World Economic Situation and Prospects 2011

Executive Summary

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Executive Summary

The global economic outlook

Weaker global growth is expected in 2011 and 2012…

After a year of fragile and uneven recovery, global economic growth started to decelerate on a broad front in mid-2010. The slowdown is expected to continue into 2011 and 2012 as weaknesses in major developed economies continue to provide a drag on the global recovery and pose risks for world economic stability in the coming years. The unprecedented scale of the policy measures taken by Governments during the early stage of the crisis no doubt helped stabilize financial markets and jump-start a recovery. The policy response weakened during 2010, however, and is expected to be much less supportive in the near term also, especially as widening fiscal deficits and rising public debt have undermined support for further fiscal stimuli. Many Governments, particularly those in developed countries, are already shifting towards fiscal austerity. This will adversely affect global economic growth during 2011 and 2012.

…as multiple risks to the recovery remain

Despite the notable progress made in reducing the share of troubled assets in the banking sector, multiple risks remain. Real estate markets may deteriorate further, credit growth remains feeble, and levels of unemployment are persistently high. Most countries have kept in place, or even intensified, policies of cheap money (low interest rates and quantitative easing) in efforts to help financial sectors return to normalcy and stimulate economic activity as fiscal stimuli are being phased out. This has, however, added new risks, including greater exchange-rate volatility among major currencies and a surge of volatile capital flows to emerging markets, which have already become a source of economic tension and could harm the recovery in the near term. Such tensions have weakened the commitment to coordinate policies at the international level, which in turn has made dealing with the global imbalances and other structural problems that led to the crisis, as well as those that were created by it, all the more challenging.

The global recovery has been dragged down by the developed economies

World gross product (WGP) is forecast to expand by 3.1 per cent in 2011 and 3.5 per cent in 2012. The recovery may, however, suffer setbacks and slow to below 2 per cent, while some developed economies may slip back into recession if several of the downside risks take shape.

Among the developed economies, the United States of America has been on the mend from its longest and deepest recession since the Second World War, but has nonetheless been experiencing the weakest recovery pace in history. Although the level of gross domestic product (GDP) will return to its pre-crisis peak by 2011, a full recovery of employment will take at least another four years. Growth in many European countries will also remain low; drained by drastic fiscal cuts, some may continue to be in recession. Growth in Japan will also decelerate notably.
Developing country growth will also moderate

Developing countries and the economies in transition continue to drive the global recovery, but their output growth is also expected to moderate during 2011 and 2012. Developing Asia continues to show the strongest growth performance. Strong growth in major developing economies, especially China, is an important factor in the rebound in global trade

Source: UN/DESA and Project LINK
Note: For the baseline forecast assumptions, see box I.1. The pessimistic scenario refers to a situation of enhanced macroeconomic uncertainty in the outlook (see box I.4), while the optimistic scenario is one of limited, but improved, international policy coordination (see box I.5).

a Partly estimated.
b United Nations forecasts.
and commodity prices, which is benefiting growth in Latin America, the Commonwealth of Independent States and parts of Africa. Yet, the economic recovery remains below potential in all three regions. The fuel-exporting economies of Western Asia have not levelled oil production after the cutbacks made in response to the global recession; hence, the recovery in this region is also below pre-crisis levels of output growth.

Formidable challenges remain for the long-run development of many low-income countries. In particular, the recovery in many of the least developed countries (LDCs) will also be below potential.

### The outlook for employment, achievement of the Millennium Development Goals and inflation

Between 2007 and the end of 2009, at least 30 million jobs were lost worldwide as a result of the global financial crisis. Despite a rebound in employment in parts of the world, especially in developing countries, the global economy will still need to create at least another 22 million new jobs in order to return to the pre-crisis level of global employment. At the current speed of the recovery, this would take at least five years.

**Long-term unemployment is rising**

Owing to the below-potential pace of output growth in the recovery, particularly in developed economies, few new jobs have been created to rehire those workers who have been laid off. As more Governments are embarking on fiscal tightening, the prospects for a quick recovery of employment look even gloomier. The longer term employment consequences of the present crisis are already becoming visible, as the share of the structurally or long-term unemployed has increased significantly in most developed countries since 2007.

#### Persistent high unemployment in developed countries

![Percentage share of labour force](chart)

**Source**: UN/DESA.

\[a\] Partly estimated.

\[b\] United Nations baseline forecasts.
The recovery of employment has been faster in developing countries

Workers in developing countries and economies in transition have also been severely affected by the crisis, although the impact in terms of job losses emerged later and was much more short-lived than in developed countries. The impact on aggregate employment was also softened by the absorption of many workers into the informal sector, although many more workers have ended up in more vulnerable jobs with lower pay as a result. Job growth in developing countries started to rebound from the second half of 2009; by the end of the first quarter of 2010, unemployment rates had already fallen back to pre-crisis levels in a number of developing countries.

