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Slower Growth in Emerging Markets, a Gradual Pickup in Advanced Economies

- *Global growth is projected at 3.3 percent in 2015, marginally lower than in 2014, with a gradual pickup in advanced economies and a slowdown in emerging market and developing economies. In 2016, growth is expected to strengthen to 3.8 percent.*
- *A setback to activity in the first quarter of 2015, mostly in North America, has resulted in a small downward revision to global growth for 2015 relative to the April 2015 World Economic Outlook (WEO). Nevertheless, the underlying drivers for a gradual acceleration in economic activity in advanced economies—easy financial conditions, more neutral fiscal policy in the euro area, lower fuel prices, and improving confidence and labor market conditions—remain intact.*
- *In emerging market economies, the continued growth slowdown reflects several factors, including lower commodity prices and tighter external financial conditions, structural bottlenecks, rebalancing in China, and economic distress related to geopolitical factors. A rebound in activity in a number of distressed economies is expected to result in a pickup in growth in 2016.*
- *The distribution of risks to global economic activity is still tilted to the downside. Near-term risks include increased financial market volatility and disruptive asset price shifts, while lower potential output growth remains an important medium-term risk in both advanced and emerging market economies. Lower commodity prices also pose risks to the outlook in low-income developing economies after many years of strong growth.*

Developments Affecting the Forecast

Weaker First-Quarter Growth

In the first quarter of 2015, the starting point for this update of the IMF's global economic forecasts, world growth—at 2.2 percent—fell some 0.8 percentage point short of the forecasts in the April 2015 WEO. The shortfall reflected to an important extent an unexpected output contraction in the United States, with attendant spillovers to Canada and Mexico. One-off factors, notably harsh winter weather and port closures, as well as a strong downsizing of capital expenditure in the oil sector contributed to weakening U.S. activity.

Outside North America, positive and negative surprises were roughly offsetting. Growth in output and domestic demand in emerging market and developing economies broadly weakened, as expected.

Oil Price Rebound

Oil prices have rebounded more than expected in the second quarter of 2015, reflecting higher demand and expectations that oil production growth in the United States will slow faster than previously forecast. Nevertheless, the average annual oil price expected for 2015—US\$59 a barrel—is in line with the oil price

assumption in the April 2015 WEO, with a somewhat smaller increase forecast for 2016 and beyond, as global oil supply is running well above 2014 levels and global oil inventories are still rising. The reduction in oil investment may, however, lead to a somewhat weaker boost to activity in North America from lower oil prices than expected earlier.

Inflation

With the rebound in oil prices, fuel end-user prices have started rising. Monthly headline inflation has thus started to bottom out in many advanced economies, but the impact of disinflationary factors earlier in the year was stronger than expected, particularly in the United States. Core inflation has remained broadly stable well below inflation objectives. In many emerging market economies, notably those with weak domestic demand, headline inflation has declined.

Rise in Bond Yields

Longer-term sovereign bond yields have risen by about 30 basis points in the United States and by about 80 basis points on average in the euro area (excluding Greece) since April. However, financial conditions for corporate and household borrowers have remained broadly



favorable. Higher yields partly reflect improving economic activity and the bottoming out of headline inflation, while in the euro area, they also reflect a correction after earlier declines to extremely compressed levels in response to increased bond purchases by the European Central Bank.

Other Factors

In currency markets, the dollar has depreciated by some 2 percent in real effective terms relative to the baseline values assumed for the April 2015 WEO, while the euro has appreciated by about 1 percent. But compared to average levels in 2014, the euro and the yen are still at depreciated levels and will, therefore, continue to support the recovery in the euro area and Japan in 2015–16. Given the constraints on monetary policy in these economies because of the zero lower bound on policy interest rates, this is expected to be a net positive for the global economy, as discussed in the April 2015 WEO. Bond yields and risk premiums in emerging market economies have risen broadly in line with those on advanced economy instruments. But capital flows to those economies are estimated to have decreased in 2015 compared to the second half of 2014, and many have seen further currency depreciation.

More recently, the bank holiday in Greece and subsequent referendum, along with increased uncertainty about the prospects for and nature of any future support from the international community, have led to sharply higher spreads on Greek sovereign bonds, especially at short maturities. Elsewhere, financial market reactions have been relatively muted, with some decline in the prices of risky assets and a modest increase in the prices of safe-haven sovereign bonds.

After a major rally over the past year, with the Shanghai composite index up by over 150 percent when it peaked in mid-June, the Chinese stock market has declined by about 30 percent in recent days, with the authorities taking several steps to contain the decline and the rise in market volatility.

Overall, as discussed below, these developments have not changed the broad outlook picture for the global economy, although they are expected to result in somewhat lower annual global growth in 2015 owing to the impact of the weaker first-quarter growth on annual growth in advanced economies (Table 1).

