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Statement by Mr. José Antonio Ocampo
Under-Secretary-General for Economic and Social Affairs of the United Nations

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Global Economic Conditions and Prospects

The growth of the world economy has decelerated measurably in the course of 2005, following an exceptionally strong and broad expansion in the previous year. According to the United Nations Department of Economic and Social Affairs, the gross world product (estimated on the basis of market exchange rates) is expected to register a growth of about 3 per cent in 2005, with a forecast of the same pace for 2006.[1]

While part of the moderation has resulted from the maturing of the cyclical recovery in a number of economies and from the associated unwinding of the earlier policy stimuli, the world economy at large has also encountered increasingly strong constraints, several of which are structural in nature.

Most prominent among these constraints are the enormous global imbalances: the external deficit of the United States, which is expected to exceed $700 billion in 2005, will be even higher next year; this will be matched by a growing sum of surpluses in a number of economies, mainly in East Asia, Europe and oil-exporting countries. The widening imbalances have increasingly given rise to concern about their sustainability, about the risks associated with various re-balancing processes, and about the consequence for the stability of the world financial markets and global economic growth. Some take an optimistic view on the question of sustainability, based on the observation that today's world economy differs substantially from that of the 1980s, when a disorderly adjustment of the global imbalances last brought a substantial shock to the global economy. Nonetheless, the expanding global imbalances clearly generate the risk of an abrupt reversal.

The persistent advance in oil prices is a second source of concern. Oil prices have surged on average by about 50 per cent so far during 2005, on top of an already significant increase in the previous year. The strong growth in global oil demand has moderated recently, but global oil production is still running near its full short-run capacity. The tight situation in the global oil market has also been exacerbated by such occasional shocks as the hurricanes and geopolitical instability. While many oil-exporting countries continue to benefit from the higher oil prices, a number of oil-importing economies, particularly some low-income oil-importing developing countries, have shown growing signs of deterioration. These include rising inflation, worsening external and fiscal balances, declining profits in some sectors, and even energy rationing in some cities. Although the claim by some analysts about the imminent advent of the "peak" in long-run global oil production remains moot, the tension in the global oil market is unlikely to abate soon. Consequently, oil prices are likely to stay at high levels and to continue to curb global growth. Meanwhile, an intensified international competition for oil not only poses challenges for the economic development of many developing countries, but it also complicates the global geopolitical situation.

[1] The United Nations outlook for the world economy is published in the *World Economic Situation and Prospects*, released in January every year, along with an updated version in June for the substantive session of the Economic and Social Council.

In the face of these and other constraints, the broad global expansion is gradually giving way to more diverse performance across countries in the coming year.

Among the developed economies, the growth of the United States is expected to slow, as household spending already seems overstretched, although a sound corporate finance position augurs well for a solid growth in business investment. Hurricane Katrina, aside from its large number of casualties and its devastating structural damages, is expected to have only a mild drag on the growth of the United States in the rest of 2005, and the reconstruction will likely stimulate growth in 2006. With a better-than-anticipated recovery and a gradual improvement in its economic fundamentals, Japan is expected to sustain its current growth and may finally extricate itself from a protracted deflation. Anemic growth remains probable for most of the developed economies in Europe, despite a few sporadic indicators of tentative strengthening in export and investment in some large European economies. In contrast, dynamism continues to characterize economies of the new European Union members.

Performance in developing countries has been sustained, with Africa's GDP expected to expand by 5 per cent in both 2005 and 2006, even though a number of countries in the region have just suffered a decline in agricultural output and some others have been adversely affected by the phase-out of the world Agreement on Textiles and Clothing (ATC). Economies in South and East Asia are expected to register another solid growth in 2005, but some deceleration is expected for 2006, as more depressing effects of higher oil prices will pass through into these economies when the governments reduce various support measures provided for domestic energy users. Growth in the two largest economies in the region, China and India, is expected to moderate in 2006, while most countries in West Asia continue to benefit, directly or indirectly, from higher oil prices. While political instability remains the key hurdle for economic growth, particularly in Iraq, the recent progress made by Israel and Palestine has renewed hopes for economic reconstruction in the region. Growth in Latin America and the Caribbean has been "normalizing" from the strong recovering pace of the previous year. Many South American economies continue to gain from a propitious external sector, including both robust external demand and an improvement in the terms of trade, while countries in the central and northern region face increasing pressure on their manufacturing sector from other international competitors.

In the economies in transition, CIS members are expected to register robust growth, as high oil prices buttress a robust rise in income and domestic demand. Meanwhile, the transition economies in Southeastern Europe are expected to grow at a moderate pace.

This forecast of global conditions is premised on the absence of a disorderly reversal of global imbalances and further hikes in oil prices. There are, however, substantial downside risks. Beyond the concern for the sustainability of global imbalances and the impact of further oil price increases, other non-negligible risks include: a possible lull, or even reversal, in the trend of a substantial appreciation of house prices in a number of large economies (a few countries have already felt the impact of a softening housing market); a significant rise in long-term interest rates; and disruptions caused by more terrorist attacks and natural disasters.

