

Global economic recovery remains patchy and fragile

Global economy underpinned by robust emerging and developing economies

In its latest World Economic Outlook, the International Monetary Fund (IMF) noted that the global economic recovery will be unbalanced, sluggish in developed economies but much stronger in emerging and developing economies. The IMF forecasts the **global economy to grow by 4.8% in 2010 before falling to 4.2% in 2011**.

Economic growth in developed economies is projected at 2.7% in 2010 and 2.2% in 2011, with economic slack remaining substantial and unemployment persistently high for some time. Improvements in business investment in the developed economies most affected by the global financial crisis have not led to substantially lower unemployment. Financial sector weaknesses remain largely unresolved, curtailing credit provision.

Unemployment in advanced economies has only slightly moderated. In the United States, the unemployed face long periods of joblessness. In the Euro area, the labour market shows continued resilience in Germany, but unemployment in Spain is not showing any signs of abating from very high levels, owing to labour market rigidities and the collapse of construction. High unemployment, stagnant incomes, low consumer confidence and reduced household wealth are likely to continue restraining household consumption in developed economies.

In contrast, the **emerging and developing economies are expected to achieve robust growth** of 7.1% and 6.4% in 2010 and 2011, respectively. Emerging economies expanded by about 8% during the first half of 2010, significantly stronger than the 3.5% achieved by developed economies.

Emerging Asian economies have recorded strong economic growth, as robust domestic demand spread from China, India, and Indonesia to other Asian economies. In China, major fiscal stimulus, a large expansion of credit, and measures to boost household incomes and consumption have increased domestic demand growth to nearly 13% in 2009. Fixed investment in Asian and Latin American emerging economies has rebounded very strongly since the onset of the global downturn, just as inventory restocking has slowed and policy stimulus has waned. This suggests that private domestic demand has recovered, and filled the void left by the withdrawal of fiscal stimulus. Unemployment in emerging economies has broadly declined alongside the strengthening economic recovery.

US economic recovery continues at slower pace

The US economy is recovering, thanks to policy stimulus. However, the pace of recovery has moderated. The US economy grew at an annualised rate of 1.7% in the June quarter of 2010, almost half the 3.7% growth rate posted in the March quarter, primarily reflecting sluggish private consumption. Private consumption in the US has remained weak due to deteriorations in household net worth, high unemployment and tight credit conditions.

The IMF expects the US economic recovery to continue, but at a slower rate. Reflecting this, the IMF has revised the US growth projections for 2010 and 2011 to 2.6% and 2.3%, from 3.3% and 2.9% previously forecast in July 2010. The unemployment rate is likely to hover close to 10% in both years.

The IMF warned that **significant downside risks remain**. Residential and commercial real estate markets are still fragile. Further loan write-downs at small and medium-size banks could inhibit recovery of normal credit conditions. The sharp rise in US government debt has increased vulnerability to financial market sentiment. Also, easing consumer price inflation, together with weak labour markets and relatively low consumption demand, could lead to deflation.

Euro area economy to recover gradually

The sovereign debt crisis in Europe occurred before the economy recovery in Europe could gain traction. However, decisive and far-reaching policy responses in Europe have helped to ease the panic in financial markets and moderated the adverse impact on European economies.

Going forward, the **economic recovery in Europe is likely to be gradual**. The IMF now projects the Euro area economy to expand 1.7% and 1.5% in 2010 and 2011, respectively, up from earlier forecasts of 0.7% and 0.2% made in July. Despite robust manufacturing exports in recent months, moderate recovery is expected in Germany because weak growth is expected among its trading partners. In France, growth is projected to be modest, as private consumption is weakened by high unemployment and the withdrawal of stimulus measures. In Italy, the recovery is expected to be even more subdued, as a persistent competitiveness problem limits the scope for export growth, and planned fiscal consolidation weakens private demand. Constrained by fiscal and competitiveness imbalances, growth in Greece, Ireland, Portugal, and Spain is projected to be much lower.

Downside risks to Europe's economic outlook emanate from **continued weakness in Europe's banking systems**. European banking systems are still heavily reliant on government support and are highly vulnerable to deterioration in the real economy, and funding strains. Hence, if unaddressed, renewed financial sector stress could spread via trade and cross-border bank flows, and could have significant adverse effects on real economic activity across Europe.

Asia leads the global economic recovery

Asian economies are expected to underpin the global economic recovery. The IMF forecast developing Asian economies (including China, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam) to grow 9.4% and 8.4% in 2010 and 2011, respectively. Meanwhile, the newly industrialised economies in Asia (including Singapore, Hong Kong, South Korea and Taiwan) are expected to expand 7.8% and 4.5%.

In China, real gross domestic product (GDP) grew at an annual rate of 10.3% in the June quarter, compared with 11.9% in the March quarter. Continued growth in retail sales and industrial production confirms that **the recovery in private demand in China has sustained beyond the support from policy stimulus**.

Overall, **economic growth in China is projected to average 10.5% in 2010 and 9.6% in 2011, driven by domestic demand**. The slight moderation in recent economic activity is expected to continue through 2011 in light of tighter restrictions on credit growth, measures to cool the property market, and the planned unwinding of fiscal stimulus in 2011. On average, the IMF expects that, over 2010 and 2011, private domestic demand is poised to contribute two-thirds of near-term growth and government spending about one-third.

The **Indian economy has been performing well, with industrial production at a two-year high**. Leading indicators, such as the production manufacturing index and measures of business and consumer confidence, continue to improve. Economic growth is projected at 9.7% in 2010 and 8.4 percent in 2011, led increasingly by domestic demand. Robust corporate profits and favourable external financing are expected to encourage investments.

In Japan, an export-led recovery since the June quarter of 2009 strengthened in early 2010, thanks to a stronger-than-anticipated recovery in the Western advanced economies and rising demand for capital goods from China. However, **sporadic appreciation of the yen and the recent cooling of the US economy will continue to slow Japanese exports**. Although investment activity is projected to pick up, sparked by export-oriented businesses, the unwinding of fiscal stimulus and the sluggish labour market are likely to weigh on near-term growth. Real GDP growth in Japan is projected at 2.8% in 2010 and 1.5% in 2011.

Strong economic growth in Asia to benefit the Australian economy

The **shift towards the Asian economies driving world growth is favourable for Australia's growth outlook**. Asia takes about 70% of Australia's exports which are mainly mineral commodities. Higher commodity prices, mainly for iron ore and coal, have driven the terms of trade to near record highs. This has in turn led to significant increases in corporate profitability, improvements in business and consumer sentiments and brightening of employment prospects in Australia. The IMF forecast the Australian economy to grow 3.0% in both 2010 and 2011, with the unemployment rate at 5.2% in 2010 and 5.1% in 2011. IMF's forecasts for Australia are broadly consistent with those from the Federal Treasury and the Reserve Bank of Australia (Tables 1 and 2).

Table 1: Comparison of GDP growth forecasts

	2010	2011
IMF	3.0	3.0
Federal Treasury*	3.0	3.75
Reserve Bank of Australia*	3.75	3.75

* Fiscal years 2010-11 and 2011-12

Table 2: Comparison of unemployment forecasts

	2010	2011
IMF	5.2	5.1
Federal Treasury*	5.0	4.75

* Fiscal years 2010-11 and 2011-12

Key factors affecting medium-term growth prospects

Looking further ahead, the IMF stressed that a sustained global economic recovery rests on the strengthening of private demand in advanced economies, which would then pave the way for allowing more fiscal consolidation without jeopardising economic growth; as well as the further development of domestic demand in emerging economies.