2010 High-level Segment
GLOBAL POLICY DIALOGUE

Informal Note
Executive Summary of WESP Mid-2010:
World Economic Situation and Prospects 2010-11

Having fallen into the most severe recession since World War Two, the world economy is on the way to recovery. Following a contraction of 2.0 per cent in 2009, world gross product (WGP) is expected to grow by 3.0 per cent in 2010 and 3.1 per cent in 2011, (Table A.1). The pace of the recovery remains subdued, however. It is far from sufficient to recuperate the job losses and close the output gap created by the deep recession. The baseline forecast assumes that the multi-year policy stimulus measures put in place in the major economies will be implemented as envisaged, implying that in most countries government stimulus will continue at least during 2010, and that private sector confidence will pick up gradually.

Buttressed by unprecedented government support worldwide, global financial markets have progressively stabilized. By mid-2010, systemic risks in the world financial system have abated notably, while risk premia in most credit market segments have dropped to pre-crisis levels. Also, major equity markets have recovered on average about half of the losses incurred during the crisis, while banks and other financial institutions have managed to rebuild their capital. Capital inflows are gradually returning to many developing economies, and prices of primary commodities have rebounded after steep declines from the start of the crisis to the second quarter of 2009.

The recovery in the real economy has also gained more traction. Propelled by fiscal stimulus packages and expansionary monetary policies, most economies registered positive growth in late 2009 and early 2010. The increase in policy-engendered public spending and the turn-around in inventories, which were curtailed precipitously during the crisis, have been major factors in the growth recovery. Meanwhile, household consumption and business investment are showing tentative signs of revival and international trade and global industrial production, which both collapsed during the crisis, have been rebounding steadily, although they are still below their pre-crisis peaks.

Yet, important weaknesses remain in the world economy. Despite the huge amount of liquidity that was injected into the financial system, credit flows to non-financial sectors in many economies, particularly the major developed economies, remain subdued. While the rebound in equity prices has mitigated the losses of many financial institutions, the process of establishing sounder balance sheets through write downs of troubled assets and de-leveraging is still on-going. At the same time, public finances of many developed countries have deteriorated rapidly due to the impact of the crisis and the policy responses. In some, such as in Greece, Portugal, Spain and Ireland, they have already become a new source of financial instability.

The recovery of economic activity at the global level is weaker and slower than observed after previous recessions of recent date. Economic recovery is also uneven across countries. In most developed countries, private sector activity is not yet on a solid footing. Facing elevated unemployment rates, soaring public debt, and limited credit flows, growth prospects for most developed economies remain lacklustre, unable to provide sufficient impetus to the global economy. While developing Asia, particularly China and India, is leading the way among developing countries, the recovery is much more subdued in many economies in Africa and Latin America. Although most economies in transition are seeing a visible rebound from the deep downturn in 2009, the recovery is fragile being heavily dependent on conditions in world commodity markets and access to external borrowing.

Many developing countries are still suffering from the fallout of the global financial crisis. Though only 10 developing countries are expected to register another year of decline of per capita income during 2010, the impact on labour markets and social conditions is still being felt more broadly. The reduction in employment and income opportunities has led to a considerable slowdown in progress towards poverty reduction and the fight against hunger. By the end of 2010, the crisis will have left an estimated 64 million more persons in extreme poverty relative to the pre-crisis trend. The steep rise in food prices during 2007-2008 is estimated to have increased the number of malnourished people by 63 million, while the global economic crisis may have led to another 41 million undernourished than would have been the case without the crisis.

The number of unemployed worldwide rose by more than 34 million people in 2009 as the estimated global rate of unemployment increased from 5.7 per cent at the end of 2007 to 6.6 per cent by the end of 2009. In many developing countries, informal sectors absorbed the impact on unemployment. As jobs in the informal sector tend to be more precarious and receiving low pay, the number of working poor is estimated to have increased by 215 million. At the present rate of recovery, it is expected to take at least 4 to 5 years to bring unemployment rates down to pre-crisis levels in most developed countries. In many developing economies informal sectors may continue to expand as firms postpone hiring.

The risk of a protracted period of mediocre growth for the world economy remains high in the aftermath of the global financial crisis. This poses several policy challenges.

Policy challenges

First, dealing with the jobs crisis is of immediate urgency as persistent high unemployment and underemployment rates are slowing the global recovery itself as well as progress towards poverty reduction in developing countries. Much of the demand recovery still rests on government support. In most countries, these support measures will need to be maintained during 2010 and perhaps into 2011. In order to accelerate recovery in job markets, however, much more of the demand stimulus will need to be focused on providing incentives to productive employment creation. Job growth will also be a key ingredient in redressing the trend towards widening fiscal deficits by stemming the drop in tax revenue and reduce the need for social protection spending. Exit strategies from the extraordinary stimulus measures thus will need to be closely coordinated with labour market policies.

Second, there is a need for more resources and greater efforts to make up for the significant setbacks in progress towards the Millennium Development Goals (MDGs). Low-income countries with limited fiscal space are in need of additional ODA to finance the expansion of social services and programs needed to meet the MDGs and engage in counter-cyclical policies. These increased needs contrast with the still significant shortfall in aid delivery against commitments. Although OECD's Development Assistance Committee (DAC) expects continued modest growth in total net ODA for 2009 and 2010, the estimated shortfall against the Gleneagles commitments will be $20 billion in 2010. Apart from fulfilling commitments, donor countries should consider mechanisms to de-link aid flows from their business cycles to prevent delivery shortfalls in times of crisis when the need for development aid is most urgent.

