

TRADE AND DEVELOPMENT REPORT 2017

BEYOND AUSTERITY:
TOWARDS A GLOBAL NEW DEAL

Chapter I

CURRENT TRENDS AND CHALLENGES IN THE WORLD ECONOMY



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CURRENT TRENDS AND CHALLENGES IN THE WORLD ECONOMY

A. The world economy: Performance and prospects

Despite renewed optimism about the prospects for a broad-based global recovery, global growth is unlikely to rise much beyond the average rate of 2.5 per cent recorded in the five-year period 2011–2016; the forecast for the world economy in 2017 is 2.6 per cent, not much higher than in 2016 (2.2 per cent) and the same as in 2015 (table 1.1). The pick-up in performance can be attributed largely to the turnaround in some larger developing countries that were experiencing recession, and in the group as a whole (from 3.6 in 2016 to 4.2 per cent in 2017). But with growth in Japan, United States, and the core euro zone economies stuck at a low level and clear signs of a slowdown in the United Kingdom, the global environment will – unless there is a significant, and coordinated, break with fiscal caution and austerity in these economies – continue to hamper growth prospects across the developing world.

1. Ten years on

There is no disagreement about when and where the Great Recession started. In July 2007, with housing prices in the United States already on a downward tilt, the securities-trading company turned investment bank Bear Stearns revealed that two of its hedge-fund operations had run out of money. The subsequent sudden stop in interbank lending in August, along with heightened stress around other short-term money market instruments, sent financial markets into palpitations and several financial institutions exposed to mortgage-backed assets into cardiac arrest, to which Bear Stearns itself, along with Northern Rock, a bank in the United Kingdom, would shortly succumb.

It would take another year for the full effects of heightened financial stress to be felt; but crucially the warning signs went largely ignored by markets

and policymakers alike. The International Monetary Fund did indicate concerns about market turmoil in its *World Economic Outlook* (IMF, 2007: xi), but this was judged to be a temporary threat to otherwise “sound fundamentals”. Inflationary pressures in emerging economies and further fiscal consolidation in advanced economies purportedly remained the big policy challenges, with global growth for 2008 predicted to slow, “but remain at a buoyant pace”.

That prognosis proved highly optimistic and the world economy, beginning in its most advanced regions, suffered a financial meltdown following the collapse of Lehmann Brothers and fell into recession in 2008 and 2009. Nearly a decade later, despite buoyant financial markets and recent signs of a cyclical bounce-back, global growth remains well below the levels recorded in the run-up to the crisis and continues to depend, to an unhealthy extent, on rising levels of debt. Inadequate demand, weak investment and declining productivity growth in many countries further constrain the growth potential.

The United States acted quickly to stem the financial collapse in 2008 but the subsequent recovery has been sluggish by historical standards and unbalanced in the distribution of gains between the middle-class and the wealthy and between finance and industry. The crisis in Europe was more pronounced and has proved more obdurate. A principal reason is that having been forced by the severity of the crisis to opt for a strong fiscal stimulus, most developed countries retreated from their expansionary fiscal stance and relied instead on monetary policy instruments, in the form of quantitative easing and low interest rates, including negative policy rates in recent years. While the withdrawal of the fiscal stimulus affected growth adversely, the monetary policies that helped banks and financial firms to stabilize and return to

TABLE 1.1 World output growth: Annual percentage change 1991–2017^a

Country or area	1991–2000		2001–									
	2000	2008	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 ^b
World	2.9	3.2	1.5	-2.1	4.1	2.8	2.2	2.3	2.6	2.6	2.2	2.6
Developed countries	2.6	2.2	0.0	-3.7	2.6	1.5	1.1	1.2	1.8	2.2	1.7	1.9
<i>of which:</i>												
Japan	1.3	1.2	-1.1	-5.4	4.2	-0.1	1.5	2.0	0.3	1.2	1.0	1.2
United States	3.6	2.5	-0.3	-2.8	2.5	1.6	2.2	1.7	2.4	2.6	1.6	2.1
European Union (EU-28)	2.2	2.2	0.4	-4.4	2.2	1.7	-0.4	0.3	1.7	2.3	1.9	1.9
<i>of which:</i>												
Euro zone	2.1	1.9	0.4	-4.5	2.1	1.6	-0.9	-0.3	1.2	2.1	1.7	1.8
France	2.0	1.8	0.2	-2.9	2.0	2.1	0.2	0.6	0.6	1.3	1.2	1.4
Germany	1.7	1.3	1.1	-5.6	4.1	3.7	0.5	0.5	1.6	1.7	1.9	1.9
Italy	1.6	1.0	-1.1	-5.5	1.7	0.6	-2.8	-1.7	0.1	0.8	0.9	1.0
United Kingdom	2.6	2.5	-0.6	-4.3	1.9	1.5	1.3	1.9	3.1	2.2	1.8	1.5
EU Member States after 2004	2.0	4.9	3.7	-3.4	2.0	3.1	0.5	1.2	2.9	3.6	2.9	3.2
Transition economies	-4.9	7.1	5.4	-6.6	4.7	4.7	3.3	2.0	0.9	-2.2	0.4	1.8
<i>of which:</i>												
Russian Federation	-4.7	6.8	5.2	-7.8	4.5	4.3	3.5	1.3	0.7	-2.8	-0.2	1.5
Developing countries	4.8	6.2	5.3	2.4	7.8	5.9	4.9	4.8	4.4	3.8	3.6	4.2
<i>Africa</i>	2.6	5.7	5.4	3.0	5.2	1.2	5.7	2.4	3.7	3.0	1.5	2.7
North Africa, excl. the Sudan and South Sudan	2.8	5.0	6.3	2.8	4.1	-6.6	10.2	-3.7	1.2	2.9	2.1	3.2
Sub-Saharan Africa, excl. South Africa	2.7	6.8	6.0	5.4	6.8	4.9	4.8	5.8	5.8	3.8	1.7	3.2
South Africa	2.1	4.4	3.2	-1.5	3.0	3.3	2.2	2.3	1.6	1.3	0.3	0.5
<i>Latin America and the Caribbean</i>	3.1	3.9	3.9	-1.8	6.0	4.4	3.0	2.8	1.0	-0.3	-0.8	1.2
Caribbean	2.3	5.1	2.6	-0.9	3.1	2.2	2.2	2.9	2.8	3.9	1.7	2.6
Central America, excl. Mexico	4.4	4.6	3.8	-0.7	3.7	5.4	4.8	3.6	3.8	4.3	3.7	4.0
Mexico	3.1	2.7	1.4	-4.7	5.2	3.9	4.0	1.4	2.2	2.6	2.3	1.9
South America	3.1	4.2	5.0	-0.8	6.6	4.7	2.6	3.3	0.2	-1.8	-2.5	0.6
<i>of which:</i>												
Brazil	2.8	3.7	5.1	-0.1	7.5	3.9	1.9	3.0	0.1	-3.8	-3.6	0.1
<i>Asia</i>	6.2	7.3	5.8	3.9	8.8	7.1	5.5	5.8	5.6	5.2	5.1	5.2
East Asia	8.2	8.4	7.0	6.1	9.7	7.8	6.2	6.4	6.2	5.5	5.5	5.6
<i>of which:</i>												
China	10.6	10.9	9.7	9.4	10.6	9.5	7.9	7.8	7.3	6.9	6.7	6.7
South Asia	4.9	6.9	4.9	4.4	9.1	5.5	3.2	4.9	6.4	6.1	6.5	6.3
<i>of which:</i>												
India	6.0	7.6	6.2	5.0	11.0	6.1	4.9	6.3	7.0	7.2	7.0	6.7
South-East Asia	5.0	5.6	4.2	1.6	8.0	4.8	5.8	5.0	4.4	4.4	4.5	4.7
West Asia	4.0	5.8	4.1	-2.0	6.1	8.4	5.0	5.2	3.4	3.7	2.2	2.7
<i>Oceania</i>	2.6	2.7	0.7	1.3	5.6	1.9	1.9	3.2	4.7	4.4	2.0	2.6

Source: UNCTAD secretariat calculations, based on United Nations Department of Economic and Social Affairs (UN DESA), *National Accounts Main Aggregates* database, and *World Economic Situation and Prospects: Update as of mid-2017*; ECLAC, 2017; *OECD.Stat*, available at: <http://stats.oecd.org/> (accessed 17 July 2017); IMF, 2017; Economist Intelligence Unit, *EIU CountryData* database; JP Morgan, *Global Data Watch*; and national sources.

^a Calculations for country aggregates are based on gross domestic product at constant 2005 dollars.

^b Forecasts.

profit have been less successful in boosting consumer spending and investment.

As long as debt was being incurred largely to save the financial sector there were no objections to large-scale public borrowing. But once that was done, the traditional hostility of finance against government deficits and public debt resurfaced, on the (often hidden) assumption that increased taxation of high earnings and profits to finance larger state expenditures was not possible. The retreat from proactive fiscal policy was further justified on the grounds that a high public debt-to-GDP (gross domestic product) ratio would generate stagflationary pressures.

Despite the massive infusion of liquidity by central banks, lending to firms and households did not resume as expected. In response, policymakers have nudged interest rates into negative territory, in an unprecedented attempt to push banks into lending rather than holding interest-bearing deposits with the central bank.¹ The difficulty, until recently, was that households and firms seemed to be wary about borrowing more, as they were still not sure that the bad times were behind them. Banks, too, remained cautious about increasing their exposure to indebted households. This could partly explain the thirst for government bonds that has driven their yields to negative territory as well. On the other hand, as countries

BOX 1.1 Austerity: The new normal

In the search for signs of a return to growth of the magnitude seen before the 2008 crisis, one factor that is often ignored is the role of procyclical fiscal policies in prolonging the recession. After a short period immediately following the crisis, when almost all countries opted for fiscal stimuli that ensured a rebound from the depths of the crisis, most governments have adopted a conservative fiscal stance. Austerity, and therefore low growth, is the new normal. An assessment of trends in a geographically dispersed, economically diverse and illustrative set of 19 countries suggests that barring five (Brazil, China, Germany, India and South Africa), all others have been holding down government spending over the six years ending 2016.

