World Economic Situation and Prospects

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Medium-term perspective

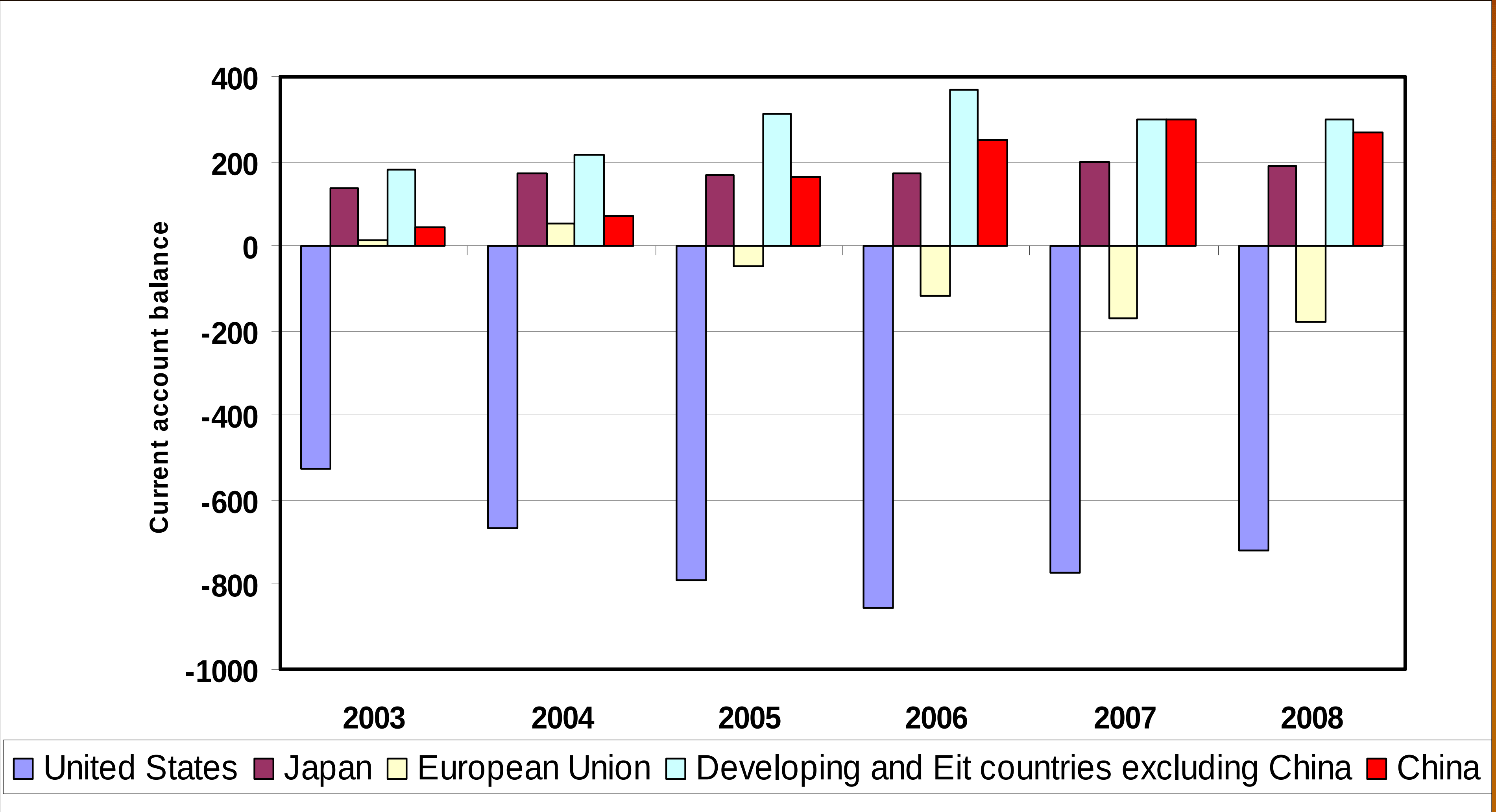
- Persistent global imbalances
- Increasing inequality within and between countries
- Increased economic insecurity due to:

