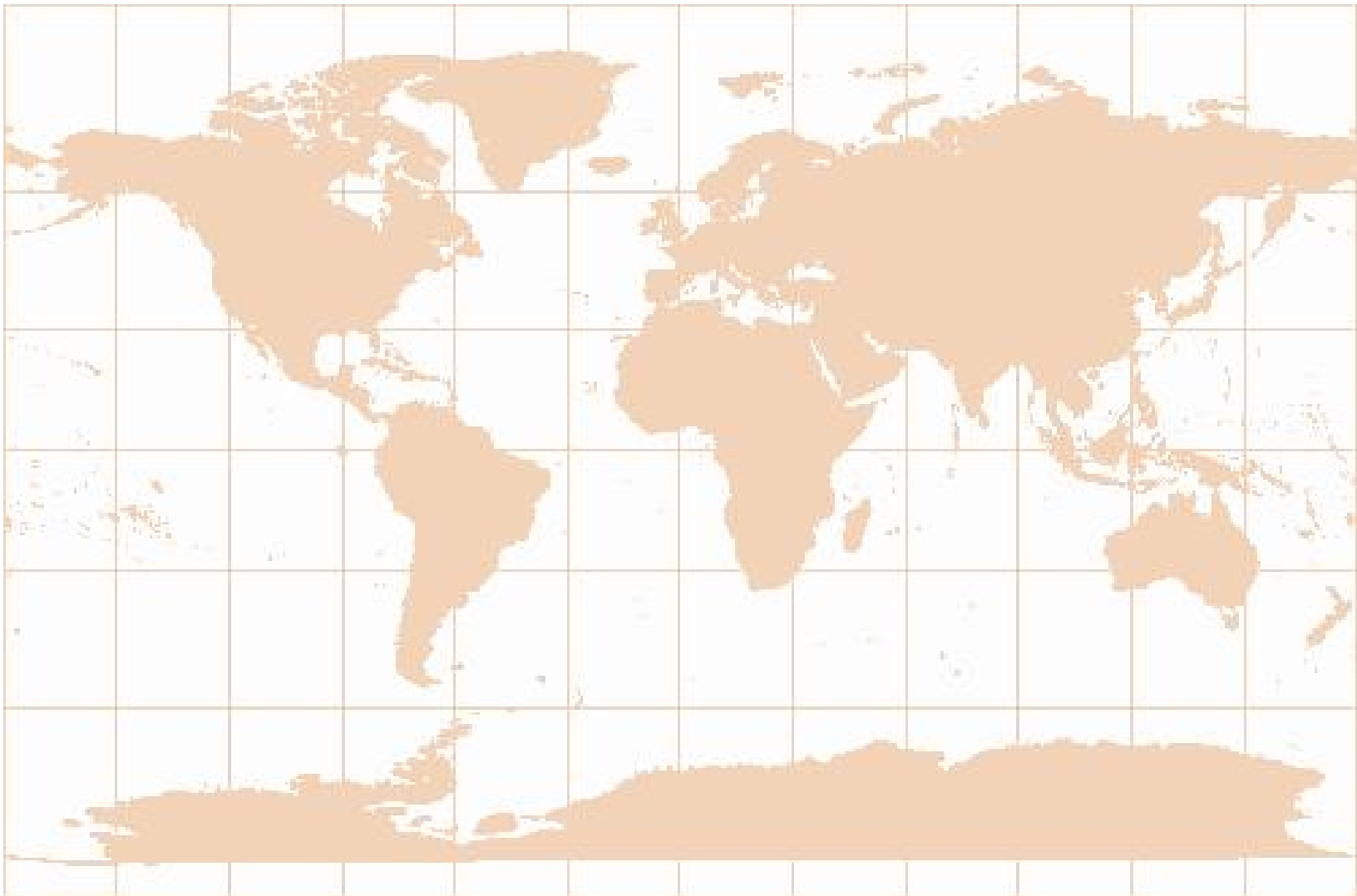


World Economy At Large 2013

Update as of mid-2013*



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Summary

Despite improved global financial conditions and reduced short-term risks, the world economy continues to expand at a subdued pace. After a marked downturn over the past two years, global economic activity is expected to slowly gain momentum in the second half of 2013 and 2014 on the back of accommodative monetary policies in developed and developing economies. Most world regions are likely to see a moderate pick-up in activity, but growth will continue to be below potential and employment gains, especially in developed economies, will remain weak at best. The short-term risks associated with the situation in the euro area, the fiscal adjustments in the United States and the economic slowdown in large developing countries have diminished, but not disappeared. At the same time, new medium-term risks have emerged, including possible adverse effects of unconventional monetary measures in developed economies on global financial stability. These risks have the potential to once again derail the feeble recovery of the world economy. The main priority for policy makers worldwide should therefore be to support a robust and balanced global recovery, with a focus on promoting job creation. International policy coordination needs to be enhanced to mitigate negative policy spillovers, curb protectionism, promote cooperation in reforming the international financial system, and ensure sufficient resource flows to developing economies, and in particular the least developed countries.

I. Global macroeconomic trends

Subdued global growth in 2013, some improvement expected for 2014

Despite improved global financial conditions and reduced short-term risks, the world economy continues to expand at a subdued pace. After a marked downturn over the past two years, global economic activity is expected to slowly gain momentum in the second half of 2013. Most world regions are likely to see a moderate strengthening, but growth will still remain below potential. In the baseline outlook, global growth has been revised slightly downward from the forecasts presented in the *World Economic Situation and Prospects 2013*. Growth of world gross product (WGP) is now projected at 2.3 per cent in 2013, the same pace as in 2012, before gradually strengthening to 3.1 per cent in 2014 (see table 1). Several key risks and uncertainties remain, and, if not mitigated, could derail global growth again, as in the past few years.

Since late 2012, several new policy initiatives in major developed economies have reduced systemic risks and helped stabilize consumer, business and investor confidence, but with very limited impacts on growth. In the euro area, sovereign bond risk premia of debt-distressed countries have fallen notably, but the real economy is held back by austerity programs, weak bank lending and continued uncertainty, and only a very gradual recovery is expected as these factors diminish. Significant downside risks remain if the vicious cycle of deleveraging and banking sector fragility continues unabated. In the United States, the avoidance of the fiscal cliff and the expansion of monetary easing, along with a continued recovery in the housing sector, have improved growth prospects. While private sector demand is projected to gradually strengthen, the automatic spending cuts and uncertainties associated with budget issues will continue to weigh on aggregate demand. In Japan, the bold expansionary policy actions adopted by the monetary and fiscal authorities are expected to provide some support for economic activity in the short run. They may, however, also create heightened medium-term uncertainties regarding the sustainability of public debt.

