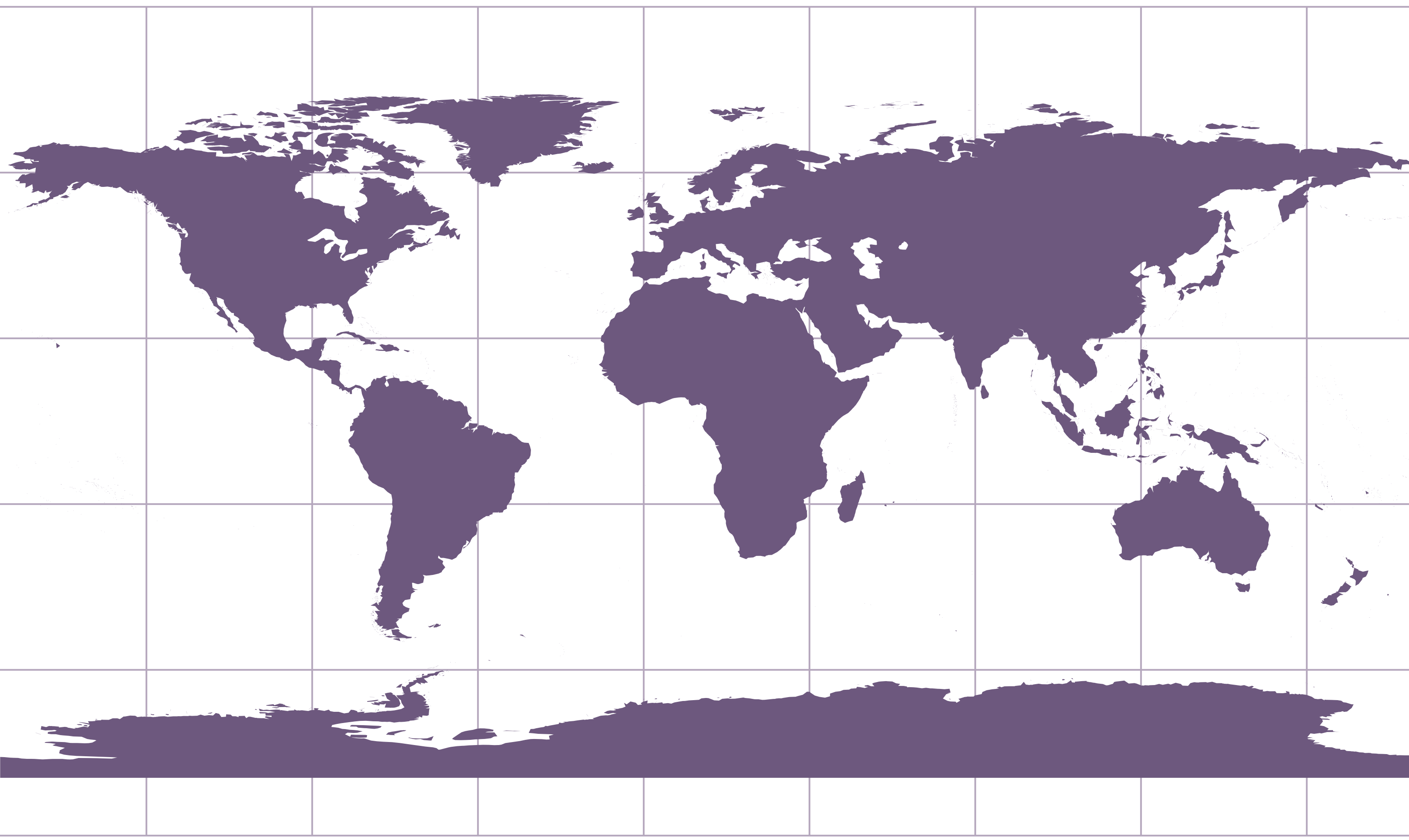
World Economic Situation and Prospects 2017



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Executive summary

Prospects for global macroeconomic development

The global economy remains trapped in a prolonged episode of slow growth

In 2016, the world economy expanded by just 2.2 per cent, the slowest rate of growth since the Great Recession of 2009. Underpinning the sluggish global economy are the feeble pace of global investment, dwindling world trade growth, flagging productivity growth and high levels of debt. Low commodity prices have exacerbated these factors in many commodity-exporting countries since mid-2014, while conflict and geopolitical tensions continue to weigh on economic prospects in several regions.

