Challenges and downside risks for the world economy

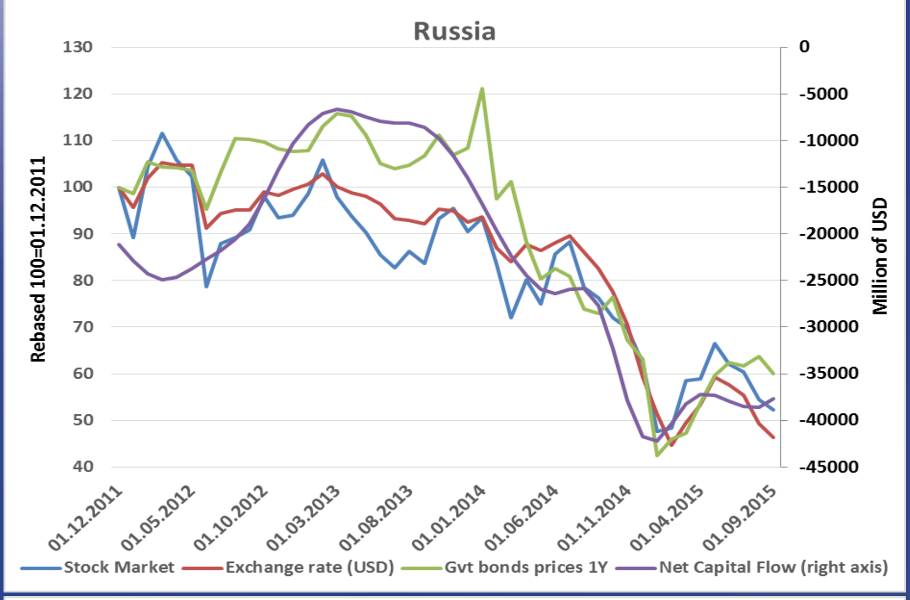
A year of living dangerously

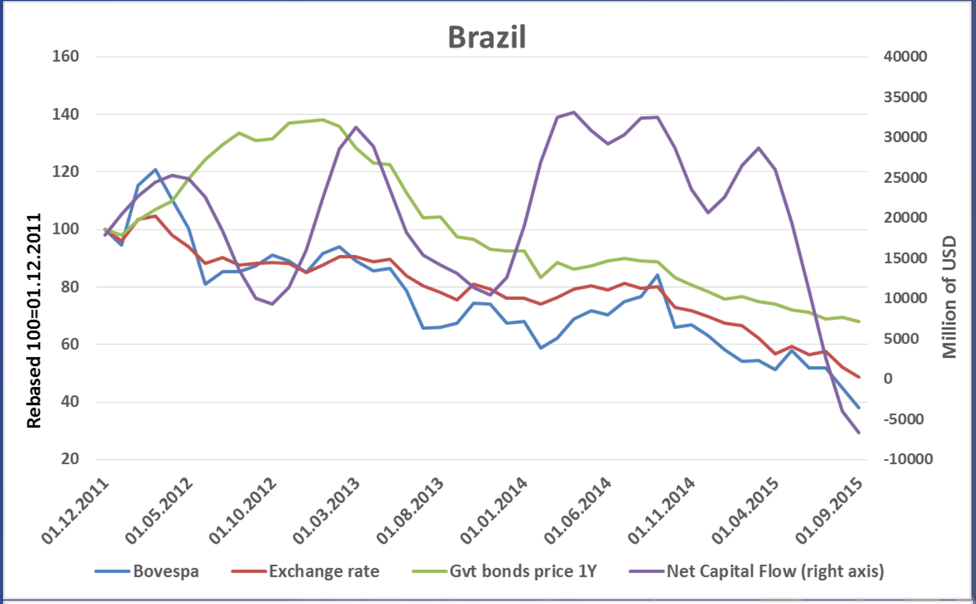
UNCTAD, TDB
January 26th, 2016

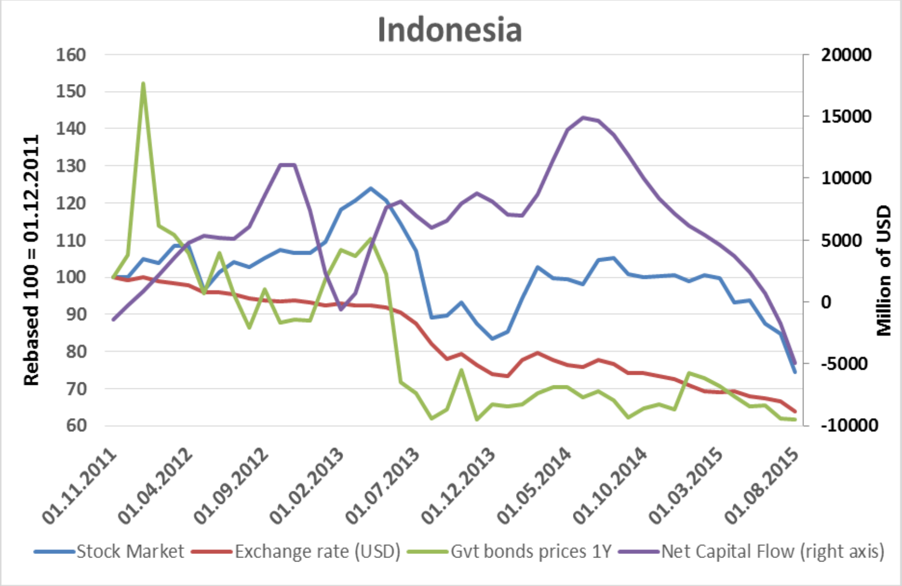
"It's the (world) economy…stupid"

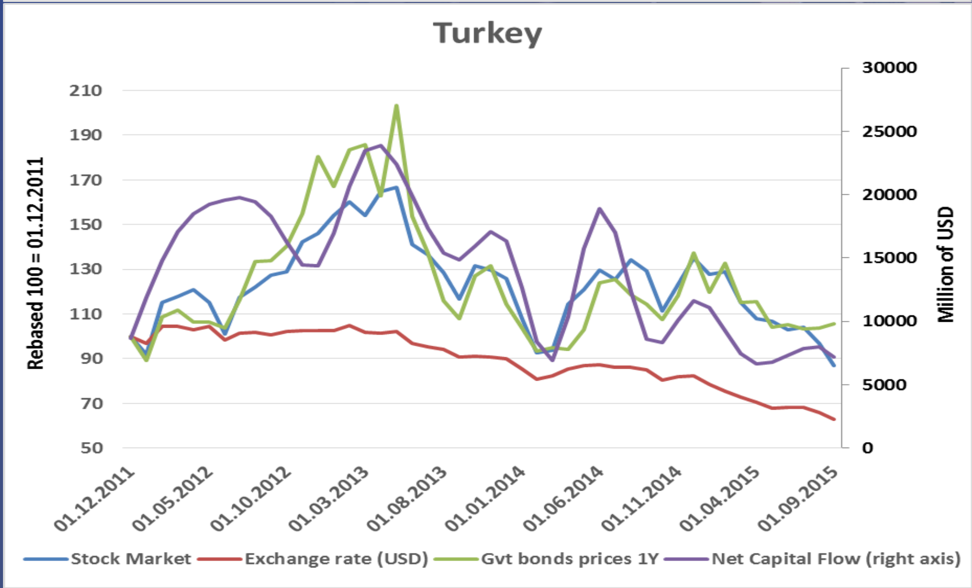
- With tepid recovery in advanced economies and strong headwinds in many developing and transition economies, the crisis is not over and the risk of a prolonged period of turbulence and stagnation persists
- Focus now on emerging economies (third phase)…but insufficient demand and failure to tame finance in AEs are compounding their problems
- Combining monetary expansion with fiscal and wage restraint has been ineffective and spillovers to the rest of the world now turning negative
- Weak demand, financial instability and high inequality leading to a new "abnormal" …. cant grow without adding to instability; cant stabilise without damaging growth … a policy problem
- Expansionary policies needed to address the roots of the crisis on both the demand and supply side; alternative G20 agenda

