

# Executive summary

## Prospects for global macroeconomic development

Urgent and concrete policy action is needed to reduce risks to the global economy and secure the foundations for stable and sustainable economic growth. A dynamic and inclusive global economy is central to delivering the ambitious targets of the 2030 Agenda for Sustainable Development. Policymakers must work to contain short-term risks from financial vulnerabilities and escalating trade disputes, while advancing a longer-term development strategy towards economic, social and environmental goals. Decisive policy actions rely on a multilateral, cooperative and long-term approach to global policymaking in key areas, including combatting climate change, sustainable finance, sustainable production and consumption, and redressing inequality. This also requires progress towards a more inclusive, flexible and responsive multilateral system.

## On the surface, global economic growth appears firm, masking underlying risks and imbalances

Economic growth accelerated in more than half the world's economies in both 2017 and 2018. Developed economies expanded at a steady pace of 2.2 per cent in both years, and growth rates in many countries have risen close to their potential, while unemployment rates in several developed economies have dropped to historical lows. Among the developing economies, the regions of East and South Asia remain on a relatively strong growth trajectory, expanding by 5.8 per cent and 5.6 per cent, respectively in 2018. Many commodity-exporting countries, notably fuel exporters, are continuing a gradual recovery, although they remain exposed to volatile prices. The impact of the sharp drop in commodity markets in 2014/15 also continues to weigh on fiscal and external balances and has left a legacy of higher levels of debt.

Global economic growth remained steady at 3.1 per cent in 2018, as a fiscally induced acceleration in the United States of America offset slower growth in some other large economies. Economic activity at the global level is expected to expand at a solid pace of 3 per cent in 2019, but there are increasing signs that growth may have peaked. The growth in global industrial production and merchandise trade volumes has been tapering since the beginning of 2018, especially in trade-intensive capital and intermediate goods sectors. Leading indicators point to some softening in economic momentum in many countries in 2019, amid escalating trade disputes, risks of financial stress and volatility, and an undercurrent of geopolitical tensions. At the same time, several developed economies are facing capacity constraints, which may weigh on growth in the short term.

## Beneath the headline figures, economic growth is uneven and is often failing to reach the regions that need it most

These headline figures conceal fragilities and setbacks in many developing economies and the uneven pace of economic progress across the world. While economic prospects at the global level have improved over the past two years, several large developing countries have seen per capita income decline. Further declines or weak per capita income growth are anticipated in 2019 in Central, Southern and West Africa, Western Asia, and Latin America and the Caribbean—homes to nearly a quarter of the global population living in extreme poverty.

Even where per capita growth is strong, it is often driven by core industrial regions, leaving peripheral and rural areas behind. While unemployment rates are at historical lows in several developed economies, many individuals, notably those with low incomes, have seen little or no growth in disposable income for the last decade. More than half of the world population has no access to social protection, perpetuating high levels of subsistence activities. These imbalances push the targets of eradicating poverty and creating decent jobs for all further from reach. Inadequate income growth also poses risks to many of the other Sustainable Development Goals, as countries strive to alleviate infrastructure bottlenecks, improve health, upgrade human capital and broaden opportunities.

## Resource-rich countries often struggle to tap into their development potential

Many of the developing economies that are falling behind depend heavily on commodities, both in terms of export revenue and financing fiscal expenditure. The combination of high volatility of export and fiscal revenues often translates into large swings in economic activity, and lower rates of growth over the longer term. These effects are exacerbated in countries with weak governance and poor institutional quality, where the lack of diversification may act as a barrier to socioeconomic development. Among the commodity-dependent growth laggards, many have also been mired in long-standing armed conflicts or have faced civil unrest and instability in recent decades.

## Uncertainties, risks and implementation of the 2030 Agenda for Sustainable Development

### Increasing downside risks and vulnerabilities threaten the short-term sustainability of economic growth

The steady pace of global economic growth masks the build-up of several short-term risks with the potential to severely disrupt economic activity and inflict significant damage on longer-term development prospects. This would make many of the targets of the 2030 Agenda for Sustainable Development much harder to accomplish. Countries with significant vulnerabilities, such as large macroeconomic imbalances and high levels of external debt, are particularly susceptible to such disruptions. As policy space has narrowed considerably across the world, any external shock could have severe and long-lasting implications for global growth and socioeconomic conditions.

## Escalating trade policy disputes pose short-term threats...

Over the course of 2018, there was a significant rise in trade tensions among the world's largest economies, with a steep rise in the number of disputes raised under the dispute settlement mechanism of the World Trade Organization. Moves by the United States to increase import tariffs have sparked retaliations and counter-retaliations. Global trade growth has lost momentum, although stimulus measures and direct subsidies have so far offset much of the direct negative impacts on China and in the United States.