The exercise reported here tests for the presence of austerity by first projecting what annual general government spending (excluding on interest payments) in the post-2007 period would have been if the pre-crisis trend in spending persisted, and then comparing the forecast figures with actual spending. Projections are made by extrapolating the trend increase in real spending excluding interest payments (deflated by the consumer price index) over a period ending in the fourth quarter of 2007. Periods from which the trend rate is estimated vary because of the availability of data, with the longest period taken for calculating the trend rate of growth of spending stretching from the first quarter of 1996 to the last quarter of 2007. The intensity of austerity is captured by calculating the cumulative or total excess of projected spending over actual spending across the six years 2011–2016, and expressing it as a ratio of actual spending in 2016.

In countries with no austerity the ratio would equal zero (if actual spending is on trend) or turn negative (because actual spending is above projected levels, and the excess of the latter over the former is a negative number). For the rest, for purposes of capturing the intensity of austerity, countries for which the ratio is positive but below 0.5 (or a cumulative shortfall of 50 per cent of 2016 spending over 2011–2016) are considered as reflecting *limited austerity*; those with ratios in the range of 0.5 to 1 as reflecting medium levels of austerity; those with ratios in the range above 1 but going up to 2 as reflecting significant austerity; and those with ratios above 2 as reflecting severe austerity. Two countries out of the selected 19 (Greece and Hungary) are subject to severe austerity, whereas Austria, France, Poland and the United States are only subject to limited austerity. Eight (Argentina, Bulgaria, Czechia, Italy, Netherlands, Portugal, Spain and the United Kingdom) are distributed in the medium and significant austerity categories.

No austerity (figures ≤ 0)	Brazil, China, Germany, India, South Africa
Limited austerity (figures > 0 but ≤ 0.5)	Austria, France, Poland, United States
Medium austerity (figures > 0.5 but ≤ 1)	Argentina, Bulgaria, Netherlands
Significant austerity (figures > 1 but ≤ 2)	Czechia, Italy, Portugal, Spain, United Kingdom
Severe austerity (figures > 2)	Greece, Hungary

What emerges, therefore, is that many countries in this sample are wedded to austerity. Interestingly, in the selected sample, emerging market economies dominate the ‘no austerity’ group. In the case of some of these (Brazil and South Africa, for example), high spending was a result of the commodities boom, which lasted until 2014 and increased revenues and outlays. With the boom having ended, countries are now choosing to rein in expenditures. Since spending cuts following the end of the boom occur with a lag, the countries concerned have recorded relatively high levels of spending when compared to their pre-crisis trend rate of growth. But there are signs in 2016 that spending is being curtailed by governments in these countries as well. In others, such as China and India, governments seem to have reduced spending less from the immediate post-crisis stimulus levels. The difficulty, however, is that in China this spending has been financed by large-scale borrowing, especially by provincial governments, making it harder to sustain. Finally, in the case of Germany, despite the absence of fiscal austerity as defined here, saving exceeds investment, so that the country is contributing inadequately to global demand even while exporting its way to growth.

have gone in for interest-rate cuts and reduced capital inflows, the effective depreciation of currencies has been significant vis-à-vis the United States dollar, but only marginal vis-à-vis one another, diminishing the chances of an export boom.

With fiscal expansion off the table and monetary policy inadequate, the new normal has been sluggish

growth. In fact, austerity seems to characterize the fiscal position in most developed countries (box 1.1), as real government spending has fallen short of what it would have been if the trend increase in government expenditure prior to the crisis had been sustained.

By early 2017, optimism about the prospects of a break with the past seem to have made a guarded

return, based on better employment figures and/or an uptrend in otherwise volatile quarterly growth figures. The IMF (2017) raised its forecast for global growth to 3.5 per cent for 2017² and the World Trade Organization (WTO, 2017) anticipated a return to a more robust international trading environment; the media quickly echoed this optimism as an antidote to the string of bad news stories over the previous 12 months. A pick-up in growth and a steady drop in unemployment in Western Europe, in particular, have been heralded as indicating a fresh start for the region and beyond. Signs of a recovery in Japan in the fourth quarter of 2016 also continued into the first quarter of 2017, albeit from a low level.

Other economic signals, however, carry more mixed messages. The economy of the United States performed indifferently in the first quarter of 2017, growing at an annualised rate of just 1.4 per cent, while real wage growth remains sluggish and inflation well below the Federal Reserve's target despite falling unemployment. The United Kingdom, which was among the fastest-growing G7³ economies in recent years, has also begun to show signs of a Brexit backlash with growth in the first quarter of 2017 at just 0.2 per cent.

The situation in developing economies is, if anything, even more difficult to gauge, with considerable regional and country-level variation. The rapid recovery from the initial financial shock of 2008 has given way to a persistent slowdown in growth. The rate of output growth for the group declined continuously from 7.8 per cent in 2010 to 3.6 per cent in 2016, and is currently projected to rise to 4.2 per cent in 2017. Growth in the world's two most populous economies, China and India, remains relatively buoyant, but is still at a slower pace than before the crisis and with serious downside risks. The start of 2017 also saw some of the other larger emerging economies move out of the recessionary conditions of the previous year, but with little chance of growth returning to rates registered in the first decade of the new millennium.

Two factors play a role here. The first is the fact that, while oil and commodity prices are up from their recent troughs, they are still well below the highs they experienced during the boom years, which dampens the recovery in commodity-exporting countries. Second, fiscal tightening and/or enforced austerity continue to constrain domestic demand and growth in many countries. Indeed, with advanced

economies abnegating responsibility for a coordinated expansionary push, austerity has become the default macroeconomic policy position in many emerging economies. This is certainly true of those facing fiscal imbalances and mounting debt levels, but is also relevant in other countries pressured by foreign, especially financial, investors (see box 1.1). If capital flight necessitates a cutback in imports in order to reduce the trade and current account deficits on the balance of payments, matters could deteriorate further. Not surprisingly, anxious policymakers across the South are focusing their attention on the actions of the United States Federal Reserve, on the decisions of commodity traders and on the predatory practices of hedge funds, with a growing realization that they have limited control over some of the key components of their economic future.

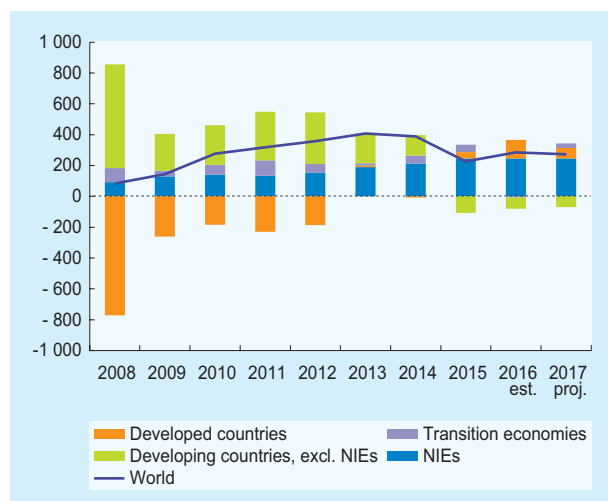
In the absence of sustained international efforts to manage a coordinated expansion across the global economy, boom and bust, against a backdrop of austerity, is likely to remain the dominant growth pattern. Despite some moments of guarded optimism, stable and inclusive economies will remain elusive.

2. Where will global demand come from?

There is much uncertainty about the possible sources of the stimulus for a more robust recovery. In the past, the economy of the United States functioned as the principal driver of global demand, drawing imports from the rest of the world and running large current account deficits. Its status as the home of the world's reserve currency allowed it to finance these deficits with capital inflows, which were even adequate to finance large outflows of capital from the country. In the process, a mutually convenient relationship emerged between the United States and the rest of the world, which "financed" domestic expansion in the United States by providing capital flows that triggered credit-financed private investment and consumption booms. That expansion then had positive effects on growth in the rest of the global economy, since it was accompanied by rising imports into the United States. While major exporting nations like China, Germany and, to a lesser extent, Japan, were the chief beneficiaries of this, expansionary impulses did spread to other countries and regions, albeit to varying degrees.

But this mode of global growth could not be sustained, since it created macroeconomic imbalances that were

FIGURE 1.1 Current account balance, global and by region, 2008–2017
(Billions of current dollars)



Source: UNCTAD secretariat calculations, based on IMF, 2017; and IMF, *Balance of Payments Statistics* database.

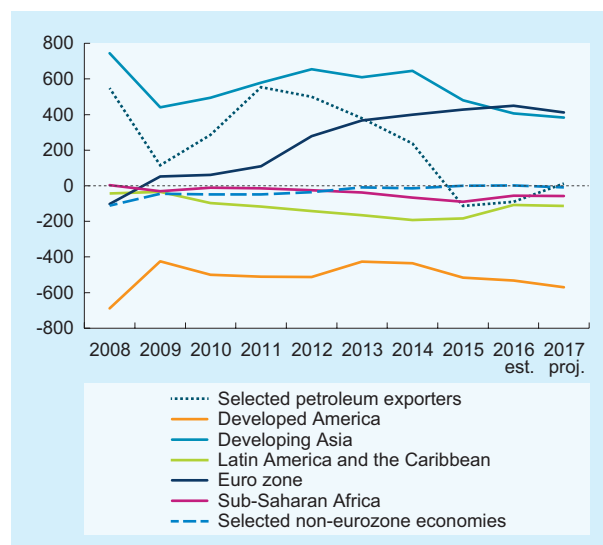
Note: NIEs = Hong Kong (China), Republic of Korea, Singapore and Taiwan Province of China.

bound to hit limits at some point, and possibly erupt in crises, as they did in 2001 and again more severely in 2008–2009. A better and more preferable route to global growth would be to enable and allow domestic expansion within countries. That would require international coordination, which has been lacking in the recent past. This is unfortunate, because since the global financial crisis, the net stimulus of the economy of the United States to the rest of the world has been shrinking. And in the absence of other demand stimuli the global economy cannot escape its “new normal”.

As figure 1.1 shows, the developed economies as a group ran a huge current account deficit of more than \$700 billion in 2008. This shrank dramatically the following year, and thereafter, especially since 2013, many advanced economies have posted growing current account surpluses, implying that, as a group, they no longer provide a net demand stimulus to the world economy. Meanwhile developing economies, as a group, ran surpluses until 2014, which have since turned to deficits. However, these deficits were much smaller in absolute size and so could not counteract the impact of the declining net demand from the advanced economies.

