

Global Economic Prospects 2009

Forecast Update

March 30, 2009

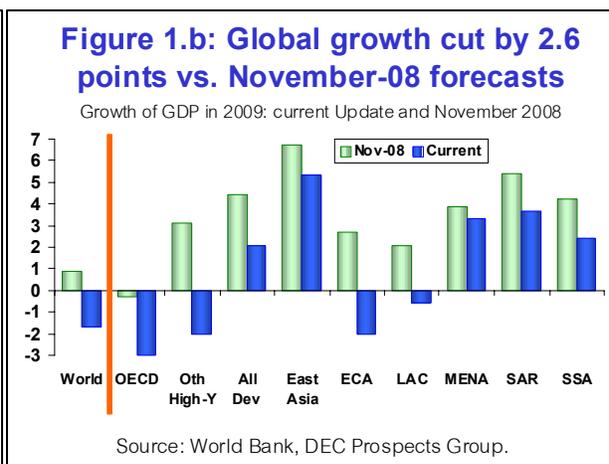
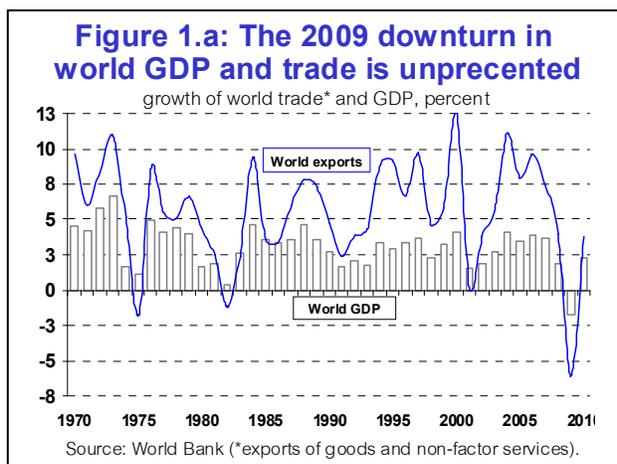
**World Bank
DEC Prospects Group**

Overview

What began six months ago with a massive de-leveraging in financial markets has turned into one of the sharpest global economic contractions in modern history. As investors repatriated overseas assets and credit conditions were tightened, firms around the world had to scale-back production and postpone capital spending plans. Faced with unprecedented loss of wealth and rapidly weakening labor markets, consumers reined-in spending, especially for durable goods.

This update of the projections in the World Bank's *Global Economic Prospects* report (GEP) of December 2008, reflects the rapid deterioration in financial and economic conditions—and the increasingly negative interaction between weakening economies and fragile financial systems—that have come to the fore since late 2008 for virtually every country in the world.

- Global GDP is expected to contract by 1.7 percent in 2009, which would be the first decline in world output on record (table 1.a and figures 1.a and 1.b). This marks a substantial 2.6 point deterioration from earlier GEP forecasts.
- High-income countries are in deep recession this year, with OECD economies likely to contract 3 percent and other high-income countries 2 percent.
- GDP among developing economies should ease from an advance of 5.8 in 2008 to 2.1 percent (contrasted with earlier projections for 4.4 percent growth). Two developing regions, Europe and Central Asia, and Latin America and the Caribbean will witness GDP decline in the year.
- Volumes of world trade in goods and services are expected to drop 6.1 percent in 2009, with a significantly sharper contraction in trade volumes of manufactured products.
- Oil prices are expected to remain more-than 50 percent below 2008 levels, averaging \$47 per barrel for the year, while the decline in non-oil commodity prices is forecast to remain in excess of 30 percent.



High-income countries fall into deep recession.

The global character of the recession has carried a dramatic impact on economic performance among high-income countries. Until mid-2008 the slowing of OECD domestic demand was partially offset by continued strong growth in exports of capital- and higher-tech products, supplying the investment that underpinned fast growth in the developing countries. Conditions have now reversed, as the collapse of high-income exports is reinforcing contraction in domestic demand in high-income countries. The tight global links between trade in manufactured products and the capital expenditures needed to support economic activity have now transformed into a vicious circle.

Economies specialized in capital goods production—among them Japan, Germany, Taiwan, China, and the United States—have been most adversely affected by the downturn in investment spending. The declines are especially dramatic in Asia. For example, the volume of goods exports from Japan had in January declined 40 percent from a year earlier. The size of the contraction in Taiwan, China was 30 percent and in Singapore 25 percent. The fall in industrial production was of similar magnitude in those countries. Consistent with that picture, GDP in Japan dropped 12.1 percent at an annualized rate (saar) in the fourth quarter of 2008, at 21 percent in Korea and 25 percent in Taiwan, China.