Developing countries and economies in transition continue to register much stronger growth than developed economies. In response to the economic slowdown in 2012, many of them, including some large countries in East Asia, South Asia and Latin America, adopted more expansionary monetary and – to a lesser extent – fiscal policies to strengthen domestic demand. This, along with a slight upturn in external demand, should provide a lift to economic growth in 2013. The pick-up in growth will, however, be slower than previously estimated as many large economies in this group, including Brazil, China, India and Russia face significant structural challenges. Potential growth in many developing countries is likely lower than before the global financial crisis; China, for example, is expected to have shifted to a lower but more sustainable and balanced growth trajectory. The least developed countries (LDCs) are projected to see faster growth in 2013 than in the past two years. However, with commodity demand moderating and Official Development Assistance (ODA) falling, the pace of expansion in LDCs will still be notably slower than during the period 2004-08.

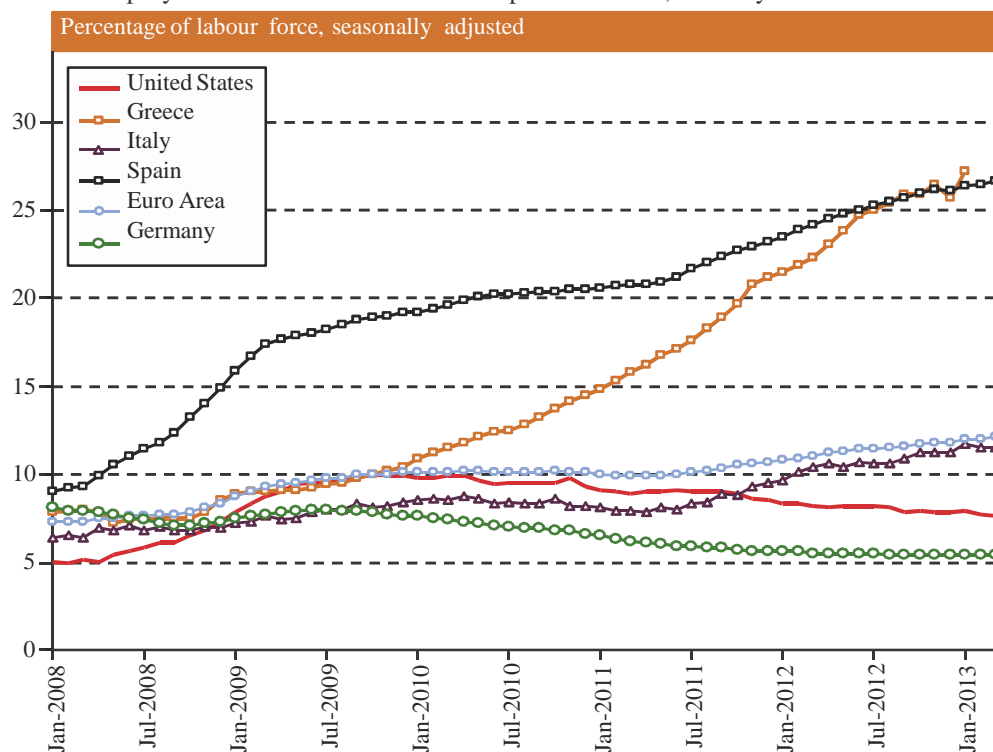
Table 1
Growth of world output, 2011–2014, annual percentage change

	2011	2012 ^a	2013 ^b	2014 ^b	Change from January 2013	
					2013 forecast	2014
World	2.8	2.3	2.3	3.1	-0.1	-0.1
Developed economies	1.4	1.2	1.0	2.0	-0.1	0.0
United States of America	1.8	2.2	1.9	2.6	0.2	-0.1
Japan	-0.6	2.0	1.3	1.6	0.7	0.8
European Union	1.5	-0.3	-0.1	1.3	-0.7	-0.4
EU15	1.4	-0.4	-0.2	1.3	-0.7	-0.3
New EU Members	3.2	0.8	1.1	2.2	-0.9	-0.7
Euro area	1.4	-0.6	-0.4	1.1	-0.7	-0.3
Other European	1.6	1.9	1.7	2.2	0.2	0.3
Other developed countries	2.5	2.6	2.0	2.7	0.0	-0.3
Economies in transition	4.5	3.2	3.1	3.7	-0.5	-0.5
South-Eastern Europe	1.1	-1.1	1.0	1.8	-0.2	-0.8
Commonwealth of Independent States and Georgia	4.8	3.5	3.3	3.9	-0.5	-0.5
Russian Federation	4.3	3.4	2.9	3.5	-0.7	-0.7
Developing economies	5.8	4.6	5.0	5.4	-0.1	-0.2
Africa	1.0	5.1	4.6	5.1	-0.2	0.0
North Africa	-5.6	5.6	3.6	4.4	-0.5	-0.1
East Africa	6.3	6.1	6.2	6.3	0.1	0.2
Central Africa	5.1	5.5	5.3	5.4	0.6	0.9
West Africa	6.1	6.4	6.7	6.9	0.1	0.1
Southern Africa	3.9	3.6	3.9	4.4	-0.1	0.0
East and South Asia	6.9	5.5	5.8	6.1	-0.2	-0.2
East Asia	7.1	5.9	6.1	6.3	-0.1	-0.2
China	9.2	7.8	7.8	7.7	-0.1	-0.3
South Asia	6.4	3.9	4.7	5.4	-0.3	-0.3
India	7.5	5.1	5.5	6.1	-0.6	-0.4
Western Asia	6.8	3.1	3.4	3.8	0.1	-0.3
Latin America and the Caribbean	4.3	3.0	3.6	4.2	-0.3	-0.2
South America	4.5	2.5	3.5	4.2	-0.5	-0.2
Brazil	2.8	0.9	3.0	4.2	-1.0	-0.2
Mexico and Central America	4.0	4.0	3.9	4.1	0.0	-0.5
Caribbean	2.7	2.5	3.0	3.7	-0.7	-0.1
Least developed countries	3.4	3.8	5.8	5.7	0.1	0.2
<i>Memorandum items:</i>						
World trade ^c	6.9	2.7	3.5	5.0	-0.8	0.1
World output growth with PPP-based weights	3.7	3.0	3.1	3.8	-0.2	-0.2

Labour markets: more pains in the euro area

The employment situation remains a key policy challenge in a large number of economies, as the world economy continues to expand well below its potential. Among developed countries, unemployment is most severe in parts of the euro area, which continue to see sharp contractions of economic activity amid stringent fiscal austerity programs (see figure 1). In early 2013, the unemployment rate increased to 26.7 per cent in Spain and 27.2 per cent in Greece, with youth unemployment rates exceeding 59 per cent. In addition, unemployment is still on the rise in other euro area countries such as Belgium, Finland, France and Italy. Average unemployment in the euro area reached a new all-time high of 12.1 per cent in March 2013, and is forecast to average 12.8 per cent in 2014. The unemployment rate in the United States has fallen, but is still high by historical standards and the drop partly reflects a significant decline in labour force participation. Long-term unemployment remains near historic highs. Some further improvement is expected in the outlook period, with US unemployment forecast to average 7 per cent in 2014.