- retreat of governments

- growing interdependence

- market reforms of social security systems

Global current account imbalances



US financial crisis

Sub-prime crisis → credit crunch

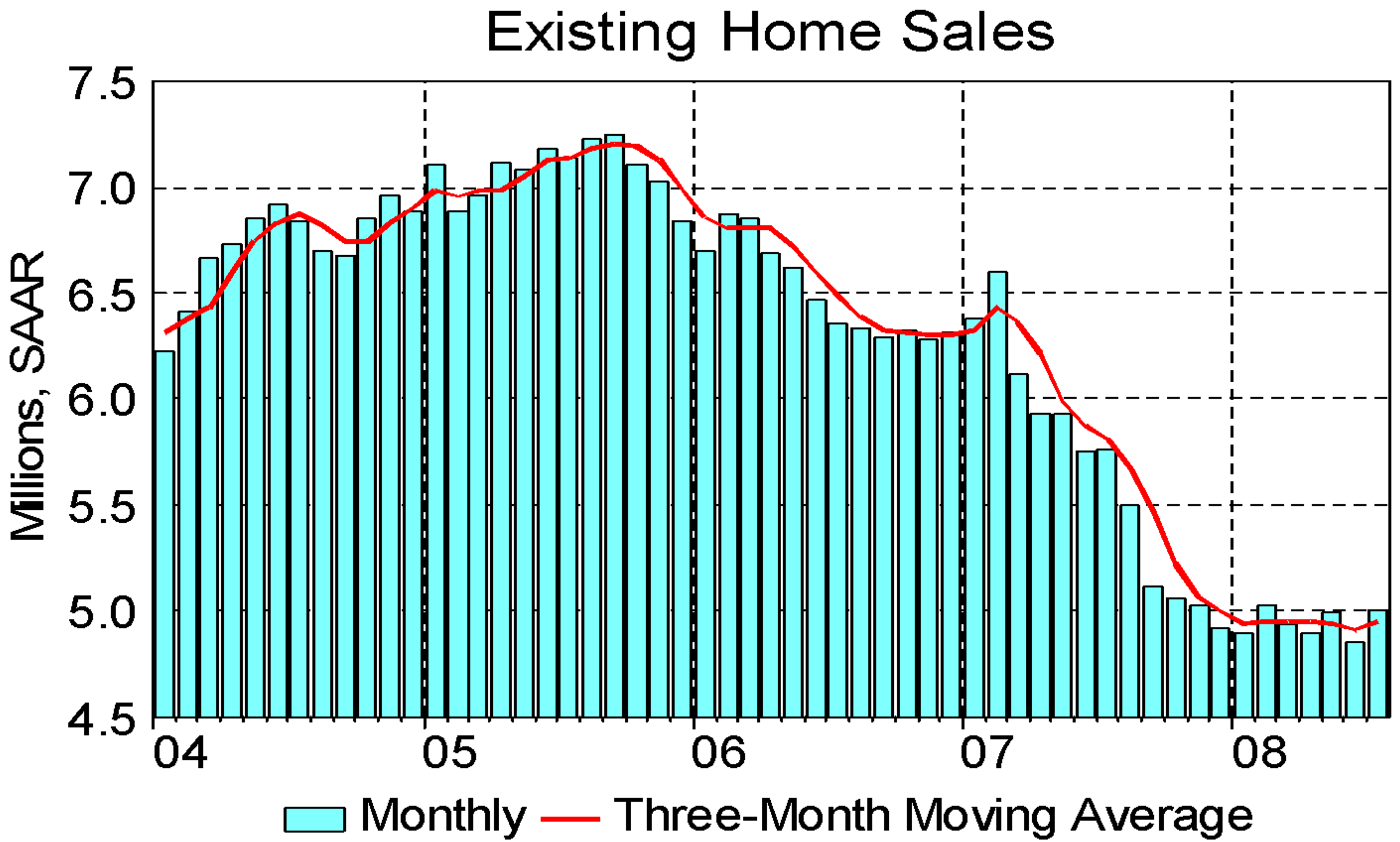
→ asset price deflation

Earlier asset price bubbles due to:

- 1990s' financial deregulation,

  e.g. repeal of Glass-Steagall in 1999
- aggressive monetary easing following 2001 downturn
- greatly increased debt-income ratios of US households

US home sales collapse



US financial crisis not over

- Banks continue to 'go under'
- De facto nationalization of particular liabilities on large investment bank's balance sheets via Federal Reserve
- 'Bail-out' of Fannie Mae/Freddie Mac likely
- Large scale nationalization of US mortgage market being considered