The adjustments in 2009 growth forecasts are in line with these immediate impacts. The Japanese economy is now expected to shrink 5.3 percent (a markdown of 5.2 points since November), roughly twice the contraction in Europe and the United States. GDP in all high-income countries together is anticipated to decline 2.9 percent in 2009—a step-down from GEP projections of 2.8 percentage points (table 1.a and figure 1.b).

Developing economies are being hit hard by financial crisis.

The deceleration in economic growth in low-and middle income countries as a group is expected to match the deceleration in high-income countries. The developing world is anticipated to see growth fall from 5.8 percent in 2008 to 2.1 in 2009, a drop of 3.7 percentage points, similar to the falloff in high-income economies. This highly synchronous growth collapse cannot be solely explained by trade linkages, but illustrates also that developing countries have been directly hit in their domestic economies by the financial crisis. The reversal of capital flows, collapse in stock markets, and in general the deterioration in financing conditions have brought investment growth in the developing countries to a halt, and in many developing countries investment is sharply declining.

Table 1.a Global growth forecasts; with comparison to Nov-08 projections.

(percent change from previous year)

| | Current Forecasts | | | Nov- 2008 Forecast | | Difference | |
|--|-------------------|-------------|------------|--------------------|------------|-------------|-------------|
| | 2008 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 |
| Real GDP growth | | | | | | | |
| World ^a | 1.9 | -1.7 | 2.3 | 0.9 | 3.0 | -2.6 | -0.7 |
| World (PPP weights) ^b | 3.1 | -0.6 | 2.9 | 1.9 | 3.9 | -2.5 | -1.0 |
| High-income | 0.8 | -2.9 | 1.6 | -0.1 | 2.0 | -2.8 | -0.4 |
| OECD countries | 0.7 | -3.0 | 1.5 | -0.3 | 1.9 | -2.7 | -0.3 |
| Euro Area | 0.7 | -2.7 | 0.9 | -0.6 | 1.6 | -2.1 | -0.7 |
| Japan | -0.7 | -5.3 | 1.5 | -0.1 | 1.5 | -5.2 | 0.0 |
| United States | 1.1 | -2.4 | 2.0 | -0.5 | 2.0 | -1.9 | 0.0 |
| Non-OECD | 2.8 | -2.0 | 2.9 | 3.1 | 5.3 | -5.1 | -2.4 |
| Developing | 5.8 | 2.1 | 4.4 | 4.4 | 6.0 | -2.3 | -1.6 |
| <u>East Asia and Pacific</u> | 8.0 | 5.3 | 6.6 | 6.7 | 7.8 | -1.4 | -1.2 |
| China | 9.0 | 6.5 | 7.5 | 7.5 | 8.5 | -1.0 | -1.0 |
| Indonesia | 6.1 | 3.4 | 5.4 | 4.4 | 6.0 | -1.0 | -0.6 |
| Thailand | 2.7 | -2.0 | 1.7 | 3.6 | 5.0 | -5.6 | -3.3 |
| <u>Eur. and Central Asia</u> | 4.2 | -2.0 | 1.5 | 2.7 | 5.0 | -4.8 | -3.5 |
| Russia | 5.6 | -4.5 | 0.0 | 3.0 | 5.0 | -7.5 | -5.0 |
| Turkey | 1.5 | -2.0 | 1.5 | 1.7 | 4.9 | -3.7 | -3.4 |
| Poland | 4.8 | 0.5 | 2.8 | 4.0 | 4.7 | -3.5 | -1.9 |
| <u>Latin America & Carib.</u> | 4.3 | -0.6 | 2.2 | 2.1 | 4.0 | -2.8 | -1.9 |
| Brazil | 5.1 | 0.5 | 3.2 | 2.8 | 4.6 | -2.3 | -1.4 |
| Mexico | 1.4 | -2.0 | 1.8 | 1.1 | 3.1 | -3.1 | -1.3 |
| Argentina | 6.8 | -1.8 | 1.9 | 1.5 | 4.0 | -3.3 | -2.1 |
| <u>Middle East/ N. Africa</u> | 5.5 | 3.3 | 4.3 | 3.9 | 5.2 | -0.6 | -0.9 |
| Egypt | 7.2 | 4.0 | 4.8 | 4.5 | 6.0 | -0.5 | -1.2 |
| Iran | 5.2 | 3.0 | 4.0 | 3.5 | 4.2 | -0.5 | -0.2 |
| Algeria | 3.2 | 2.2 | 3.5 | 3.8 | 5.4 | -1.6 | -1.9 |
| <u>South Asia ^c</u> | 5.6 | 3.7 | 6.2 | 5.4 | 7.2 | -1.7 | -1.0 |
| India | 5.5 | 4.0 | 7.0 | 5.8 | 7.7 | -1.8 | -0.7 |
| Pakistan | 5.8 | 1.0 | 2.5 | 3.0 | 4.5 | -2.0 | -2.0 |
| Bangladesh | 6.2 | 4.5 | 4.0 | 5.7 | 6.2 | -1.2 | -2.2 |
| <u>Sub-Saharan Africa</u> | 4.9 | 2.4 | 4.1 | 4.2 | 5.5 | -1.8 | -1.4 |
| South Africa | 3.1 | 1.0 | 3.1 | 2.2 | 4.1 | -1.2 | -1.0 |
| Nigeria | 6.1 | 2.9 | 4.2 | 5.8 | 6.2 | -2.9 | -2.0 |
| Kenya | 2.4 | 2.0 | 3.4 | 3.7 | 5.9 | -1.7 | -2.5 |
| <i>Memorandum item:</i> | | | | | | | |
| Developing countries excl China and India | 4.6 | 0.0 | 2.67 | 2.9 | 4.7 | -2.9 | -2.1 |

