Global Economic Prospects

HIGHLIGHTS FOR CHAPTER 1

Global Outlook: Disappointments, Divergences, and Expectations

***Global Economic Prospects*, January 2015**

Key Points

- *As in previous three years, growth in 2014 has disappointed. Compared with the June 2014 Global Economic Prospects, global growth was revised down by 0.2 percentage point in 2014 to 2.6 percent, 0.4 percentage point to 3 percent in 2015.*
- *Increasingly divergent trends are at work in major economies. The recovery gained traction in the United States and the United Kingdom but is struggling in the Euro Area and Japan, while a carefully managed slowdown is underway in China.*
- *Several major forces shape the global outlook in 2015-16: easy, but tightening, financial conditions; continued soft commodity prices; and weak global trade.*
- *Risks to this slow-moving global recovery are significant and tilted to the downside.*
- *The forces driving the global outlook and the associated risks pose significant policy challenges.*

Disappointments. The recovery has been weaker than anticipated in June 2014, partly for one-off reasons, with a string of disappointing growth outturns in the Euro Area, Japan, parts of emerging Europe (especially Russia) and Latin America (Figure 1A). The Euro Area and Japan accounted for more than half of the downward revisions to global growth in 2014 (and one-third of the downward revisions to global growth in 2015, Figure 1B). Global growth picked up only marginally to 2.6 percent in 2014 from 2.5 percent in 2013.

Divergences. Growth in major economies has increasingly diverged, as the recovery in the United States and the United Kingdom gains momentum but the Euro Area and Japan lag behind. China is still growing at a robust pace but continues on a path of gradual deceleration. Growth in middle- and low-income countries slipped, reflecting cyclical factors, domestic policy tightening, and political tensions. Deeper, structural factors, including a trend slowdown in productivity, dampen growth prospects over the medium-term.

Expectations. Several major forces are driving the global outlook: soft commodity prices that are expected to persist; continued low interest rates but increasingly divergent monetary policies across major economies; and weak world trade (Figures 1C). In particular, the sharp decline in oil prices since mid-2014 will support global activity and help offset some of the headwinds to growth in oil-importing developing economies (Figures 1D). However, it will dampen growth prospects for oil-exporting countries, with significant regional repercussions. Overall, global growth is expected to rise moderately, to 3.0 percent in 2015, and average about 3.3 percent through 2017 (Figure 1E). High-income countries are likely to see growth of 2.2 percent in 2015-17, up from 1.8 percent in 2014, on the back of gradually recovering labor markets, ebbing fiscal consolidation, and still low financing costs. In developing countries, as the domestic headwinds that held back growth in 2014 ease and the recovery in high-income countries slowly strengthens, growth is projected to gradually accelerate, rising from 4.4 percent in 2014 to 4.8 percent in 2015 and 5.4 percent by 2017 (Figure 1F).

Risks. Risks to this slow-moving global recovery are significant and tilted to the downside. Financial market volatility could sharply raise developing countries' borrowing costs, an unwelcome development after several years of heavy capital market issuance by some developing countries. Intensifying geopolitical tensions, bouts of volatility in commodity markets, or financial stress in a major emerging market could lead to a reassessment of risk assets. If the Euro Area or Japan slips into a prolonged period of stagnation or deflation, global trade could weaken even further. Although it is a low-probability event given China's substantial policy buffers, a sharper decline in growth could trigger a disorderly unwinding of financial vulnerabilities and would have considerable implications for the global economy.

Policy challenges. The forces driving the global outlook and the associated risks pose significant policy challenges. In high-income countries, the still-fragile recovery calls for continued accommodative monetary policy and a flexible approach to fiscal policy, which supports growth but is also accompanied by concrete medium-term consolidation plans and structural reforms. In developing countries, global financial tightening could reduce capital flows and trigger further currency depreciations. Though depreciation may strengthen exports and help current account adjustments, they could weaken balance sheets and dampen the disinflationary effects of soft commodity prices. Some developing countries' central banks may thus have to weigh monetary policy measures to support growth against those needed to stabilize inflation and currencies or bolster financial system stability. Fiscal stimulus can also be considered in the event of a sharp cyclical downturn. In practice, however, the use and effectiveness of fiscal policy as a countercyclical policy tool may be constrained by the availability of fiscal space. Both high-income and developing countries need to undertake comprehensive structural reforms, including improvements in institutions and public infrastructure, in order to promote growth and job creation.

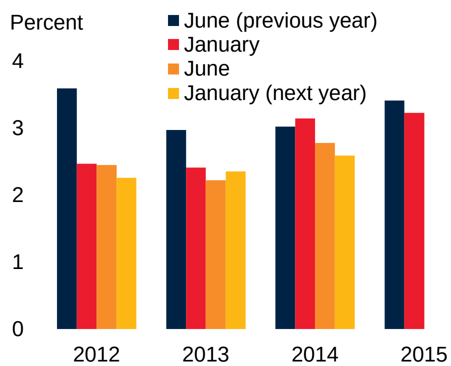
Low-income countries. Growth remained robust in low-income countries at about 6 percent in 2014 on the back of rising public investment, strong capital inflows, good harvests, and improving security conditions in a number of conflict countries. It is expected to remain around 6 percent in 2015–17. Soft commodity prices, especially for oil exporters, as well as weak growth in the Euro Area, an important trading partner for West Africa, are expected to hold back growth in many low-income countries. However, strong government consumption and investment growth is expected to mitigate these headwinds.