Real side consequences

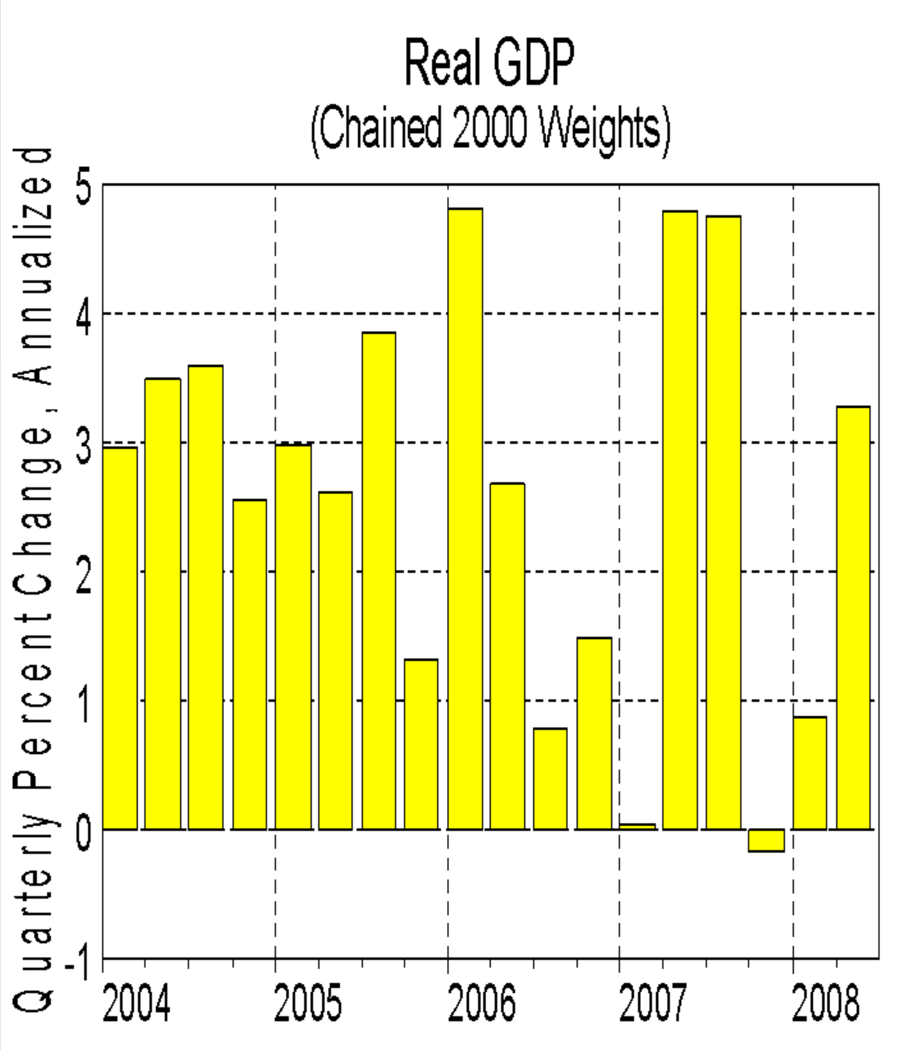
- US *GDP growth* surprisingly resilient