Source: World Bank. Notes: a: GDP in 2000 constant dollars, 2000 prices and market exchange rates. b: GDP measured at 2000 PPP weights. c: GDP figures for South Asia refer to fiscal years (FY). The FY runs from Jul-1 through Jun-30 in Pakistan and Bangladesh; and from Apr-1 through Mar-31 in India. Due to reporting practices, where FY2007/08 is reported in 2008 for Pakistan and Bangladesh and in 2007 for India, there is an illusion of a lag in the impact of the global crisis upon Pakistan and Bangladesh compared with India.

- *Europe and Central Asia (ECA)* has been most adversely affected by recent developments, with an expected 2 percent contraction of GDP in 2009, compared to 4.2 percent growth in 2008 (figure 1.b). The growth markdown for ECA is 4.8 points from the November GEP projections, the sharpest revision among developing regions. Financial stress is highest among several Central and Eastern European countries which had drawn in foreign capital to feed domestic lending; oil exporters are under increasing financial strain, with the Russian ruble under pressure. Many countries entered the

global financial crisis with current account deficits in excess of 10 percent of GDP, which made them especially vulnerable to a reversal of capital flows. Further build-up of foreign debt has become problematic and even the rollover of existing debt has become difficult. Without large-scale international assistance a much sharper contraction than anticipated in this update is likely for several countries in the region. The adjustment process is especially harsh because exports to the Euro Area are declining, and remittances from the European Union as well as from Russia to smaller CIS countries are falling.

