GCC Knowledge Note: Global Economic Trends
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Global GDP growth remains lackluster, at an estimated 2.4 percent in 2015, down from 2.6 percent in 2014. This performance reflects sluggish world trade, particularly merchandise trade, and persistently weak commodity prices. These trends are contributing to subdued inflation in advanced economies and commodity-importing emerging market and developing economies (EMDEs), while consumer prices are elevated or accelerating in many commodity-exporting EMDEs.

Despite the headwinds to growth, financial conditions in EMDEs have improved somewhat since the start of 2016. Asset prices and capital flows have rebounded, while bond spreads have receded. EMDE exchange rates have rallied somewhat against the U.S. dollar after plunging during the past three years. Oil prices have risen from January lows, although they remain low versus historical levels due to both supply and demand factors.

Economic performance in large emerging markets—including multiyear contractions in Brazil and Russia and continued rebalancing in China—could set back any improvement in the pace of global growth in 2016. Oil-exporting EMDEs, where fiscal buffers are declining and in most cases inflation is accelerating, are under particular pressure.

With their high dependence on the oil sector for government and export revenues, the prolonged period of low oil prices continues to have detrimental impacts on GCC economies. Budget rebalancing is underway, but further fiscal consolidation is likely in the medium term given that oil prices are expected to recover only gradually. Slowing growth in GCC countries stands to generate negative spillovers for oil-importing countries in the Middle East and North Africa through trade, investment, and remittances channels.

Global Outlook

Global growth: activity lackluster. With the slowing of growth in emerging market economies, the contribution to global growth from advanced economies ticked upwards in 2014 and 2015 (Figure 1A). However, disappointing growth outcomes during the fourth quarter of 2015 in the United States and Euro Area, as well as contracting activity in Japan, contributed to a deceleration of global growth to 1.5 percent (q/q, annualized), from 2.4 percent the previous quarter. High-frequency indicators point to weak momentum carrying over into 2016, as evidenced by subdued industrial production (Figure 1B) and falling manufacturing purchasing managers’ indexes in emerging and advanced economies in February. The weak indicators in February were followed by tentative signs of stabilization in March, however.

World trade: sluggish. Global merchandise trade was subdued in 2015, as import demand fell in commodity exporters, and weakened in China due to slowing activity and economic rebalancing (Figure 1C). Last year’s merchandise trade growth of 1.7 percent almost matched the post-crisis low reached during the Euro Area crisis in 2012. Services trade appeared more resilient, supported by strengthening consumer spending and rising purchasing power among major oil importing economies. The volume
of world trade fell by 0.4 percent (m/m) in January 2016, and is expected to remain weak in 2016, despite some offsetting effect from services trade growth.

**Global inflation: subdued except in commodity exporters.**
In response to weak global growth prospects, softening inflation expectations, and financial market turmoil, central banks in advanced economies have maintained low policy interest rates (United States, United Kingdom, Japan) or shifted towards further accommodation (Euro Area) at their March rate setting meetings as they seek to avoid inflation expectations becoming entrenched at excessively low levels (Figure 1D). Among commodity-importing emerging and developing economies (EMDEs), as well, inflation is contained, and is below target levels most countries (most notably, Vietnam, Romania, Poland, Thailand). For many commodity exporters with floating exchange rate regimes, however, inflation is elevated or accelerating (Ukraine, Ghana, Kazakhstan, Brazil, Russia).

**FIGURE 1:** Global growth, trade, and inflation

**A. Global GDP growth and contribution**

**B. Industrial production**

**C. World merchandise trade growth**

**D. Inflation expectations**


A: EMDE commodity exporters are countries in the World Bank’s classification of emerging and developing economies (EMDE) where, on average in 2012-14, either (i) total commodities exports accounted for 30 percent or more of total exports or (ii) exports of any single commodity accounted for 20 percent or more of total exports. Countries for which these thresholds are met as a result of re-exports are excluded. EMDE non-commodity exporters are the rest of the EMDE group.

B: The last observations are December 2015. Data are seasonally adjusted.

D: Inflation expectations are defined as the 5-year ahead 5-year rate of inflation compensation derived from the inflation swaps market in the given countries. The last observations are March 2016.
Emerging market assets: rally through March. Emerging markets (EM) assets continued to rally through mid-March, reversing the losses of the first few weeks of 2016. The EM bonds and FX indexes jumped to four-month highs in March, and EM stocks have turned positive for the year after falling as much as 11 percent in just the first three weeks of 2016 (Figure 2A). However, the recent rally in EM assets contrasts with the current subdued outlook for EM economies. Against the backdrop of persistent concerns about EM growth, further volatility is to be expected.