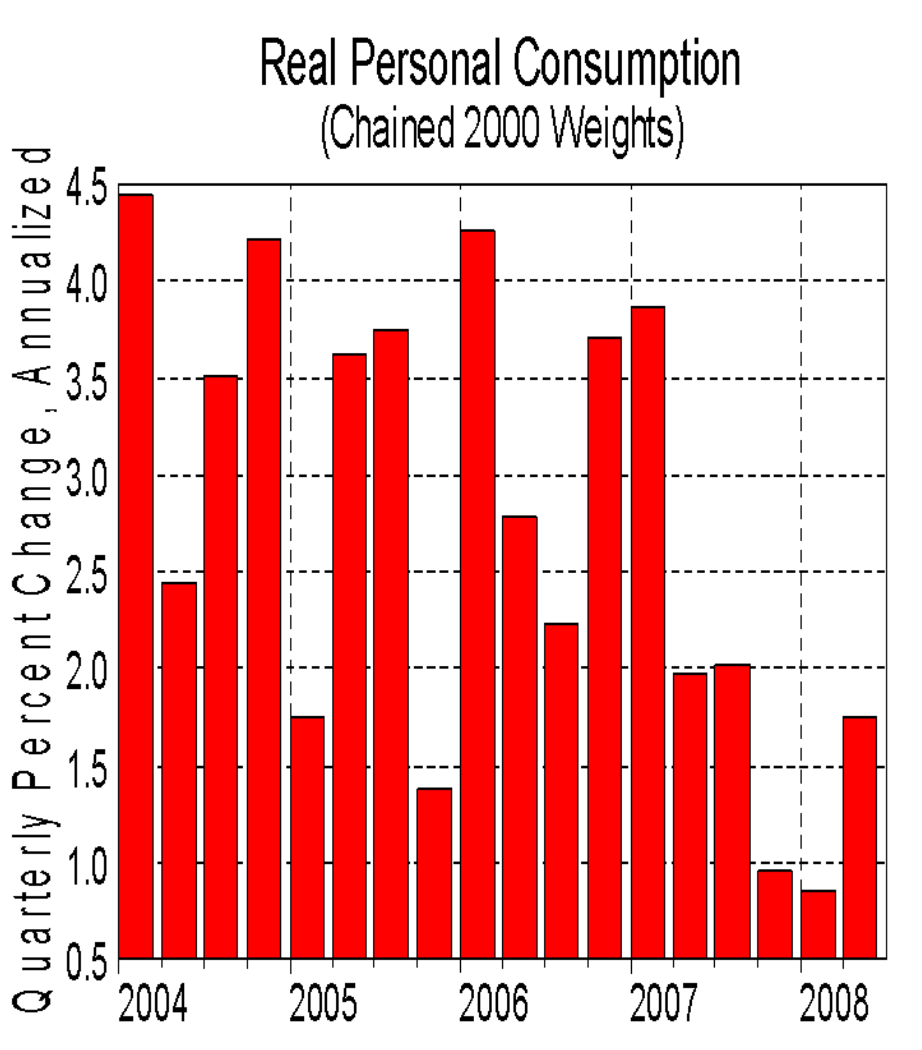
  08Q2 US real GDP growth: 3.3%,

  driven by exports and government spending

  (Aug 28 BEA News Release)
- US *employment* contracting
- US *household consumption* receding

US GDP and consumption





US policy responses so far

- Tax stimulus package largely ineffective in medium term, as households save much of additional income.
- Recent housing legislation expected to help only 5% of homeowners who owe more than their houses are worth.
- Most policy response through US Fed: credit guarantees, ‘softened’ collateral requirements, etc., for financial sector.

High, but declining, energy prices

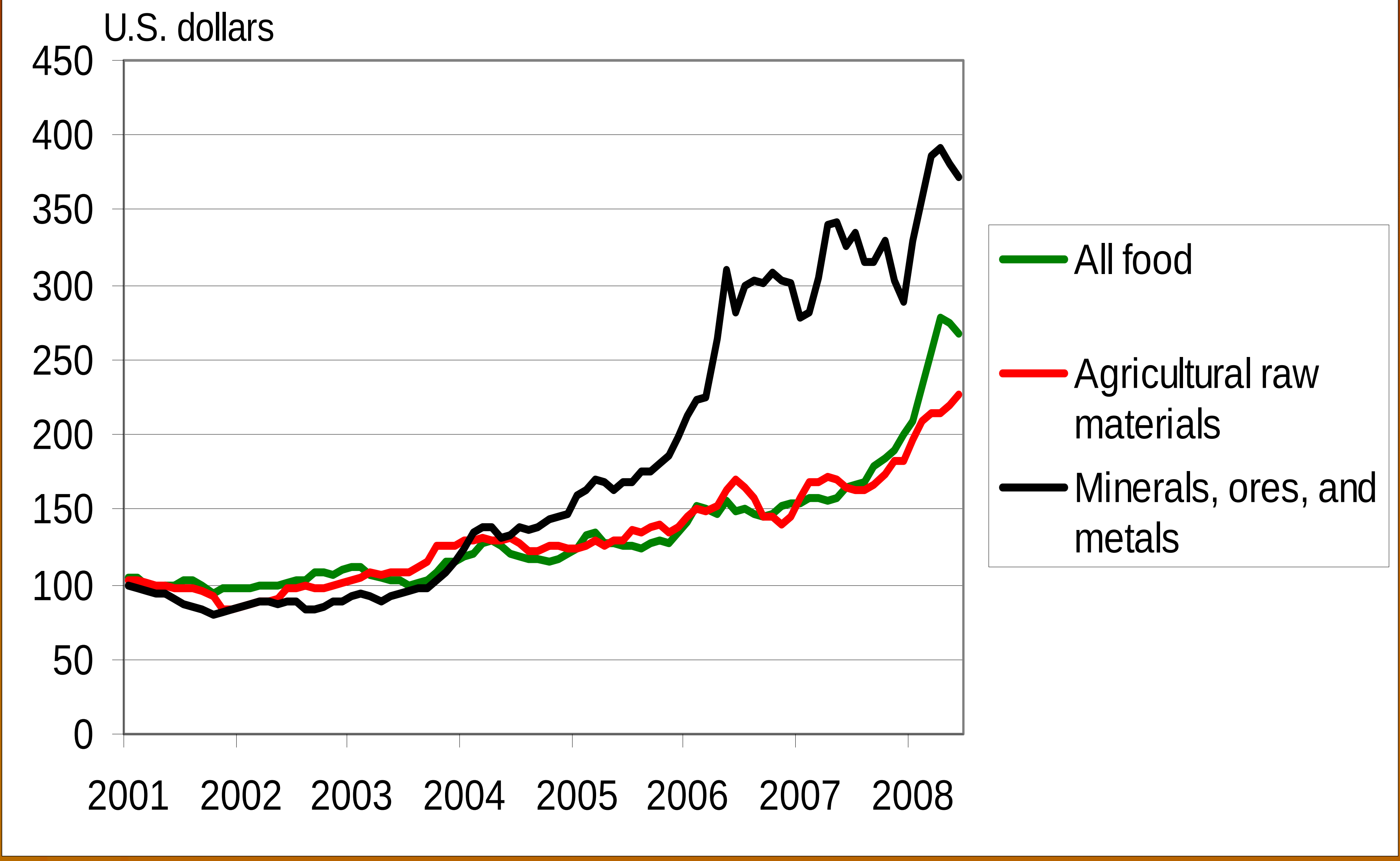
- Oil prices peaked in July above $145, but have since declined
- Weekly average US$ oil price per barrel, weighted by export volumes from major exporters, roughly $110.