The crisis has caused important setbacks in progress towards the MDGs

The economic downturn has caused important setbacks in progress towards the Millennium Development Goals (MDGs). Achieving the millennium target of halving global poverty rates by 2015 (from 1990 levels) is within reach for the world as a whole, although it will not be met in sub-Saharan Africa nor, possibly, in parts of South Asia. However, the crisis has significantly increased the challenge of achieving targets for universal primary education, reducing child and maternal mortality and improving environmental and sanitary conditions. The requirements for stepping up economic growth and social spending posed significant macroeconomic challenges even before the crisis; these have become all the more pressing in cases where setbacks have been the greatest. Unfortunately, the mood for fiscal tightening is taking hold even in those developing countries with a policy intention of safeguarding “priority” social spending. This is a worrying trend, particularly where GDP growth is still well below potential and tax revenues have declined significantly because of the crisis. Among the many low-income countries especially, sufficient support through official development assistance (ODA) will be critical for enabling stepped-up efforts to achieve the MDGs.

Inflation does not pose a present danger, except in parts of South Asia

The current rates of headline inflation have stayed at very low levels despite the massive monetary expansion. Except in some Asian economies, where increasingly strong inflationary pressures reflect a combination of supply and demand-side factors, inflationary expectations are likely to remain muted in the near future owing to the stagnation in credit growth, alongside wide output gaps and elevated unemployment in most developed economies.

Trade and commodity prices

The rebound in world trade decelerated during 2010

World trade continued to recover in 2010, but the momentum of the strong growth observed in the first half of the year has started to peter out. While the volume of exports of many emerging economies has already recovered to, or beyond, pre-crisis peaks, exports of developed economies have not yet seen a full recovery. In the outlook, world trade is expected to grow by about 6.5 per cent in both 2011 and 2012, moderating from the 10.5 per cent rebound in 2010.
Despite the gradual recovery of the past two years, the value of imports of the three largest developed economies was still significantly below pre-crisis peaks by August 2010. Meanwhile, export recovery in these economies is mirrored in the fast growth of imports by countries in East Asia and Latin America. The question now is whether emerging economies can continue to act as the engines of world trade growth in the outlook, particularly as the dynamics of the initial phase of the recovery seem to be fading and as growth in developed countries remains sluggish.

*Financial factors are exacerbating the volatility in food and other commodity prices*

Most commodity prices have rebounded. The world price of crude oil fluctuated around $78 per barrel during 2010, up from an average of $62 for 2009. However, oil prices are expected to decrease somewhat in 2011. World prices of metals followed a similar trend in 2010 and are expected to edge up only slightly in 2011 and 2012.

Food prices declined during the first half of 2010, but rebounded in the second. While the expansion of global acreage and favourable weather patterns in key producing areas helped increase global food supplies considerably during 2009 and early 2010, adverse weather conditions in mid-2010 affected the harvests of basic staples. In addition, speculation amplified many commodity prices. Food prices will remain vulnerable to supply shocks and speculative responses in commodity derivatives markets.

*International finance for development*

*Net transfers from developing to developed countries increased again in 2010 and are set to continue on this trend*

Developing countries as a group continued to transfer vast amounts of financial resources to developed countries. In 2010, net transfers amounted to an estimated $557 billion—a slight increase from the level registered in the previous year. As has been the pattern for more than a decade, much of the net transfers reflect additional reserve accumulation by developing countries. In the outlook, net resource transfers from developing countries are expected to increase moderately along with the projected widening of current-account imbalances. This continuation of the pre-crisis pattern, in which, on balance, poor countries transfer significant amounts of resources to much richer nations, is also a reflection of the need felt by developing countries to continue to accumulate foreign-exchange reserves as a form of self-protection against global economic shocks. Instances of global financial market turbulence, increased exchange-rate volatility among major reserve currencies and a surge in short-term private capital flows have added to the sense of high macroeconomic uncertainty and the perceived need for self-insurance.

*Net private capital flows to developing countries have increased significantly*

Net private capital flows to developing countries have recovered strongly from their slump in 2008 and early 2009. Investors are searching for higher returns, and economic growth in emerging and other developing economies has been much stronger than in advanced economies; also, extensive monetary easing has kept interest rates very low in the latter.
With continued fragility and the substantial excess liquidity in developed financial markets, investors have shifted parts of their portfolios to emerging markets. Much of the surge in private capital flows to developing countries has taken the form of short-term, and probably volatile, equity investments, though foreign direct investment (FDI), especially in the extractive industries of commodity-exporting economies, has also increased.