World gross product is forecast to expand by 2.7 per cent in 2017 and 2.9 per cent in 2018, with this modest recovery more an indication of economic stabilization than a signal of a robust and sustained revival of global demand. The slight increase in gross domestic product (GDP) growth projected for developed economies in 2017 is largely driven by the end of the destocking cycle in the United States of America and additional policy support in Japan.

Economies in transition are expected to expand by 1.4 per cent in 2017, following two consecutive years of decline, as the region has largely absorbed the sharp terms-of-trade shock that several countries suffered in 2014-2015. Commodity exporters in developing countries are also expected to see some uptick in growth, as commodity prices stabilize and inflationary pressures driven by sharp exchange rate depreciations ease. East and South Asia will continue to grow more rapidly than other regions, benefiting from robust domestic demand and space for more accommodative macroeconomic policy. The outlook remains subject to significant uncertainties and downside risks. If these downside risks were to materialize, the moderate acceleration in growth currently projected would be derailed.

Given the close linkages between demand, investment, trade and productivity, the extended episode of weak global growth may prove self-perpetuating in the absence of concerted policy efforts to revive investment and foster a recovery in productivity. This would impede progress towards the Sustainable Development Goals (SDGs), particularly the goals of eradicating extreme poverty and creating decent work for all.

Weak investment is at the foundation of the slowdown in global growth

Investment growth has slowed significantly in many of the major developed and developing economies, as well as in many economies in transition. Protracted weak global demand has reduced incentives for firms to invest, while economic and political uncertainties have also weighed on investment. Since 2015, many countries have seen sharp contractions in investment in the oil and extractive industries, although these declines are mostly cyclical, rather than signalling significant structural progress towards a less fossil fuel-intensive economy. Lack of access to finance has also acted as a constraint in some cases, especially in countries where banks remain undercapitalized or where financial markets are under-developed. Despite record-low, often negative bond yields, Governments in developed countries have made steep cuts in public investment since 2010, reflecting fiscal adjustment policies implemented in response to high levels of government debt. Since mid-2014, Governments in many commodity-exporting countries have also curtailed much-needed investment in infrastructure and social services, in response to the sharp loss of commodity revenue. In some other developing countries in East and South Asia and parts of Africa, on the other hand, weaker private sector investment has been partially offset by an expansion of government infrastructure projects.

The extended period of weak investment is a driving factor behind the slowdown in productivity growth

Labour productivity growth has slowed markedly in most developed economies, and in many large developing and transition countries. Investment in new capital can affect factors such as the rate of innovation, labour force skills and the quality of infrastructure. These in turn drive the technological change and efficiency gains underpinning labour productivity growth in the medium term.

Government support for public goods, such as combating climate change, remains crucial, as private investors tend to evaluate risk and return over a short-term horizon and under-invest in public priorities. Investment in key areas, such as research and development, education and infrastructure, would serve to promote sustainable development and social and environmental progress, while also supporting productivity growth. While fiscal space to support an expansion of investment remains limited in many countries, especially commodity exporters that have suffered a sharp loss of commodity revenue, some large economies do have the scope to take advantage of low borrowing costs to finance investment.

Aggregate growth in the least developed countries (LDCs) remains well below the Sustainable Development Goal target of “at least 7 per cent GDP growth”

Aggregate growth in the LDCs will remain well below the SDG target in the near term, but is expected to rise modestly from an estimated 4.5 per cent in 2016 to 5.2 per cent and 5.5 per cent in 2017 and 2018, respectively. The below-target growth poses a risk to critical public expenditure on healthcare, education, social protection and climate change adaptation. The latter is all the more critical since the LDCs remain highly vulnerable to natural catastrophes and weather-related shocks.

Further efforts are also needed to diversify exports of the LDCs, which remain highly concentrated in a few primary products vulnerable to price volatility and external shocks. Under the current growth trajectory, nearly 35 per cent of the population in the LDCs may remain in extreme poverty by 2030. Without an acceleration in both GDP growth and progress towards improving income inequality, eradicating the high levels of extreme poverty in the LDCs by 2030 is a formidable challenge.

