World Bank Cuts Forecast for Global Economy, Developing Nations

By Timothy R. Homan

June 22 (Bloomberg) -- The World Bank said the global recession this year will be deeper than it predicted in March and warned that a flight of capital from developing nations will swell the ranks of the poor and the unemployed.

The world economy is forecast to contract 2.9 percent this year, compared with a prior estimate of a 1.7 percent decline, the Washington-based lender said in a report released today. Global growth will return next year with a 2 percent expansion, the bank said, cutting its forecast from a 2.3 percent prediction about three months ago.

The bank, formed after World War II to fund health and development projects in poor countries, said that while a global recovery may begin later this year, impoverished economies will lag rich nations in seeing any benefits. The lender called for “bold” policy actions to hasten a rebound and said prospects for rounding up aid for the poorest countries was “bleak.”

“While the global economy is projected to begin expanding once again in the second half of 2009, the recovery is expected to be much more subdued than might normally be the case,” the report said. “Unemployment is on the rise, and poverty is set to increase in developing economies, bringing with it a substantial deterioration in conditions for the world’s poor.”

The World Bank’s report raised concern about the shrinking amount of capital flowing into developing countries. After a peak of $1.2 trillion in 2007, capital flows this year are expected to fall to $363 billion, the report said.

“Investors’ flight from perceived danger contributed to the sharp drop in capital flows to the developing countries, a trend that is very likely to persist through the end of 2009,” the report said.

‘Grave’ Prospects

With less capital coming in, growth in the developing world will be 1.2 percent this year, the World Bank said, scaling its outlook back from a 2.1 percent prediction in March.

“Low-income countries face increasingly grave economic prospects if the dramatic deterioration in their capital inflows from exports, remittances, and foreign direct investment is not reversed in 2010,” the report said.

As a result, “developing countries will most likely face a dismal external financing climate in 2009,” the report said, adding that net private flows will “barely” be positive.

The bank downgraded its forecast for the U.S. this year, calling for a 3 percent drop in the world’s biggest economy, after predicting a 2.4 percent contraction in March.

Japan’s gross domestic product will shrink 6.8 percent this year, more than the bank’s prediction in March for a 5.3 percent decline, while the euro area will shrink 4.5 percent, almost twice as much as the previous 2.7 percent contraction forecast.

IMF Forecast

The bank’s global outlook is more pessimistic than the forecast by its sister organization, the International Monetary Fund. The fund’s forecast for this year calls for a global contraction of 1.3 percent, with growth returning to 2.4 percent in 2010.

Developing nations in eastern Europe and Central Asia will be some of the hardest hit, according to the World Bank’s revised forecasts. The region is likely to shrink 4.7 percent this year, down from the 2 percent decline projected in March.

The economies of low-income countries in Latin America and the Caribbean are likely to decline by 2.2 percent this year, while growth is expected to slow in East Asia and the Pacific, the Middle East and North Africa, South Asia and Sub-Saharan Africa, the bank said.

A shortage of aid from advanced economies will likely weigh on the finances of developing nations, the bank said.

Aid Outlook

"The amount of development assistance to low-income countries will not fully cover their external financing needs in 2009, while the outlook for donor countries to increase aid is significantly bleak, given the intense fiscal pressures they face because of the crisis," the report said.

The bank said it will take time for wealthier nations to fix financial systems shaken by a credit crisis that's led to almost $1.5 trillion in writedowns and losses, and wiped out about $26 trillion in stock-market value worldwide since 2007.

Justin Lin, the bank's chief economist, said in a statement that this hurdle, "combined with emerging limits to expansionary policies in high-income countries," will restrain a global rebound.

Still, the MSCI index of 22 developing nations is up 31 percent this year, after plunging 55 percent last year. The surge is more than seven times the 4.2 percent gain in the MSCI World Index of 23 developed countries. Leading world equity market gains is Peru's Lima General Index, which has jumped 86 percent this year, and Sri Lanka's Colombo All Share Index, which is up 65 percent.

'Unused Capacity'

"In terms of financial markets, I think people have broken the fall," Zoellick said in a Bloomberg Television interview on May 29. "But if you look at what the economists call the real economy and the manufacturing sector, I think that you still see a lot of unused capacity."

Efforts to revive domestic economies through stimulus spending should be coordinated internationally, the bank said in its report, adding that acting independently may have drawbacks.

"Any country that acts alone -- even the United States -- may reasonably fear that increases in government debt will cause investors to lose confidence in its fiscal sustainability and so withdraw financing," the report said.

The U.S. is implementing a two-year, $787 billion stimulus package, while China is spending $585 billion.

"To break the cycle and revive lending and growth, bold policy measures, along with substantial international coordination, are needed," the report said.

Global Trade

The report also said global trade is likely to drop by 9.7 percent this year. In March the bank forecast a decline of 6.1 percent.

Some companies around the world, meanwhile, are starting to reap the benefits of government aid efforts.

Dongfeng Motor Group Co., China's third-largest automaker, said it sold more vehicles in the first four months of the year as stimulus measures helped lure drivers into showrooms.

Shares of Brazil's two biggest airlines, Tam SA and Gol Linhas Aereas Inteligentes SA, both have jumped in recent weeks on signs of improving demand.

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