The decoupling myth







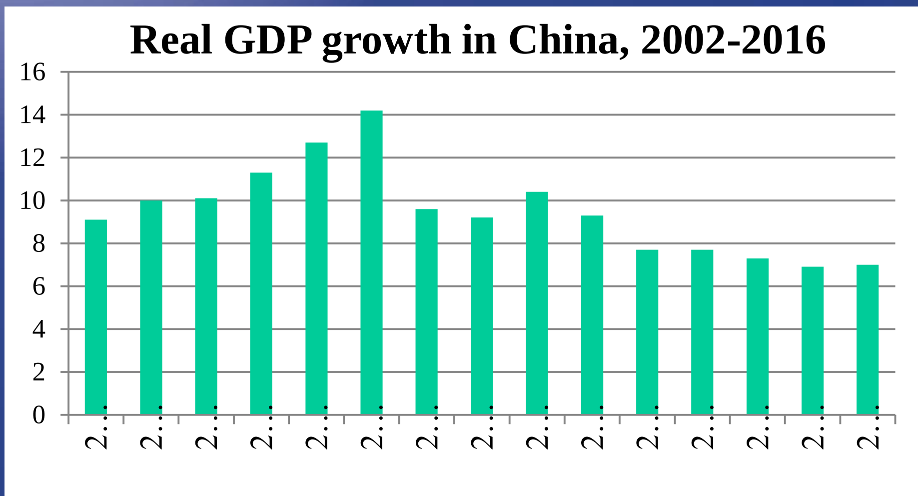


"Brand new talk, not very clear"

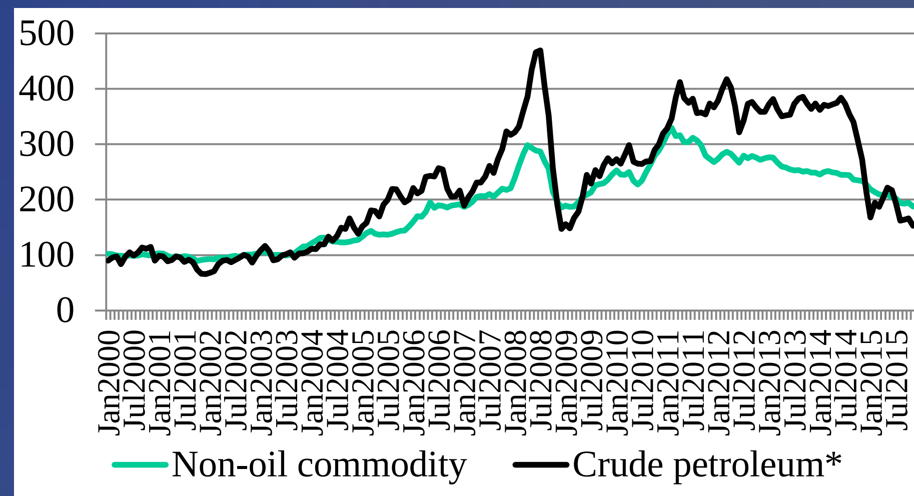
- Growth estimates for 2015 and projections for 2016 revised down (IMF; UN); downside risks
- A perfect storm (World Bank); a global recession (OECD); growing risk of social unrest (ILO)
- Financial fragility with focus on weaknesses in emerging economies; unorthodox monetary policy + structural reforms (an increasingly vague term)
- Live in an interdependent world economy which continues to be dominated by the advanced countries

