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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT, 2005

OVERVIEW

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OVERVIEW

Looking at recent trends in the world economy from the perspective of the Millennium Development Goals (MDGs), the good news is that in 2004 growth in the developing countries was rapid and more broad-based than it had been for many years. Strong per capita income growth continued in China and India, the two countries with the largest number of people living in absolute poverty. Latin America has seen a rebound from its deep economic crisis, and a return to faster growth, fuelled by export expansion. Africa again reached a growth rate of more than 4.5 per cent in 2004. Moreover, relatively strong growth in many African countries is envisaged in the short-term, owing to continuing strong demand for a number of their primary commodities. The bad news is that even growth rates of close to 5 per cent in sub-Saharan Africa are insufficient to attain the MDGs, and that the outlook for 2005, overshadowed by increasing global imbalances, is for slower growth in the developed countries with attendant effects on the developing countries.

Since the beginning of the new millennium, the performance of the world economy has been shaped by the increasingly important role of China and India. Rapid growth in these two large economies has spilled over to many other developing countries and has established East and South Asia as a new growth pole in the world economy. Their ascent has been accompanied by new features of global interdependence, such as a brighter outlook for exporters of primary commodities, rising trade among developing countries, increasing exports of capital from the developing to the developed countries, but also intensified competition on the global markets for certain types of manufactures.

Global prospects and imbalances

The slowdown in global output growth in 2005 is mainly due to a deceleration in the major developed economies and some emerging economies in Latin America and East Asia. The temporary weakness in the United States economy has not been compensated by stronger growth performance in the euro area and in Japan. Both continue to lack the dynamism needed to redress domestic imbalances and to contribute to an adjustment of the global trade imbalance. Indeed, beginning in the second half of 2004, output growth in the euro area and Japan has slowed down markedly, causing forecasts for 2005 to be revised downwards. While greatly benefiting from the global expansion over the past three years, and especially the Asian boom, neither the euro area nor Japan has managed to revive domestic demand.

Another reason for concern about global economic prospects is the increase in oil prices, which have doubled since mid-2002, to reach $58 per barrel in July 2005, despite flexible supply adjustments on the part of oil producers. However, the much feared shock of surging oil prices on economic activity and inflation in developed countries, an impact of the kind witnessed in the 1970s, has so far not occurred, for two reasons. First, developed countries have become less oil dependent, as energy is being used more efficiently. At the same time, the share of services in their GDP has gained in importance at the expense of industry, where more energy is used per unit of output. Second, the recent oil price increase was not the result of a big supply shock, but of a gradual increase in demand. Under these conditions, the wage and monetary policy responses in the developed countries have been measured, and have not jeopardized price stability or output growth.

The recent surge in oil prices has a stronger impact on oil-importing developing economies, especially in countries where industrialization has led to greater dependence on oil imports. In Brazil, for example, the oil intensity of domestic production is 40 per cent higher than the OECD average; in China and Thailand it is more than twice as high, and in India almost three times as high as in the OECD countries. Therefore, it is primarily in developing countries where inflationary pressures resulting from further rising oil prices imply risks for the sustainability of the growth process. Even though inflation has so far been modest, monetary policy has already been tightened in some countries.

On the other side, not only oil exporters but also many developing countries exporting non-oil primary commodities benefited from increased demand and rising prices for their exports. Since 2002, strong demand from East and South Asia, in particular China and India, has been the main factor behind the hike in commodity prices. In the markets for some primary commodities, emerging supply constraints have also contributed to the strong price reaction. Asian demand for primary commodities, particularly for oil and minerals such as copper, iron ore and nickel, as well as for natural rubber and soybeans, is likely to remain strong, boosting the earnings of the exporters of these products. But further developments on the markets for primary commodities will also critically depend on how

much additional supply capacity will be created by recent new investments, how fast this capacity will go on-stream, and how commodity demand from developed countries will be affected by the need to correct the existing trade imbalances.