On the other hand, some positive factors sustain the international economic environment: international trade has continued to grow at a robust pace; financial markets worldwide have in general remained calm, with both the benchmark interest rates and the yield spreads for emerging economies at historical lows; and the terms of trade for a large

number of developing countries have improved considerably. Yet even these supportive factors may encompass some risky implications. For example, the low interest rates in global capital markets may suggest not only the high liquidity that characterizes current international conditions, but also a tendency for global savings to exceed global investment, which may be generating a problem of inadequate aggregate demand at the global level. If not prudently managed, the exceptionally low risk premium for the external borrowing of many developing countries facilitated by these conditions may lead to excessive capital inflows, sowing seeds for financial crisis in the future, as they have in the past.

Policy Implications[2]

Macroeconomic policies worldwide have become less synchronized across countries, as diverse economic performances create the necessity for country-specific policy responses. In general, macroeconomic policy should continue to be accommodating in most economies to prevent global growth from weakening further. While demand in some sectors may have reached a bottleneck, such as energy and raw materials, slack capacity remains in the global economy, as indicated by both the sluggish employment situation in the majority of countries and the low degree of pass-through of energy prices into the general inflation. In this regard, the advice and conditionality given by international financial institutions (IFIs), especially the International Monetary Fund, should provide developing countries with greater flexibility in their short-term fiscal policies and with support to active employment policies.

Facing higher oil prices, as well as higher prices for some other commodities, the challenge is to ensure that the higher prices do not choke off global growth, particularly by unleashing a series of contractionary monetary policy decisions, which would itself cause another precipitous fall in prices, as has occurred previously. It is necessary to mitigate uncertainties, including geopolitical tensions, which could generate disruptions on the supply side for commodities. At the same time, because the rapid pace of industrialization in a few large developing economies seems to be a key factor behind the advance in these prices, South-South cooperation—such as joint investment and technology sharing—may alleviate the tensions in global commodity markets. On the demand side, policies in large energy and other commodity consuming countries aimed to improve their efficiency and to develop alternative energy sources will also be important. Furthermore, for the exporting countries, recycling the increased revenues will have crucial implications for financial stability in these economies, as well as in the world economy.

Policy debate continues on how to adjust the global imbalances. Such large disequilibria in the world economy have resulted from a confluence of cyclical, structural and institutional factors, including perennial differentials in growth rates, saving rates and macroeconomic policy stance across countries; drastic changes in the terms of trade; dynamic relocation in the global constellation of manufacturing, trade, services and finance; and inherent deficiencies in the international monetary and reserve system. This complex set of determinants suggests that a global re-balancing should not depend solely on a realignment of the exchange rates. Meanwhile, any unilateral shift to protectionism would be counterproductive. The movement towards more flexible exchange rate regimes in a number of developing countries facing increasing external surpluses could be beneficial for global re-balancing, but it could also lead to slower world economic growth—if it has contractionary

[2] For a comprehensive discussion on both domestic and international macroeconomic and financial policies to meet a wide range of challenges in the world economy, see *World Economic and Social Survey 2005*, United Nations Publication Sales No. E.05.II.C.1

effects on these countries, which are not accompanied by faster growth in depreciating countries. A prudent global adjustment should be guided by international coordination and cooperation among all the economies of both the deficit and the surplus countries, with the international financial institutions—and, particularly, the IMF— playing a central role in that process.

In addition to the primary concern about the global imbalances for the stability of the world economy, policymakers worldwide should also pay attention to other ramifications of the imbalances. In this regard, the conventional proposal for re-balancing the global economy through more expansionary policies in Europe and Japan, in order to narrow their growth gaps vis-à-vis the United States, should continue to be on the agenda. The specific problems associated with exchange rate movements among major currencies and, particularly, the significant wealth effects generated by movements in the value of the US dollar, may be inefficient in generating global re-balancing, and in fact yield additional risks for developing countries. More generally, it may be necessary to reform an international reserve system that depends heavily on the currencies of a few major developed countries and to give a more prominent role to the only truly international money available –the Special Drawing Rights of the IMF.

Some progress has been made in international financial reform, but much more is needed. It is particularly encouraging to see firmer commitments to increase ODA and a growing consensus in the area of aid effectiveness, specifically, on the need to align donor contributions with the national development strategies of the recipient countries, thus respecting developing countries responsibility for their own development and supporting their institution-building efforts. It is also encouraging that the IMF has recognized the problems in the current allocation of quotas. After some three years of extensive study, however, we have yet to reach agreement on how to deal with the problems of voice and representation of developing countries in international economic decision making. Indeed, the issue is not part of the agenda of the forthcoming Development Committee, and the IMFC will only hear a progress report. In other areas, there has been very limited advance. And these areas involve some major issues, such as reducing or counteracting the pro-cyclicality of private capital flows to developing countries, the design of a better system to overcome debt overhangs in non-HIPC countries, the role of the IMF in international cooperation to redress global imbalances, and the role of Special Drawing Rights in the international financial system.

Despite a notable strengthening of economic conditions in the developing countries over the past two years, the growth rates in many poor countries are still not strong enough for them to fulfill the Millennium Development Goal of halving poverty by 2015, or to meet the other internationally agreed development goals. In this regard, the renewed commitment by major developed countries to Africa—in terms of scaling up ODA and debt relief—is both timely and commendable. More importantly, at the recent UN Summit, world leaders reinforced their political commitment to the Millennium Declaration and the Monterrey Consensus. The challenge is now to deliver on these commitments.