The Updated Forecast

Advanced Economies

Growth in advanced economies is projected to increase from 1.8 percent in 2014 to 2.1 percent in 2015 and 2.4 percent in 2016, a more gradual pickup than was forecast in the April 2015 WEO. The unexpected weakness in North America, which accounts for the lion's share of the growth forecast revision in advanced economies, is likely to prove a temporary setback. The underlying drivers for acceleration in consumption and investment in the United States—wage growth, labor market conditions, easy financial conditions, lower fuel prices, and a strengthening housing market—remain intact.

The economic recovery in the euro area seems broadly on track, with a generally robust recovery in domestic demand and inflation beginning to increase. Growth projections have been revised upward for many euro area economies, but in Greece, unfolding developments are likely to take a much heavier toll on activity relative to earlier expectations. In Japan, growth in the first quarter of 2015 was stronger than expected, supported by a pickup in capital investment. However, consumption remains sluggish and more than half of quarterly growth stemmed from changes in inventories. With weaker underlying momentum in real wages and consumption, the pickup in growth in 2015 is now projected to be more modest.

Emerging Markets and Developing Economies

Growth in emerging market and developing economies is projected to slow from 4.6 percent in 2014 to 4.2 percent in 2015, broadly as expected. The slowdown reflects the dampening impact of lower commodity prices and tighter external financial conditions—particularly in Latin America and oil exporters, the rebalancing in China, and structural bottlenecks, as well as economic distress related to geopolitical factors—particularly in the Commonwealth of Independent States and some countries in the Middle East and North Africa.

In 2016, growth in emerging market and developing economies is expected to pick up to 4.7 percent, largely on account of the projected improvement in economic conditions in a number of distressed economies, including Russia and some economies in the Middle East and North Africa. As noted in earlier WEO reports, in many other emerging market and developing economies,

much of the growth slowdown in recent years has amounted to a moderation from above-trend growth.

Risks to the Forecast

The distribution of risks to the near-term outlook for global growth is broadly unchanged from that in the April 2015 WEO and is slightly tilted to the downside. The main risks highlighted in April remain relevant. In view of the muted consumption response so far, a greater boost from lower oil prices is still an upside risk, especially in advanced economies.

Disruptive asset price shifts and a further increase in financial market volatility remain an important downside risk. Term and risk premiums on longer-term bonds are still very low, and there is a possibility of markets reacting strongly to surprises in this context. Such asset price shifts also bear risks of capital flow reversals in emerging market economies. Developments in Greece have, so far, not resulted in any significant contagion. Timely policy action should help to manage such risks if they were to materialize. Nevertheless, recent increases in sovereign bond yields in some euro area economies reduce upside risks to activity in these economies, and some risks of a reemergence of financial stress remain. Further U.S. dollar appreciation poses risks of balance sheet and funding risks for dollar debtors, especially in some emerging market economies. Other risks include low medium-term growth or a slow return to full employment amid very low inflation and crisis legacies in advanced economies, greater difficulties in China's transition to a new growth model, as illustrated by the recent financial market turbulence, and spillovers to economic activity from increased geopolitical tensions in Ukraine, the Middle East, or parts of Africa.

Policy Priorities

The projected pickup in global growth, while still expected, has not yet firmly materialized. Raising actual and potential output through a combination of demand support and structural reforms continues to be the economic policy priority.

In advanced economies, accommodative monetary policy should continue to support economic activity and lift inflation back to target. In a number of countries with fiscal space, the near-term fiscal stance should be eased, especially through increased infrastructure investment. In economies with high public debt, the pace of fiscal consolidation needs to strike an appropriate balance between debt reduction and imposing a drag on economic activity. Efforts at implementing structural reforms remain urgent across advanced economies, both to tackle crisis legacies and to raise potential output.

In emerging market and developing economies, macroeconomic policy space to support demand is generally more limited but should be used to the extent possible. In many of these economies, demand support should come from fiscal policy rebalancing aimed at boosting longer-run growth, through tax reform and spending reprioritization. In oil importers, lower oil prices have reduced price pressures and external vulnerabilities, which will ease the burden on monetary policy. In oil exporters, public spending should be adjusted to lower oil revenue where there is no fiscal space. Exchange rate depreciation can help to offset the demand impact of oil-related terms-of-trade losses in countries with flexible exchange rate regimes. Structural reforms to raise productivity and remove bottlenecks to production are urgently needed in many economies.

Table 1. Overview of the World Economic Outlook Projections*(Percent change unless noted otherwise)*