Figure 1
Unemployment rates in selected developed countries, January 2008 – March 2013



Source: UN/DESA based on data from the Statistical Office of the European Commission and United States Bureau of Labor Statistics.

In most developing regions, labour markets have not as extensively suffered from weak demand as in developed economies. In some emerging economies, unemployment rates have dropped below the levels seen before the financial crisis, particularly in South America and East Asia. In both regions, the employment outlook has remained robust in the face of the recent economic slowdown.

By contrast, employment continues to be a key problem in many African countries, despite relatively high growth rates over the past few years. Importantly, developing countries face many structural labour market challenges, such as low participation rates, particularly among women; high youth unemployment; large informal sectors; high shares of low-quality jobs and slow productivity growth. Employment-population ratios remain particularly low in North Africa and Western Asia and have declined significantly in South Asia in recent years.

Trade expected to pick up only moderately

After slowing in 2012, growth in international trade is projected to pick up moderately in 2013 and 2014, in line with the expected mild recovery in global aggregate demand. Notably, the ratio between the growth of world trade and the growth of global output may be at a lower level than before the global financial crisis. In 2012, global trade volume growth declined sharply to only 2.7 per cent as a result of a synchronized slowdown in import demand in developed economies and many large developing countries. In Europe, import demand contracted, constrained by austerity measures, private deleveraging and rising unemployment. Import growth also weakened markedly in some large emerging economies, such as China, which had a strong effect on exports by resource-rich developing countries.

In 2013, growth in global trade volume is projected to recover slightly to 3.5 per cent, before strengthening to 5 per cent in 2014. This forecast reflects expectations of a moderate pick up in import demand in developed economies and most developing regions, in particular East Asia and Latin America and the Caribbean.

Commodity prices face downward pressures

International prices for primary commodities remain elevated by historical standards, but face downward pressure in the outlook period. In 2013, the aggregate commodity price index is expected to decline marginally owing to feeble global demand. A further decline by 3.3 per cent is forecast for 2014 as supply for metals and oil is likely to expand notably and the dollar is expected to strengthen against other major currencies.

The price of Brent crude remained elevated during the first half of 2013, although supply continued to exceed demand, following Saudi Arabia's activation of significant spare capacity last year. For 2013 as a whole, an average price of \$110 per barrel is expected, slightly lower than in 2012. With oil demand from developed countries declining and the United States and Iraq attempting to step up production, the average annual price is forecast to drop further to \$100 per barrel in 2014. Renewed geopolitical tensions in the Middle East could, however, increase the risk premium for oil prices.

The prices of agricultural commodities are expected to ease in 2013 as supply improves. The relatively high prices for key staples in recent years have encouraged farmers to increase planting areas. By contrast, average prices of metals and minerals are projected to rise slightly in 2013, partly owing to a pick-up in global industrial activity in the course of the year. However, in some cases, such as aluminium and copper, higher production will limit the price increases. In 2014, metal prices are expected to decline somewhat on the back of further expansions in supply and lower investment growth in China.

Global inflation slowing further

Despite the massive monetary easing by major central banks, inflation remains tame worldwide, partly reflecting large output gaps and high unemployment. Global inflation is projected to moderate further to 2.6 per cent in 2013, down from 2.9 per cent in 2012. This decline mainly results from somewhat lower inflation in the United States and Europe in the face of subdued demand, continued high unemployment and contained energy and food prices. In the economies in transition, by contrast, inflation is expected to accelerate from 6 per cent in 2012 to 7.3 per cent in 2013 as utility prices, nominal wages and public spending put upward pressure on prices. Average inflation in the developing economies will increase slightly from 5.4 per cent in 2012 to 5.6 per cent in 2013. This increase will stem from both cyclical factors, including a pick-up in demand in parts of East Asia and Latin America and the Caribbean, and one-off policy measures such as lower fuel subsidies and higher minimum wages. Various economies, especially in South Asia and Africa, will continue to face high inflation rates, mainly owing to elevated inflationary expectations, rapid credit growth and structural bottlenecks such as energy shortages. In 2014, global inflationary pressures are expected to remain mild even as economic activity, particularly in developed countries, strengthens. Most developing regions are likely to see a moderate decline in inflation as international commodity prices ease.

Capital flows to emerging economies rise; risks looming on the horizon

Global financial conditions have stabilized in recent months as new policy initiatives in developed economies, including a further expansion of unconventional monetary policies, reduced the near-term tail risks for the world economy. Increased global liquidity and higher risk appetite among investors have led to rising asset prices in developed countries, while also pushing up capital flows to emerging economies. These capital flows have been dominated by portfolio investments, especially in corporate debt. In many emerging economies, large corporations have taken advantage of low borrowing costs. Bond markets in East Asian countries as well as Mexico and Turkey saw particularly large inflows in late 2012 and early 2013. Foreign direct investment flows to emerging economies also strengthened since mid-2012.

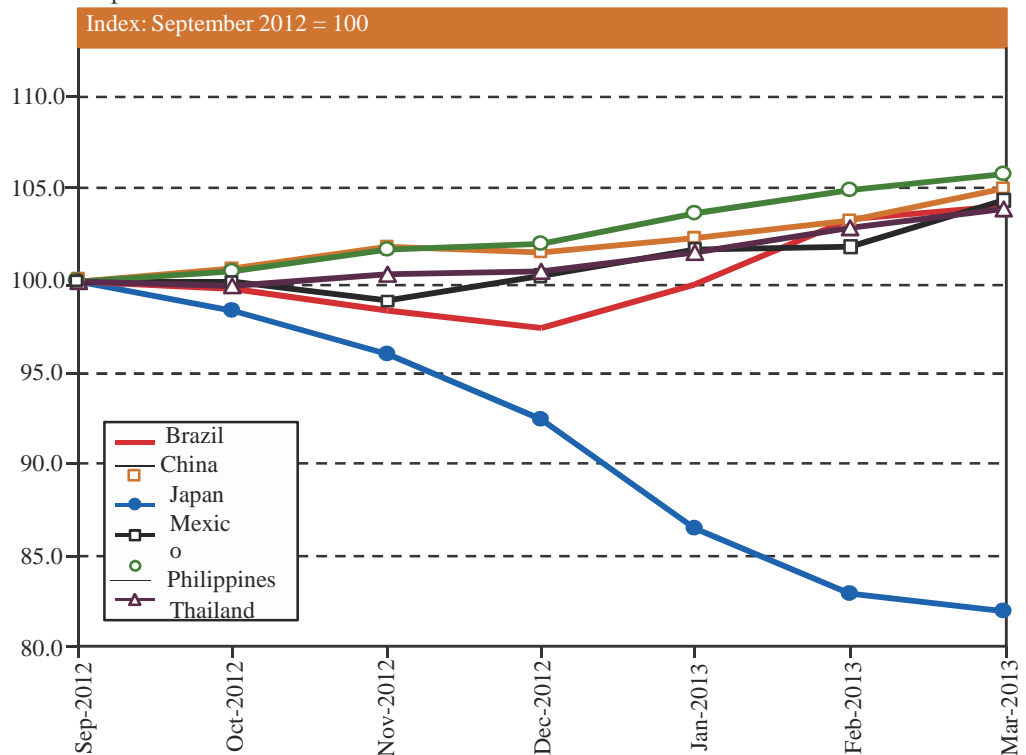
The upward trend of private capital flows to emerging economies is likely to continue as significant growth and interest rate differentials will persist in the near term. The current environment of low global interest rates, moderate volatility and rising risk appetite among investors poses, however, considerable risks for emerging economies. A further surge in capital inflows could lead to an appreciation of domestic currencies, excessive credit growth, and to a build-up of significant leverage and asset price bubbles. Corporate leverage and foreign exchange denominated debt have indeed been on the rise in parts of East Asia and Latin America—a trend, which, if continued, could lead to an increase in balance sheet risks and heightened vulnerability.