A prolonged episode of heightened tensions and spiral of additional tariffs among the world's largest economies poses considerable risk to the global trade outlook. The impact on the world economy could be significant: a slowdown in investment, higher consumer prices and a decline in business confidence. This would create severe disruptions to global value chains, particularly for exporters in East Asian economies that are deeply embedded into the supply chains of trade between China and the United States. Slower growth in China and/or the United States could also reduce demand for commodities, affecting commodity-exporters from Africa and Latin America. There is a risk that the trade disputes could aggravate financial fragilities, especially in some emerging economies. Rising import prices, coupled with tighter financial conditions and high debt-servicing costs, could squeeze profits and cause debt distress in certain industries.

## ...with longer-term repercussions

A protracted period of subdued trade growth would also weigh on productivity growth in the medium term, and hence on longer-term growth prospects. Trade supports productivity growth via economies of scale, access to inputs, and the acquisition of knowledge and technology from international contacts. Trade in services also contributes to inclusiveness, resilience, and diversification. These trade channels are strongly intertwined with investment decisions, productivity gains, economic growth and ultimately sustainable development.

## An abrupt tightening of global financial conditions could spark localized financial turmoil...

Rising policy uncertainties and deepening country-specific vulnerabilities generated bouts of heightened financial market volatility in 2018. Investor sentiments were affected by escalating trade tensions, high levels of debt, elevated geopolitical risks, oil market developments, and shifting expectations over the monetary policy path of the United States. Against this backdrop, global financial conditions experienced some tightening during the year. In the current uncertain environment, any unexpected developments or sudden shift in sentiment could trigger sharp market corrections and a disorderly reallocation of capital. A rapid rise in interest rates and a significant strengthening of the dollar could exacerbate domestic fragilities and financial difficulties in some countries, leading to higher risk of debt distress.

## ...with potential for more widespread contagion

Investors may become particularly wary of countries with significant domestic vulnerabilities, such as high current account and fiscal deficits, large external financing needs, a lack

of transparency in their debt obligations, or limited policy buffers. Financial stress can also spread between countries through banking channels and other financial market linkages. In addition, there is evidence of recent financial market contagion through discrete shifts in investor confidence, irrespective of underlying fundamentals, placing emerging markets more broadly at risk.

### Monetary policy adjustments or policy missteps in major economies could trigger heightened financial stress

Considerable uncertainty surrounds the monetary policy adjustment path in the developed economies, particularly the United States. Against a backdrop of a highly pro-cyclical fiscal expansion and an increase in import tariffs, a strong rise in inflationary pressures could prompt the United States Federal Reserve to raise interest rates at a much faster pace than currently expected, triggering a sharp tightening of global liquidity conditions.

The possible failure of policymakers in Europe to finalize legal and regulatory arrangements in advance of the intended withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union in March 2019 poses risks to financial stability, given the prominence of European banks in driving global cross-border financial flows.

Recent policy easing in China, while likely to support short-term growth, could exacerbate financial imbalances. This may raise the risk of a disorderly deleveraging process in the future, with large repercussions on real economic activity, and regional and global spillovers.

### Climate risks also threaten economic prospects, especially for small island developing States

Climate risks are intensifying, as the world experiences an increasing number of extreme weather events. Over the last six years, more than half of extreme weather events have been attributed to climate change. Climate shocks impact developed and developing countries alike, putting large communities at risk of displacement and causing severe damage to vital infrastructure. Nevertheless, the human cost of disasters falls overwhelmingly on low-income and lower-middle-income countries. Many small island developing States (SIDS) in the Caribbean and Indian and Pacific Oceans are particularly exposed to climate risks, through flooding, rising aridity, coastal erosion and depletion of freshwater. Climate-related damage to critical transport infrastructure, such as ports and airports, may have broader implications for international trade and for the sustainable development prospects of the most vulnerable nations. Risks from marine inundation of coastal infrastructure will increase substantially when global warming reaches 1.5°C, which may be reached as early as in the 2030s.

### Underlying vulnerabilities of a longer-term nature endanger the sustainability of global economic growth along financial, social and environmental dimensions

Global public and private debt levels have continued to rise. In several countries, high debt service obligations already constitute a heavy burden on government finances. More broadly, the rise in debt in developing economies has generally not been matched by an equivalent

expansion of productive assets. This raises concerns about the longer-term sustainability of debt, as well as concerns about productive capacity over the medium term, given large infrastructure gaps, degradation of existing capital and their related impact on productivity.