Source: US Government EIA (Energy Information Administration)

High commodity prices

- present rare opportunity for many developing countries to generate substantial financial resources for productive investments
- require management of "Dutch Disease" and national development strategy, with diversification away from natural resource extraction – requiring pro-active government

Non-oil commodity prices



Limitations of recent growth in developing countries

- Growth recoveries not very inclusive
- Expansions characterized by weak employment growth
  -- “Jobless growth”
- Even during expansion, inequality usually increased

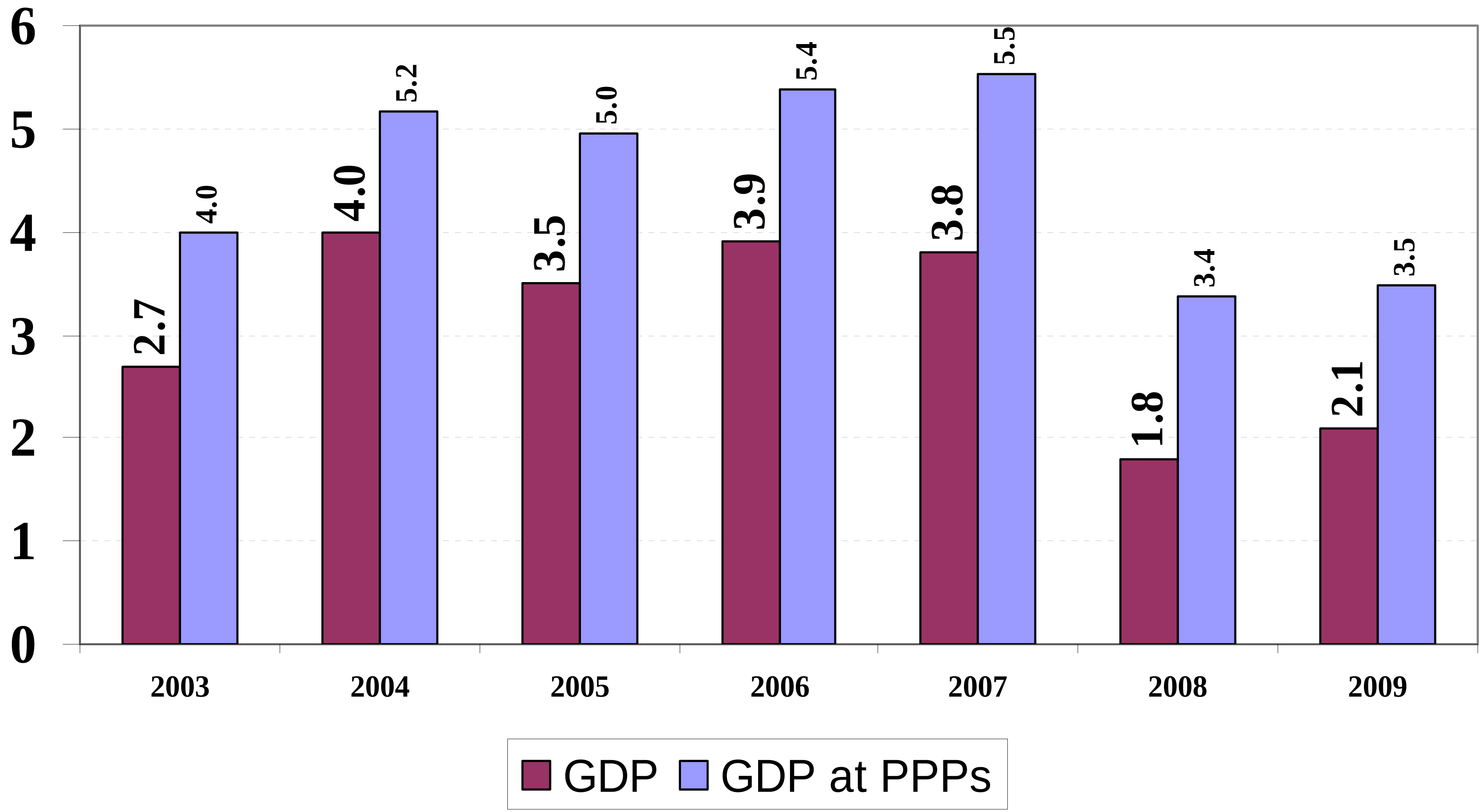
High food prices

- Recent food price spikes,
- food prices still high, but
- no significant increases after February