In contrast to private capital flows, net Official Development Assistance (ODA) declined by 6 per cent in nominal terms in 2012. In real terms, this is the first time since 1997 that ODA has fallen in two consecutive years. Most of the fall was due to lower contributions from European countries, many of which were facing severe fiscal constraints.

Exchange rates: Yen depreciates sharply; upward pressure on currencies in emerging economies

The past three quarters have seen two major trends in international currency markets, resulting from the expansion of unconventional monetary policies in developed economies and lower risk aversion among investors. First, the Japanese yen has depreciated sharply against all major currencies following the fundamental changes in the country's monetary policy strategy (see figure 2). Against the dollar, the yen depreciated by 22 per cent between September 2012 and April 2013. Second, the currencies of many large emerging economies have appreciated gradually since late 2012, mainly as a result of rising capital inflows. Upward pressures on the national currencies have been particularly significant in Brazil, Mexico, the Philippines and Thailand. The Chinese renminbi also strengthened gradually, reaching a 19-year high against the dollar in the second quarter of 2013. In several emerging economies, policymakers have expressed concerns over the shifts in competitiveness associated with the recent swings in exchange rates and the resulting negative impact on local export sectors. The sharp weakening of the yen puts particular pressure on the export industries of some East Asian countries (notably the Republic of Korea), but the magnitude of this effect is uncertain. Since capital flows to emerging economies are expected to increase in the quarters ahead, upward pressures on national currencies are likely to persist, especially in countries where economic prospects become more favourable.

Figure 2
Nominal effective exchange rate: Japan and selected emerging economies,
September 2012-March 2013



Source: UN/DESA,
based
on data from the Bank
for
International Settlements.

II. Regional outlook Developed economies

The economy of the *United States* registered moderate growth in the first quarter of 2013, after stagnating at the end of 2012. There have been measureable improvements including substantial gains in equity prices, a notable recovery in the housing market, and moderate growth in employment. These were largely driven by the continuing purchases of long-term securities by the Federal Reserve Bank (Fed) and Congress's agreement to permanently maintain lower income tax rates for a majority of households. However, the activation of the automatic government spending cuts in March 2013 is expected to weigh down the economy for the rest of the year. This will restrain the fledgling recovery in private consumption and business investment. External demand from major trading partners is expected to remain lacklustre in 2013. On the positive side, continued support is expected from the Fed, which committed itself to maintain an extremely accommodative monetary stance until the unemployment rate declines to 6.5 per cent. In the outlook, GDP growth is forecast at 1.9 per cent in 2013, lower than the 2.2 per cent of 2012. The process of deleveraging in the household and financial sectors is expected to gradually ease over the next years. This may lead to improved lending conditions, ease credit constraints and strengthen consumption spending, with GDP projected to grow by 2.6 per cent in 2014.

After expanding by 2 per cent in 2012, *Japan's* GDP is projected to grow by 1.3 per cent in 2013 and 1.6 per cent in 2014. In early 2013, the new Japanese Government introduced a stimulus package that aims at boosting domestic demand. This package consists of a supplemental budget to increase central government spending by 10.3 trillion yen (about 2.2 per cent of GDP) and a new style of monetary easing by the Bank of Japan (BOJ). The BOJ's new policy attempts to propel the annual CPI inflation rate to 2 per cent within two years by increasing its annual purchases of Japanese Government bonds to 50 trillion yen. By pushing down the yields for long-term securities and formally adopting inflation-targeting, the BOJ expects inflation expectations to rise, encouraging consumption and investment. Consumer price inflation is expected to turn positive and reach 0.3 per cent in 2013 and 1.5 per cent in 2014, assuming that the planned increase in the consumption tax rate in April 2014 will be implemented. The wage rate is also expected to rise mildly. The average unemployment rate is projected to decline from 4.4 per cent in 2012 to 4.0 per cent in 2013, mainly owing to the continued decrease in the labour force. The increase in household labour income is expected to support private consumption, especially in 2014. The recent sharp depreciation of the yen will contribute to a moderate recovery in exports in 2013 and 2014.

Western Europe remains mired in either recession or at best extremely low growth conditions. In the fourth quarter of 2012, GDP fell sharply for most countries; despite improved confidence, economic activity is estimated to have declined further in most countries during the first quarter of 2013. While activity is projected to pick up in the second half of 2013, the weak starting point and low momentum is expected to lead to yet another year of weak or negative growth. In the euro area, GDP is projected to decline by 0.4 per cent in 2013 after falling by 0.6 per cent in 2012. Only a small expansion of 1.1 per cent is forecast for 2014. While growth is generally weak, there remains considerable diversity of performance. Germany is expected to grow by 0.6 per cent in 2013 and the

United Kingdom by 0.7 per cent, but France is projected to register near zero growth, and Italy and Spain to contract by 1.5 and 1.7 per cent, respectively. The crisis countries (except Ireland) are expected to experience far worse contractions. Growth is held back by several factors: fiscal austerity, particularly in the crisis countries; weak banking systems which continue to tighten lending conditions; exceptionally low intra-regional demand; and contagion effects of the sovereign debt crisis which hurt confidence region-wide. The toxic feedback loop between weak sovereign debt positions and banking sector fragility remains active as does the downward cycle of austerity, low growth, missed fiscal targets, and further austerity. The poor growth profile has led to increasing rates of unemployment for most Western European countries. In the euro area, unemployment is expected to increase from 11.9 per cent in 2012 to 12.7 per cent in 2013, and peak in 2014 with a full-year average at 12.8 per cent. Inflation is expected to decelerate further owing to the large output gap and receding pressures from energy prices.

