Global Economic Prospects

HIGHLIGHTS FOR CHAPTER 1
Global Economy in Transition
***Global Economic Prospects*, June 2015**

Key Points

- *Global growth is expected to be 2.8 percent in 2015, slightly lower than anticipated in January, but will likely rise to 3.2 percent in 2016-17, broadly in line with previous forecasts.*
- *Developing economies are facing two transitions this year, as growth slows further to 4.4 percent.*
- *First, the widely expected tightening of monetary conditions in the United States, along with monetary expansion by other major central banks, has contributed to broad-based appreciation in the U.S. dollar and is exerting downward pressure on capital flows to developing countries. Many developing-country currencies have weakened against the U.S. dollar, particularly those of countries with weak growth prospects or elevated vulnerabilities. In some countries, this trend has raised concerns about balance sheet exposures in the presence of sizeable dollar-denominated liabilities.*
- *Second, despite some pickup in the first quarter of 2015, lower oil prices are having an increasingly pronounced impact. In oil-importing countries, the benefits to activity have so far been limited, although they are helping to reduce vulnerabilities. In oil-exporting countries, lower prices are sharply reducing activity and increasing fiscal, exchange rate, or inflationary pressures.*
- *Risks remain tilted to the downside, with some pre-existing risks receding but new ones emerging.*

Disappointments. Global growth hit a soft patch at the start of the year, but remains broadly on track to reach about 2.8 percent in 2015, somewhat below earlier forecasts, with a modest pickup in 2016-17. However, important shifts are emerging. The recovery in high-income countries is expected to strengthen, while a broad-based slowdown appears to be underway in developing countries this year (Figure 1). Looking forward, global activity should be supported by continued low commodity prices and generally still-benign financing conditions, notwithstanding the expected modest tightening in U.S. monetary policy. Among major economies, growth in the Euro Area and Japan is picking up, and the United States should continue to expand at a robust pace despite recent setbacks, while the slowdown in China is proceeding as anticipated in January. High-income countries are expected to grow by 2 percent in 2015 and 2.3 percent in 2016-17. Compared with 2014, growth in developing countries is expected to slow to 4.4 percent in 2015, 0.4 percentage point less than anticipated in January, before rising to 5.3 percent in 2016-17. For now, growth prospects for low-income countries (LICs) remain robust, above 6 percent in 2015-17, as the negative impact of low commodity prices is offset by strong public investment in several commodity-exporting LICs.

Two transitions: low commodity prices. Developing countries are facing two transitions, as they adjust to prospects of low commodity prices over the medium-term and tighter financial conditions ahead. Oil prices appear to have found some support, upon evidence of a sharp decrease in unconventional oil production capacity in the United States, but are likely to remain low. Other commodity prices continue to be soft, on weak demand as well as ample supplies. As a result, in commodity-exporting countries, especially those with limited reserve and fiscal buffers, activity has slowed more than anticipated, currencies have weakened, and domestic and external vulnerabilities have grown. In contrast, commodity-importing countries have benefited from declining vulnerabilities, as current account and fiscal balances have strengthened and inflation has fallen. Offset by country-specific headwinds, low oil prices have not yet been fully reflected in stronger activity in oil-importing countries.

Two transitions: high financing cost. In a second transition, developing countries will be at heightened risk of depreciation amid a gradual tightening of financial conditions, albeit from very accommodative levels, and moderating capital flows. Quantitative easing by the European Central Bank (ECB), continued monetary easing in Japan, and the prospect of an interest rate increase in the United States have been associated with a broad-based appreciation of the U.S. dollar and some financial market volatility. Currency depreciations have been largest in developing countries with deteriorating growth prospects—most notably commodity exporters—and elevated external vulnerabilities. Currency depreciations against the U.S. dollar have raised concerns about U.S. dollar exposures in sovereign and corporate balance sheets in some countries, especially those with rapid post-crisis credit growth. In trade-weighted terms, however, depreciations have been negligible for most developing countries and may not deliver significant competitiveness gains. With the gradual tightening in U.S. monetary policy likely to start later in 2015, capital flows are expected to ease and financial conditions for developing countries to tighten modestly.

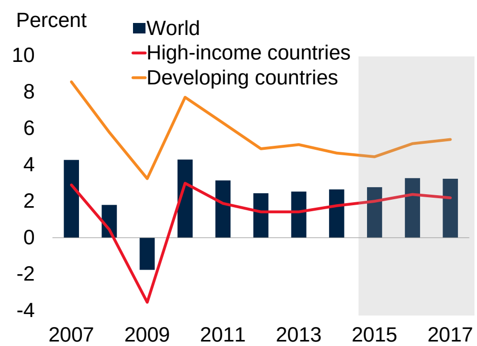
Policy challenges. Low oil prices, set against the prospect of gradually tightening global financial conditions, raises diverging policy challenges and opportunities. In many oil-importing countries, lower inflation and shrinking fiscal and external vulnerabilities have created space for central banks to cut rates to support weak activity. In countries with large fuel subsidies and low energy taxation, lower oil prices also present an opportunity for subsidy and tax reform to re-build buffers against future cyclical downturns, or to expand spending on infrastructure investment and poverty-reducing activities. In oil-exporting countries, in contrast, central banks, faced with depreciation pressures and rising inflation, have raised policy rates, despite slowing growth. In some cases, higher rates have coincided with procyclical fiscal tightening as commodity-related revenues have fallen. In most developing countries, the growth slowdown underway is a reminder of the need for structural reforms, including to promote diversification beyond commodity exports.