More broadly, the global crisis has highlighted the need for very large liquidity buffers to deal with sudden and large capital market shocks. In response to the financial crises of the 1990s, many developing countries have responded by accumulating vast amounts of reserves as a form of self-insurance. But doing so comes at high opportunity costs and, moreover, it has been conducive to the problem of the global imbalances. By better pooling reserves regionally and internationally such costs to individual countries could be reduced and it could also form the basis for more reliable emergency financing and the establishment of an international lender of last resort mechanism. Broadening existing SDR arrangements could be part of such new arrangements and, as argued at greater length in the *World Economic Situation and Prospects 2010* (http://www.un.org/esa/policy/wess/wesp.html), form part of a much needed broader reform of the global reserve system.

Third, those efforts will need to be underpinned by strengthened international policy coordination to avoid weakening of the recovery which may result from premature and uncoordinated exit strategies from the macroeconomic stimulus measures and failure to address the spill-over effects from emerging public debt crises in developed countries. Further progress on systemic reforms will also be needed. The lack of a concerted approach and greater policy coordination among members of the European Union to tackle concerns of fiscal sustainability particularly in Greece, and the fallout of the initial indecisiveness on financial markets, highlights the importance, particularly in times of greater uncertainty, of a broad and effective policy coordination among the major economies to prevent the return of global imbalances and to ensure that the recovery is sustainable. In this regard, the G20 Summit at Pittsburgh launched a framework for strong, sustainable and balanced growth, under which the deficit members in the G-20, mainly the United States, pledge to undertake policies to support private savings and to consolidate their fiscal deficit, while the surplus members agree to strengthen domestic sources of growth, through measures such as reducing financial markets distortions, boosting productivity in service sectors, and improving social safety nets. Although this framework has laid the first step towards a more balanced global growth, more specific and concrete policies need to follow. This is particularly important in the medium term, in which policy makers need to coordinate an ‘exit strategy’ and phase out stimulus measures once unemployment rates have decreased significantly, whilst simultaneously retaining a countercyclical policy framework. In the longer term, countries should ultimately coordinate their macroeconomic policies towards a combination of manageable global imbalances. These policies would require greater net financial transfers to developing countries and should ensure in the outlook that fiscal policy stances remain expansionary in developing countries, but are gradually phased out in developed countries.

Suggested key questions:

1. The gradual and mild pace of economic recovery presages a very slow recovery in employment, or even a jobless recovery. How can we enhance policies to focus more on improvement in labour markets to boost stronger employment growth?

2. Although the global imbalances narrowed markedly in 2009, they could widen with the path of the global recovery that has been set in. What measures can be taken so as to avoid a widening of the global imbalances, which portended the global financial and economic crisis in the first place? In particular, what strategies are the most likely to foster greater policy coordination between and amongst developing and in developed countries

3. What steps can be taken to de-link development aid from business cycles in developed countries and reduce the volatility of these flows? How can policies in developing economies be made more counter-cyclical?

Growth of world output, 2004 – 2011, Annual percentage change

	2004-2007 [a]	2008	2009[b]	2010[c]	2011[c]	Change from United Nations forecast of January 2010 [d] 2010
World	3.8	1.8	-2.0	3.0	3.2	0.6
Developed economies	2.6	0.4	-3.4	1.9	2.1	0.6
USA	2.6	0.4	-2.4	2.9	2.5	0.8
Japan	2.1	-1.2	-5.2	1.3	1.3	0.4
European Union	2.7	0.8	-4.2	1.0	1.8	0.5
EU15	2.5	0.5	-4.2	0.9	1.7	0.4
New EU Members	5.8	3.9	-3.5	1.7	3.2	0.5
Euro zone	2.5	0.6	-4.0	0.9	1.5	0.5
Other European	3.0	1.8	-1.7	1.9	2.2	1.2
Other developed countries	3.1	1.0	-1.0	3.1	2.9	1.0
Economies in transition	7.6	5.4	-6.7	3.9	3.4	2.3
South-eastern Europe	5.3	4.3	-3.7	1.1	3.0	0.4
CIS	7.8	5.5	-6.9	4.2	3.5	2.5
Developing economies	7.2	5.3	2.2	5.9	5.8	0.6
Africa	5.7	5.0	2.4	4.7	5.3	0.4
North Africa	5.2	4.9	3.6	4.6	5.3	0.7
Sub-Saharan Africa	6.0	5.0	1.9	4.7	5.3	0.3
East and South Asia	8.5	6.2	4.8	7.1	6.9	0.7
East Asia	8.6	6.1	4.7	7.3	6.9	0.6
South Asia	8.1	6.5	5.1	6.5	6.9	1.0
Western Asia	6.0	4.3	-1.0	4.2	4.0	0.6
Latin America & the Caribbean	5.3	4.0	-2.1	4.0	3.9	0.6
South America	5.8	5.3	-0.3	4.5	4.6	0.8
Mexico and Central America	4.1	1.7	-5.9	3.4	2.8	0.5
Caribbean	8.2	3.8	1.0	2.1	3.0	-0.4
Least developed countries	7.8	7.1	4.0	5.6	5.6	0.3
Memorandum items:						
World trade	7.7	2.7	-13.1	7.6	5.9	2.2
World output growth with PPP-based weights	4.8	2.9	-0.8	3.9	4.0	0.7

Source: UN/DESA

a Average percentage change.

b Partly estimated.

c Forecast, based in part on Project LINK.

d See *World Economic Situation and Prospects 2010*, available at http://www.un.org/esa/analysis/wess/wesp2010files/wesp2010.pdf