The new EU member States in Central and Eastern Europe will continue to see subdued growth in 2013, although the pace of expansion is projected to pick up in the second half of the year. Growth of aggregate GDP is forecast to accelerate from 0.8 per cent in 2012 to 1.1 per cent in 2013 and 2.2 per cent in 2014. Three countries, the Czech Republic, Hungary and Slovenia, entered a recession in 2012, and the Slovenian economy may shrink further in 2013. The protracted weakness in the euro area will drag down exports of the new EU members and FDI inflows into the region. Although liquidity measures of the ECB mitigated pressure on the parent banks from the EU-15 (which provide a large share of the lending in the region through local subsidiaries), those banks still continue cross-border deleveraging, constraining credit lines to the region. Domestic demand remains subdued owing to weak labour markets, stagnant real wages and fiscal austerity. Despite loose monetary policies, private credit has remained weak. Growth in Poland is expected to decelerate further to 2 per cent in 2013. For the smaller, export-oriented economies in Central Europe near-zero growth is projected, while the economies of the Baltic States may expand at an average rate of about 3 per cent. Inflation subsided in early 2013, and it is expected to continue on a moderate path in the near term.

Economies in transition

Economic performance in the countries of the *Commonwealth of Independent States (CIS) and Georgia* is expected to remain diverse in 2013. The aggregate GDP of CIS and Georgia is projected to expand by 3.3 per cent in 2013, down from 3.5 per cent in 2012. Provided the global economic environment gradually improves, growth is forecast to strengthen to 3.9 per cent in 2014. The prospects of the region's major energy exporters remain closely linked to international commodity prices, especially oil and natural gas, underscoring the need for industrial diversification. Economic growth in the Russian Federation, which strongly impacts its CIS neighbours through trade, FDI and remittance flows, is expected to slow down further from 3.4 per cent in 2012 to 2.9 per cent in 2013 in the face of challenging global conditions. Domestic demand is also slowing in response to weaker confidence and moderate inflation. Growth is expected to remain low in Belarus and in Ukraine. Abundant global liquidity has facilitated access by the CIS countries to financial markets. Nevertheless, Ukraine, which faces significant foreign debt payments in 2013, may still need balance of payments support from the IMF. Growth may slightly accelerate in Azerbaijan, driven mostly by the non-energy sector. The countries of Central Asia will

continue to register high growth rates on the back of strong export revenues and fiscal spending. In Kazakhstan, growth may accelerate thanks to the development of a new major Caspian Sea oil field. Economic activity in Armenia, Georgia, Kyrgyzstan, Republic of Moldova, Tajikistan and Uzbekistan will continue to be supported by remittances from migrant workers. Inflation in the CIS area is expected to exhibit divergent trends in 2013, with a gradual slowdown projected in the Russian Federation.

The countries of *South-Eastern Europe* will see another year of meagre economic performance in 2013, after several economies entered recession in 2012. The aggregate GDP of South-Eastern Europe, which contracted by 1.1 per cent in 2012, will expand by only 1 per cent in 2013, with a mild strengthening to 1.8 per cent forecast for 2014. The weak performance reflects unfavourable external conditions and feeble domestic demand. The ongoing weakness in Greece, Italy and Slovenia, which are important export destinations and sources of FDI and remittances for South-Eastern Europe, remains a drag on the region's near-term prospects. High unemployment and stagnant wages, coupled with deleveraging by businesses and households and lack of lending growth, continue to suppress private consumption and investment. The region's economies have limited policy space, as they are trying to rebuild fiscal buffers and monetary policies are constrained by formal and informal pegs to the euro. Strong exposure to the Greek banking sector remains a risk for the region.

Developing economies

Africa is expected to grow by 4.6 per cent this year and 5.1 per cent in 2014. This implies a very moderate downward revision by 0.2 percentage points for the current year mostly owing to the negative impact of the slowdown in developed economies on economic activity. Over the forecast horizon, growth drivers include further increases in output in the natural resources sector, which underpins rising fiscal expenditure, especially in infrastructure projects. West Africa, in particular Nigeria, will benefit from continued high oil prices, despite some declines in output. At the same time, Africa's trade and investment ties with emerging and developing economies are expected to intensify further. Across the region, rising incomes and urbanisation are supporting growth of domestic demand, which helps to reduce the exposure to external economic shocks. As a consequence, increasing diversification, for example into services (such as telecommunications and construction) will continue to create a more solid growth profile. In East Africa, these sectors as well as a growing banking sector will contribute to continued economic expansion, especially in Kenya. Growth is expected to strengthen only slowly in Southern Africa, pulled down by South Africa, which faces massive labour market challenges. High unemployment, combined with massive underemployment, continue to constitute a major policy challenge in many countries. Average inflation is forecast to moderate further, based on lower food prices and slightly moderating oil prices. However, this cannot mask the fact that in several countries, such as Sudan and Malawi, inflation remains stubbornly high. Egypt faces a problematic combination of rising prices, unsustainable subsidies and falling currency reserves. Risks to the outlook include a more severe global economic slowdown with negative impacts on trade, tourism and remittances; a more pronounced negative effect of the fiscal problems in developed countries on ODA flows; and adverse weather conditions.

Economic growth in *East Asia* is projected to pick up slightly in the outlook period, following the marked slowdown since mid-2011. The region's GDP is forecast

to expand by 6.1 per cent in 2013 and by 6.3 per cent in 2014, up from 5.9 per cent in 2012, but well below the 7.1 per cent recorded in 2011. The mild upturn is expected to be underpinned by robust growth in domestic demand and a gradual recovery in exports amid slowly improving global conditions. China's economy has likely shifted to a lower growth trajectory. The new Government is focused on the transition towards more balanced, equitable and sustainable growth, with an eye towards the underlying structural challenges of the economy. On the basis of a weaker-than-expected expansion in the first quarter, China's full-year growth in 2013 is projected at 7.8 per cent, the same pace as in 2012. The region's higher-income and strongly export-oriented economies are likely to see a mild recovery during the outlook period in line with a pick-up in global demand. Growth in these economies will, however, remain well below potential, particularly in the Republic of Korea. In Indonesia, Malaysia, the Philippines and Thailand, the growth momentum is expected to remain fairly robust owing to buoyant consumption and investment demand. In most economies, domestic demand will be supported by stable labour market conditions, strong household income growth, and accommodative monetary policies. Average consumer price inflation is forecast to accelerate only slightly to 3.1 per cent in 2013 as further weakening of global commodity prices, combined with an appreciation of most national currencies, helps curb inflationary pressures. Monetary and fiscal policies are expected to become slightly less accommodative in the outlook period, although central banks will remain reluctant to raise interest rates, fearing further increases in capital inflows.