**The crisis has increased the need for ODA, but has complicated the delivery on commitments**

The global financial crisis and economic recession of 2008 and 2009 negatively impacted many developing countries and put a severe strain on many low-income countries, making the delivery of committed ODA even more critical. Although net transfers to low-income countries have remained positive during 2010, the fragile recovery in developed countries and the possible threat of a double-dip recession create considerable uncertainty about the future volume of ODA flows. Moreover, aid delivery is falling short of commitments by the donor community.

**The debt situation in many developing countries has improved, but problems remain**

Despite improvements in the debt position of many developing countries prior to the crisis, some countries, including some small middle-income countries, remain in vulnerable situations. In the wake of the crisis, other developing economies have moved into more critical debt positions. The total external debt (public and private) of developing countries as a share of GDP rose to 24.8 per cent in 2009, an increase of 2.2 percentage points over the previous year, while the downward trajectory of the debt service-to-exports ratio was
reversed because of the negative impact of the crisis on the dollar value of both GDP and exports. As a result, the average external debt-to-export ratio of developing countries and transition economies increased from 64.1 per cent in 2008 to 82.4 per cent in 2009. In many countries, debt ratios increased even more significantly, as managing the impact of the crisis resulted in rapid increases in public debt. Despite the generous debt relief provided, 13 (out of 40) heavily indebted poor countries (HIPC) are classified as being “in debt distress” or at “high risk of debt distress”, while 7 non-HIPC low-income countries are identified as facing debt problems.

The persisting external debt problems among both low- and middle-income countries and the surge of sovereign debt distress among a number of developed countries points to the limits of the existing arrangements for dealing with debt problems. It also points to the urgent need for setting up an international sovereign debt workout mechanism which would allow countries to restructure their debt in a timely and comprehensive manner.

Some progress has been made towards providing a better framework for regulating the financial sector

A reform agenda set out by the Group of Twenty (G20) envisaged the introduction of macroprudential supervision that would take due account of systemic risk and the overall stability of the financial system, including pro-cyclicality and moral hazard caused by activities of systemically important financial institutions. A new capital and liquidity reform package, Basel III, was agreed upon and issued by the Basel Committee on Banking Supervision. This is an important step forward, as it requires banks to hold larger amounts of capital and reserves against outstanding loans so as to increase their resilience under more turbulent financial market conditions. However, these new capital and liquidity standards apply only to banks. Consequently, more also needs to be done to address risks outside the traditional banking system (investment banks, hedge funds, derivatives markets, and so forth), which represented a major factor in generating the global crisis in 2008. The new standards and rules will have to be made applicable across different types of financial markets and institutions offering similar products.

Uncertainties and risks

Key uncertainties and risks to the baseline scenario for 2011 and 2012 are slanted towards the downside.

Fiscal austerity could risk further deceleration of the recovery

Despite continued fragile recovery, the sense of urgency and the will to move fiscal and monetary policies in tandem dissipated during 2010 over worries, especially in developed countries, that fiscal sustainability could be in jeopardy. Such worries are juxtaposed to fears that the phasing-out of fiscal stimulus and a quick retreat into fiscal austerity would risk further deceleration of the recovery and fail to bring unemployment down, while public debt ratios would continue to rise because of insufficient output growth.

Since budget deficits have widened sharply, public debt of developed countries will continue to increase, even under conservative assumptions, surpassing 100 per cent of GDP, on average, in the next few years. Governments of many advanced economies
will thus face large and increasing funding needs. At the same time, the risk of enhanced financial fragility has increased because of the way in which public indebtedness became linked to the health of the banking sector during the crisis: while Governments have guaranteed vast amounts of bank liabilities, banks have been purchasing large amounts of government securities. As a result, a heightened risk for the financial health of one of these two parties will feed into the other, possibly forming a vicious circle that could amplify the risk throughout the whole economy.

**Increased exchange-rate instability remains a risk…**

The exchange rates among major currencies experienced high volatility during 2010, with escalated tension spreading rapidly to other currencies. The failure to maintain exchange-rate stability among the three major international reserve currencies has also affected currencies of emerging economies. The surge in capital inflows to emerging economies, fuelled by the quantitative easing in developed countries and portfolio reallocation by international investors, as well as by the weakening of the dollar, has led to upward pressure on the exchange rates of some emerging economies. Developing countries have responded by intervening in currency markets and/or imposing capital controls to avoid soaring exchange rates, loss of competitiveness and inflating asset bubbles. Currency instability and perceived misalignment of exchange rates could become part of a major skirmish over trade, which may well turn into a wave of protectionist measures and retaliations worldwide, once again risking derailment of global growth and destabilization of financial markets.