Despite the increasing importance of the fast growing developing countries for international commodity markets, developed countries, which still account for two thirds of global non-fuel commodity imports, will continue to play an important role. It is unlikely that the growing imports of primary commodities by China and India alone will bring about a permanent reversal of the declining trend in real commodity prices. Indeed, in real terms, commodity prices are still more than one third below their 1960–1985 average. Moreover, the sharp fluctuations in commodity prices constrain the ability of many developing countries to attain a path of stable and sustained growth and employment creation that could benefit all segments of their population and allow them to reach the MDGs.

The large global current-account imbalances represent the greatest short-term risk for stable growth in the world economy. The United States trade deficit has continued to grow despite the depreciation of the dollar: it has lost 18 per cent of its value on a trade-weighted basis since February 2002. And the United States current-account deficit accounts for two thirds of the combined global surpluses. The deficit has increased in recent years vis-à-vis virtually all its trading partners; the increase has been the most pronounced in trade with Western Europe and China. On the other hand, China's trade is in surplus not only with the United States but also with many other developed countries. However, despite these surpluses, China's imports from these countries have also increased rapidly, as have its imports from neighbouring countries and other developing countries.

A well coordinated international macroeconomic approach would considerably enhance the chances of the poorer countries to consolidate the recent improvements in their growth performance. Such an approach would also have to involve the major developing countries and aim at avoiding deflationary adjustments to the global imbalances.

East and South Asia as a new growth pole

Asia has been a region of economic dynamism over the past four decades, with different economies in the region successively experiencing rapid growth. The large size of the countries that entered this process most recently, China and India, has established the East and South Asian region as a new growth pole in the world economy. Due to the high dependence of these large Asian economies on imports of primary commodities for industrial output growth, in particular fuels and industrial raw materials, and the resulting linkages with other developing countries, variations in their growth performance will have strong repercussions on the terms of trade and export earnings of other developing countries. This inevitably raises the question of the sustainability of the pace of growth of these two economic powers in the medium and long term.

In terms of per capita GDP, both China and India still have a long way to go to approach the levels of the leading economies. Their potential for catching up is enormous. To realize this potential, it will be crucial for both countries to achieve further productivity gains in manufacturing activities

and ensure that all segments of their population participate in income growth. Broad-based income growth is essential for accelerating the eradication of poverty and gaining widespread social acceptance of the required structural changes; but wage increases throughout the economy in line with rising productivity are also a central pillar for the expansion of domestic consumption and, thus, the sustainability and stability of output growth. Fixed capital formation depends on favourable demand expectations in general, and not just on exports, which are subject to the vagaries of the world market and to changes in international competitiveness.

Shifting trade patterns in China and India

Sustained rapid growth and rising living standards in China and India have been accompanied by a dramatic increase in Asia's shares of world exports and raw material consumption. Given the large size of the Chinese and Indian economies and their specific patterns of demand, changes in their structure of supply and demand have a much larger impact on the composition of world trade than did those of other late industrializers in Asia during their economic ascent. The impact of China's growth on international product markets and global trade flows is already apparent. India's merchandise trade structure may follow a sequence of changes similar to that of China, with a lag of one or two decades, if industrialization in India gains the same importance in its further economic ascent as it did in the other fast growing Asian economies.

Metal use in China – and to a lesser extent in India – has strongly increased over the past few decades, particularly since the mid-1990s. In China, growth in the use of aluminium, copper, nickel and steel now exceeds that of GDP. Part of this recent increase coincides with very high rates of investment, especially in infrastructure. However, this recent rapid rise in China's intensity of metal use, and the concomitant increase in its imports of minerals and mining products, may well slow down once investment growth, especially in construction and infrastructure, decelerates. By contrast, India's intensity of metal use has remained fairly stable over the past four decades, reflecting the country's slower pace of industrialization and the relatively small share of investment in infrastructure in its

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