Headline numbers shaking global markets

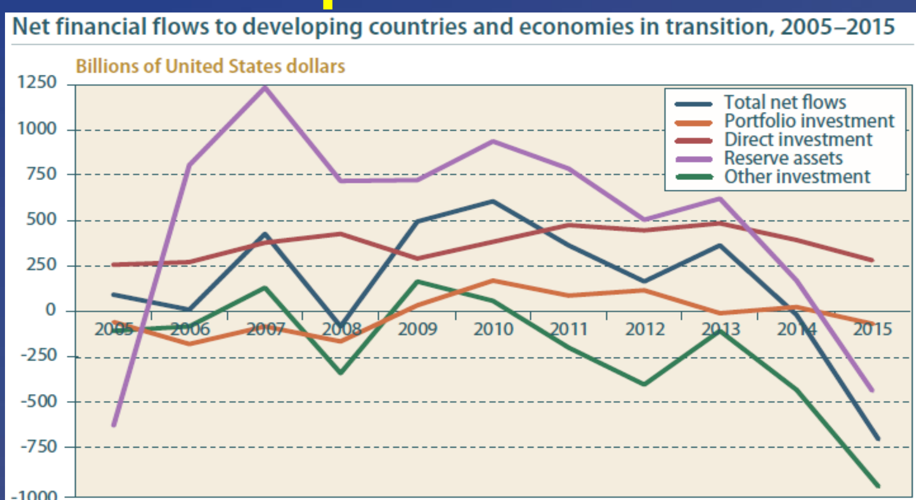
Slowdown in China



Falling commodity prices



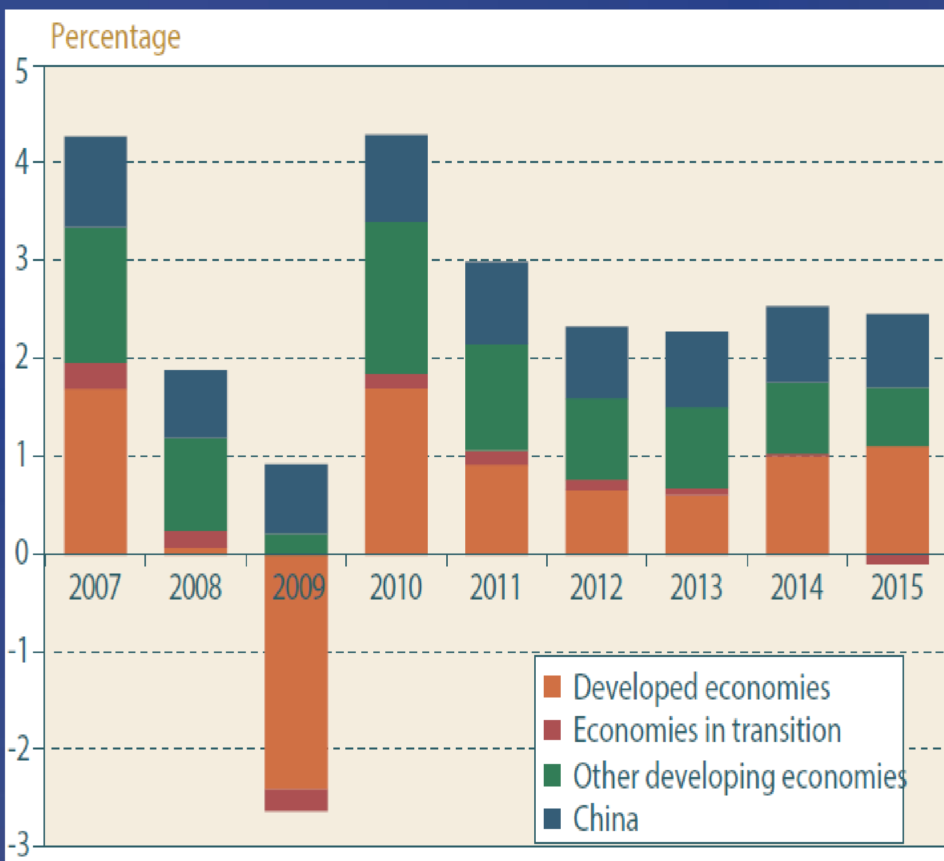
Capital reversals