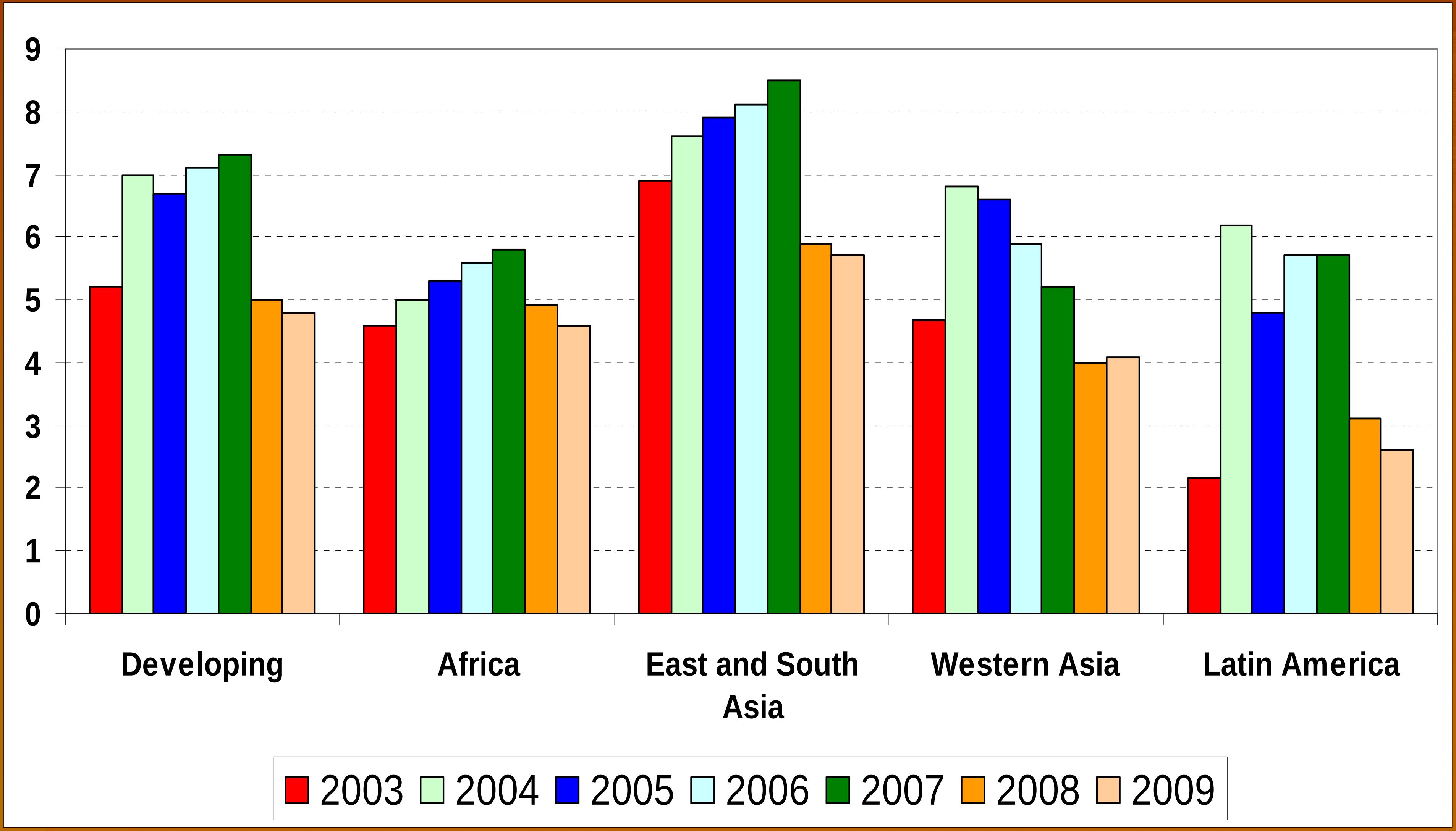
Implications for global economy

- ***Global economy at brink of recession?***
- Slowing GDP growth in OECD countries and, increasingly, the developing world, will limit the potential for US exports to sustain US growth.
- Export-led growth in developing countries slowing. EU cannot and will not take on external deficits as US did.