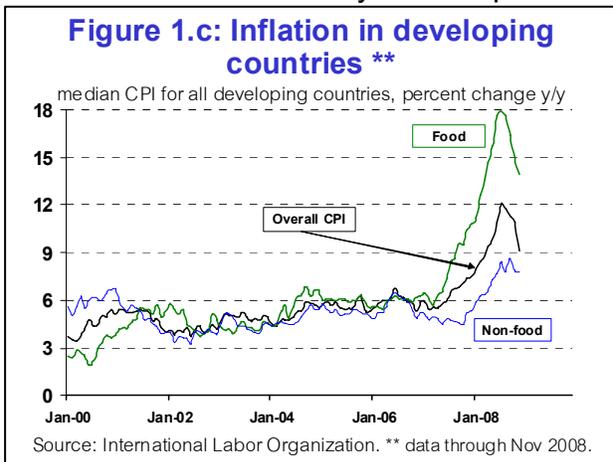
- *Latin America and the Caribbean* (LAC) is the second developing region where GDP is likely to contract in 2009, a fall of 0.6 percent following gains of 4.3 percent in 2008. Though growth outturns are likely to be diverse, a confluence of factors points to an overall downturn for regional GDP. Several countries have strong ties with the U.S. financial system and many companies felt immediately the impact of the credit crunch. Terms of trade for commodity exporters will plummet, pressuring budgets for a number of countries. Some of these countries had failed to build up sufficient buffers during the commodities boom, but had instead used the high commodity prices to overheat their economies. Countries with close trade and other trade links to the United States (notably Mexico) are sharing the falloff in auto- and other manufacturing output, while remittances tied to activity in U.S. construction and related sectors falloff in the year.
- *East Asia and the Pacific* (EAP) is likely to be most affected by the falloff in global investment and trade, crimping industrial production and fostering declines in capital spending. Investment stood at 36.3 percent of GDP in 2008, contrasted with 26.5 percent for developing countries excluding EAP, and contraction in capital outlays is likely to carry proportionately larger effects on regional growth. Regional exports shift from gains of 15 and 10 percent in 2007 and 2008 respectively, to decline of 1 percent in 2009. Against this background, GDP eases to 5.3 percent in 2009, as growth in China slumps to 6.5 percent, and several ASEAN members, including Thailand fall to recession.
- *South Asia* (SAR) has been marked down to 3.7 percent growth for 2009 from 5.4 percent anticipated earlier—and down from 5.6 percent registered in 2008. Though terms of trade have moved in favor of the region with the falloff in oil prices, weakening demand in export markets (including burgeoning Indo-Sino trade) is being felt sharply, as is a tempering of services exports from India's high-tech centers, as capital spending wanes globally. Remittances are anticipated to ease as conditions in host countries falter, albeit with some lag. Capital inflows have diminished, contributing to falloff in investment growth, notably in India. Fiscal support for slowing economies may face constraints in already quite high budget deficits.
- Growth in the *Middle East and North Africa* (MENA) appears least affected among developing regions by the global crisis to date. Growth for 2009 drops just 0.3 points from earlier projections to 3.3 percent. But the shift from MENA's strong 2008 performance is more pronounced, falling from a gain of 5.5 percent, powered in part by oil revenues and strong activity in Egypt, Morocco among other countries. Reduced oil revenues and cuts in oil output will restrain GDP among oil exporters to 2.9 percent from 4.5 percent in 2008; while recession in the EU, reduced tourism arrivals and remittance flows are likely to yield an easing in growth among non-oil economies to 3.6 percent in 2009 from 6.5 percent in the preceding year.
- GDP growth for *Sub-Saharan Africa* in 2009 is expected to halve from the robust 4.9 percent outturns of 2008, dropping 1.8 points below earlier projections. The dramatic shift in commodity prices will carry strong effects across countries, as growth among oil exporters falls to 3.3 percent from the 6.8 percent boom of 2008. At the same time

commodity dependent economies will slow into 2009 as demand and international commodity prices continue to fall. GDP in South Africa is likely to register 1 percent, as exports exact a toll on growth and private consumption weakens.

Far-reaching effects of the current downturn.

The present recession is spreading pervasive effects throughout the global economy that go well beyond substantial declines in GDP, production and trade. Commodity prices have halved, triggering sizable shifts in terms of trade and current account positions, while rapidly lowering domestic inflation across the world. Fiscal pressures are mounting swiftly, even for governments that enjoyed budget surplus at the start of the crisis. And large financing gaps on balance of payments are emerging for a large number of countries, which are increasingly likely to require large-scale support from official sources to prevent harsh market-driven corrections.

The *commodity price* boom that began in 2003 came to an end in July 2008. Apart from strong demand, a number of factors drove prices higher, including a weak dollar, low pre-boom investment in extractive industries, supply disruptions, biofuel mandates, investment fund activity, and (during 2008) government policies such as export taxes and bans on several food commodities. Many of these factors reversed at mid-year 2008, as the incipient slowdown in economic activity and fallout from the financial crisis induced massive price declines across all commodity sectors.

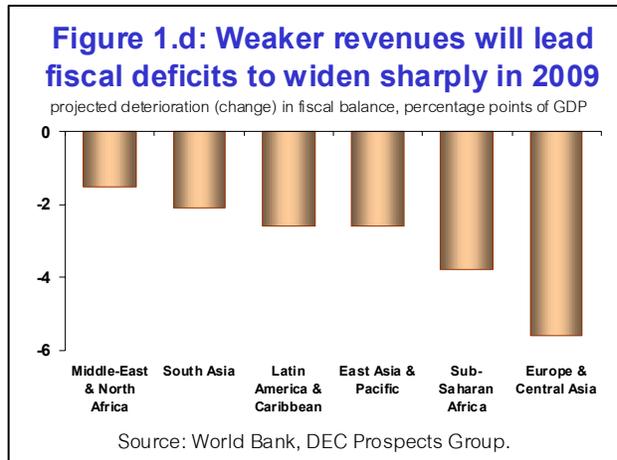


By December 2008, crude oil prices dropped to \$41/bbl—down nearly 70 percent from July peaks—while non-energy prices fell nearly 40 percent. Demand for most commodities slowed or declined—including import demand in China—particularly for oil and metals. Against this background, current projections call for crude oil to average near \$47/bbl in 2009, some \$27/bbl below earlier expectations, with non-oil commodities falling 32 percent. As most of these declines have already been realized for the year, the remainder of 2009 should be characterized by little overall change in price levels, though volatility is apt to remain elevated. As demand is not expected to recover meaningfully until 2010 or thereafter, prices should remain low in part due to idle capacity that could be reactivated in the case of metals and oil, and spare agriculture capacity.

