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FOR INFORMATION

FIRST ITEM ON THE AGENDA

The Global Jobs Pact: Policy coherence and international coordination

Addendum

Summary of recent world economic forecasts

Economic growth

1. Forecasts released since mid-2009 by the main intergovernmental agencies point to a bottoming out of the recession and a weak and fragile recovery in 2010. However, within this global picture there are important variations in performance between regions and countries. All forecasters express concern that recovery in employment will lag well behind a turnaround in output.

2. In mid-2009, the United Nations (UN) expected the world economy to shrink by 2.6 per cent in 2009, after an expansion of 2.1 per cent in 2008 and nearly 4 per cent per year between 2004 and 2007. Although a mild recovery was expected in 2010, risks remained on the downside and developing countries were being hit disproportionately hard by the crisis.

3. In the October 2009 issue of the *World Economic Outlook*, the International Monetary Fund (IMF) predicted a 1.1 per cent decline in world output in 2009 and growth of 3.1 per cent in 2010. This was an upward revision of July forecasts. Noting the strong performance of Asian economies, the IMF warned that “the pace of recovery is slow, and activity remains far below pre-crisis levels. Growth is being led by a rebound in manufacturing and a turn in the inventory cycle, and there are some signs of gradually stabilizing retail sales, returning consumer confidence, and firmer housing markets. As prospects have improved, commodity prices have staged a comeback from lows reached earlier this year, and world trade is beginning to pick up. The triggers for this rebound are strong public policies across advanced and many emerging economies that have supported demand and all but eliminated fears of a global depression”.

Overview of IMF *World Economic Outlook*
(percentage change in output year over year)

	Projections			
	2007	2008	2009	2010
World output	5.2	3.0	–1.1	3.1
Advanced economies	2.7	0.6	–3.4	1.3
Emerging and developing economies	8.3	6.0	1.7	5.1
Selected countries/regions				
United States	2.1	0.6	–3.4	1.5
European Union	3.1	1.0	–4.2	0.5
Japan	2.3	–0.7	–5.4	1.7
China	13.0	9.0	8.5	9.0
India	9.4	7.3	5.4	6.4
Russian Federation	8.1	5.6	–7.5	1.5
Central and Eastern Europe	5.5	3.0	–5.0	1.8
Brazil	5.7	5.1	–0.7	3.5
Mexico	3.3	1.3	–7.3	3.3
Africa	6.3	5.2	1.7	4.0
Middle East	6.2	5.4	2.0	4.2
World trade volume (goods and services)	7.3	3.0	–11.9	2.5

Source: IMF *World Economic Outlook. Sustaining the recovery* (October 2009), table 1.1.

Risks to recovery

4. According to the IMF, the main short-term risk is that the recovery could stall and deflationary forces become entrenched. “A premature exit from accommodative monetary and fiscal policies, possibly driven by rising concerns about government intervention and unconventional action by central banks, seems to be a significant risk because the policy-induced rebound could be mistaken for the beginning of a strong recovery.” The Fund is concerned that policy support might not be extended long enough to allow private demand to make a sustained recovery. Furthermore, “progress in repairing financial balance sheets could be undercut by rising unemployment, greater-than-expected increases in delinquencies on residential mortgages and commercial real estate, and more corporate bankruptcies”. With banks still only weakly capitalized, this could lead to even tighter financial conditions.

Continuing credit squeeze

5. The *Global Financial Stability Report*, also published by the IMF in October, analyses conditions in the finance markets. Whilst acknowledging some signs of stabilization, it identifies several strains which continue to impair the functioning of markets. One of the pressures it highlights is that half of bank write-downs still have to be completed and that banks have raised less than half of the capital they need to cover losses. It envisages the supply of bank credit falling for the remainder of 2009, and continuing to fall into 2010, both in the United States and Europe. Even with anaemic private sector demand, the report suggests that credit supply will not be sufficient, with the added implication that this could inhibit recovery.