Figure 1.2 provides the regional division of these current account balances over this period. Several significant features emerge: a rise and then equally

FIGURE 1.2 Current account balance, selected country groups, 2008–2017
(Billions of current dollars)



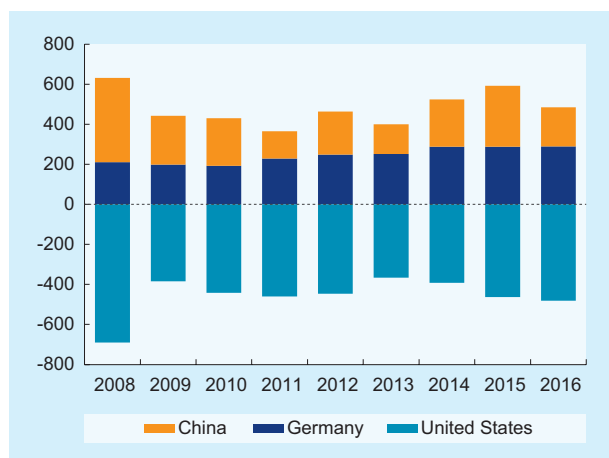
Source: See figure 1.1.

Note: Selected non-euro zone economies are non-euro zone European Union Member States after 2004 and South-East Europe. Selected petroleum exporters are developing and transition economies with the following criteria: average 2013–2015 share of country fuels (Standard International Trade Classification (SITC) 3) export in the total country export (SITC 0–9) > 50 per cent and average 2013–2015 share of country fuels (SITC 3) export in the total world fuels (SITC 3) export > 0.1 per cent. This group overlaps with others.

sharp decline in the surpluses of the petroleum exporters, driven by swings in oil prices; a decline, increase and then decline again for emerging and developing Asia; a decline in the North American deficit followed by only a marginal increase after 2014; and most strikingly of all, a very significant increase in the surpluses of the euro zone.

While these regional aggregates are instructive, it is clear that they are driven by a few large countries. Figure 1.3 provides data on the three most significant: China, Germany and the United States. The deficit of the United States fell after 2008 and since then the net stimulus coming from that economy has been stagnant or falling. The Chinese current account surpluses have been much more variable and since 2015 on a clearly declining path. The exception is Germany, which since 2010 has been running the largest surpluses of any economy in the world – and furthermore, these surpluses have been increasing recently. Unlike the Chinese expansion, which during the boom created more growth in a range of other developing countries by drawing them into value chains for export to the advanced countries, the German expansion has not

FIGURE 1.3 Current account balance, major economies, 2008–2016
(Billions of current dollars)



Source: IMF, *Balance of Payments Statistics* database.

had similar positive effects for most developing countries. Moreover, the adverse influence this has on the global economy has been compounded by a wider euro zone trend, whereby austerity policies and slower wage growth in the peripheral economies have added to the region's current account surplus, in an implicit effort to export the euro zone's deflation and unemployment to the rest of the world.

Finding quick and effective ways to recycle surpluses is a singularly critical challenge for the international economic community. Germany, which now has the largest current account surplus both in absolute and relative (share of GDP) terms, has recently announced its intention to launch a Marshall Plan for Africa, though neither the scale nor the intent appear to have much in common with the original model that helped to rebuild post-war Europe. The "One Belt, One Road" project in China offers much greater ambition. If implemented as planned, the investments involved in the project are huge – an estimated \$900 billion.⁴ As of now, however, much of the project is still on the drawing board; and both the scale and the pace of implementation may depend on how the domestic imbalances in China are managed.

3. Implications for global trade

Given the generalized weakness of demand, global trade does not promise to serve as a stimulus for growth for any group of economies. It is true that after significant slowdowns in 2015 and 2016, global

trade showed some signs of recovery in early 2017, but thus far the upturn is modest and the strength and longevity of the revival are open to question. The trade recovery was led by a marked rebound in merchandise imports into emerging Asia and a weaker expansion of imports into the United States and Latin America in late 2016 and early 2017. In Europe, though trade (both imports and exports) stalled in late 2015–early 2016, it recovered to roughly the same growth as experienced since early 2013. This contrasts with imports into Africa and West Asia, which recorded a cumulative decline of more than 20 per cent in real terms since late 2015. Incorporating the expected recovery, the annual growth figure for total merchandise trade in volume in 2017 is expected to be above 3 per cent – a definite improvement when compared with the previous four years, even if from a low base.

This forecast assumes that no major deterioration in trading relationships occur in the near future. During the first half of 2017, the likelihood of a major trade policy change, primarily in the United States, that would adversely affect global demand had diminished. The United States Administration announced plans to renegotiate and update the North American Free Trade Agreement rather than withdraw completely from it. It also diluted criticism of trade and exchange rate policies of China. But more recently, promises of enhanced tariff protection for the steel industry in the United States, which could trigger retaliatory measures on the part of other countries, have led to increased uncertainty.

Global merchandise trade recovered from the troughs of late 2015 to early 2016, according to monthly data available until May 2017 (figure 1.4). Nevertheless, the prognosis for 2017 is not so bright. On average, import and export volumes grew by only 1.9 per cent in 2016 (table 1.2), significantly lower than the average annual rate of 7.2 per cent recorded during the pre-crisis period 2003–2007. As anticipated in *TDR 2016*, this growth rate was below that of global output for the third consecutive year, a feature that otherwise in the last two decades has been observed only in periods of major crises. Further, in the advanced economies, import volumes during the first five months of 2017 were only 6.3 per cent above their level in 2008.

The growth of exports from the developed countries was either low or negative in 2016, because of feeble demand from key developing countries.

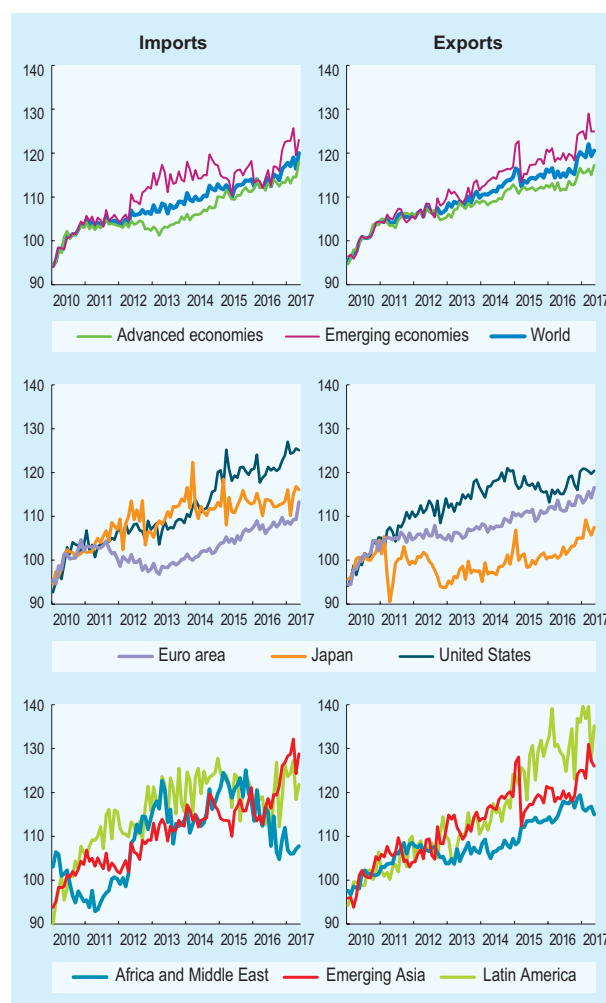
Major exporters of commodities in Africa, Latin America and West Asia, affected by declining and low commodity prices since 2014, experienced a significant decline in imports. While import growth remained positive in the rest of developing Asia, some recently released soft indicators on trade suggest that this could peter out. For example, recently declining freight rates suggest that trade between Asia and developed markets may have peaked.⁵ These trends suggest that any sustained recovery in merchandise trade would have to wait for a revival of global demand.

Global services trade was also sluggish in 2016. World services exports measured in current United States dollars remained under \$5 trillion, recording an annual growth rate of just 0.4 per cent.⁶ Developing countries and transition economies recorded the second of two consecutive years of decline, with services exports falling by 1.1 per cent and 0.9 per cent respectively in 2016. Exports of services from least developed countries recorded a 3.6 per cent decline, with travel receipts (which account for almost half of total services) declining by 3.4 per cent. Meanwhile, in developed economies, exports of services grew by a meagre 1 per cent, largely driven by the robust growth of 6.9 per cent in Japan.

This subdued expansion at the global level was the outcome of contrary trends across the main categories of exports of services. On the one hand, transport (which accounts for roughly one fifth of total trade in services) shrank by 4.3 per cent, influenced also by declining transportation costs. Exports of financial services (almost 9 per cent of trade in services) also registered a decline of 3.9 per cent. This partly reflected falls for the second consecutive year in Europe and the United States, the two main providers of financial services abroad. On the other hand, export of travel services (about one quarter of global trade in services) expanded by 1.8 per cent, because of continued expansion mainly in Japan and to a lesser extent in Latin America and the Caribbean. Telecommunications, computer and information services – one of the fastest-growing components of trade in services in recent years that now account for about one tenth of total exports in services – grew by 4.5 per cent.

Volume figures for the two largest components of trade in services – which provide quantity data and thus avoid concerns related to valuation issues – offer additional insight on trends in the trade in services.

FIGURE 1.4 World trade by volume, January 2010–May 2017
(Index numbers, 2010 = 100)



Source: UNCTAD secretariat calculations, based on the Centraal Planbureau (CPB) Netherlands Bureau of Economic Policy Analysis, *World Trade* database.

Note: Country groupings are those used by the CPB Netherlands Bureau of Economic Policy Analysis, *World Trade* database.

World seaborne trade volumes grew 2.6 per cent in 2016, up from 1.8 per cent in 2015. Although positive, this growth rate is short of the historical average of 3 per cent recorded over the past four decades. In China, import demand was the main driver, with the country's import volumes rising by 6.7 per cent in 2016. However, subdued expansion in the import demand of other countries – especially commodity-exporting and oil-exporting developing economies – limited overall growth. Even so, developing countries continued to fuel international seaborne trade both in terms of imports and exports, accounting for 59 per cent of goods loaded and 64 per cent of goods unloaded (UNCTAD, 2017).