US interest rates

First-round risks (1) “The market is very worried about China”

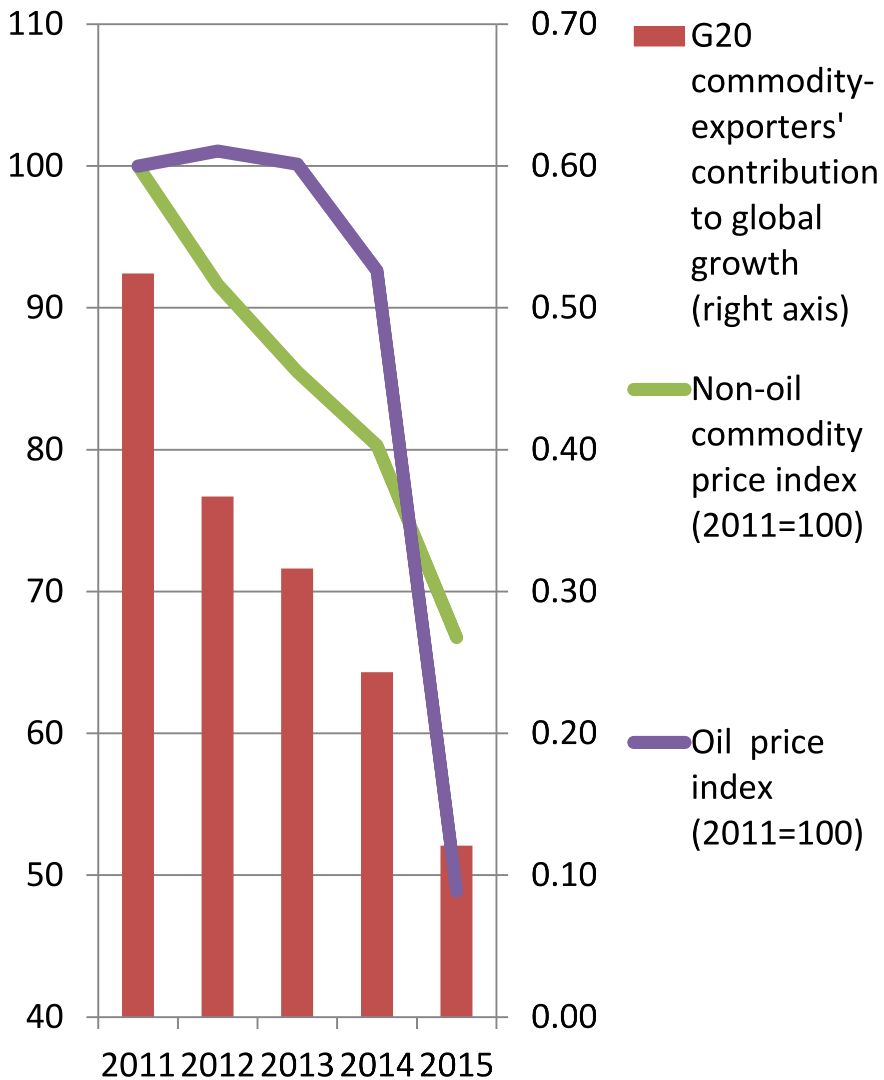
China's contribution to global growth remains robust

