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

World Economic Situation and Prospects

Monthly Briefing

No. 101 10 April 2017

Global issues

Multinational enterprises supporting jobs growth in the United States rather than diverting jobs abroad

The labour market in the United States of America has exhibited a pronounced recovery since the global financial crisis, when the unemployment rate reached a peak of 10 per cent in October 2009. The headline unemployment rate stood at 4.5 per cent in March 2017, in line with the average unemployment rate seen at the peak of the housing market bubble in 2006. While this headline figure masks some deeper labour market issues[1], the improvement is nonetheless impressive, reflecting a net increase of 15.7 million payroll jobs. The continued strengthening of the labour market was a key factor underpinning the decision by the Federal Open Market Committee—which is mandated to foster maximum employment and price stability—to raise the target range for the federal funds rate by 25 basis points on 16 March 2017.

The labour market recovery owes much to the dynamism of multinational enterprises (MNEs) operating in the United States. MNEs are firms that own a significant stake (at least 10 per cent, according to the definition applied in the international economic accounts of the United States) in enterprises located in one or more other countries. The primary firm is designated as the 'parent' company, with subsidiary foreign-based firms designates as 'affiliates'. Majority-owned foreign affiliates (MOFAs) are those where the parent company owns at least a 50 per cent share of the affiliate, and therefore holds considerable sway over the firm's decision-making.

MNEs play an important role in the economy of the United States. More than 25 per cent of private sector employment is attributed to MNEs—including both national MNEs and the affiliates of foreign MNEs operating in the United States (figure 1). MNEs

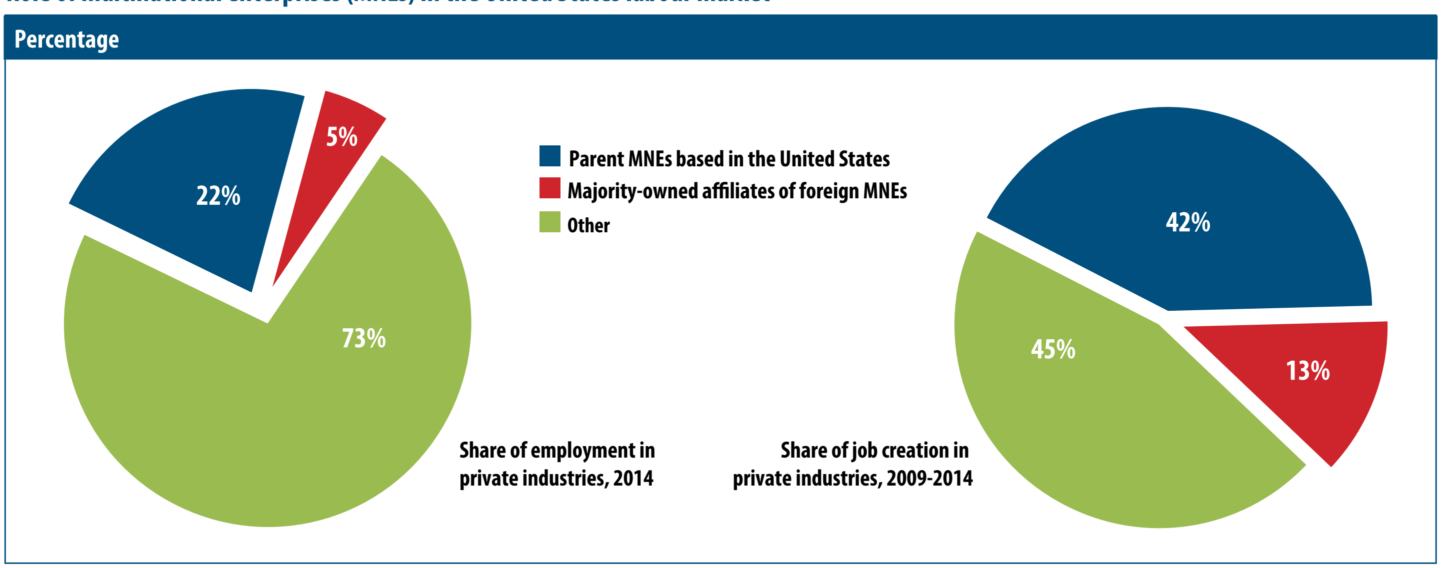
1 See discussion in *World Economic Situation and Prospects Monthly Briefing No. 100* (March 2017).