Capital flows: rebound. The rally in equity prices has been accompanied by a rebound in capital inflows to emerging markets, which in March registered the first net inflows to EM bond and equity funds since December (Figure 2B). However, a sustained recovery of inflows is likely to require long-term improvements in economic fundamentals. After posting the slowest first two months in over five years, bond issuance activity also picked up in March, as the persistently low yield environment in advanced economies and stabilization in commodity prices have pushed borrowing costs significantly lower (Figure 2C). However, the market environment is likely to remain volatile as rating momentum in emerging markets continues to trend downward.

Exchange rates: strengthening. Emerging market currencies have rallied recently as stabilizing commodity prices and a more dovish tone from the U.S. Federal Reserve boosted investor appetite for riskier assets. A gauge of 20 developing-country currencies against the dollar rose to a four-month high in mid-March, led by the Brazilian real and the Colombian peso. The index is up more than 3 percent this year after plunging by more than 30 percent during the past three years. Several commodity exporters (Azerbaijan, Kazakhstan, Russia) have devalued their currencies and/or moved to manage floating regimes and some non-commodity exporters have also followed the same path (Egypt, Turkey). After initial bouts of volatility and weakening, exchange rates in these countries appear to be stabilizing.

Commodity prices: seeking a floor amid abundant supplies. The weakness of commodity prices, especially energy, persisted into early 2016 (Figure 2D). Oil prices rose from under $30/bbl in January to $37/bbl during the first half of March on improved sentiment fed by an uptick in China’s demand indicators, a weaker U.S. dollar, and supply outages in a number of countries (Iraq, Nigeria, United Arab Emirates). More importantly, December 2015 marked the first reported year-on-year decline in U.S. oil production in more than four years (Figure 2E). Despite discussion among producers to freeze output at January levels, the price rally stalled as the market remains oversupplied with large stocks, particularly in the United States. Crude oil stocks in the OECD as a whole reached a record high of 1.2 billion barrels in early 2016 (Figure 2F). Metal prices have also risen from January lows on expectations of firming demand and production cuts. Markets remain oversupplied with large stocks, however, and capacity continues to rise, especially for iron ore and copper. Agricultural prices continued their downward trend in early 2016, mainly due to ample supplies that reflect surpluses accumulated during the past two seasons, along with a balanced market in 2015–16. In addition to well-supplied markets, the weakness in agricultural prices has been aided by lower energy prices (agriculture is an energy intensive sector) and the plateauing of demand for biofuels. Fears that El Niño could disrupt food supplies did not materialize, apart from some local supply disruptions, especially in Latin America and East Asia.

Advanced Economies

United States: mixed signals. Strong job gains continue to accompany lackluster real GDP growth. Payroll employment increased 215,000 in March, following an upwardly revised 245,000 gain in February. Net hiring during the first quarter averaged 209,000 per month, close to the robust job growth of 229,000 per month during 2015. As more people returned to the labor market, the labor force participation rate rose to 63 percent, the highest since March 2014, while the unemployment rate rose marginally, to 5 percent, from 4.9 percent in February. High-frequency data point to moderate GDP growth in the first quarter, currently tracking at around 2 percent. Consumer spending started the year on a relatively subdued note, but a stabilization in industrial production in January-February and a pick-up in the PMI...
FIGURE 2: Capital flows, oil prices, and other emerging market indicators

A. Emerging markets financial assets

Index (Jan. 2 2015 =100)

- EM equities
- EM bonds
- EM FX

Jan-15 Apr-15 Jul-15 Oct-15 Jan-16

B. Flows into EM bond and equity markets

$ billion

- EM equities
- EM bonds

Jan-15 May-15 Sep-15 Jan-16

C. Emerging market bond spreads

EM sovereign bond yields, percent

Jan-14 Jul-14 Jan-15 Jul-15 Jan-16

D. Commodity prices

US$ nominal, 2010=100

- Agriculture
- Energy
- Metals

Jan-11 Jul-11 Jan-12 Jul-12 Jan-13 Jul-13 Jan-14 Jul-14 Jan-15 Jul-15 Jan-16

E. U.S. oil production

Year-over-year change, kb/d

Jan-10 Jan-11 Jan-12 Jan-13 Jan-14 Jan-15 Jan-16

F. OECD crude oil stocks

Million barrels

- OECD crude oil stocks
- 5 year average


A: The last observations are March 2016.
B: The last observations are the week ending March 16, 2016. Weekly net inflows into EM equity and bond funds.
C: The last observation is March 2016.
D: Grain includes maize, wheat and rice. The latest observations are February, 2016.
E: Shaded area (last 11 observations) are a forecast.
F: The last observations are January 2016.
in March suggest that conditions could be gradually bottoming out in manufacturing. Conditions remain in place for a continued recovery, supported by resilient consumer spending amid improving labor market conditions. Core inflation (excluding energy and food prices) has gradually increased recently.