6. The dilemma concerning the withdrawal of the exceptional support provided to the finance sector's liquidity is also discussed in the report. A premature withdrawal of crisis measures could risk provoking a double-dip recession, but prolonged access to easy money could fuel asset bubbles and a further, and perhaps worse, financial crisis.

Rebalancing global demand

7. Looking to the medium term, the IMF expects the growth in global output to remain below potential during the period up to 2014, with high unemployment rates, especially in advanced economies, mainly as a result of subdued demand. The Fund therefore stresses the importance of rebalancing global demand, as well as improving supply-side performance. This is seen mainly as a shift towards consumption-led growth in emerging developing countries, notably China, and surplus economies, such as Japan and Germany – and is expected to be a drawn-out process.

8. However, such a shift would have to counter a number of factors dampening economic activity in many emerging and developing countries. The global average for growth in developing countries in 2009 is strongly influenced by the performance of India and China. During 2009, the least developed countries were primarily hit by a fall in the export revenues of African mineral exporters, as a result of the sharp drop in prices, as well as in the revenues of Asian low-cost manufacturing exporters, as a result of weaker demand. Many least developed countries and other developing nations rely on export tax revenues. The fall in the price of minerals has thus created a major fiscal problem, which threatens core public spending on education and health.

9. The drop in global economic activity, combined with much weaker capital flows to developing countries, is thus placing a serious financial strain on a large number of low- and middle-income countries. Many countries are finding it difficult to generate sufficient foreign currency from exports or are borrowing to cover import demand. The World Bank has estimated that borrowing needs for developing countries will exceed net capital inflows by between US$350 billion and US$635 billion in 2009. Many countries were meeting this financing gap by drawing down on the international currency reserves. However, the sustainability of this strategy was uncertain. The challenges of widening current account deficits and deteriorating fiscal positions were seen as most acute in countries with wide current account deficits and/or elevated government debt. If financing was not fully available to such economies, "heavy compression of domestic demand and exchange-rate depreciation will be required to restore internal and external balances". [1] Central and Eastern European countries were considered to be among the most vulnerable to such a squeeze.

Trade flows

10. Close monitoring of increased trade protection has helped to contain the risk of a spread of market closing measures. Nevertheless, trade flows dropped precipitously in 2009, and are only expected to grow by 2.5 per cent in 2010, compared to over 7 per cent in 2007. The Baltic Dry Index, a measure of shipping costs, widely watched as a lead indicator of

[1] World Bank: *Global Development Finance 2009: Outlook summary* (Washington, DC, 2009).

international trade prospects, remains well down from its peak of over 11,000 in mid-2008, at around 3,000 during the third quarter of 2009.

Conclusion

11. Like many individual national economies, the world economy is walking a tightrope between ongoing recessionary pressures, resulting from the squeeze on credit to households and firms, rising unemployment, reduced earnings and weak consumer confidence, and the reflationary measures taken by governments through tax cuts and increased spending. The signs of a recovery in private sector demand, to take over from the exceptionally strong public sector efforts as a motor of recovery, are still weak. Many firms still report high rates of capacity underutilization and low investment intentions. Forecasters are thus including many caveats about downside risks, although some expect a sharp "bounce" effect once the decline stops and growth resumes.

12. However, there is one point on which all agree, namely that labour market indicators, notably unemployment, will continue to worsen until well into 2010, especially in advanced countries. Recovery is thus unlikely to be led by these countries, which account for 55 per cent of global output. China, India and Brazil, which together account for 19 per cent of global gross domestic product (GDP), are forecast to achieve relatively strong growth in 2010. Overall, unless a stronger policy effort is made to rekindle private consumption, which accounts for around three-quarters of GDP in most countries, global recovery is likely to be gradual. This will entail a focus on providing support for employment and household incomes, the main components of which are wages and social transfers, such as pensions and child support.

Sources:

IMF: *World Economic Outlook. Sustaining the recovery* (October 2009).
UN: *World Economic Situation and Prospects 2009. Update as of mid-2009*.
World Bank: *Global Development Finance 2009: Charting a global recovery*.
UNCTAD: *The Least Developed Countries Report 2009. The State and development governance* (16 July 2009).

Submitted for information.