TABLE 1.2 Export and import volumes of goods, selected regions and countries:
Annual percentage change 2013–2016

Country or area	Volume of exports				Volume of imports			
	2013	2014	2015	2016	2013	2014	2015	2016
World	3.1	2.0	1.4	1.7	2.3	2.5	1.9	2.1
Developed countries	2.1	1.7	2.1	1.0	0.0	2.8	3.3	2.7
<i>of which:</i>								
Japan	-1.5	0.6	-1.0	0.3	0.3	0.6	-2.8	-0.3
United States	2.6	3.3	-1.1	-0.2	0.8	4.7	3.7	3.6
European Union	1.9	1.6	3.3	1.1	-1.0	3.2	4.1	2.8
Transition economies	2.0	0.5	1.0	-1.6	-0.4	-7.9	-19.9	7.3
Developing countries	4.4	2.5	0.6	2.8	5.5	2.7	1.1	1.1
<i>Africa</i>	-1.6	-2.0	0.6	2.9	6.8	3.6	0.7	-4.6
<i>of which:</i>								
Sub-Saharan Africa	2.8	1.9	0.7	-0.3	7.5	4.3	-0.3	-6.6
Latin America and the Caribbean	2.4	2.3	3.2	2.3	3.8	0.0	-2.0	-4.2
East Asia	6.7	4.9	-0.6	0.6	7.0	3.4	-1.1	2.2
<i>of which:</i>								
China	8.5	5.6	-0.9	0.0	9.1	2.9	-1.8	3.1
South Asia	0.0	1.1	-1.4	18.1	-0.4	4.7	7.4	8.9
<i>of which:</i>								
India	8.5	3.5	-2.1	6.7	-0.3	3.2	10.1	7.3
South-East Asia	5.0	3.7	3.7	3.9	4.2	2.4	5.7	4.4
West Asia	3.7	-3.2	-0.6	3.5	6.7	2.2	3.1	-2.4

Source: UNCTAD secretariat calculations, based on UNCTADstat.

International tourist arrivals grew 3.9 per cent in 2016, its lowest rate since 2009. Figures varied across regions with Africa registering the highest increase (8.3 per cent) on the back of a strong rebound in sub-Saharan Africa (10.7 per cent), followed by developing Asia (7.4 per cent) and Latin America and the Caribbean (5.5 per cent). Meanwhile, tourist arrivals in developed economies grew 4.9 per cent. In transition economies, performances were rather mixed, but overall negative owing to a decline of 8.6 per cent in the Russian Federation. During the first four months of 2017, the situation improved with 6 per cent growth year on year, suggesting a rising trend in this sector. Momentum remained in destinations that registered robust positive figures in previous years, while arrivals rose in regions that had displayed a sluggish trend (UNWTO, 2017).

4. Commodity price trends

One much-cited tendency in global markets in recent months is the reversal of the commodity price decline that began after the end of the boom in 2011. The index of prices for all commodities is projected to rise by 14.4 per cent in 2017, based on a comparison of the average of the price index over January to June 2017 and the average over January to December 2016 (table 1.3). The rebound in the prices of petroleum

products plays an important role here. However, there is considerable uncertainty on whether that rebound will be sustained. Crude oil prices have registered gains, but remain below the \$50 mark despite tensions in West Asia and OPEC (Organization of the Petroleum Exporting Countries) efforts to curb supply. There is also news of a rise of oil inventories in the United States, as shale makes a comeback in the context of a gradual price increase and technologically driven cost-reduction. This seems to be pushing prices down once again. Thus, the OPEC Reference Basket touched \$45.21 per barrel in June 2017, representing a decline of over \$7 from the previous peak recorded in January 2017. Metals prices also registered recent declines because of a fall in demand from China and the United States, among other importers. So, while most commodities did recover from the downturn experienced after the end of the commodity price boom, the rebound appears to be losing momentum.

In real terms, commodity prices globally are at the levels of the late 1980s, albeit with major variations in the dynamics of the different groups. In particular, agricultural commodities are at one of their lowest levels since 2002. Few commodities are currently doing better than in the 1980s in terms of price levels, among which are oil and the precious metals, including gold, silver and platinum.

TABLE 1.3 World primary commodity prices, 2008–2017
(Percentage change over previous year, unless otherwise indicated)

Commodity groups	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 ^a
All commodities^b	33.4	-30.8	24.6	27.8	-3.5	-4.2	-8.0	-34.3	-8.7	14.4
Non-fuel commodities^c	21.7	-17.3	28.1	18.8	-12.7	-6.9	-8.0	-17.1	1.7	9.8
Non-fuel commodities (in SDRs)^c	17.6	15.0	29.4	14.8	-10.1	-6.2	-8.0	-10.0	2.4	12.0
All food	32.9	-8.8	10.9	23.1	-6.5	-9.6	-1.1	-13.8	2.5	1.0
Food and tropical beverages	32.4	-1.2	10.3	22.8	-9.7	-9.2	2.4	-10.9	0.6	1.0
<i>Tropical beverages</i>	20.5	4.0	15.9	26.7	-20.4	-19.8	21.1	-5.1	-4.8	0.6
Coffee	15.4	-6.9	27.3	42.9	-25.7	-23.6	29.9	-19.7	2.1	3.3
Cocoa	32.2	11.9	8.5	-4.9	-19.7	2.0	25.6	2.3	-7.7	-29.5
Tea	27.2	16.5	-1.0	11.4	0.8	-23.9	-10.4	43.1	-15.6	28.9
<i>Food</i>	36.7	-2.8	8.4	21.4	-5.6	-5.8	-2.8	-12.9	2.6	1.1
Sugar	26.9	41.8	17.3	22.2	-17.1	-17.9	-3.9	-21.0	34.4	-3.0
Beef	2.6	-1.2	27.5	20.0	2.6	-2.3	22.1	-10.5	-11.1	7.6
Maize	34.0	-24.4	13.2	50.1	2.6	-12.1	-22.2	-14.7	-4.1	-2.9
Wheat	27.5	-31.4	3.3	35.1	-0.1	-1.9	-6.1	-23.1	-15.5	4.8
Rice	110.7	-15.8	-11.5	5.9	5.1	-10.6	-17.8	-10.9	2.2	0.0
Bananas	24.6	0.7	3.7	10.8	0.9	-5.9	0.6	2.9	4.8	5.1
Vegetable oilseeds and oils	34.0	-22.6	12.2	23.8	0.5	-10.3	-8.2	-20.4	7.3	1.1
Soybeans	36.1	-16.6	3.1	20.2	9.4	-7.9	-9.7	-20.6	3.9	-0.8
Agricultural raw materials	8.7	-16.4	41.7	23.9	-20.3	-9.5	-12.7	-13.3	-0.7	10.0
Hides and skins	-11.3	-30.0	60.5	14.0	1.4	13.9	16.5	-20.6	-18.8	3.6
Cotton	12.8	-12.2	65.3	47.5	-41.8	1.5	-8.8	-14.7	5.4	15.6
Tobacco	8.3	18.0	1.8	3.8	-3.9	6.3	9.1	-1.7	-2.3	0.5
Rubber	16.9	-27.0	90.3	32.0	-30.5	-16.7	-30.0	-20.3	5.3	40.0
Tropical logs	39.3	-20.6	1.8	13.5	-7.1	2.6	0.4	-16.5	-0.3	-2.2
Minerals, ores and metals^d	16.3	-26.9	45.4	12.3	-16.2	-2.4	-14.1	-23.1	1.7	23.1
Aluminium	-2.5	-35.3	30.5	10.4	-15.8	-8.6	1.1	-10.9	-4.2	18.0
Phosphate rock	387.2	-64.8	1.1	50.3	0.5	-20.3	-25.6	6.5	-5.8	-13.1
Iron ore	26.8	-48.7	82.4	15.0	-23.4	5.3	-28.4	-42.4	4.6	27.7
Tin	27.3	-26.7	50.4	28.0	-19.2	5.7	-1.8	-26.6	9.4	13.7
Copper	-2.3	-26.3	47.0	17.1	-9.9	-7.8	-6.4	-19.8	-11.6	18.4
Nickel	-43.3	-30.6	48.9	5.0	-23.4	-14.3	12.3	-29.8	-18.9	1.7
Lead	-19.0	-17.7	25.0	11.8	-14.2	3.9	-2.2	-14.8	4.7	18.9
Zinc	-42.2	-11.7	30.5	1.5	-11.2	-1.9	13.2	-10.6	8.2	28.7
Precious metals	23.5	7.8	27.4	30.8	3.6	-15.8	-11.0	-9.8	7.2	-0.7
Gold	25.1	11.6	26.1	27.8	6.4	-15.4	-10.3	-8.4	7.6	-0.8
Fuel commodities	38.7	-38.9	22.6	31.4	-0.9	-1.1	-7.5	-43.8	-17.7	22.0
Crude petroleum ^e	36.4	-36.3	28.0	31.4	1.0	-0.9	-7.5	-47.2	-15.7	19.5
Memo item:										
Manufactures^f	4.9	-5.6	3.0	8.9	-1.7	3.6	-1.5	-9.8	-1.9	..

Source: UNCTAD secretariat calculations, based on UNCTAD, *Commodity Price Statistics Online*; and United Nations Statistics Division (UNSD), *Monthly Bulletin of Statistics*, various issues.

Note: In current dollars unless otherwise specified.

a Percentage change between the average for the period January to June 2017 and the average for 2016.

b Including fuel commodities and precious metals. Average 2013–2015 weights are used for aggregation.

c Excluding fuel commodities and precious metals. SDRs = special drawing rights.

d Excluding precious metals.

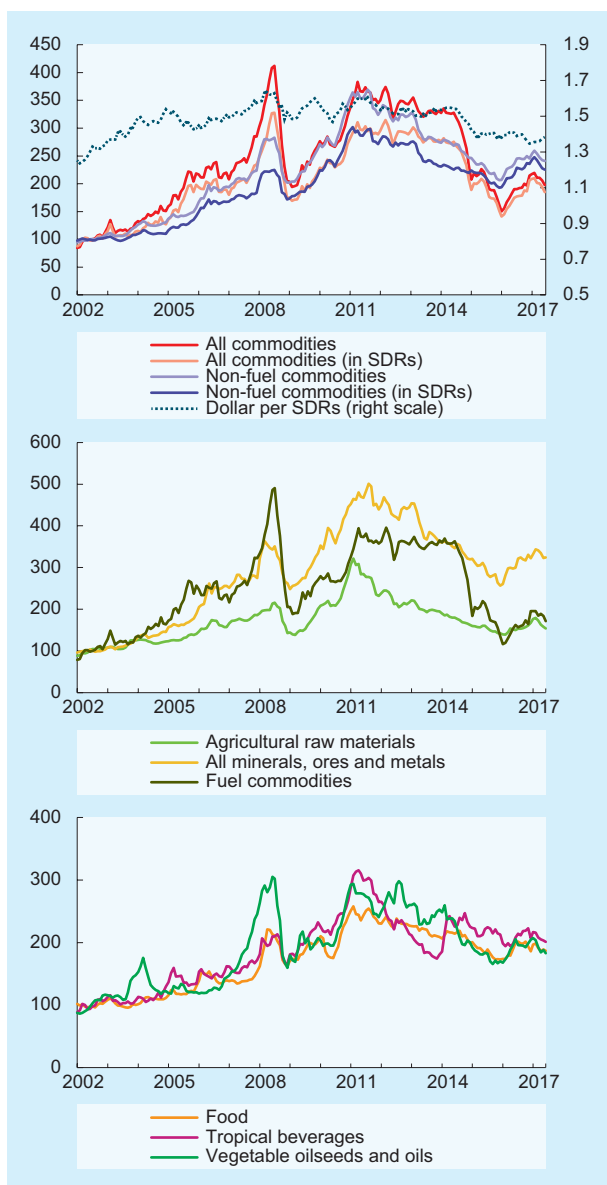
e Average of Brent, Dubai and West Texas Intermediate, equally weighted.

f Unit value of exports of manufactured goods of developed countries.