World growth slowing



For all developing regions, slowdown forecast



Poverty

New August 2008 World Bank estimates:

- Global poverty 50% higher than previously estimated (1.4bn in 2005 at $1.25/day),
- Poverty down from 42% (1990) to 26% (2005) declining about 1% p.a.

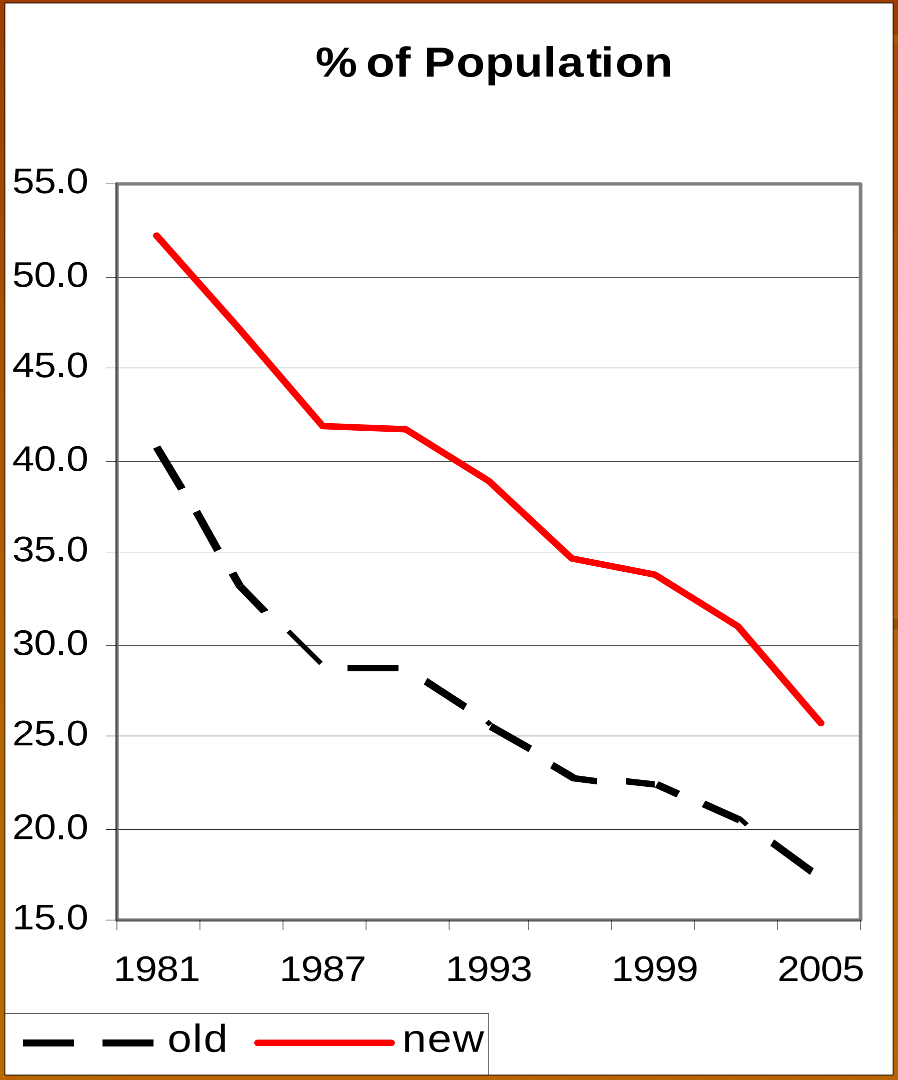
  but mainly China, little progress in SSA
- Main criticisms remain unaddressed