Poverty. The Millennium Development Goal to halve extreme poverty was reached in 2010. Since then, the World Bank Group set a new goal, to reduce extreme poverty to below 3 percent by 2030. Under current growth projections, reaching this goal will be challenging. This increases the urgency of implementing growth-enhancing policies and structural reforms.

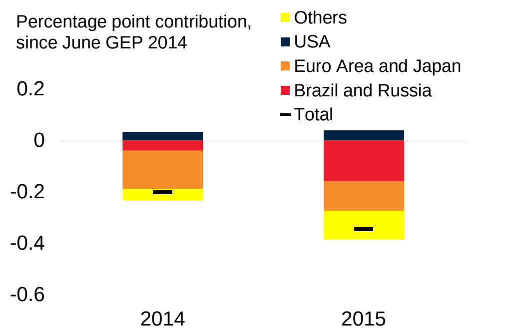
Figure 1: Global Prospects: Disappointments, Divergences, and Expectations

Growth disappointed again in 2014 and has been revised downwards in 2015-16. Increasingly divergent trends are at work in major economies, with the recovery gaining momentum in the United States but stuttering in the Euro Area and Japan. Different growth prospects in major economies coincide with divergent monetary policy stances. In large developing countries, growth has slowed and, especially in 2015, is set to vary significantly across them.

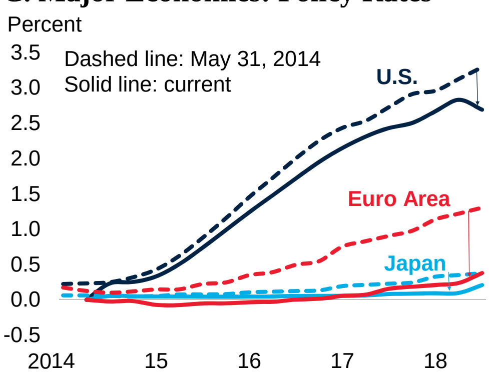
A. Global GDP growth forecasts



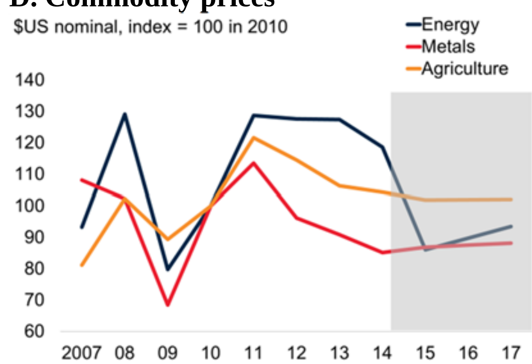
B. Contribution to revisions of global growth forecasts[1]



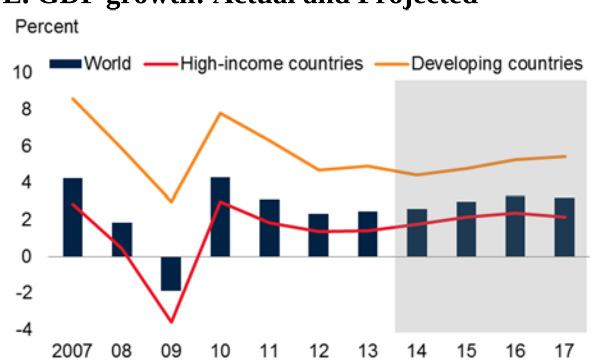
C. Major Economies: Policy Rates[2]



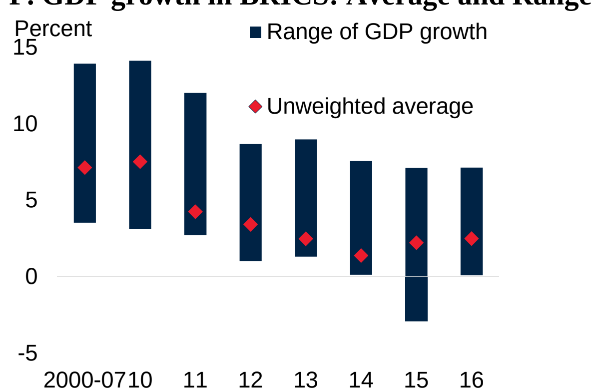
D. Commodity prices[3]



E. GDP growth: Actual and Projected



F. GDP growth in BRICS: Average and Range [4]



Sources: World Bank, Bloomberg.

1. Contribution to global growth revisions between June GEP 2014 and January GEP 2015.
2. Policy rate expectations are based on forward swap rates.
3. Energy consists of oil, natural gas, and coal. Agriculture consists of grains, edible oils, oil deeds, and tropical commodities. Metals include the six base metals (aluminum, copper, lead, nickel, tin and zinc) and iron ore.
4. Unweighted average and range (from minimum to maximum) of GDP growth in Brazil, Russia, India, China, and South Africa.