What needs to be noted (figure 1.5) is that while the commodity price cycles for the major groups of commodities were more or less similar, the post-2011 end to the boom varied across commodity groups. Energy prices were stable during 2011–2014 and then declined, while prices of other commodities have declined continuously after 2011. In the case of fuel oil,

the price reduction after 2014 was so sudden and sharp because previous price trends themselves affected supply by making unused locations and technologies viable, adding supply factors to the impact of fluctuations in demand. The duration of the price decline was the longest in the case of minerals, ores and metals, for which the rebound in prices was also the strongest.

FIGURE 1.5 Monthly commodity price indices by commodity group, January 2002–June 2017
(Index numbers, 2002 = 100)

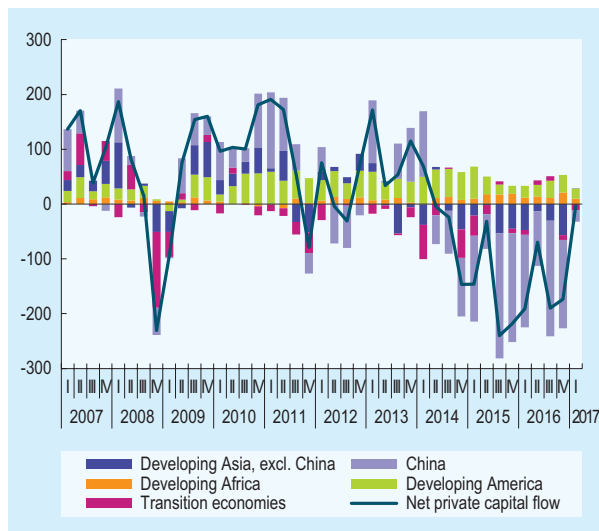


Source: UNCTAD secretariat calculations, based on *UNCTADstat*.
Note: Crude oil price is the average of Brent, Dubai and West Texas Intermediate, equally weighted. Index numbers are based on prices in current dollars, unless otherwise specified.

5. Capital flows

The landscape with respect to capital flows has changed significantly in recent years. After the surge in capital flows during the easy money years of the pre-crisis period between 2003 and 2007, flows to developing countries collapsed in the midst of the crisis, when international investors booked profits in emerging market economies and transferred funds to

FIGURE 1.6 Net private capital flow by regions, 2007–2017
(Billions of current dollars)



Source: UNCTAD, *Financial Statistics Database* based on IMF, *Balance of Payments* database; and national central banks.

cover losses incurred at home. But as governments and central banks in the developed world chose to opt for large-scale liquidity infusion at near-zero interest rates, the flow of capital to many developing countries revived, with certain periods when flows surged.

However, ever since the United States Federal Reserve began to speak of the possibility of tapering off its quantitative easing policies, capital flows have once again become volatile, beginning with the “taper tantrum” of 2013. As figure 1.6 shows, net capital flows to developing and transition economies have been negative since the second quarter of 2014, with the adverse consequences discussed in *TDR 2016*.

In most of the so-called emerging markets, capital outflows consist largely of the outflow of portfolio investment from debt and equity markets. Volatile portfolio capital flows were evident in China as well, with the period of positive net inflows from mid-2011 ending in the last quarter of 2014. Thereafter there were net outflows of portfolio capital from China, which went from \$8.1 billion in the first quarter of 2015 to \$40.9 billion in the first quarter of 2016. Chinese Government intervention in the form of limited capital controls caused net inflows to turn positive once again. While some have attributed the overall capital outflow from China over this period partly to a substantial increase in Chinese foreign direct investment (FDI) abroad, especially from the

second half of 2015, there was additionally the impact of a pronounced decline of FDI into China from 2013.

Other developing regions were also affected by declining net inflows or rising net outflows of capital. The only exception is Africa, where the relatively stable positive capital flows have largely been driven by FDI. Overall, the trend towards negative net capital flows continues to pose a core challenge for developing and transition economies, particularly in view of the expected return to a “normal” monetary and interest-rate policy in the United States. Although there was a sharp fall in net capital outflow to \$3.8 billion into developing countries as a group in the first quarter of 2017, it does not follow that they will experience net inflows in the near future, as the exchange rate policies of China and further tightening of capital controls have played a major role in this result. Other regions (developing America and Africa) that have enjoyed positive inflows in recent years are experiencing declining inflows.

A feature of capital flows is the continuing importance of external debt. Total external debt stocks of developing countries and economies in transition are estimated to have reached \$7.1 trillion in 2016, an overall increase of 80 per cent since 2009, representing an average annual growth rate of 8.8 per cent over

the period. Even though external debt-to-GDP ratios remain relatively low by recent historical standards, rising from 21 per cent in 2009 to 26.3 per cent by 2016, debt service burdens have risen sharply over 2015 and 2016. For all developing countries, the ratio of external debt service to GDP rose from 9.1 per cent in 2009 to 13.1 per cent in 2015, and was 12.3 per cent in 2016. This increase in debt service burdens has hit the most vulnerable developing countries the hardest, including commodity exporters, countries dealing with large refugee inflows, and small island developing states. Further signs of trouble on the horizon include the growing share of short- relative to long-term debt in total external debt stocks (up from 21 per cent in 2009 to 27 per cent in 2016); as well as a significant slowdown in the growth of international reserves, which grew by only 4 per cent between 2009 and 2016, compared to 24 per cent between 2000 and 2008.

Aggregate debt, domestic and external in emerging market economies, especially private sector non-financial debt, has been of particular concern for some time. This now stands at over 140 per cent of combined GDP, with credit to the Chinese private non-financial sector having risen from 114 per cent to 211 per cent between the fourth quarters of 2008 and 2016.

B. Regional growth trends

1. Developed countries

Within the overall scenario of depressed demand, the performance of individual economies and the factors influencing that performance have not necessarily been similar. The recent slowdown in the United States reflects a significant slowdown in household spending, at a time when the return to fiscal conservatism has set limits on government expenditure. Growth of personal consumption expenditure in the first quarter of 2017 was at its lowest since 2009, standing at an annual 1.1 per cent, or well below the 3.5 per cent rate in the previous quarter and 1.6 per cent and 2.3 per cent respectively in the corresponding quarters of 2016 and 2015. The persistence of the Great Recession was widely seen as being partly the result of a decline in credit-financed spending by households that were already overburdened with large debts at a time when the value of their housing equity and other assets had

fallen. This means that balance sheet effects could continue to hold back growth (see box 1.2).

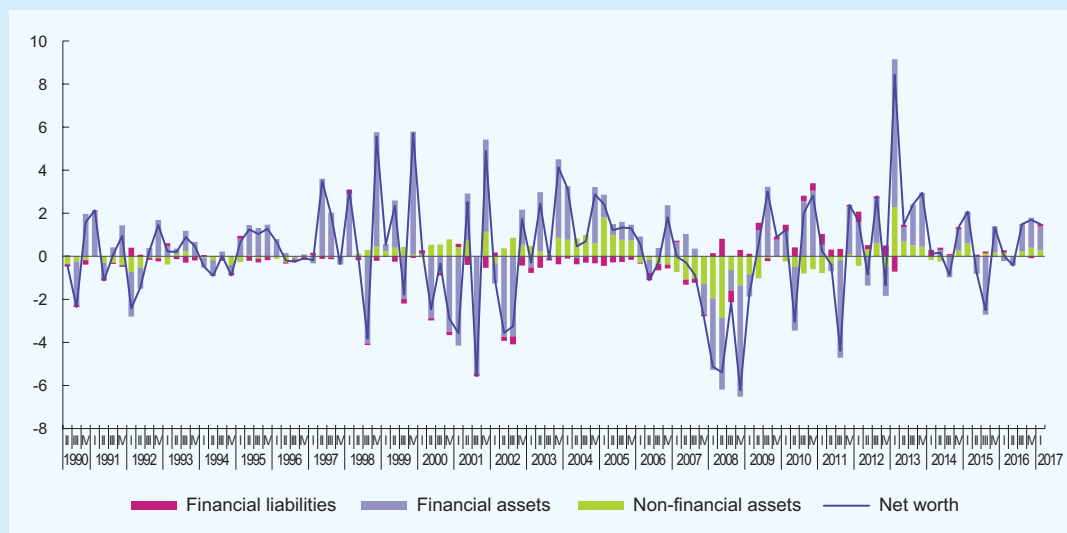
This prospect of persistently low growth in the United States is reinforced by waning expectations of a shift from a monetary to a fiscal stimulus generated by the new United States Administration. While the Trump Administration has promised a tax-cut stimulus, there is no concrete plan to ensure that this does not result in a substantial widening of the fiscal deficit, and so it is likely to face obstacles in implementation. Meanwhile, there is no evidence yet of a significant step up in infrastructure spending, which too is likely to run up against a fiscal constraint.

As table 1.1 makes clear, the euro zone recovery came much later than in the United States, lagging behind by several years, with growth staying well below the peak reached in the immediate post-crisis

BOX 1.2 Debt and recovery: The experience of the United States

In the United States, one expected consequence that followed the adoption of an easy money regime is inflation in financial asset values. Reflecting this tendency, the New York Stock Exchange composite index registered a trend increase from its early 2009 trough to reach levels higher than where it stood at its peak in mid-2007. The effect this has had on aggregate wealth increase was greater than that due to increased housing equity resulting from house price increases and new acquisition of houses. As figure 1.B2.1 shows, the contribution that financial assets made to the net worth of households and non-profit institutions was much higher than the contribution of non-financial assets in recent years. But there are two reasons why this did not generate a strong wealth effect, in the form of increased private borrowing to finance consumption and investment. First, consumers and banks were still unsure whether the financial turnaround would last and would not be followed by a return to crisis. Second, since wealth accumulation was predominantly in the form of capital gains in financial markets, it has mainly occurred among the already rich, increasing inequality but not spurring demand.