Garnering the resources to finance the investment needed in the LDCs remains difficult. Investment in these countries would need to expand at an average annual rate of at least 11 per cent through 2030, a significant acceleration relative to recent trends. Foreign direct investment (FDI) continues to bypass many LDCs and remains concentrated in extractive industries. Greater efforts are needed to mobilise domestic and international, public and private resources for achieving the SDGs of these countries.

Sustained improvements in carbon emissions mitigation will require concerted efforts to improve energy efficiency and promote renewable energy

The level of global carbon emissions has stalled for two consecutive years. This positive development reflects the declining energy intensity of economic activities, a rising share of renewables in the overall energy structure, and slower economic growth in major emitters.

However, the world remains some distance from achieving a sustained decoupling between economic growth and carbon emissions growth. Despite advancements, especially in developing countries, where the level of new renewable energy investment exceeded that of developed countries in 2015, renewable energy still accounts for only a small share of global power generation. New renewable investment dropped sharply in the first half of 2016, and the improvements to emissions mitigation witnessed in recent years could easily reverse without concerted efforts from the public and private sectors to improve energy efficiency and promote renewable energy, supported by international cooperation on clean technology transfer and climate finance.

International trade and finance

World trade at a standstill

Dwindling world trade growth is both a contributing factor and a symptom of the global economic slowdown. World trade volumes expanded by just 1.2 per cent in 2016, the third-lowest rate in the past 30 years. Cyclical factors — such as the composition of global demand and heightened uncertainty — continue to restrain global trade growth, while the impact of a number of structural shifts that favoured the rapid expansion of global trade in the 1990s and 2000s have started to wane, coupled with slower progress in trade liberalisation. The ratio of world trade growth to world gross product growth has declined significantly since the 1990s. While global import penetration is expected to exhibit a modest recovery, world trade growth is unlikely to outpace world gross product significantly in the coming years. World trade is projected to expand by 2.7 per cent in 2017 and 3.3 per cent in 2018.

Closing the investment gap to achieve the SDGs by 2030 requires the mobilization of significant financial resources

The prolonged slowdown in global economic growth makes generating the long-term investment necessary for achieving the SDGs particularly challenging. International finance is a critical complement to domestic revenue mobilization, which has grown steadily in developing countries over the last 15 years, but has yet to close investment financing gaps.

However, international capital inflows remain volatile, and net flows to developing countries are estimated to remain negative at least through 2017, underscoring the challenges of financing long-term sustainable development.

Since the global financial crisis, low interest rates have prompted sovereign bond issuance by developing countries in international capital markets. However, in some cases, concerns over debt sustainability are now being realised, especially where repayment burdens are subject to significant exchange rate movements. The provision of international public finance, including official development assistance (ODA) from Members of the OECD Development Assistance Committee, increased in 2015, but remains below United Nations targets. The increase in ODA to a large extent reflects the resources spent on refugees in host countries. Lending by multilateral development banks and through South-South cooperation also increased in 2015. Nonetheless, available domestic and international financial resources remain insufficient to fill investment financing gaps for sustainable development, particularly in the poorest countries.

Aligning institutional investment with sustainable development requires a change in the incentive structure

Aligning investment with the SDGs, including building sustainable and resilient infrastructure, requires policies and regulatory frameworks that incentivize changes in investment patterns. Current FDI patterns are not fully aligned with sustainable development, and the bulk of recent flows have been directed towards cross-border mergers and acquisitions, which may have limited impact on jobs and development. A reallocation of 3 to 5 per cent of institutional investor assets towards long-term investment in sustainable development could have an enormous impact. Yet to date, investment by institutional investors in the long-term illiquid assets necessary for sustainable development has been limited. Investment by institutional investors has tended to be short-term oriented, as reflected in the volatility of cross-border portfolio flows. Volatile international portfolio and banking flows can undermine sustainable development rather than support it.

Aligning incentives in capital markets with long-term investment in sustainable development and also incentivizing greater direct investment can be addressed through the financial governance architecture, and supported through various policy mixes including pricing externalities, effective regulatory frameworks, blended finance and guarantees and leveraging private investment through public intermediaries, such as development banks.

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