**Euro Area: weak trade offsetting solid domestic demand.**

Growth for the fourth quarter of 2015 of 1.3 percent (q/q saar) was consistent with average growth for the full year of 1.6 percent. Domestic demand for the fourth quarter was solid, with consumer spending up 0.9 percent (q/q saar), government consumption up 2.2 percent (boosted by refugee-related spending), and capital spending up 5.4 percent (helped by mild weather). This was partly offset by sluggish export growth (0.9 percent during the second half of 2015) and robust import growth (4.3 percent). High-frequency data for the first quarter of 2016 suggest modestly strengthening activity in manufacturing and services (industrial production growth rebounded to 2.8 percent y/y, retail sales growth to 2 percent y/y in January, and services PMI increased to 54 in March). Rising uncertainties in recent months (including the terrorist attacks in Brussels, the influx of asylum seekers and the uncertainty surrounding a referendum on the United Kingdom’s membership in the European Union) could weigh on confidence in the months ahead.

**Japan: more weakness.** After contracting by 1.1 percent in the final quarter of 2015, the economy showed further signs of weakness in early 2016. Surveys generally remain downbeat, with the manufacturing PMI dropping to a nine-month low in March, and the service sector PMI falling to an eight-month low. Real consumption, domestic machinery orders and real exports, however, showed some signs of stabilization at the start of 2016. Despite weak and volatile growth, labor market conditions continue to tighten against the backdrop of a shrinking and aging population. The unemployment rate declined further to 3.3 percent in February, the active job openings-to-applicants ratio has risen steadily, and the perception of labor shortages has heightened to levels last seen in 1992. Headline inflation continues to hover around zero, and there are concerns that annual wage negotiations may result in limited gains in base pay amidst persistently low inflation expectations.

**Emerging and Developing Economies**

**Growth: softening.** Growth in emerging and developing economies (EMDEs) slowed in 2015 to 3.4 percent, the weakest showing since 2009, and a pace well below the pre-crisis average. Both Brazil and the Russia are experiencing deep contractions, above-target inflation, and deteriorating public finances. The contraction in Russia is having substantial spillovers for other countries in the region, especially in Central Asia and the Caucasus, through trade, remittances, and capital flow channels. Falling activity in Brazil is expected to weigh on growth in other South American economies, including Argentina, Paraguay, Ecuador, and Peru. Growth in South Africa continues to be bottlenecked by infrastructural challenges. India’s economic growth remains robust, although the outlook for 2016 is slightly less optimistic than expected in January. An expected second year of contraction in Brazil and Russia in 2016 will help delay a meaningful recovery in growth in EMDEs until 2017.

**China: continued rebalancing.** Indicators in the first two months of 2016 point to further slowing and rebalancing in China, calibrated by policy stimulus. Industrial production growth was 5.4 percent (y/y) in both January and February, decelerating from 5.9 percent in December, and manufacturing PMI has been below the expansionary level of 50 for the past year, at 49.7 in March. Retail sales and fixed investment continue to grow robustly, expanding at double digit rates in the first two months of 2016 (even as domestic credit eased from January highs). While consumer price inflation accelerated to 2.3 percent (y/y) in February, producer prices declined further, but at a slower pace (Figure 3B). Efforts to move towards greater exchange rate flexibility and capital account liberalization continue to pose complex policy challenges. Foreign exchange reserves fell by $28.6 billion to $3.2 trillion in February 2016, considerably less than the declines of around $100 billion in January and December, suggesting that capital outflows have moderated.

**Oil exporters: under pressure.** Many oil-exporting countries entered the oil price plunge with significant reserves and fiscal surpluses. The duration and magnitude of the price slump means these buffers are eroding rapidly, however. Key challenges include weakening current accounts (Azerbaijan, Colombia, Kazakhstan, Russia) and depreciated exchange
rates (Angola, Azerbaijan, Colombia, Kazakhstan, Nigeria, Russia), which in some cases have been met with the imposition of foreign exchange controls (Azerbaijan, Nigeria). Other challenges include accelerating inflation, tighter monetary policy (Colombia, Kazakhstan, Russia), falling government revenues, and tighter fiscal policy (Angola, Colombia, and to some extent Mexico). Weakened fiscal positions may be challenged further by oil price assumptions in 2016 budgets that exceed the $37 average projected oil price in the World Bank’s January 2016 Commodity Markets Outlook.

Oil importers: narrowing vulnerabilities, lagged benefits to growth. In oil importers, pressures on external balances, inflation, and government budgets are easing. The lower price of energy imports has helped narrow persistent trade deficits (Egypt, India, Turkey) and reduce stress on exchange rates. The pass through from lower oil prices has slowed inflation, and in many countries provided the scope for monetary easing in support of faster growth, including in high income countries. Fiscal balances have improved among several oil importers (Bangladesh, Egypt, India, Pakistan, Turkey), as budgetary outlays on subsidies fall. In this context, several countries, both oil exporters and importers have sought to eliminate or reduce fuel subsidies.