FIGURE 1.B2.1 Contribution to growth to net worth of households and non-profit organizations in the United States, second quarter 1990–first quarter of 2017
(Percentage points)



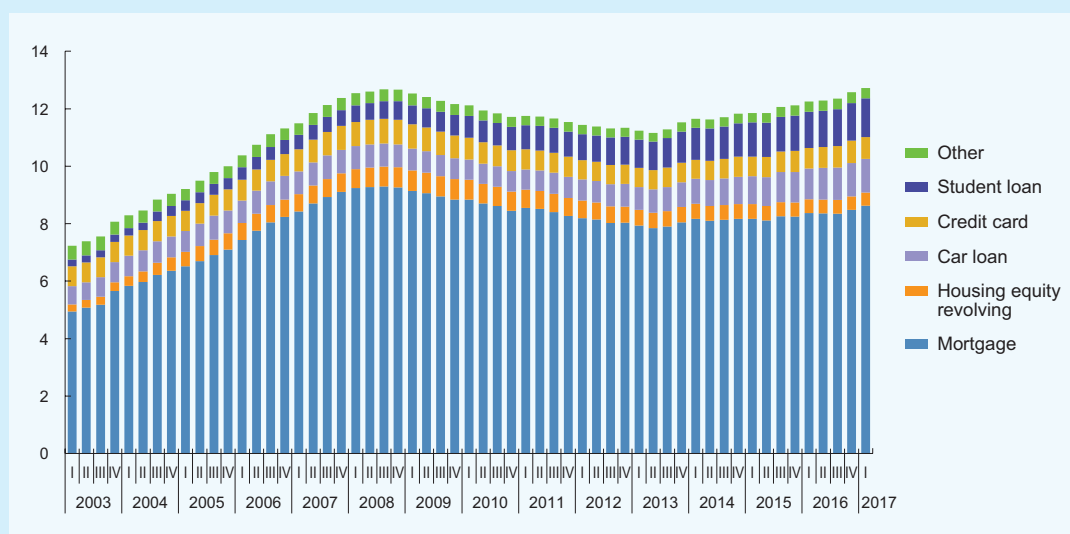
Source: Board of Governors of the Federal Reserve System, Financial Accounts of the United States (first quarter of 2017).
Note: Underlying data refers to flow of funds data in current dollars.

However, the large infusion of liquidity and zero or negative interest rates charged by the Federal Reserve have put considerable pressure on banks to lend, to some effect. As figure 1.B2.2 indicates, the process of deleveraging that had begun in the third quarter of 2008 was reversed in the second quarter of 2013, at a time when total household debt was still 54 per cent above its 2003 level, when the global liquidity surge began. Around half of the loans taken on after this recent return to borrowing on the part of households are mortgage loans, with salutary effects on the housing market. House prices bottomed out in mid-2009 and were flat until mid-2013, after which they have been rising. A consequence of this rise in price of both housing and financial asset prices is that the ratio of the net worth of households and non-profits to personal disposable income has gone up from its post-crisis low in early 2009, and especially after mid-2011.

recovery. This is largely because of tight fiscal policy in the core countries and significant to severe austerity in the periphery, with economic and social stress levels remaining high. Unemployment has fallen only moderately, from a high of 12 per cent in 2013

to 10 per cent in 2016, and is still well above the pre-crisis level. Moreover, earnings have not risen, as workers have to make do with lower-quality work and reduced working hours. Annual real wage growth between 2008 and 2015 was below 1 per cent with the

FIGURE 1.B2.2 Total household debt balance and its composition
(Trillions of dollars)

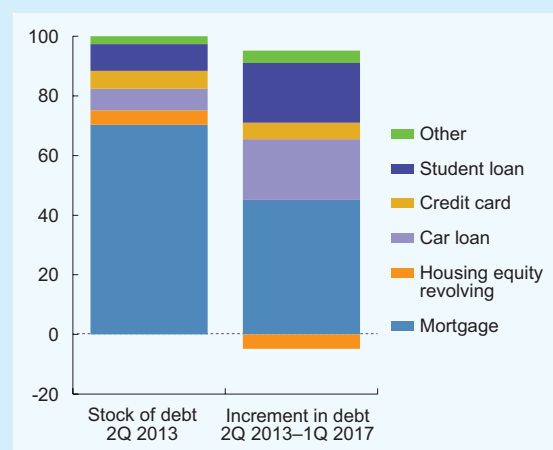


Source: New York Fed Consumer Credit Panel/Equifax, available at: https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/HHD_C_Report_2017Q1.xlsx (accessed 17 July 2017).

Significantly, the composition of the stock of household debt has been changing. In mid-2013 mortgage loans accounted for 70 per cent of outstanding household debt, but they contributed only 50 per cent of the increase in household debt between then and the first quarter of 2017 (figure 1.B2.3). On the other hand, car loans and student loans (which were respectively 7.3 per cent and 8.9 per cent of the debt stock in the second quarter of 2013) contributed 22.5 and 22.3 per cent of the increment in debt up to the first quarter of 2017. In other words, close to 45 per cent of the increase in credit in the period when banks have been “forced” to lend was on account of car loans (which increased by 66 per cent over this period) and student loans (which more than doubled).

This shift in the composition of debt may have had an adverse impact on output growth. The rising magnitude of student debt leads those who hold these loans to defer entry into mortgage agreements and postpone home-ownership, thereby reducing the demand for mortgage loans. Hence, the growth-inducing effect of this round of increased household borrowing is likely to be lower than it would have been if such education was publicly funded. Moreover, it is now becoming clear that car loans were provided to many who did not have the ability to meet the debt service commitments involved. The situation with student loans is worse. The percentage of loan balances going into “serious delinquency” has been hovering around a 10 per cent annual rate since 2012.

FIGURE 1.B2.3 Composition of stock of and increment in household debt
(Percentage)



Source: See figure 1.B2.2.

exceptions of Estonia, Latvia and Slovakia, and wages have actually contracted in several member countries.

Some good news is that growth in the peripheral countries of the euro zone badly hit by the crisis, has

overtaken that in the three biggest economies in the zone: Germany, followed by France and Italy. As a result, overall growth in the zone is expected to pick up this year, providing the basis for wider growth optimism in some circles. But this should be tempered

by the recognition that even with Germany recording its best sustained growth performance for quite some time, the core of the zone (and the European Union) continues to exhibit weak average growth.

It is in this light that optimistic perceptions of an imminent and strong recovery in Europe should be assessed. A series of factors underpin this optimism. After peaking in 2013, the euro area unemployment rate fell as noted above. Household financial indicators and surveys of consumer confidence have shown a steady improvement over the same period. As unemployment drops and confidence grows, household consumption has supported the ongoing recovery. In addition, the combination of low inflation and interest rates has contributed to a steady depreciation of the real effective exchange rate of the euro since 2014. Improved external competitiveness has translated into strong export growth across the region between 2014 and 2017. Finally, business confidence, manufacturing activity and investment indicators are all in positive territory.

However, several challenges remain. First, despite the current upturn, aggregate euro area GDP by the first quarter of 2017 was still barely 3.1 per cent above its level in 2008. Indeed, aggregate domestic demand has failed to recover, as euro area spending remains below pre-crisis levels. Sustained fiscal consolidation combined with high unemployment rates account for these developments. In addition, aggregate investment in the euro area shows a declining trend over the last decade, decreasing from 23.1 per cent of GDP in 2007 to 20.1 per cent in 2016. The ensuing reliance on external demand to sustain the recovery, as discussed earlier, imposes significant strains on the rest of the global economy. It is worth recognizing that this weak economic performance helps to account for the recent political uncertainty observed in the region.

Second, there is the divergent character of the recovery. This can be observed through the evolution of several indicators in the euro core area and the periphery. In the case of GDP per capita, while Germany has enjoyed a 9.7 per cent increase with respect to its pre-crisis levels, the picture is different in the periphery. GDP per capita remains well below the 2008 levels for countries such as Greece, Portugal and Spain. This is also true for Italy, and even the second largest economy of the bloc, France, has barely managed to recover. Over this period, French GDP per capita has increased only 0.7 per cent. Labour markets present

a similar picture. While unemployment in Germany has dropped to 3.8 per cent in the second quarter of 2017, this indicator remains stubbornly high for the countries that were hit harder by the crisis. Broad unemployment and youth unemployment are 22.6 and 46.6 per cent in Greece; 11.8 per cent and 38.7 per cent, respectively, for Italy; 9.9 and 24.3 per cent in Portugal; and 18.2 per cent and 40.8 per cent for Spain. In the meantime, consumer price indices (CPI) tell a related story of divergent economic performance. Headline CPI for the entire euro area has been getting closer to the 2 per cent inflation target set by the European Central Bank over the first months of 2017. But this has been influenced by the increase in the CPI indicator for Germany since the beginning of 2016. Inflationary pressures in Germany contrast with low inflation elsewhere: increases in CPI in Greece, Italy, Portugal and Spain remain stuck below 1 per cent because of weak domestic demand and unutilized productive capacity.

A third challenge, as noted earlier, is the impact of the current European growth path on the rest of the world. Pre-crisis growth was based on the expansion of intra-European trade and financial imbalances. Since the crisis, the reduction of domestic demand and competitive real exchange rates, underpinned by wage deflation and a weak euro, have allowed Europe to export these imbalances to the rest of the world. Current account balances, by definition, must even out on a global scale, so from the perspective of developing countries this is especially troubling.

The economy of the United Kingdom remained buoyant in the second half of 2016 following the Brexit vote. This was largely thanks to strong household spending on the back of rising housing prices and a return to the debt market, though the decline in the value of the sterling also provided a boost to exports. However, currency depreciation is also driving inflation because of the increased cost of imports. As the benefits of lower oil and commodity prices disappear, this problem can intensify. Real wages, which had fallen 8 per cent since the 2008 crisis, have shown some signs of recovering but only slowly, rising by 2.1 per cent in the three months to March 2017. However, the start of Brexit negotiations which only began in June 2017 have been marked by a good deal of political uncertainty which seems likely to stymie the economic recovery over the near term. Growth in the first quarter of 2017 slowed to 0.2 per cent quarter-on-quarter with the United Kingdom performing worse than most European economies.