After experiencing a sharp slowdown over the past two years, *South Asia* is expected to see a moderate recovery. The region's GDP is projected to expand by 4.7 per cent in 2013 and by 5.4 per cent in 2014. The recovery will be based partly on an upturn in private demand, following the recent easing of monetary policy, and a gradual strengthening of exports amid slowly improving global conditions. Structural factors such as stubbornly high inflation, large fiscal deficits, political uncertainties, fragile security conditions, and transport and energy constraints will keep growth and investment below potential. In India, full-year growth slowed to 5.1 per cent in 2012 owing to ongoing weakness in investment, a significant deceleration in household consumption and sluggish exports. While India's growth is likely to have bottomed out, the recovery will be slower than previously expected, with economic activity forecast to expand by 5.5 per cent in 2013 and 6.1 per cent in 2014. The rest of the region continues to be characterized by stark differences in economic performance; growth in 2013 is projected to range from -0.3 per cent in the Islamic Republic of Iran to more than 6 per cent in Bangladesh and Sri Lanka. Monetary policy is constrained by persistently high consumer price inflation, which is forecast to average 12.4 per cent in 2013. Energy shortages, high inflationary expectations, and adjustments in administered fuel and electricity prices continue to provide upward pressure on prices. Fiscal policy space is limited by large budget deficits of more than 5 per cent of GDP in most economies.

Economic growth in *Western Asia* decelerated in the second half of 2012 owing mainly to weakening external demand, especially from the euro area. Most oil-exporting countries increasingly relied on their weakly diversified non-oil sector as a source of economic growth. Economic activity also decelerated in oil-importing countries, burdened by high import bills, slackening demand and shrinking policy space. Turkey and Israel were particularly affected by the deteriorating external environment and experienced a significant drop in full-year growth. Average regional economic growth is expected to increase

slightly from 3.1 per cent in 2012 to 3.4 per cent in 2013 on the back of gas production in Israel and rebounding private demand in Turkey. Assuming a gradual recovery in the developed economies from the second half of 2013, regional economic growth is forecast to accelerate to 3.8 per cent in 2014. Several Gulf Cooperation Council (GCC) countries scaled back their oil production during the last quarter of 2012 to absorb excess supply in the market and support high prices. For most GCC countries, ongoing large public expenditures in both the oil and non-oil sectors support investment and consumption. The civil war in the Syrian Arab Republic continues to weigh on the risk perception of the region, especially of neighbouring countries. In Jordan and Lebanon, trade, tourism and investment have remained subdued.

Economic growth in *Latin America and the Caribbean* is expected to accelerate from 3.0 per cent in 2012 to 3.6 per cent in 2013 and 4.2 per cent in 2014. This will mainly be driven by a strengthening of domestic demand, in particular investment spending. In Mexico and Central America, economic activity is projected to expand by 3.9 per cent in 2013, a pace similar to the past few years. However, growth will continue to be strongly affected by developments in the US economy. In South America, growth will strengthen to 3.5 per cent in 2013 as the economies of Argentina and Brazil gradually gain momentum. Brazil is expected to grow by 3.0 per cent, driven by a rebound in investment demand, following monetary policy loosening and reductions in energy costs and payroll taxes. In Argentina, the agriculture sector will drive the upturn, but business confidence remains weak. The Caribbean is expected to expand by 3.0 per cent in 2013, 0.5 percentage points higher than in 2012. Across the region, domestic demand continues to be supported by robust labour markets, most notably in South America and Mexico. The regional unemployment rate declined to a multi-year low of 6.4 per cent in 2012, and is likely to remain low in the short term. The regional fiscal position slightly deteriorated last year, and public debt remains high in the Caribbean countries. However, many countries, especially in South America, retain space for countercyclical policies. The inflation outlook is fairly stable, although inflation is expected to accelerate somewhat in 2013 amid more accommodative monetary policies in some countries.

The economies of the *least developed countries* (LDCs) are projected to see a marked increase in growth from 3.8 per cent in 2012 to 5.8 per cent in 2013. Improved economic and political conditions in Sudan and Yemen, following severe economic contractions in the last two years, account for much of this improvement. Oil and mineral exporting LDCs will continue to benefit from relatively high commodity prices and investment in new production capacities. These countries remain, however, vulnerable to sudden and drastic swings in commodity demand. While solid primary commodity exports will produce some positive wider impacts regarding the reduction of poverty and increases in incomes, the lack of a more equitable distribution of these benefits remains a major problem in several LDCs. In many LDCs, the agriculture sector dominates the economy, generating volatile macroeconomic performances owing to the dependence on weather conditions and harvest levels. Gambia, for example, is projected to see a jump in growth from 2.4 per cent in 2012 to 8.2 per cent in 2013 owing to a strong harvest. For LDCs in aggregate, the solid growth performance will translate into higher per capita growth of 3.5 per cent in 2013, although this will fall short of the increase needed for a more pronounced reduction in poverty levels.

III. Uncertainties and Risks

The world economy continues to face significant uncertainty, with risks still tilted to the downside. The *World Economic Situation and Prospects 2013* released in January examined three major global risks and analyzed their potential impact on global growth: a substantial worsening of the euro area crisis; the United States falling off the fiscal cliff; and a hard landing for some large developing economies. Since then, there has been improvement in some of these areas, with short-term risks diminishing but not disappearing. These three risks are updated below.

Meanwhile, new risks and uncertainties have emerged, particularly for the medium run. First, the ever-expanding monetary measures adopted in developed economies could have significant adverse effects on financial stability in the future. The new bold policy actions adopted by Japan, for example, could help reverse the country's economic weakness, but they also entail certain risks and uncertainties as already evidenced by the sharp devaluation of the yen. Second, a prolonged period of subdued growth in many economies with high unemployment and inadequate investment may have led to noticeably lower potential output in the world in the medium term. These factors and other risks, including those beyond the economic domain (such as geopolitical risks and natural disasters) have the potential to derail the still feeble global recovery. This could lead to much lower growth in the world economy than what is projected in the baseline outlook.

Euro area risks diminished, but still potent

The crisis in the euro area remains a major risk factor for the world economy, although recent policy actions have lowered some of the short-term risks. In particular, the European Central Bank's Outright Monetary Transactions (OMT) program and other policy initiatives since late 2012 have significantly reduced sovereign risks and the risk of a euro area break-up. This explains why the political impasse in Italy and the Cypriot bank bail-out have caused only limited disturbances.

Despite the progress, considerable banking and fiscal risks remain. A large number of banks still have weak balance sheets, remain fragile and could face insolvency. The recent Cypriot bail-out actually raised risks in the banking sector by increasing the possibility of bank runs. This has heightened the urgency to create a region-wide banking union, but significant uncertainties over the time frame and the final form remain. In addition, despite improved bank liquidity, there continues to be considerable fragmentation in financial conditions across the region. Lending conditions are very tight in the Southern countries, particularly for small and medium-sized businesses, but markedly easier in other parts of the region. The ongoing lack of adequate access to funding in the crisis countries hinders economic activity, exacerbates unemployment and could threaten the recovery.