Risks. Global risks to growth remain tilted to the downside. Deflation risks in the Euro Area remain but have receded as inflation expectations have picked up. However, the likelihood of disruptive financial market adjustments in developing countries may have increased as the monetary tightening cycle in the United States nears.

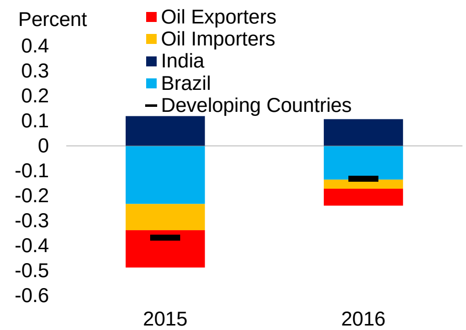
Figure 1: Global Economy in Transition

The global economy is growing somewhat more slowly than expected, with disappointments in developing countries, especially in oil exporters and Brazil. While the recovery in high-income countries provides increasing support to global activity, growth in developing countries is expected to decelerate further in 2015. Oil prices appear to have found a floor on evidence of supply adjustment in the United States. Risks remain tilted to the downside, with bouts of financial market volatility—including possibly around the first U.S. interest rate hike—potentially affecting more vulnerable emerging and developing countries.

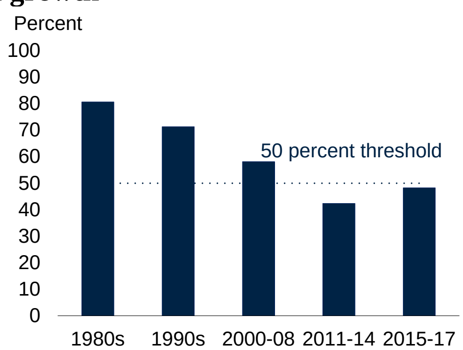
A. Growth forecasts



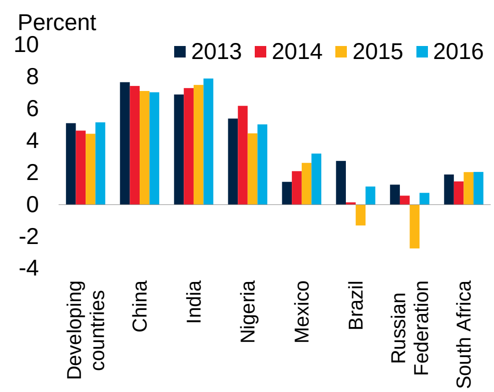
B. Contribution to developing countries' growth revisions



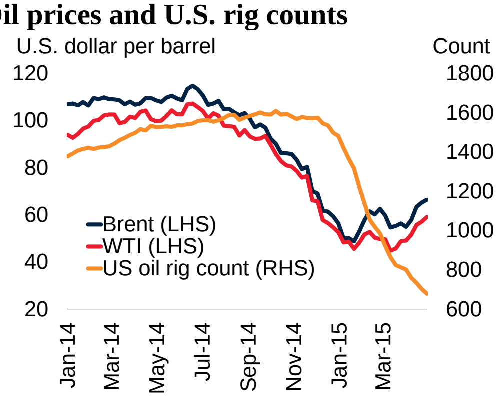
C. High-income countries: Contribution to global growth



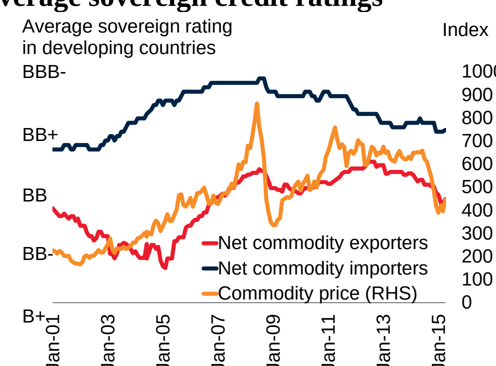
D. Emerging and developing countries: Growth



E. Oil prices and U.S. rig counts



F. Average sovereign credit ratings[4]



Sources: World Bank, Bloomberg, Haver Analytics, Federal Reserve St. Louis, U.S. Federal Reserve Board
A. Shaded areas indicate forecasts.
F. The sovereign rating is calculated based on the simple average of long-term foreign-currency credit ratings of countries by Standard & Poor's Rating Service. The latest observation is April 2015.