The new uncertainties generated by a hung parliament that needs to negotiate the Brexit deal may constrain growth even more.

The economy of Japan has now expanded, albeit weakly, for six consecutive quarters, which is the longest run of growth in more than a decade, with a growth rate of 1.2 per cent expected this year. However, this growth has been largely driven by exports, and not by domestic demand, especially private consumption, which the Japanese Government has tried hard to stimulate. Part of the reason for the increase in exports is the correction of the long-term overvaluation of the currency, with its value falling from ¥101 to the dollar in late September 2016 to about ¥117 to the dollar at the end of December 2016. Exports, which had been shrinking for many months preceding December 2016, have since recorded positive changes (relative to the corresponding month of the previous year) until April and are being seen as the main stimulus to growth. But with the world economy still sluggish, this does not give grounds for much optimism. Meanwhile, the yen has shown signs of once again appreciating vis-à-vis the dollar, touching around ¥110 to the dollar in early June.

The failure of domestic demand to pick up is related to rather unusual trends in the Japanese labour market. An ageing population has ensured that despite many decades of stagnation or low growth, the unemployment rate in Japan, at 2.8 per cent, is at a 20-year low. Still, a significant part of the workforce is in temporary or part-time occupations with no security of employment. As a result, the tight labour market has not resulted in any upward pressure on wages, with both nominal and real wages being stagnant. This partly explains why the government's push to increase consumption, spur demand and inflate the economy has, so far, proved only partially successful.

2. Transition economies

After two years of a regional economic downturn caused by a considerable terms-of-trade shock, the economic performance of transition economies in the Commonwealth of Independent States (CIS) finally started to improve in the last quarter of 2016 and the beginning of 2017. A barely positive growth of GDP in 2016 is likely to strengthen moderately in 2017 on the back of a slight increase in global commodity prices from their recent trough, and a

modest recovery in the Russian Federation. Given weak global demand, slow growth of international trade, and, in particular, the uncertain future direction of international commodity prices, the prospects for a more dynamic growth of the CIS economies, which are characterized by high commodity dependence and low economic diversification, are not too bright.

The Russian economy's return to growth in 2017 because of the recovery of energy prices will have a positive effect on other CIS economies, which are heavily reliant on remittances and import demand from the leading economy of the region. However, the recent currency devaluations in most of these economies will not translate into much stronger export performance because of their limited manufacturing capacities and the low price elasticity of their main exports. Policy space in several countries will continue to be limited, because of the adoption of IMF programmes, the lingering effects of the recent financial crisis, and the dollarization of their economies. In the medium term, however, the potential influence of China through its "One Belt, One Road" initiative, promises to diminish serious infrastructure and financial bottlenecks of the countries in the region and create conditions for higher economic growth.

In contrast to the CIS countries, the performance of the transition economies in South-East Europe is noticeably better, and is likely to remain so. GDP growth of 2.7 per cent in 2016 is likely to accelerate further and surpass 3 per cent in 2017. The improvement in economic conditions of the European Union, which consumes between 50 per cent and 80 per cent of the total exports of the South-East European economies, coupled with more abundant FDI, increase in remittances from the European Union and growth of tourism receipts, has translated into strengthening of real incomes and domestic demand.

3. Developing countries

(a) Latin America: The costs of dependence

Latin America is among the regions that have been significantly affected by the policy-driven persistence of the Great Recession, with sluggish trade growth and a weak and much-delayed recovery. Short-term assessments point to a minor recovery in 2017 in the economies of Latin America and the Caribbean (LAC), after two years of contraction in 2015 and 2016 when GDP fell by 0.3 per cent and

0.8 per cent respectively. Underlying this is a fall in investment. Aggregate investment rates have fallen from 21.3 per cent in 2013 to 18.4 per cent in 2016. Growth in the region is projected to exceed 1 per cent in 2017, which is a small improvement when seen in the context of the negative growth of the previous two years. To recall, between 2004 and 2010, LAC countries as a group recorded relatively high rates of growth in all years except 2009, when the region, like the rest of the world, suffered the consequences of the financial crisis in Europe and the United States.

However, average performance indicators tend to obscure the heterogeneity that characterizes Latin America, with countries at different points of the economic cycle in 2017. In the case of Mexico, low oil prices and uncertainty regarding United States trade policy are expected to cause a further deceleration in growth to 1.9 per cent in 2017. The situation is more complex in South America. Countries that have been able to cope with the commodity downturn with a degree of success, such as Chile, Colombia and the Plurinational State of Bolivia, are expected to pick up again in 2017. Other oil exporters, such as the Bolivarian Republic of Venezuela and Ecuador, are expected to continue with low growth. Brazil, the largest economy of the region, is projected to stabilize after two years of economic contraction, albeit achieving a rate of growth of just 0.1 per cent. In general, Central American and Caribbean economies have been able to outperform commodity exporters in South America.

As discussed in various *TDRs* since 2003, the relatively long period of high growth in Latin America and the subsequent bust was closely connected to commodity price movements and related capital flows.

In many countries, commodity exports have a significance far beyond being drivers of foreign exchange earnings. In the case of Mexico, for example, net oil exports accounted for only 0.7 per cent of GDP in 2014, but they amounted to 30 per cent of fiscal revenues. This makes the impact of a decline in oil revenues far more significant than the importance of those export revenues to the country's GDP. Overall, the fiscal position of many countries in the region improved because of the gains from increases in the volume as well as the terms of trade. On the other hand, when the boom ended, public revenue growth was adversely affected, undermining the ability of Latin American governments to finance the many

social protection and redistribution schemes they had put in place, which had helped to reduce poverty and inequality. Between 2002 and 2014, general government social spending across the region rose from 15.2 per cent to 19.5 per cent of GDP (ECLAC, 2017). Although central government spending remained broadly stable after the commodity shock, amounting to 20.5 per cent of GDP in 2016, the fiscal deficit in South America increased from 2 per cent in 2013 to 3.9 per cent in 2016. This willingness to increase borrowing (from a low base) has softened the impact of the commodity bust, but the effects of the latter are visible.

The recent reversal of commodity price trends has led to the expectation that the recession in many LAC countries has now bottomed out. Average GDP growth rate in 2017 for the South American economies as a group is projected to be 0.6 per cent. Even this low but positive growth estimate is encouraging, inasmuch as it comes in the wake of two years of contraction in South America. The subregion contracted 1.8 per cent in 2015 and 2.5 per cent in 2016.

In Mexico, inflation triggered by currency depreciation resulting from a trade slowdown has prompted the Mexican Central Bank to implement contractionary monetary policy measures, while the government is in the midst of a multi-year fiscal consolidation plan. According to the OECD's index of industrial production, production is slightly down in the first quarter of 2017, after an essentially flat year in 2016 (growth of -0.1 per cent). Exports fell 1.9 per cent in 2016 despite the export advantages that exchange rate depreciation is supposed to bring. The merchandise trade balance in Mexico has been negative every year since 1997, despite its sizeable merchandise trade surplus with the United States (which was equivalent to 10.7 per cent of the GDP of Mexico in 2015).

Matters are better for the Central American economies, in which growth (excluding Mexico) had decelerated from 4.3 per cent in 2015 to 3.7 per cent in 2016. Because of resilient domestic demand, this deceleration appears to have been halted, with the growth rate forecast for 2017 placed at 4 per cent. For the Caribbean, average growth is forecast at a respectable 2.6 per cent in 2017, when compared with a contraction of 1.7 per cent in 2016.

Another factor often referred to when examining the influences on economic expansion in the LAC region is the movement of capital into and out of countries,

which – through its direct impact on investment, and indirect impact mediated by the levels of liquidity and credit and by exchange rates and export volumes – can affect growth. However, from an examination of trends in the biggest six LAC countries during this century it appears that only two (Brazil and Mexico) benefited substantially from the post-2003 surge in cross-border flows. Even in their case, such flows were very volatile and the period since mid-2014 has seen a collapse in capital inflows. This compounded the problems created by the end of the commodity boom, by depressing domestic investment and consumption as well.

In sum, while growth is low in much of the LAC region, it seems to have hit a floor from which some economies at least seem to be rebounding. The problem is that a strong recovery seems to be dependent on a significant turnaround in export prices and volumes, which, given trends elsewhere in the world economy, especially in China, seems unlikely in the near future. In addition, there is considerable uncertainty with respect to the trade policies that the current United States Administration would adopt, which could have significant implications for growth in the region.

(b) African growth engine back in second gear

Beginning in 2014, lower global oil prices and the end of the commodity boom have affected the African continent (parts of which also suffered a drought) extremely adversely, with growth in the region falling from 3 per cent in 2015 to 1.5 per cent in 2016, and projected to rise to 2.7 per cent in 2017. This masks significant differences in the growth performance of individual countries in 2016, from above 7 per cent in Côte d'Ivoire and Ethiopia, to 1.1 per cent in Morocco and 0.3 per cent in South Africa. In addition, Nigeria saw GDP contracting by 1.5 per cent, while Equatorial Guinea recorded a fall of around 7 per cent.

In the case of many of these economies, their recent predicament is the result of a long-term failure to ensure growth through diversification, and in most cases overdependence on one or a very few commodities. An extreme case is Nigeria, one of the largest economies of the African region, where the oil and gas sector accounts for a little more than a third of its GDP and more than 90 per cent of export earnings. The oil price decline dampened demand through its direct effects and indirect effects on government revenues and expenditures, and so was clearly responsible

for economic contraction in Nigeria. The recovery in early 2017 is still halting at best. On the other hand, the absence of adequate economic diversification and the consequent dependence on imports has meant that current account deficits have widened, leading to currency depreciation and domestic inflation. So the structure of the Nigerian economy has made it a victim of stagflation driven by current global circumstances. Other economies affected by recent oil price movements include Democratic Republic of the Congo; Equatorial Guinea, where oil accounts for 90 per cent of GDP and is almost the only export earner; and Libya, which derives 95 per cent of its export revenues from oil.

Given the overall high level of commodity-export dependence in African economies, the generalized decline and subsequent low level of commodity prices noted earlier has generated similar outcomes in many other economies. Needless to say, the extent and duration of the price change varied. Non-fuel commodity prices rose 1.7 per cent in 2016 relative to 2015 levels, partly due to the slow recovery in metal and mineral prices, as the deceleration of growth in China led to falls in demand. China accounts for 9 per cent of African merchandise exports and primary commodities account for about 92 per cent of African exports to China. As a result, countries with all kinds of commodity dependence have been affected adversely.