Summary

- The United States Federal Reserve raises its key policy rate by 25 basis points, amid continued strengthening of labour market conditions
- Rapid rise in inflation poses policy challenges for several developing economies in Africa, South Asia and Western Asia
- East Asian economies are experiencing a rebound in exports, but the trade outlook faces significant downside risks

Figure 1

Role of multinational enterprises (MNEs) in the United States labour market



Source: Staff calculations based on data from the Bureau of Economic Analysis.

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Table 1
Average growth of employees per annum by firm type, 2009-2014
(Compound annual growth rate: percentage)

	All US private sector	Parent MNEs based in the United States	US-based MOFAs of foreign MNEs	Foreign-based MOFAs of US MNEs
All industries	1.5	3.0	3.8	5.0
Mining	5.6	9.0	15.6	-4.9
Manufacturing	0.6	1.0	4.5	5.9
Wholesale trade	0.8	9.9	1.2	-7.4
Retail trade	0.9	4.4	3.5	1.6
Information	-0.5	1.9	3.4	4.0
Finance and insurance	0.5	2.4	1.2	13.0
Professional, scientific, and technical services	2.1	4.7	4.8	7.4
Construction	0.2	2.2	7.1	18.9
Transportation and warehousing	1.8	4.6	2.6	-4.6
Administration, support, and waste management	3.6	1.0	3.2	0.9
Health care and social assistance	2.3	4.7	5.8	-8.6
Accommodation and food services	2.4	1.7	5.2	11.1

Source: Staff calculations based on data from the Bureau of Economic Analysis.

have acted as the driving force behind the labour market recovery since the global financial crisis, with average annual employment in MNEs expanding more than twice as rapidly as employment in private sector firms that operate exclusively in the United States. As a result, MNEs accounted for more than half of net private sector employment gains from 2009-2014 (figure 1).

Job creation abroad by parent companies in the United States has also increased rapidly since 2009, at an average annual rate of 5 per cent, outpacing the rate of growth of employment in the parent companies themselves. Nonetheless, over 65 per cent of the employment of the United States MNEs remains domestically, and in level terms, roughly 50 per cent more jobs have been created in the United States by MNEs since 2009 compared to those created abroad.

The dominance of MNEs in labour market recovery has been broad-based across sectors. Jobs growth in MNEs outpaced total private sector employment growth in all of the major industries, with the exception of administration, support and waste management, as well as the accommodation and food services sectors (table 1).

These findings suggest that the efficiency gains afforded to MNEs from locating production and distributions networks in multiple locations have supported jobs growth in the United States since 2009, rather than diverting jobs abroad. There is a risk that any policy changes that restrict the ability of firms to take advantage of location choice may, therefore, jeopardize jobs.

The United States Government has proposed a sweeping review of existing trade deals, and is expected to formally trigger the renegotiation of the North American Free Trade Agreement (NAFTA) in April. NAFTA came into effect on 1 January 1994, establishing a free-trade zone in North America. The agreement lifted tariffs on the majority of goods produced by the signatory nations, the United States, Canada and Mexico. It also gradually removed barriers to cross-border investment and to the movement of goods and services between the three countries. This opened the door to a rapid expansion of intricate cross-border production chains. The number of employees of the United States MOFAs operating in Canada and Mexico has increased by more than 50 per cent since 1994. The production networks of some enterprises are set up so that intermediate goods cross borders multiple times before the final goods are produced. The policy changes that have been put forward by the United States include introducing steep import tariffs on goods produced by affiliates operating in Mexico, which could severely disrupt the production networks that have evolved over the last two decades.