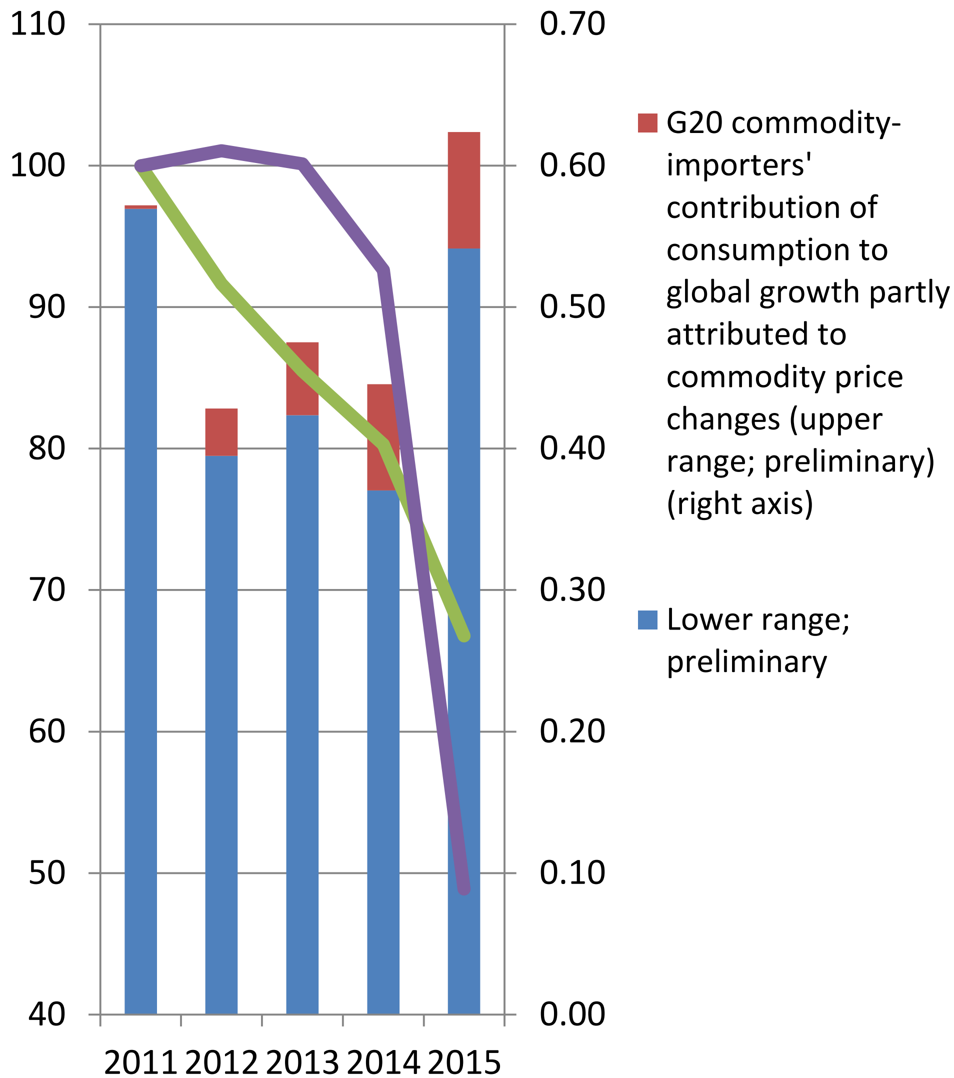


Vigilant policy action and plenty of room for further interventions

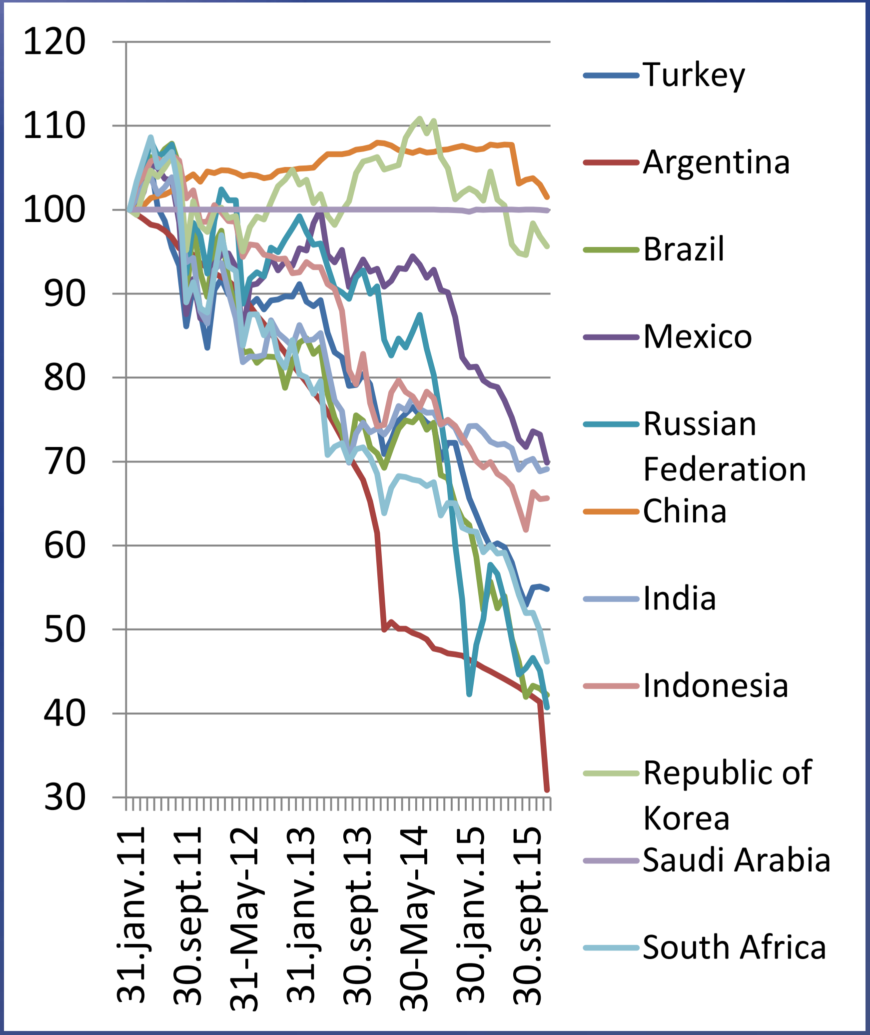
- Interventions in the real economy: rebalancing away from investment, promoting increased household spending, revamping the social security system, supporting local and state governments, etc.
- Fostering production upgrade
- Exchange rate policy shift (measuring the level of Renminbi against a basket of 13 currencies) and 'soft' controls over capital outflows
- Reunifying financial and economic policy to improve coordination

First-round risks (2) Falling commodity prices …..not translating to global acceleration