CPI inflation across the G-7 countries as well as developing economies is slated to slow substantially into 2009-10, with the former easing to 0.4 percent from 2.9 percent in 2008 as commodity prices retrench and weak demand and continued rise in unemployment keep price pressures at bay. Central bank fears of deflation will likely be offset by continued additions of liquidity to economies through stimulus programs and financial support measures. For developing countries, the median personal consumption deflator is viewed to fall from 8.5 percent in 2007-08 to 5 percent by 2010 (figure 1.c). Even if prices temporarily fall in some developing countries, the risk of

widespread deflation is still small, as the fall in commodity prices is expected to be a one-time event, and core inflation was till recently on an upward trend, in response to the surge in food prices during 2008. Moreover, many countries may experience further weakening of their currencies, which would curb disinflationary pressures.

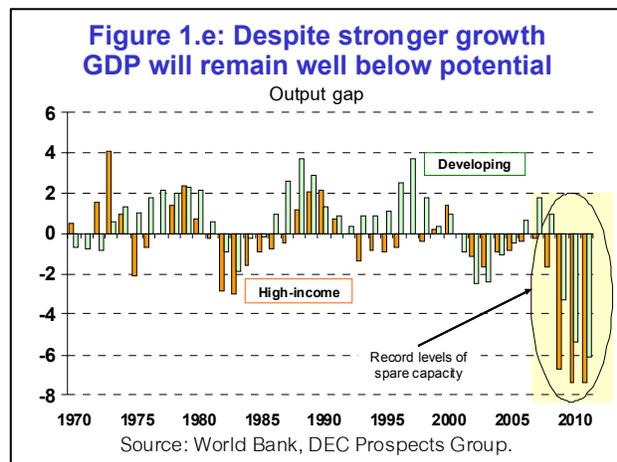
All developing countries now face the prospect of substantial deterioration in *fiscal balances*, as tax revenues fall (a good proportion related to international trade and the collapse in the manufacturing sectors), borrowing costs skyrocket and transfers to maintain social safety nets burgeon. Stimulus packages and other measures to mitigate mounting stress in the private sector are bound to lead to further deterioration in fiscal positions in the coming years. The most substantial widening in fiscal shortfall is expected in developing Europe and Central Asia, where contraction in trade and production is severe, the private sector is highly vulnerable, and social safety nets have broad coverage (figure 1.d).



External financing requirements for developing countries as a group are anticipated to increase to \$1.3 trillion in 2009, comprised of current account deficits (\$330 billion) and principal repayments on private debt coming due (\$970 billion). With a decline in capital flows to developing countries underway, this would generate an estimated financing gap of between \$270-\$700 billion, depending on the size of roll-over risks and the magnitude of capital flight. Regions with the largest funding gaps are Europe and Central Asia, Latin America, and Sub-Saharan Africa. In the current projections, 84 of 109 developing countries would face financing gaps, in most cases too large to cover by drawing down reserves alone. This suggests that in the absence of sufficient international support, countries could be forced into generating a sharp reversal in current account balance, implying further decline in domestic demand and imports.

Modest recovery in 2010 possible, but highly uncertain

Debates regarding the possible “shape” of recovery from the current downturn continue. But there is little question that the outlook for 2010 in particular, is surrounded by extreme uncertainty across a wide array of policy- and other variables that will eventually bring about a revival in economic activity. The pronounced cycle in worldwide investment could have sufficient dynamic to carry global growth back to positive territory by 2010, as the pace of decline in investment moderates, and postponed



demand for durable consumer goods begins to catch up. Together with the effects of monetary and fiscal stimulus this results in the modest global recovery in the baseline forecast presented here.

However, continued banking problems or even new waves of tension in financial markets could lead to stagnation in global GDP or even to another year of decline in 2010. In all cases, the estimated *output gap*¹ would increase in 2010 because (in the baseline as well), growth falls well short of potential (figure 1.e). This implies that unemployment and fiscal deficits will increase further into 2010, in high-income and developing countries alike, while disinflationary conditions could persist well into the year.

¹ The output gap is here defined as the difference between actual GDP and GDP at full employment (potential), expressed as a percent of potential GDP in percent.