Developed economies

United States: More rapid pace of interest rate hikes

The Federal Open Market Committee (FOMC) of the United States Federal Reserve raised the target range for the federal funds rate by 25 basis points on 16 March, following a rise of the same magnitude in December 2016. The participants of the FOMC and financial market actors anticipate two further interest rate increases in the United States before the end of 2017, for a cumulative 75 basis points rise this year. This marks the onset of a more rapid pace of interest rate hikes in the United States, after policy rates were increased by just 25 basis points in both 2015 and 2016.

The FOMC will continue to closely monitor incoming data on labour market conditions, inflationary pressures and expectations, as well as financial and international developments in order to determine the appropriate path for the federal funds rate. The core inflation measure closely monitored by the FOMC remained stable at 1.8 per cent in February 2017, slightly below the target of 2 per cent and only marginally higher than the average level of 1.7 per cent in 2016. This suggests that the rise in energy prices has had, so far, limited impact on core prices. Any policy initiative to increase the tax rate on imported goods would be expected to raise inflationary pressures and accelerate the pace of interest rate rises beyond current market expectations.

Japan: 2017 budget may encourage more women to seek employment

Japan's Parliament has approved the budget for fiscal year 2017, which runs from 1 April 2017-31 March 2018. The budget includes a number of measures that may encourage a rise in the share of women participating in the workforce. Female labour force participation, at roughly 50 per cent of the female population aged 15 and older, remains significantly lower than male participation, which stands at 70 per cent. The budgetary measures include an expansion of childcare facilities, an extension of the eligible period for maternity leave benefits, changes to pension eligibility requirements, and a rise in the income threshold for spousal tax deductions. A higher rate of labour force participation would raise productive capacity in Japan and ease some of the fiscal pressures of the ageing population. More than 27 per cent of Japan's population is aged over 65, compared to just 17 per cent in 2000.

Government spending in 2017 will also be supported by the fiscal stimulus measures introduced in the Second Supplementary Budget of August 2016, which includes nearly 3 trillion yen in infrastructure investment spending for this year. After two years of declining government investment, the stimulus measures are expected to contribute approximately 0.4 percentage points to gross domestic product (GDP) growth this year.

Europe: The United Kingdom formally starts its exit from the EU

The United Kingdom of Great Britain and Northern Ireland formally gave notice of its exit from the European Union (EU), setting off a negotiation process that will cover a broad range of issues. These negotiations hold the potential to negatively affect the economies of both the EU and the United Kingdom due to the implied risks and uncertainties regarding the final outcome. Meanwhile, inflation in the United Kingdom increased to 2.3 per cent in February, compared to 1.8 per cent in the previous month, exceeding the Bank of England's policy target of 2.0 per cent. While higher energy prices were a main driver of the increasing inflation rate, upward price pressure was visible on a broader scale. In general, inflation in the United Kingdom is being propelled upward by a combination of higher commodity prices and the decline in the value of the pound in the wake of the vote to leave the EU, which is driving up import prices.

Unemployment continued to fall in the EU, reaching 8.0 per cent in February compared to 8.9 per cent in the previous year. However, labour market conditions vary considerably across the region. The Czech Republic, Germany and Malta registered the lowest unemployment rates at 3.4 per cent, 3.9 per cent and 4.1 per cent, respectively, while the rate remained high in Greece and Spain, at 23.1 per cent and 18.0 per cent, respectively. The overall unemployment numbers also mask some significant structural issues. For example, in Finland, the rate of unemployment fell to 9.2 per cent in February compared to 9.4 per cent a year ago, on the back of rising employment and lower unemployment among those aged 15-24 years. However, unemployment in this younger age group remains high at almost 23 per cent. In addition, there has been a further increase in the number of people who have stopped looking for a job, partly due to skill mismatches and barriers to mobility.

Among the EU members from Eastern Europe, several countries experienced a pick-up in inflation. In February, consumer price inflation reached a four-year record in Hungary and Poland. However, as core inflation remains relatively contained, the record-low policy rates in the countries with flexible currencies are likely to continue for the rest of the year.