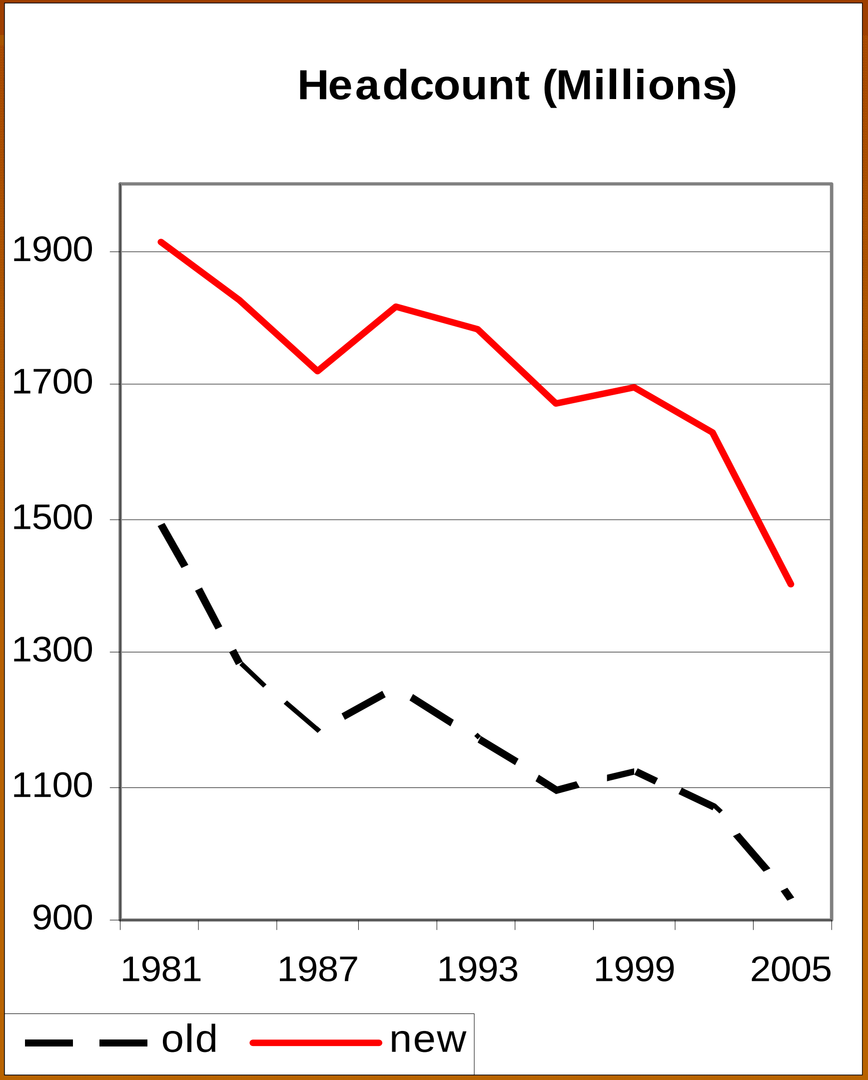
  - money-metric approach

  - inter-temporal PPPs?!

  - ad hoc, changing poverty line

New and old poverty estimates for developing countries, 1981-2005





Implications for international community

- Despite growing interdependency, international cooperation has weakened
- Bretton Woods institutions, OECD, G7 and G20 failing to provide leadership
- Declining aid since 2005 likely to worsen with slowdown, exacerbating poverty and effects of rising food and fuel prices
- Rethinking development strategies

Implications for developing countries

- Successful “decoupling” more unlikely
- MDGs more difficult to achieve

  (will discuss revised WB poverty estimates later)
- Need to embed investment, employment and economic security policies in broader national development strategies

Thank you

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