…as does an uncoordinated rebalancing of the world economy

The global imbalances may widen again, which in turn could feed more instability back into financial markets. Prospects for narrowing the imbalances will depend on how successful economies will be in making structural adjustments. However, the path of these adjustments is unclear, particularly given the uncertainties about how the risks of a further slowing of growth and the persistence of high rates of unemployment, sovereign debt problems and further exchange-rate instability will all play out. Even if the global imbalances do not edge up significantly in the near term, the underlying adjustment in stocks of international asset and liability positions would continue to move in a risky direction, particularly as the global financial crisis has caused a surge in net foreign liabilities of the United States.

More quantitative easing and a further depreciation of the dollar might be a way for the United States to try to inflate and export its way out of its large foreign liability position, but it would more likely risk disruption of trade and financial markets. Moreover, dollar weakness poses a threat because it increases import prices in the United States, the world’s largest consumer market, and thus erodes purchasing power. This could lead to a decline in global trade, constituting the antithesis of the United States consumption boom that fuelled global economic growth before the financial crisis.

Accordingly, if concerns grow about exports’ being hit by dollar weakness, developing countries will understandably feel inclined to intervene in their foreign-exchange markets, as is already the case. However, frequent intervention in foreign-exchange markets increases the potential for international currency and trade conflicts, which could further undermine the international cooperation shaped at the level of the G20. A further waning of the commitment to international policy coordination will be an added liability for the prospects of a balanced and more sustained global recovery.
Policy challenges

Five major policy challenges need to be addressed

The potentially damaging spillover effects of national policies once again highlight the need for strengthened international policy coordination. Unfortunately, during 2010, the cooperative spirit among policymakers in the major economies has been waning. World Economic Situation and Prospects 2011 suggests that avoiding a double-dip recession and moving towards a more balanced and sustainable global recovery would require that at least five related major policy challenges be addressed.

First, continued and coordinated stimulus

First, by using the ample fiscal space that is still available in many countries, additional fiscal stimulus, in tandem with appropriate monetary policies, is needed in the short run to boost the global recovery. Such action should be adequately coordinated among the major economies to ensure a reinvigoration of global growth that will also provide external demand for those economies which have exhausted their fiscal space. Absent a new net fiscal stimulus and faster recovery of bank lending to the private sector, growth is likely to remain anaemic in many countries in the foreseeable future.

Second, redesigning fiscal stimulus

Second, fiscal policy needs to be redesigned to strengthen its impact on employment and aid in the transition towards promoting structural change for more sustainable economic growth. A prudent policy would be to target public investments with a view to alleviating infrastructure bottlenecks that mitigate growth prospects. One priority area would be to expand public investment in renewable clean energy as part of commitments to reduce greenhouse gas (GHG) emissions, and in infrastructure that provides greater resilience to the effects of climate change. Another area might be to expand and improve public transportation networks, which would create potentially significant amounts of new jobs while at the same time helping to reduce GHG emissions, particularly in rapidly urbanizing environments. Social protection policies are another crucial element in cushioning the impact of economic shocks, boosting aggregate demand and contributing to the sustainability of economic growth.

Third, more effective monetary policy and addressing international spillover effects

The third challenge is to find greater synergy between fiscal and monetary stimulus, while counteracting damaging international spillover effects in the form of increased currency tensions and volatile short-term capital flows. This will require reaching agreement about the magnitude, speed and timing of quantitative easing policies within a broader framework of targets to redress the global imbalances. It will also require deeper reforms of financial regulation, including those for managing cross-border capital flows, as well as in the global reserve system in order to reduce dependence on the United States dollar.
Fourth, more predictable access to
development finance for achieving the MDGs

The fourth challenge is to ensure that sufficient resources are made available to developing
countries, especially those possessing limited fiscal space and facing large development
needs. These resources will be needed, in particular, to accelerate progress towards the
achievement of the MDGs and for investments in sustainable and resilient growth. Apart
from delivering on existing aid commitments, donor countries should consider mecha-
nisms to delink aid flows from their business cycles so as to prevent delivery shortfalls in
times of crisis, when the need for development aid is most urgent.

Fifth, more concrete and enforceable
targets for international policy coordination

The fifth challenge is to find ways to arrive at credible and effective policy coordination
among major economies. In this regard, there is some urgency in making the G20 frame-
work for sustainable global rebalancing more specific and operational. In this context,
establishing concrete “current-account target zones” might be a meaningful way forward.
Having clear and verifiable targets for desired policy outcomes would help make parties
accountable, while the possible loss of reputation through non-compliance would be an
incentive to live up to policy agreements. Such target zones would also highlight the need
for both surplus and deficit countries to contribute to sustaining global effective demand.

The target zones should not, however, be seen as an end in themselves, but
rather as a guide towards a sustainable growth path for the world, which should encompass
the proposed actions to address all five challenges listed above. They should also be seen as
an intermediate step towards the more fundamental reforms of the global reserve system
and the financial regulation that are needed to prevent future global financial instability
and meltdowns.