Economies in transition

CIS: The Russian Federation loosens monetary policy

Amid a stronger currency, a moderately tight monetary policy and a still feeble aggregate demand, inflation in the Russian Federation subsided to its lowest level in over 25 years, reaching 4.3 per cent in March. In response, the central bank reduced its key policy rate by 25 basis points to 9.75 per cent in late March. Further gradual loosening of monetary policy may be envisaged over the course of the year, contingent on low capital outflows, absence of a strong rise in inflationary pressures and stability in the foreign exchange market. The purchase of foreign currencies in order to replenish the Reserve Fund should reduce the sensitivity of the rouble's exchange rate to the oil price.

Among the other CIS economies, a divergence in inflationary trends was observed. In Belarus, inflation slowed markedly, and the National Bank of the Republic of Belarus decided to cut its policy rate by 100 points to 14 per cent from mid-April. In Tajikistan, the shortage of foreign exchange caused the currency to depreciate in January and February, prompting the monetary authorities to hike the key policy rate by a further 350 basis points to 16 per cent in March, following a 150 basis points increase in February to curb inflationary risks. This move is alongside ongoing efforts to reduce dollarization of the economy. Inflation also remained high in Azerbaijan, reaching 12.5 per cent in February. In contrast, Armenia experienced a deflation in January and February despite higher fuel prices.

The intensification of instability in Eastern Ukraine has led to a blockade of rail and cargo links and disruption of coal supplies to the energy and steel sectors. This is threatening to derail the incipient recovery and worsen the growth outlook for 2017. In March, the Government of Ukraine imposed additional restrictions on the subsidiaries of several Russian state-owned banks, curtailing capital transfers out of the country. These domestic and regional tensions delayed the disbursal of the next $1 billion tranche of the IMF support programme, which was eventually approved in early April.

Developing economies

Africa: Adverse weather conditions weighing on the growth outlook of the Southern and East African economies

Food inflation stands at double-digit levels in sixteen mostly East African countries. This has been driven largely by agricultural shortages due to a recent El Niño-induced drought. Currency depreciations have also fuelled inflationary pressures, particularly for the large commodity exporters.

Looking ahead, droughts in the south of the continent have been followed by exceptional heavy rains and floods, still threatening agricultural production. Despite the anomalies, prospects for the next harvest have improved in a few areas. South Africa is expecting the highest maize harvest in decades, while in North Africa, winter rainfall points to a rapid harvest recovery. However, the impact of El Niño on food security and agricultural livelihoods will persist in the Horn of Africa. The impact of unfavourable weather on the health, nutrition, protection, education, and water and sanitation sectors is likely to persist throughout the year, posing a risk to the growth and development prospects of these economies.

Despite high inflation levels and currency pressures following the recent United States Federal Reserve interest rate hike, monetary policy has not been tightened across the continent. Instead, Ghana, Malawi, Uganda, United Republic of Tanzania and Zambia have recently decided to cut policy rates to boost domestic economic activity.

East Asia: Rebound in exports but high uncertainty clouds the trade outlook

Following two years of weak trade performance, the East Asian region experienced a rebound in export growth in the first two months of 2017. While the significant increase in export values is partly attributed to higher export prices, available data also indicates a moderate recovery in volume growth, reflecting a gradual improvement in global demand conditions.

In Singapore, the Republic of Korea and Taiwan Province of China, export values grew at a double-digit pace, buoyed by stronger shipments of semiconductors and other electronic components. Other economies in the region, such as Malaysia, the Philippines and Thailand, also benefited from the recent upturn in global demand for electronics. By markets, the improvement in East Asia's export growth was mainly driven by stronger intraregional demand, in particular from China, as well as an improvement in demand from the United States.

Leading indicators, such as the Manufacturing Purchasing Managers' Indices (PMI) and export orders, suggest that the region's export growth will likely sustain a favourable momentum into the second quarter. Nevertheless, the trade outlook is clouded with considerable risks and uncertainty. The shifting policy direction in the United States and in parts of Europe portends a potentially more restrictive global trade environment. This may have considerable impact on East Asian economies, given that the United States and the European Union collectively account for about 27 per cent of the region's total exports.