Meanwhile, South Africa fell into a “technical recession”, two consecutive quarters of negative GDP growth, with a drop of 0.3 per cent in the fourth quarter of 2016, followed by a drop of 0.7 per cent in the first quarter of 2017.⁷ This contraction was due to the poor performance of manufacturing and trade, so much so that despite marked production improvements in agriculture and mining, the contraction of the former two sectors could not be neutralized. Clearly internal demand constraints have also played a role here.

All in all, Africa has been hit badly in the current global environment, even though East Africa, led by Ethiopia, Kenya, Rwanda and United Republic of Tanzania, managed to record respectable growth in 2016.

(c) Can high growth return to developing Asia?

Asia continues to be the most dynamic region in the world economy, with robust domestic demand in the region's largest economies helping to keep GDP growth on a reasonable even keel. Growth

in the region, though modest relative to the recent historical trend, is an estimated 5.1 per cent in 2016 and projected to be 5.2 per cent for 2017. The corresponding figures for the two most populated and fastest-growing countries in the region were 6.7 per cent in 2016 and estimated to stay the same in 2017 for China; and 7 per cent and 6.7 per cent for India.⁸ The issue in the region, therefore, is not the rate of growth relative to the rest of the world, but rather whether the future is going to see a return to the much higher rates of growth of the past or approach lower levels. In fact, the slowdown in China, which has become a major source of global demand, gives some cause for concern. There are reasons to worry about other countries in the region too, particularly because the contribution of investment to overall growth has also waned, especially in countries such as Indonesia, Malaysia and Thailand.

The export-led growth strategy of some of the countries in the region is coming under severe strain amid the continuing weakness in external demand, volatile capital flows and tightening of global financial conditions. The economies of South-East Asia are unlikely to see a return to the growth rates enjoyed before the global crisis any time soon. Exports continued to remain low for cyclical and structural reasons; despite a partial recovery in 2016, they dipped far below what was observed in the years following the 2008 crisis until 2012 for most countries of the region. In addition to industrial exports, the region has also experienced trade losses among net commodity exporters (e.g. Indonesia) to some extent. Imports, having contracted during the first half of 2016, recovered in the latter half of 2016 in many countries of the region such as China, India, Indonesia and Thailand. Growth in a number of countries in South Asia, including Bangladesh and Pakistan, appears to have benefited in recent years from new opportunities linked to the “One Belt, One Road” initiative in China.

The gradual slowdown of China is expected to continue as it moves ahead with rebalancing its economy, towards domestic markets. However, the explosion of domestic debt since the crisis is proving a major challenge to sustained growth. According to comparable data from the Bank for International Settlements, the debt-to-GDP ratio of China stands at 249 per cent as compared with 248 per cent in the United States and 279 per cent in the euro zone. Despite this debt build-up, which calls for deleveraging, every time there are signs of a slowdown the only instrument

in the hands of the Chinese Government seems to be to expand credit. Fears of a hard landing resulted in a ¥6.2 trillion increase in debt in the first three months of 2017.⁹

The Indian banking sector, too, which since 2003 has expanded credit to the retail sector (involving personal loans of various kinds, especially those for housing investments and car purchases) and to the corporate sector (including for infrastructure projects), is now burdened with large volumes of stressed and non-performing assets. Data for all banks (public and private), relating to December 2016, point to a 59.3 per cent increase over the previous 12 months, taking it to 9.3 per cent of their advances, compared with a non-performing assets (NPAs) to advances ratio of 3.5 per cent at the end of 2012.¹⁰

Rising NPAs are making banks much more cautious in their lending practices with signs of a reduction in the pace of credit creation. Since debt-financed private investment and consumption was an important driver of growth in India, it is more than likely that the easing of the credit boom would slow GDP growth as well. Thus, the dependence on debt makes the boom in China and India difficult to sustain and raises the possibility that when the downturn occurs in these countries, deleveraging will accelerate the fall and make recovery difficult. Expecting these countries to continue to serve as the growth poles that would fuel a global recovery is clearly unwarranted.

(d) West Asia

In 2016 GDP growth in West Asia weakened further, dropping to 2.2 per cent, down from 3.7 per cent in 2015 as a result of the fall in oil prices, oil production cuts mandated by OPEC, and fiscal austerity. Reductions in oil production will continue to keep GDP growth in 2017 to around 2.7 per cent, well below pre-crisis levels.

The weak recovery in oil prices after the collapse hurts most the oil exporters, and among them those characterized by extreme dependence on energy for national income, exports and revenues, like the Gulf Cooperation Council countries (GCC – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates). The windfall from the oil price boom of the 2000s resulted in large fiscal and current account surpluses that enabled these countries to rapidly accumulate assets and expand their Sovereign Wealth Funds. For instance, prior to the 2014 oil price fall, in

2013, the regional average fiscal surplus was 9.2 per cent of GDP. However, between 2014 and the end of 2016, regional budget surpluses have given way to a deficit averaging 10.4 per cent of GDP; while current account surpluses gave way to deficits averaging 3.3 per cent of GDP.

Over 2015–2016, economic performance in the subregion has been dominated by the terms-of-trade shock delivered by the collapse in oil prices that started in June 2014 and the subsequent policy responses to the shock. Reacting to the terms-of-trade shock, governments drew down reserves and sold Sovereign Wealth Fund assets, resorted to large-scale external borrowing (\$38.9 billion in 2016 alone), adopted domestic fiscal austerity involving spending cuts, placed controls on the public sector wage bill and reduced subsidies. With oil prices not expected to return to budgetary breakeven levels, fiscal deficits and financing needs are expected to remain large in GCC countries over the short to medium term.

The strong growth of Turkey since 2000 has doubled its per capita GDP and propelled it to the status of an

upper-middle income country, with the seventeenth-largest economy in the world. However, since 2015, Turkey has not been able to sustain this performance. In 2016, GDP growth rate decelerated to 3 per cent, down from 5.8 per cent in 2015 but is projected to pick up to around 4 per cent in 2017. Unemployment in 2016 rose to 10.9 per cent, up from 9.1 per cent in 2011. A sharp decline in tourism revenue, the rise in global oil prices and the depreciation of the lira have contributed to a more difficult economic environment. The Iranian economy has, by contrast, been experiencing a revival, with growth of 4.7 per cent in 2016 and an estimated 5.1 per cent in 2017 (as compared with 0.4 per cent in 2015), thanks largely to a sharp increase in oil production after the lifting of sanctions, and the effects of this on household incomes, consumption and domestic investment. Inflation in the Islamic Republic of Iran, which was high during the sanction years, fell to single-digit levels, and is currently around 9 per cent per year. Like other oil-exporting countries, the immediate economic prospects of the Islamic Republic of Iran depend on the trend in oil prices, as oil accounts for around 60 per cent of exports.

C. The way forward

Whether a country has been able to grow largely based on the domestic market or has relied on exports as the driver of growth, global conditions are not conducive for a return to more widespread buoyancy. Talk of technology or trade as the disruptive villains in this narrative distracts from an obvious point: unless significant and sustainable efforts are made to revive global demand through wage growth in a coordinated way, the global economy will be condemned to prolonged stagnation with intermittent pick-ups and recurrent downturns.

In a world of mobile finance and liberalized economic borders, no country can attempt a significant fiscal expansion alone without risking capital flight, a currency collapse and a crisis. On the other hand, closing borders to preclude that outcome is unwelcome and difficult because of the large volume of legacy foreign capital that has accumulated within the

borders of many countries. Any sign of imposition of stringent capital controls would trigger large-scale capital flight with the same consequences. What is needed therefore is a globally coordinated strategy of expansion led by state expenditures, with intervention that guarantees some policy space to allow all countries the opportunity of benefiting from the expansion of their domestic and external markets. As of now the sentiment seems to be different, with nationalist rhetoric, protectionist arguments and a beggar-thy-neighbour outlook dominating economic discourse. Growing inequalities feed this xenophobic turn, which provides a convenient “other” to blame for everybody’s problems.

Clearly, viable and equitable growth in this context will require a fiscal stimulus, along with other elements of a regulatory and redistributive framework, that must be coordinated across countries. ■

Notes

- 1 This possibility was anticipated by Michał Kalecki, 1971 [1943]: 4–5.
- 2 The IMF figure is based on PPP exchange rates, equivalent to 2.9 per cent using market exchange rates.
- 3 Group of Seven: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.
- 4 Estimate by Fitch Ratings quoted in Peter Wells and Don Weinland, “Fitch warns on expected returns from One Belt, One Road”, *Financial Times*, 26 January 2017, available at: <https://www.ft.com/content/c67b0c05-8f3f-3ba5-8219-e957a90646d1> (accessed 8 May 2017).
- 5 The average cost of shipping a 40-foot container from China to northern Europe rose from about \$400 in March last year to above \$2,000 in October. By May, it had fallen back to about \$1,700. See Jonathan Wheatley, “Has the global trade revival run out of puff?”, *Financial Times*, 30 May 2017, available at: <https://www.ft.com/content/d94e8898-412d-11e7-9d56-25f963e998b2> (accessed 17 July 2017).
- 6 Data on trade in services described in this paragraph come from *UNCTADstat* and correspond to the concepts and definitions of the IMF (2009), *Balance of Payments and International Investment Position Manual*, sixth edition.
- 7 Statistics South Africa (2017), *Gross Domestic Product, First Quarter 2017*, available at: <http://www.statssa.gov.za/publications/P0441/P04411stQuarter2017.pdf> (accessed 17 July 2017).
- 8 China is reported to have grown at an annual rate of 6.9 per cent in the first two quarters of 2017, and India has reported a fall in growth to 6.2 per cent in the first quarter.
- 9 Gabriel Wildau and Don Weinland, “China debt load reaches record high as risk to economy mounts”, *Financial Times*, 24 April 2016, available at: <https://www.ft.com/content/acd3f2fc-084a-11e6-876d-b823056b209b?mhq5j=e1> (accessed 14 July 2017).
- 10 Data compiled by Care Ratings and reported in George Mathew, “Bad loan crisis continues: 56.4 per cent rise in NPAs of banks”, *The Indian Express*, 20 February 2017, available at: <http://indianexpress.com/article/business/banking-and-finance/bad-loan-crisis-continues-56-4-per-cent-rise-in-npas-of-banks-rbi-4533685/> (accessed 17 July 2017).

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