reinforcing linkages between trade, investment and productivity growth. In this regard, policies should focus on upholding and revitalizing multilateral trade cooperation, emphasizing the possible benefits from trade in services.

Progress towards sustainable development

Weak growth in per capita income poses setbacks to sustainable development targets in several regions

The uneven pace of global economic recovery continues to raise concerns regarding prospects for achieving the Sustainable Development Goals. Many countries have even suffered recent setbacks, as average incomes declined in four major developing regions in 2016.

In 2017–2019, further setbacks or negligible growth in per capita gross domestic product (GDP) is anticipated in Central, Southern and West Africa, Western Asia, and Latin America and the Caribbean. These regions combined are home to 275 million people living in extreme poverty. This underscores the importance of addressing some of the longer-term structural issues that hold back more rapid progress towards sustainable development and to ensure that the targets of eradicating poverty and creating decent jobs for all are not pushed further from reach. Failure to address these issues may leave a quarter of the population of Africa in extreme poverty by 2030.

Supporting growth in LDCs requires both financial resources and progress towards addressing institutional deficiencies and security concerns

Very few of the least developed countries (LDCs) are expected to reach the Sustainable Development Goal target for GDP growth of "at least 7 per cent" in the near term. Approaching this target will require higher levels of investment in many LDCs. Mobilizing necessary financial resources may be approached through various combinations of domestic and international, public and private sources of finance. However, more rapid progress in many of the LDCs is hindered by institutional deficiencies, inadequate basic infrastructure, high levels of exposure to weather-related shocks and natural disasters, as well as challenges related to security and political uncertainty. These barriers must be addressed to ensure that available finance is channelled efficiently towards productive investment.

Accelerated economic growth increases need to consider links to environmental sustainability

The acceleration in economic growth also bears an environmental cost. The frequency of weather-related shocks continues to increase, highlighting the urgent need to build resilience against climate change and contain the pace of environmental degradation. While the level of global energy-related carbon emissions remained flat between 2013–2016, the return to stronger GDP growth is likely to result in higher emission levels.

International shipping and aviation emissions do not fall under the purview of the Paris Agreement, and emissions from these two sectors have grown faster than those from road transport over the past 25 years, and have continued to rise unabated since 2013. While air pollution measures have been strengthened in both shipping and aviation industries, it is not clear that current policies will be sufficient to reduce emissions to levels consistent with the objectives of the Paris Agreement.

Transition towards sustainable energy remains gradual

Transition towards sustainable energy is advancing at a gradual pace. Renewables account for more than half of all recently installed power capacity, but still provide only about 11 per cent of global power generation. China remains the world's biggest investor in renewables, and renewable investment in 2017 will be supported by massive wind projects in Australia, China, Germany, Mexico, the United Kingdom and the United States. At a time when many countries, notably in Africa, continue to suffer from severe shortages of energy supply, there is enormous potential to lay the basis of environmentally sustainable growth in the future through smart policies and investments today.

Uncertainties and risks

Economic prospects remain vulnerable to changes in trade policy, a sudden deterioration in global financial conditions and rising geopolitical tensions

While many of the overhanging fragilities from the global financial crisis have eased, a number of uncertainties and risks loom on the horizon. Elevated levels of policy uncertainty continue to cloud prospects for world trade, development aid, migration and climate targets, and may delay a more broad-based rebound in global investment and productivity. Rising geopolitical tensions could intensify a tendency towards more unilateral and isolationist policies. The prolonged period of abundant global liquidity and low borrowing costs has contributed to a further rise in global debt levels and a build-up of financial imbalances. It is also linked to the current high levels of asset prices, which suggest an under-pricing of risk.

Many developing economies—especially those with more open capital markets—remain vulnerable to spikes in risk aversion, a disorderly tightening of global liquidity conditions, and sudden capital withdrawal. Monetary policy normalization in developed economies could trigger such a spike. Central banks in developed economies are currently operating in largely unchartered territory, with no historical precedent as guidance. This makes any adjustment of financial markets less predictable than during previous recoveries and amplifies the risks associated with policy errors.

Policy challenges and the way forward

Synchronized upturn among major economies, stable financial market conditions and the absence of major negative shocks offer opportunities to reorient policy

While a number of risks and uncertainties remain, what stands out in the current economic environment is the alignment of the economic cycle among major economies, stability in financial market conditions and the absence of negative shocks such as commodity price dislocations.

As conditions for more widespread global economic stability solidify, the need to focus policy actions on economic crisis consequences and short-term macroeconomic stabilization has eased. Coupled with improving investment conditions, this creates greater scope to reorient policy towards longer-term issues, such as strengthening the environmental quality of economic growth, making it more inclusive, and tackling institutional deficiencies that hinder development.

Reorienting policy to address these challenges and maximizing co-benefits between development objectives can generate stronger investment, higher job creation and more sustainable medium-term economic growth. Current investment in areas such as education, expanding access to healthcare, building resilience to climate change, improving the quality of institutions, and building financial and digital inclusion, will support economic growth and job creation in the short-term. It will also accelerate progress towards social and environmental goals and raise the longer-term potential for sustainable growth.

Policy reorientation should encompass four concrete areas: increasing economic diversification, reducing inequality, strengthening financial architecture and tackling institutional deficiencies

Policymakers should use the current macroeconomic backdrop to focus on four concrete areas. First, the long-standing need for economic diversification in countries that remain heavily dependent on a few basic commodities cannot be overstated. The heavy economic costs related to recent commodity price realignments proves the point.

Stemming and redressing the rise in inequality is also crucial for ensuring balanced and sustainable growth going forward. This requires a combination of short-term policies to raise living standards among the most deprived, and longer-term policies that address inequalities in opportunity, such as investment in early childhood development, broadening access to healthcare and education, and investment in rural roads and electrification.

A third crucial area is realigning the global financial architecture with the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda. This requires creating a new framework for sustainable finance and shifting gradually from the current focus on short-term profit towards a target of long-term value creation, in a socially and environmentally responsible manner. Macroprudential policies, well coordinated with monetary, fiscal and foreign exchange policies, can support these goals by promoting financial stability and containing the build-up of financial risks.

Finally, weak governance and political instability remain fundamental obstacles to achieving the 2030 Agenda for Sustainable Development. At the same time, stronger global economic growth can do little on its own to help those afflicted by conflict situations, where there is little scope for meaningful progress towards sustainable development. Policy priorities must include redoubling efforts to support conflict prevention and resolution and tackling the institutional deficiencies underpinning many of these obstacles.