Global growth in 2014 was lower than initially expected, continuing a pattern of disappointing outturns over the past several years. Growth picked up only marginally in 2014, to 2.6 percent, from 2.5 percent in 2013. Beneath these headline numbers, increasingly divergent trends are at work in major economies. While activity in the United States and the United Kingdom has gathered momentum as labor markets heal and monetary policy remains extremely accommodative, the recovery has been sputtering in the Euro Area and Japan as legacies of the financial crisis linger, intertwined with structural bottlenecks. China, meanwhile, is undergoing a carefully managed slowdown. Disappointing growth in other developing countries in 2014 reflected weak external demand, but also domestic policy tightening, political uncertainties and supply-side constraints.

Several major forces are driving the global outlook: soft commodity prices; persistently low interest rates but increasingly divergent monetary policies across major economies; and weak world trade. 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. However, it will dampen growth prospects for oil-exporting countries, with significant regional repercussions.

Overall, global growth is expected to rise moderately, to 3 percent in 2015, and average about 3.3 percent through 2017. High-income countries are likely to see growth of 2.2 percent in 2015-17, up from 1.7 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. Lower oil prices will contribute to diverging prospects for oil-exporting and -importing countries, particularly in 2015.

Risks to this slow-moving global recovery are significant and tilted to the downside. Financial market volatility, compounded by the risk of a sudden deterioration in liquidity conditions, could sharply raise developing countries' borrowing costs, an unwelcome development after several years of heavy capital market issuance in 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.

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 of fiscal policy as a countercyclical policy tool may be constrained by a lack of fiscal space that limits the ability to use fiscal stimulus and its effectiveness. 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. This will help lift growth towards rates needed to achieve poverty reduction targets by 2030.

This edition of the *Global Economic Prospects* also includes four essays that analyze key challenges and opportunities currently confronting developing countries: fiscal policy as a countercyclical policy tool; causes and implications of cheap oil; weak trade that fails to act as an engine of growth; and remittances as a means of steadying consumption during sudden stops.

**Fiscal Space**

Will fiscal policy be able to support activity effectively if needed? Over the past three decades, fiscal policy in developing countries has become increasingly countercyclical. The wide fiscal space accumulated prior to the global financial crisis not only made it possible for developing countries to implement fiscal stimulus during the crisis, but also made the stimulus more effective in supporting growth as fiscal multipliers tend to be higher in countries with greater fiscal space.

However, in many developing countries, fiscal balances have yet to be restored to debt-stabilizing levels. This has likely dampened the effectiveness of fiscal policy, reducing fiscal multipliers by about one-third from pre-crisis levels. Over the medium-term, many countries need to rebuild fiscal buffers and to restore fiscal sustainability. The speed at which fiscal space should be restored depends on a host of country-specific factors. These include cyclical conditions as well as constraints on monetary policy, for example the post-crisis accumulation of private sector debt or still-elevated inflation in several developing countries. Well-designed and credible institutional arrangements—fiscal rules, stabilization funds, and medium-term expenditure frameworks—can help rebuild fiscal space and strengthen policy outcomes, enabling fiscal stimulus, and larger and more effective programs for poverty reduction.

**Weak Trade**

What are the sources and implications of the recent decline in oil prices? Following four years of stability at around $105/bbl, oil prices have declined sharply since June 2014. A number of factors have driven the recent plunge in oil prices: several years of upward surprises in oil supply and downward surprises in demand, unwinding of some geopolitical risks that had threatened production, changing OPEC policy objectives, and appreciation of the U.S. dollar. Although it is difficult to precisely determine the relative importance of these factors, supply-related factors appear to have played a dominant role. If sustained, lower oil prices will contribute to global growth and lead to sizeable real income shifts to oil-importing countries from oil-exporting ones. For oil-importing countries, weak oil prices will support activity and reduce inflationary, external, and fiscal pressures. On the other hand, oil-exporting countries will be adversely impacted by weakening fiscal and external positions and reducing economic activity. However, soft oil prices present a significant window of opportunity to reform energy taxes and fuel subsidies, which are substantial in several developing countries.