## Eradicating poverty by 2030 will require both double-digit growth in Africa and steep reductions in income inequality

Along social dimensions, economic growth is often failing to reach those that need it most. Weak per capita income growth in regions where poverty levels and inequality remain high acts as a severe impediment to social development. Despite substantial progress over the last two decades, more than 700 million people remain below the extreme poverty line, of which more than half are in Africa. Achieving the target of eradicating poverty by 2030 will require dramatic shifts in countries where poverty rates remain high, both in terms of sharp accelerations in economic growth and steep reductions in income inequality. In Africa, economic growth needs to rise to double-digit levels to reach poverty reduction targets, well beyond growth rates recorded over the last 50 years.

## A fundamental shift in the way the world powers economic growth is imperative

To avoid substantial changes to current human and natural systems, global CO<sub>2</sub> emissions must start to decline well before 2030. While some progress has been made in reducing the greenhouse gas intensity of production, the transition towards environmentally sustainable production and consumption is not happening fast enough, allowing the level of carbon emissions to rise and accelerating climate change. A fundamental and more rapid shift in the way the world powers economic growth is urgently needed if we are to avert further serious damage to our ecosystems and livelihoods. Such a fundamental transformation requires policy action on many fronts, the acceleration of technological innovation, and significant behavioural changes.

## Policy challenges and the way forward

### The multilateral approach to global policy making is facing significant challenges

There has been a growing perception that the benefits of increasing economic integration have not been equitably shared between or within countries. The benefits from trade and financial liberalization are now increasingly viewed as exacerbating income and wealth inequality within countries, limiting policy space and even, in some cases, undermining national sovereignty. Institutions and agreements at the heart of the multilateral system have been facing increased pressure. These pressures have materialized in the areas of international trade, international development finance, and tackling climate change.

The threats to multilateralism come at a time when international cooperation and governance are more important than ever. Many of the challenges laid out in the 2030 Agenda for Sustainable Development are global by nature and require collective and cooperative action.

## There is need to work towards a more inclusive, flexible and responsive multilateral system

In today's closely integrated world economy, internationally agreed rules and institutions are vital for ensuring well-functioning markets, resolving disagreements and guaranteeing stability. Strengthening multilateralism is, therefore, central to advancing sustainable development across the globe. To be effective, multilateral systems must respond to legitimate concerns and criticisms. The architecture of the multilateral trading system needs to be better aligned with the 2030 Agenda for Sustainable Development, creating an inclusive, transparent and development-friendly framework for international trade. Progress in international tax cooperation must enable all countries to receive their fair share of taxes from international companies, which is especially important for the poorest countries. To halt global warming, greater international cooperation on green technology, including affordable technology transfer, is needed to support transition towards sustainable production in many developing countries, especially the least developed countries (LDCs).

## International tax cooperation must complement effective national tax policies

The international community must continue to work for a fair, sustainable and modern international tax system, supported by pro-growth tax policies. Efforts should be universal in approach and scope, and should fully take into account the different needs and capacities of all countries. In the digitalized era, a multilateral approach to taxation is essential. Nevertheless, this must leave space for countries to adopt effective tax policies that enhance domestic public finance for sustainable development. Effective and well-managed mobilization, budgeting and use of domestic public resources are critical to providing essential public goods and services, strengthening infrastructure, reducing inequality and supporting macroeconomic stability.

## Delivering environmentally sustainable growth requires fundamental shifts in policy and consumption

Economic decision-making must fully integrate the negative climate risks associated with emissions, thereby reducing the demand for carbon-intensive services and fossil fuel-based technology. This can be achieved through tools such as carbon pricing measures, energy efficiency regulations such as minimum performance standards and building codes, and reduction of socially inefficient fossil fuel subsidy regimes. Governments can also promote policies to stimulate new energy-saving technologies, such as research and development subsidies. In countries that remain highly reliant on fossil fuel production, economic diversification is vital.

## Managing natural resource wealth requires far-sighted policy strategies

Natural resource wealth can create vast development opportunities for an economy when matched with effective management and far-sighted policy strategies. Returns from the commodity sector can provide vital revenue to support broader access to education and

health care, investment in critical infrastructure, provision of crucial social protection services and to promote economic diversification. Diversification will strengthen resilience, and in many cases is also an environmental necessity. Achieving this requires a comprehensive approach to commodity management embedded within a broad sustainable development strategy. Key elements include strengthening institutions, increasing transparency, developing countercyclical policies, and targeted investment in human capital.

### Education, employment policies and rural infrastructure are central to reducing inequality

High levels of inequality are a major barrier to achieving the 2030 Agenda for Sustainable Development. Broadening access to education and improving its quality are crucial to redressing this obstacle. Employment policies, such as raising minimum wages and expanding social protection, have also been shown to raise the living standards of the lowest income earners. Prioritizing rural infrastructure development, through public investment in transport, agriculture and energy, can also support poverty alleviation and narrow the rural-urban divide.