	Year over Year						Q4 over Q4		
	2013	2014	Projections		Difference from April 2015 WEO Projections 1/		Projections		
			2015	2016	2015	2016	2014	2015	2016
World Output 2/	3.4	3.4	3.3	3.8	-0.2	0.0	3.3	3.3	3.7
Advanced Economies	1.4	1.8	2.1	2.4	-0.3	0.0	1.7	2.2	2.3
United States	2.2	2.4	2.5	3.0	-0.6	-0.1	2.4	2.4	2.8
Euro Area 3/	-0.4	0.8	1.5	1.7	0.0	0.1	0.9	1.8	1.6
Germany	0.2	1.6	1.6	1.7	0.0	0.0	1.5	1.8	1.5
France	0.7	0.2	1.2	1.5	0.0	0.0	-0.0	1.7	1.3
Italy	-1.7	-0.4	0.7	1.2	0.2	0.1	-0.4	1.2	1.3
Spain	-1.2	1.4	3.1	2.5	0.6	0.5	2.0	3.3	2.2
Japan	1.6	-0.1	0.8	1.2	-0.2	0.0	-0.9	1.7	1.3
United Kingdom	1.7	2.9	2.4	2.2	-0.3	-0.1	3.2	2.2	2.1
Canada	2.0	2.4	1.5	2.1	-0.7	0.1	2.5	1.0	2.3
Other Advanced Economies 4/	2.2	2.8	2.7	3.1	-0.1	0.0	2.6	2.8	3.1
Emerging Market and Developing Economies 5/	5.0	4.6	4.2	4.7	-0.1	0.0	4.7	4.3	5.0
Commonwealth of Independent States	2.2	1.0	-2.2	1.2	0.4	0.9	-1.0	-3.5	1.5
Russia	1.3	0.6	-3.4	0.2	0.4	1.3	0.4	-4.8	1.8
Excluding Russia	4.2	1.9	0.7	3.3	0.3	0.1	...	...	...
Emerging and Developing Asia	7.0	6.8	6.6	6.4	0.0	0.0	6.9	6.6	6.4
China	7.7	7.4	6.8	6.3	0.0	0.0	7.3	6.8	6.3
India 6/	6.9	7.3	7.5	7.5	0.0	0.0	7.5	7.3	7.5
ASEAN-5 7/	5.1	4.6	4.7	5.1	-0.5	-0.2	4.8	4.7	5.2
Emerging and Developing Europe	2.9	2.8	2.9	2.9	0.0	-0.3	2.6	3.5	3.0
Latin America and the Caribbean	2.9	1.3	0.5	1.7	-0.4	-0.3	1.2	-0.1	2.1
Brazil	2.7	0.1	-1.5	0.7	-0.5	-0.3	-0.2	-2.1	2.3
Mexico	1.4	2.1	2.4	3.0	-0.6	-0.3	2.6	2.5	3.0
Middle East, North Africa, Afghanistan, and Pakistan	2.4	2.7	2.6	3.8	-0.3	0.0	...	...	...
Saudi Arabia	2.7	3.5	2.8	2.4	-0.2	-0.3	1.6	2.7	2.6
Sub-Saharan Africa	5.2	5.0	4.4	5.1	-0.1	0.0	...	...	...
Nigeria	5.4	6.3	4.5	5.0	-0.3	0.0	...	...	...
South Africa	2.2	1.5	2.0	2.1	0.0	0.0	1.3	1.5	2.4
<i>Memorandum</i>									
Low-Income Developing Countries	6.1	6.0	5.1	6.2	-0.4	0.2	...	...	...
World Growth Based on Market Exchange Rates	2.5	2.7	2.6	3.2	-0.3	0.0	2.5	2.6	3.1
World Trade Volume (goods and services)	3.3	3.2	4.1	4.4	0.4	-0.3	...	...	...
Imports									
Advanced Economies	2.1	3.3	4.5	4.5	1.2	0.2	...	...	...
Emerging Market and Developing Economies	5.2	3.4	3.6	4.7	0.1	-0.8	...	...	...
Commodity Prices (U.S. dollars)									
Oil 8/	-0.9	-7.5	-38.8	9.1	0.8	-3.8	-28.7	-16.8	5.5
Nonfuel (average based on world commodity export weights)	-1.2	-4.0	-15.6	-1.7	-1.5	-0.7	-7.5	-12.6	0.7
Consumer Prices									
Advanced Economies	1.4	1.4	0.0	1.2	-0.4	-0.2	1.0	0.2	1.5
Emerging Market and Developing Economies 5/	5.9	5.1	5.5	4.8	0.1	0.0	5.0	6.0	4.7
London Interbank Offered Rate (percent)									
On U.S. Dollar Deposits (six month)	0.4	0.3	0.4	1.2	-0.3	-0.7	...	...	...
On Euro Deposits (three month)	0.2	0.2	0.0	0.0	0.0	0.0	...	...	...
On Japanese Yen Deposits (six month)	0.2	0.2	0.1	0.1	0.0	-0.1	...	...	...

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during May 4–June 1, 2015. Economies are listed on the basis of economic size. The aggregated quarterly data are seasonally adjusted. Lithuania is now included in the euro area. Lithuania was previously included in the other advanced economies.

1/ Difference based on rounded figures for both the current and April 2015 WEO forecasts.

2/ The quarterly estimates and projections account for 90 percent of the world purchasing-power-parity weights.

3/ Includes Lithuania, which joined the euro area in January 2015.

4/ Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

5/ The quarterly estimates and projections account for approximately 80 percent of the emerging market and developing economies.

6/ For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with FY2011/12 as a base year.

7/ Indonesia, Malaysia, Philippines, Thailand, Vietnam.

8/ Simple average of prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil. The average price of oil in U.S. dollars a barrel was \$96.25 in 2014; the assumed price based on futures markets is \$58.87 in 2015 and \$64.22 in 2016.