Why has global trade been weak in the post-crisis years? Global trade grew less than 4 percent a year during 2012-14, well below the pre-crisis average annual growth of about 7 percent. If global trade had continued to expand at its historical trend, it would have been some 20 percent above its actual level in 2014. The slowdown in global trade has been driven by both cyclical factors, notably persistently weak import demand in high-income countries, and structural factors, including the changing relationship between trade and income. Specifically, world trade has become less responsive to changes in global income because of slower expansions of global supply chains and a shift in demand toward less import-intensive items.

**Remittances**

Can remittances help stabilize consumption? Remittance flows to developing economies are projected to continue to expand, while private capital flows might moderate as global interest rates begin rising or if growth in developing economies remains subdued. Remittances are generally a more stable source of external funding that is less correlated with the domestic cycle than other types of private flows. For example, during past sudden stops, when capital flows to developing countries fell on average by 25 percent, remittances increased by 7 percent. Given these tendencies, remittances to heavily reliant developing countries can help ease liquidity constraints, improve access to financial services, and smooth household consumption, especially during periods of financial stress.

**Table 1.1 The global outlook in summary**
*(percentage change from previous year)*

| | 2012 | 2013 | 2014e | 2015f | 2016f | 2017f |
|---|---|---|---|---|---|---|
| *REAL GDP*[1] | | | | | | |
| **World** | **2.4** | **2.5** | **2.6** | **3.0** | **3.3** | **3.2** |
| **High income** | **1.4** | **1.4** | **1.8** | **2.2** | **2.4** | **2.2** |
| Euro Area | -0.7 | -0.4 | 0.8 | 1.1 | 1.6 | 1.6 |
| Japan | 1.5 | 1.5 | 0.2 | 1.2 | 1.6 | 1.2 |
| United States | 2.3 | 2.2 | 2.4 | 3.2 | 3.0 | 2.4 |
| **Developing countries** | **4.8** | **4.9** | **4.4** | **4.8** | **5.3** | **5.4** |
| East Asia and Pacific | 7.4 | 7.2 | 6.9 | 6.7 | 6.7 | 6.7 |
| Europe and Central Asia | 1.9 | 3.7 | 2.4 | 3.0 | 3.6 | 4.0 |
| Latin America and the Caribbean | 2.6 | 2.5 | 0.8 | 1.7 | 2.9 | 3.3 |
| Middle East and North Africa | 1.4 | 0.5 | 1.2 | 2.5 | 3.0 | 3.5 |
| South Asia | 5.0 | 4.9 | 5.5 | 6.1 | 6.6 | 6.8 |
| Sub-Saharan Africa | 4.0 | 4.2 | 4.5 | 4.6 | 4.9 | 5.1 |
| *MEMORANDUM ITEMS* | | | | | | |
| World real GDP (2010 PPP weights) | 3.1 | 3.2 | 3.3 | 3.6 | 4.0 | 4.0 |
| World trade volume (GNFS)[2] | 2.8 | 3.4 | 4.0 | 4.5 | 4.8 | 4.8 |
| Commodity Prices | | | | | | |
| Non-oil commodities | -8.6 | -7.2 | -3.6 | -1.1 | 0.2 | 0.3 |
| Oil price[3] | 1.0 | -0.9 | -7.7 | -31.9 | 4.9 | 4.7 |
| **International capital flows to developing countries (% of GDP)** | | | | | | |
| Developing countries | 5.0 | 5.9 | 5.8 | 5.5 | 5.3 | |
| East Asia and Pacific | 4.6 | 6.4 | 6.3 | 5.9 | 5.5 | |
| Europe and Central Asia | 8.0 | 7.4 | 5.4 | 6.0 | 6.2 | |
| Latin America and Caribbean | 5.4 | 5.9 | 6.2 | 5.9 | 5.7 | |
| Middle East and North Africa | 1.8 | 2.3 | 1.8 | 1.8 | 1.9 | |
| South Asia | 5.7 | 4.6 | 5.4 | 5.3 | 5.3 | |
| Sub-Saharan Africa | 5.6 | 5.2 | 4.5 | 4.7 | 4.8 | |

Source: World Bank.
Notes: PPP = purchasing power parity; e = estimate; f = forecast.
1. Aggregate growth rates calculated using constant 2010 dollars GDP weights.
2. World trade volume for goods and non-factor services.
3. Simple average of Dubai, Brent and West Texas Intermediate.