Lower sovereign yields, meanwhile, have not yet broken the downward spiral formed between fiscal consolidation and the economic downturn. Risks on the fiscal front are primarily related to countries missing their fiscal targets and having to undertake additional austerity measures. The countries already under assistance programs will have to follow agreed-upon consolidation and restructuring measures. These measures may become more onerous, particularly in light of the harsh resolution to the recent Cypriot crisis, which demonstrated that support for assistance has dwindled. In countries not

under assistance programs, the key question is whether they will be forced to adopt new measures given that they are likely to miss their current deficit reduction targets.

Fiscal cliff in the US averted, significant uncertainties remain

In the United States, the full impact of the fiscal cliff was averted when an agreement was reached in March 2013 over the Bush-era tax cuts – extending most, but not all of the cuts. But Congress failed to agree on a new deficit reduction plan, triggering automatic, across-the-board spending cuts (sequestration) worth \$1.2 trillion over the next nine years. For the remainder of fiscal 2013, this is estimated to result in a cut of \$85 billion. In the baseline outlook, it is assumed that the sequestration will be replaced at the end of the current fiscal year (September 2013) by a new agreement with a combination of some tax increases and lower spending cuts than in the sequestration. It is also assumed that Congress will increase the debt ceiling in May 2013.

Significant uncertainties and risks remain, however: political gridlock may result in a failure to raise the debt ceiling and the sequestration may continue into 2014 and beyond. An additional risk is that the private sector proves to be less resilient than expected to the sequestration. If any of these transpire, economic growth in 2013-2014 would be much lower than projected in the baseline. Policy impasse and more fiscal tightening could erode consumer and business confidence, leading to weaker consumer spending, business investment and hiring. This, in turn, could undermine the recovery in the housing sector.

Risk of further slowdown in some large developing economies remains

Many large developing countries, including Brazil, China, India and the Russian Federation, saw a significant deceleration in GDP growth in the past two years, owing to a combination of weak external conditions and domestic impediments. In the baseline outlook for 2013-2014, growth in these economies is expected to strengthen in some cases, such as Brazil and India, and to stabilize in others, such as China. For some economies, however, the risk of a further considerable slowdown in growth remains.

In China, for example, economic activity moderated again in the first quarter of 2013, with growth slowing to 7.7 per cent year on year and 1.6 per cent quarter on quarter. While the baseline forecast projects growth to stabilize between 7-8 per cent in the coming years, the possibility of a slowdown to about 5 per cent cannot be ruled out. The major risks for China's economy are associated with the housing bubble, the surge in shadow banking activities, lack of transparency in local government debt, excess capacity in many key industrial sectors, and challenges in economic restructuring and reforms. China's authorities have so far made only limited progress in addressing these interconnected challenges despite continuing policy efforts. After a short period of stabilization, housing prices started to move up again in 2012, triggering a new round of tightening measures in early 2013. Local government debt, through special financing vehicles, and shadow banking activities, which evade conventional banking regulations and supervisions, boomed over the past few years. The size of shadow banking loans reached an estimated 30-40 per cent of GDP by the end of 2012. Meanwhile, GDP growth continues to depend to a high degree on government-guided investment. This implies that the ongoing

economic restructuring aimed at raising the consumption to GDP ratio and lowering the investment to GDP ratio entails the risk of slowing growth too rapidly. Without decisive policy action, a further moderation in GDP growth and rising financial risks could feed into each other to form a vicious cycle. As indicated in the *World Economic Situation and Prospects 2013*, a drop in China's growth to about 5 per cent would have a measurable impact on economic activity, especially in commodity-exporting developing countries.

IV. Policy challenges

The top priority for macroeconomic policies worldwide remains to support a robust global recovery, with a focus on promoting job creation. The policy stance and policy mix in individual countries should, however, be based on country-specific circumstances, while taking into consideration potential tradeoffs and institutional and resource constraints. Meanwhile, international policy coordination should be enhanced to mitigate negative policy spillovers across countries, curb protectionism, promote cooperation in reforming the international financial system, and ensure sufficient resource flows to the least developed countries.

Fiscal policy

The fiscal stance in most developed economies, with the salient exception of Japan, is expected to continue tightening in 2013, although the degree of tightening is expected to ease in some countries in 2014. In the United States, automatic government spending cuts were activated in March 2013. Real government spending is projected to decline markedly, by 4 per cent in 2013, and another 1 per cent in 2014, although it is possible that some of the cuts will be reduced by subsequent agreements in late 2013. In the euro area, countries in debt crisis or under debt distress are still subject to sizeable consolidation programs, but the timetable for achieving targets has in some cases been extended. Countries facing limited fiscal pressures, such as Germany, are expected to adopt a more neutral fiscal stance. The European Union's new fiscal compact, which limits structural government budget deficits, entered into force on January 1 2013. Fiscal policy in the region will thus remain tight over the next few years. Bucking the trend in developed economies, Japan's Government launched a new fiscal stimulus package of about 2.2 per cent of GDP for fiscal year 2013, despite the fact that both the deficit and debt are among the highest in developed economies.

Concerns about future debt sustainability have been behind the fiscal tightening in many developed countries. *Ceteris paribus*, the higher the debt to GDP ratio, the higher the proportion of government revenue spent on interest payments. A continuously rising debt will eventually lead to a debt crisis. However, debt sustainability is not simply determined by the single indicator of the debt to GDP ratio, with a fixed threshold. Debt sustainability for a country depends on a complex set of variables, including, for example, interest rates, potential GDP growth, the proportion of debt held by foreign investors, the currency composition and term structure of debt, the domestic savings rate, external balances, the structure of government spending and revenue, and the demographic structure. The wide range of these variables explains why some countries have fallen into debt crisis at a moderate debt ratio while others remain solvent at a much higher debt ratio.

The fiscal challenge for policymakers in most developed countries is to support a solid recovery in output and employment in the short run, while at the same time ensuring the sustainability of public finances in the long run. According to recent studies, the negative effects of fiscal tightening on output and employment in the current economic environment are much larger than originally estimated, particularly when a group of countries tighten their fiscal policies simultaneously. Therefore, for those countries facing low financing costs and high unemployment, it would be desirable to postpone fiscal tightening until the economy has recovered. At the same time, policymakers should lay out a credible plan for fiscal sustainability. Countries in debt crisis or facing high financing costs may have to front-load fiscal consolidation, but they should maintain adequate social protection for the most vulnerable groups and continue to invest in human capital, in the process of making necessary structural reforms to enhance long-run productivity. Spending cuts should also be combined with revenue measures, including measures to curb illegal tax evasion and aggressive tax avoidance, which cause hundreds of billion dollars of tax revenue losses every year.