First-round risks (3): exchange rate pressures

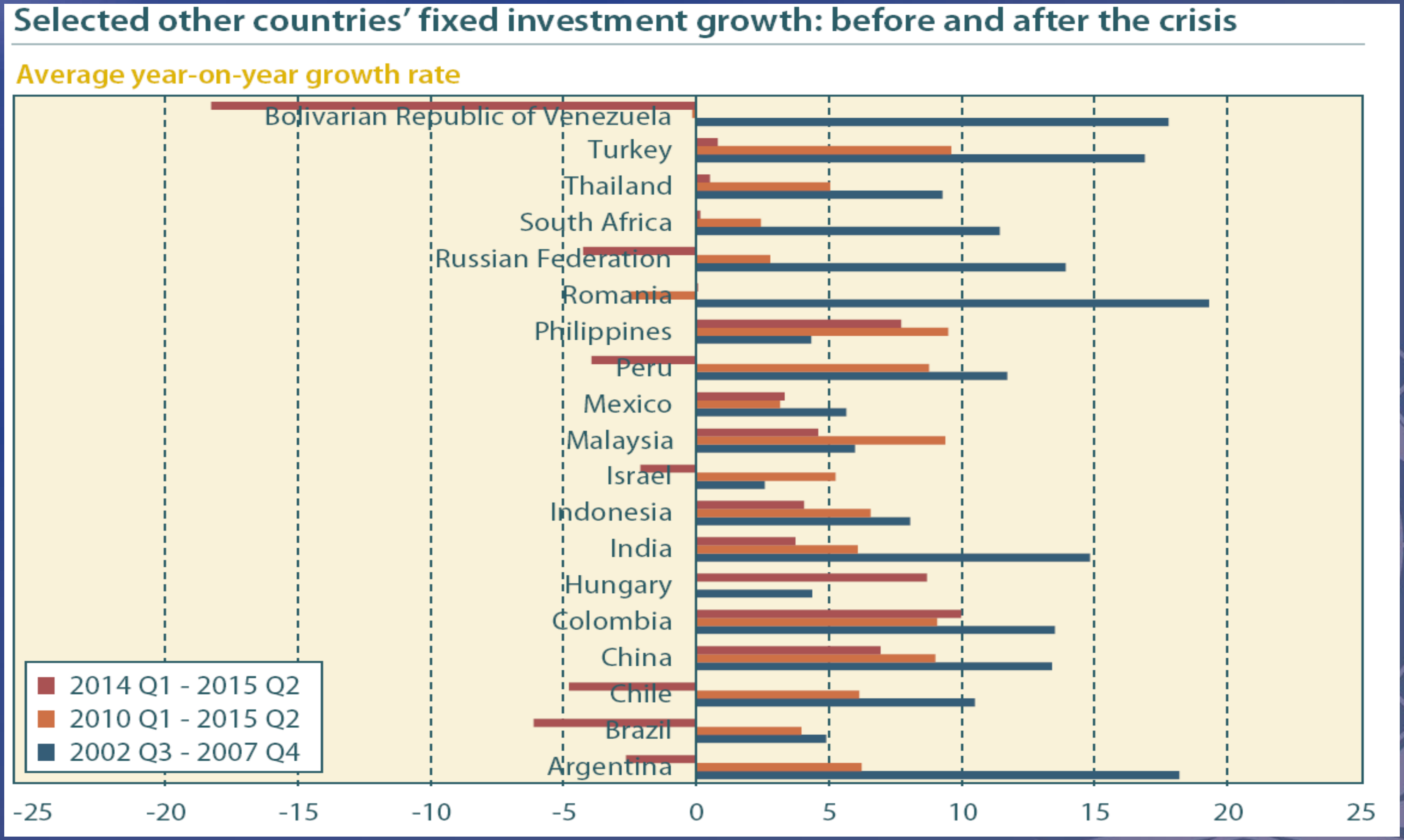


- Inflationary pressures
- Erosion of real wages
- Monetary policy responses of contractionary character (to 'attract capital', to 'contain inflation')
- Calls for fiscal austerity?
- Debt management crisis, affecting financial and corporate bonds and hitting the public sector (bail-outs?)

Second-round risks (1):

China's adjustment to a new growth path

Weak investment recovery in emerging economies



Second-round risks (2)

- No coordinated policy stimuli across major G20 economies
- Developed economies face stronger headwinds, not only because of negative feedbacks from emerging economies, but also:
- impact of $ appreciation on net exports and net worth (value of assets abroad); limits to fiscal relaxation; negative effect on spending of corporations and households due to stock market falls (failure to address wage share decline)
- insufficient stimuli from EU fiscal policy, too weak recovery of real earnings and declining stock markets affecting corporate spending, a debt-deflationary trap may persist; wont 'export its way out' on the back of further monetary easing and devaluation
- return to a more deflationary trend in Japan with more fiscal contractionary measures combined with stock market falls and weak export growth