BRICS spillovers. Since 2010, a synchronous growth slowdown has been underway in emerging and developing economies, including in all of the largest ones (the BRICS—Brazil, Russia, India, China, South Africa) with the exception of India. Given their size and integration with the global economy, a slowdown in the BRICS could have significant global spillovers through trade and finance. Specifically, the World Bank’s January 2016 Global Economic Prospects finds that a 1 percentage point decline in BRICS growth is associated with lower growth in other emerging markets by 0.8 percentage point, in frontier markets by 1.5 percentage points, and in the global economy by 0.4 percentage point over the following two years.

 GCC Economies

Reflecting high dependence of the oil sector for export and fiscal revenues, the sustained drop in oil prices underway since mid-2014 has had profound impacts on Gulf Cooperation Council (GCC) economies (Figure 4A). GDP growth in 2015 is estimated to have slowed, and in Kuwait’s case contracted, across the region (Figure 4B). With fiscal breakeven oil prices well above current market prices (particularly in Bahrain, Oman, and Saudi Arabia),
FIGURE 4: Macroeconomic conditions in GCC economies

A. Oil dependence, 2014

B. GDP growth

C. Government finances

D. 5-year sovereign CDS spreads

E. Foreign exchange reserves

F. Gap between spot exchange rate and 12-month forward rate

A: For 2015, growth rate is actual Saudi Arabia and estimates for other countries.
B: e= expected.
C: For Saudi Arabia, bars for revenue and expenditure show half of actual amounts.
D: UAE reflects the simple average of spreads for Abu Dhabi and Dubai. For all countries, the last observation is March 30, 2016.
E: Latest month is February 2016 for Kuwait, Qatar, and UAE; January 2016 for Saudi Arabia; and December 2015 for Oman. Percentages reflect difference between current level and average in the first half of 2015.
government finances in GCC countries have deteriorated rapidly. Fiscal deficits widened to double-digit levels in most countries in 2015, reflecting sharp revenue losses, although they are expected to recede modestly in 2016 with procyclical budgets planned. Rebalancing in 2016 will come predominantly through planned or already-implemented reductions in spending on infrastructure projects, fuel and utility subsidies, and government wage obligations (Figure 4C). A GCC-wide agreement to implement a value-added tax of an expected 5 percent at the start of 2018 was announced in March. Further consolidation is expected in the medium term given that oil prices are expected to recover only gradually.

Increasing pressure on government finances was reflected in sovereign rating downgrades in early 2016 for Bahrain, Oman, and Saudi Arabia and a spike in sovereign credit default swap (CDS) spreads. Although spreads have since receded, they remain high versus levels of the past 12 months in Saudi Arabia and Bahrain (Figure 4D). Large buffers in the form of foreign exchange reserves and sovereign wealth funds in most countries continue to provide a considerable amount of cushion for public finances, however.

Together, the plunge in oil prices and an appreciating U.S. dollar have raised concerns about the sustainability of long-standing currency pegs. Declining foreign exchange reserves in Saudi Arabia, Oman, and Qatar reflect that these resources have been used to help defend pegs (Figure 4E). The risk of strong upward inflationary pressure following large currency devaluation (consumer goods are largely imported in GCC countries) will factor heavily into central banks’ decisions about exchange rate regime. Markets have in recent months increasingly expected policymakers to defend their pegs for the time being, as reflected in a declining gap between spot and forward exchange rates, following a spike at in early 2016 (Figure 4F). Maintaining fixed exchange rates implies that interest rates will likely be adjusted with shifts in U.S. monetary policy, as suggested by the rate increases in Bahrain, Kuwait, and the United Arab Emirates that followed the December hike by the U.S. Federal Reserve.

With fiscal austerity underway and the oil price outlook lower for 2016 than for 2015, growth will likely slow in GCC countries this year. Although still above the threshold of 50, composite (manufacturing and services) PMI in Saudi Arabia and the United Arab Emirates has been broadly declining for the past 18 months, reaching an all-time low in Saudi Arabia (since surveys began in August 2009) of 53.9 in January. Slowing growth in GCC countries stands to generate negative spillovers for oil-importing countries in the Middle East and North Africa through trade, investment, and remittances channels. Indeed, growth in oil-importing countries in the region is expected to weaken in 2016, although there are also domestic challenges at work in these countries.

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1 Kuwait pegs to an undisclosed basket of currencies, while all other GCC countries maintain conventional pegs against the U.S. dollar.
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