South Asia: Sri Lanka's central bank raises interest rates to curb inflationary pressures and to stabilize the rupee

The monetary policy stance remains broadly accommodative in most South Asian economies as consumer price inflation continues to be relatively low and stable, providing a significant support to economic activity. Against this backdrop, a noticeable exception is Sri Lanka, where the monetary tightening cycle initiated in early 2016—due to balance of payments difficulties—has recently accelerated. In March, the central bank raised its standing lending facility rate by 25 basis points to 8.75 per cent, in order to contain the build-up of adverse inflation expectations, capital outflows and demand side pressures through excessive credit expansion. In particular, since early 2016, consumer price inflation has increased continuously from less than 2.0 per cent in January 2016 to above 6.8 per cent in February 2017, the highest rate since mid-2013. The uptick in inflation in recent months has been driven by an increase in food prices, owing to the lingering and severe drought affecting the country. Some estimates suggest that this year's rice harvest will be less than half the normal production.[2] In addition, private credit growth has remained stubbornly high, while continued large capital outflows have also exacerbated downward pressures on the domestic currency. Besides the rationale behind the central bank's decision, tighter monetary conditions will prolong the difficulties of Sri Lanka's economy to close the output gap and to resume higher growth rates. In 2016, GDP growth was 4.4 per cent, well below the average of 6.3 per cent growth seen between 2005 and 2015.

Western Asia: Monetary policy stance tightened

Following the United States Federal Reserve's policy rate hike, the central banks of Bahrain, Jordan, Kuwait, Qatar, Saudi Arabia, Turkey and the United Arab Emirates have tightened their monetary policy stances. In the case of the United Arab Emirates, the 25 basis point rise in the policy deposit rate was accompanied by a rise in the policy lending rate—the first such change in the lending rate since 2009. The Saudi Arabian Monetary Authority, on the other hand, only raised its policy deposit rate, leaving lending rates at 2009 levels. For the Central Bank of Jordan, the 25 basis point rate rise in March followed a 50 basis points hike in February, as a precautionary policy shift to curb rising inflation. While keeping its key policy rate low, the Central Bank of the Republic of Turkey (CBRT) raised the late liquidity window lending rate again following its previous hike in January. Consumer inflation reached 10.3 per cent in February, and a high inflation trend is expected to persist due to the pass-through effects of the significant depreciation in the Turkish lira over the past 6 months.

Latin America and the Caribbean: Slower average growth in the Caribbean, with large cross-country differences

Amid challenging external conditions, average economic growth in the Caribbean slowed considerably in 2016. In contrast to South America, the sub-region has, however, not suffered an outright contraction of output. GDP is estimated to have grown by 1.6 per cent in 2016, down from 3.8 per cent in 2015. These aggregate figures mask stark differences in economic performance across the Caribbean countries. On one side of the spectrum is the Dominican Republic, which has been the fastest-growing economy in Latin America and the Caribbean in each of the past three years. In 2016, GDP expanded by 6.6 per cent on the back of buoyant investment (especially in infrastructure), a rebound in mining activity as well as robust growth in tourism and remittance inflows. However, economic activity in the Dominican Republic remains heavily dependent on the United States which has created some uncertainty over the country's short- and medium-term outlook.

On the opposite side of the spectrum are Trinidad and Tobago and Suriname, which experienced deep recessions in 2016. In both countries, the collapse in commodity prices (particularly oil), coupled with structural constraints and institutional weaknesses, has resulted in severe macroeconomic imbalances, including large fiscal and current account deficits. Significant adjustment measures have been implemented in both countries to restore macroeconomic stability, in the case of Suriname within the context of a Stand-by Agreement with the IMF.

2 World Food Programme, available from http://documents.wfp.org/stellent/groups/public/documents/ena/wfp289877.pdf