By contrast, most developing countries and economies in transition are expected to adopt a relatively neutral fiscal stance: with mild tightening in some countries, such as Brazil and the Russian Federation, and a moderate expansion in others, such as China and the Republic of Korea. While these economies have lower government deficits and debt levels than developed economies, their fiscal positions are generally weaker than before the global financial crisis. In these economies, the structure and composition of government spending and revenue needs to be adjusted according to country-specific priorities: for some countries, such as China, it is desirable to increase the proportion of public spending on the social safety net, healthcare and education; other countries, such as Brazil and India, need to enhance spending on infrastructure investment. In the long run, fiscal policy should be used to guide the transformation of the development model in these economies towards a more inclusive and sustainable system, for example through public investment in green technology.

The fiscal balances of the least developed countries (LDCs) will remain under pressure from various directions. Sustained public spending is needed to deal with a variety of serious issues, while the ability to raise tax revenues is often low. Since official development assistance accounts for a significant share of public revenue in many LDCs, they are severely impacted by the move towards fiscal consolidation in developed economies.

Monetary policy

Major developed economies have recently strengthened their monetary policy measures, both quantitatively and qualitatively, in an attempt to offset the negative effects of tighter fiscal policies on output and employment. Policy interest rates in these countries are expected to remain at or close to zero in 2013-2014. The central banks will continue to implement large-scale asset purchasing (LSAP) programmes. A new key feature of these policy measures is the open-ended strategy, which sets neither the total amount nor the duration for asset purchases. This strategy seems to have worked better than earlier intermittent approaches in providing a more stable anchor to financial market expectations. The major central banks have also improved their communication by clearly articulating their policy intentions to reduce uncertainties for consumers and investors. For instance, the Fed has made its forward guidance regarding the anticipated path of the federal funds

rate more explicit: it indicated that the rate would remain at the current exceptionally low level as long as the unemployment rate remains above 6.5 per cent and the projected inflation rate is below 2.5 per cent. The Bank of Japan has also explicitly defined its target to raise inflation to 2 per cent by 2015.

Major challenges for monetary policy in the developed economies lie ahead: when and how to unwind the LSAP programmes with a view to keep inflation in check and avoid risks of financial instability. For instance, the LSAPs may support delays in balance sheet cleanups in some banks, lead to excessive increases in asset prices and boost leverage and risk taking. The unwinding of securities held by the central banks could then trigger an abrupt increase in long-term interest rates resulting in losses for bond holders and a reversal of asset price rises. The central banks should therefore have a forward-looking mechanism to mitigate possible financial instability when those unconventional measures end. They should also develop a sound exit plan for the medium term and provide effective forward-guidance to anchor inflation expectations.

The monetary stance varies across developing countries and economies in transition. Most recently, several of these economies, for example India, have reduced interest rates to counter the growth deceleration, while others, such as China, have mainly relied on liquidity operations without reducing policy interest rates. In the Russian Federation, monetary policy remains restrictive in response to elevated inflation. Challenges for monetary authorities in developing countries and economies in transition also vary: a majority of these economies still require a mild accommodative monetary stance to strengthen growth, particularly domestic demand, as external demand continues to be anaemic. A few economies with strong inflationary pressures may need a neutral stance or mild monetary tightening.

A common challenge for monetary authorities in developing countries and economies in transition is to deal with the spillover effects of unconventional monetary easing by developed countries, such as increased volatility in capital inflows and international commodity prices, and appreciation pressures on local currencies. In some cases, the policy authorities may have to resort to controls on short-term capital inflows and macro-prudential measures.

International policy coordination

Most recently, the G20 has reaffirmed its framework for strong, sustainable and balanced growth, which was launched in 2009. Under this framework, G20 members running current account deficits, mainly the United States, pledged to undertake policies to support private savings and to consolidate their fiscal deficit; the surplus members agreed to strengthen domestic sources of growth, for instance by reducing financial market distortions, boosting productivity in service sectors, and improving social safety nets.

The current account imbalances across major economies have narrowed significantly from the levels prior to the financial crisis. The external deficit of the United States is estimated to be less than 3 per cent of GDP in 2013, down substantially from the peak of 6 per cent of GDP in 2006. The surpluses of China, Japan and a group of oil-exporting countries have also declined correspondingly, with the surplus of China down from 10 per cent of GDP in 2007 to about 2 per cent currently. International macroeconomic policy coordination should therefore currently be focused on strengthening the global recovery and jobs creation, but not necessarily on targeting balanced current accounts across major economies in the short run.

International policy coordination is also needed to mitigate the negative spillover effects of the unconventional monetary policy measures adopted in developed economies. It is in the interest of both issuers and holders of international reserve assets to maintain a stable value for these currencies. At the same time, strengthening growth in the depressed economies of the major issuers of international reserve currencies is also important for all of the world's economies. However, these growth-supporting policies may have the side effect of devaluating the national currencies. Therefore, balancing these twin objectives is a difficult task for the world's major central banks. Excess volatility of capital flows and international prices of primary commodities should be curbed, as it is particularly detrimental to developing countries because of their small market size and limited capacity to hedge.

International policy cooperation and coordination are needed to advance the reforms of the international financial system on several fronts. Five years after the eruption of the global financial crisis, progress in financial regulatory reform has been slow, encountering growing resistance from the financial industry. Some progress has been made in amending the global financial safety standards for the banking sector. A dozen countries have issued final regulations to implement Basel III and more countries have committed to do so during 2013. Progress has also been made in implementing over-the-counter (OTC) derivatives reforms. On the other hand, the question of ending "too big to fail" remains pending, and recommendations from the Financial Stability Board (FSB) for the oversight and regulation of the shadow banking sector have yet to be issued. More forceful efforts are needed to address the issues of international tax avoidance and evasion, particularly through tax havens.

The current phase of reforming both the IMF and the World Bank needs to be completed to make their governance structure more representative, responsive and accountable. While there has been progress in ratifying the 2010 IMF quota and governance reforms, the process has not been finalized. The new review of the IMF quota formula should be resolved quickly to enhance the voice and participation of developing economies.

International policy cooperation should ensure that sufficient resources are made available to developing countries - especially LDCs and countries which possess limited fiscal space and face large financing needs for sustainable development and poverty reduction. Official development assistance flows have declined in real terms in both 2011 and 2012. With less than 1,000 days left to the deadline of the UN Millennium Development Goals (MDGs), international donors should redouble their efforts to deliver on existing commitments. These resources are badly needed for developing countries to accelerate progress towards the achievement of the MDGs by the end of 2015, and to lay a solid foundation for long-run sustainable development beyond 2015.

Our Location

The headquarters of AJSH is located in Delhi, India. Besides this AJSH has presence all over India and United States of America through its branches / associates / affiliates.

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