Chapter IV

Regional developments and outlook

Developed economies

Developed economies are expected to see a slight increase in economic growth from 1.5 per cent in 2016 to 1.7 per cent in 2017 and 1.8 per cent in 2018, driven by relatively strong private consumption. Improvement in employment and subdued inflation continue to support households' purchasing power. At the same time, accommodative monetary policy stances will support economic activity, especially in Europe and Japan, although the limitations of unconventional monetary policy measures increasingly illustrate the need for a broader policy approach to create a more dynamic growth trajectory.

This is especially relevant in view of the continued drag on growth stemming from a number of factors. Investment remains weak, as commodity-related sectors continue to face pressure from generally low prices; in addition, businesses are confronted with major uncertainties related to the future direction of policy in the United States of America, the looming exit of the United Kingdom of Great Britain and Northern Ireland from the European Union (EU) and various geopolitical crises. Relatively high unemployment, including among youth, in numerous developed countries not only hampers economic growth, but also represents a major policy challenge as it threatens to increase structural unemployment, which in turn makes integration into the labour market increasingly difficult and costly.

In the monetary policy area, the United States Federal Reserve (Fed) is expected to continue to gradually raise interest rates, resulting in a widening divergence in interest rates relative to Europe and Japan. Inflation in the developed economies will pick up to 1.6 per cent in 2017 and 2.0 per cent in 2018, although some of this increase is less an indication of solid demand than the consequence of a base effect caused by the previous sharp fall in commodity prices.

North America: inventory destocking restricted growth in the United States in 2016

The United States economy is estimated to have expanded at a modest pace of 1.5 per

considerable uncertainty regarding the future direction of policy in the United States — including monetary, fiscal, trade, immigration, environmental and foreign policy prospects. This uncertainty is expected to have restrained investment in the short run. The potentially far-reaching spillover effects on both domestic and global economic prospects have increased the margin of uncertainty around the baseline forecasts for the United States and many other economies.

Canada, which exports roughly three-quarters of its goods and services to the United States, is highly sensitive to economic conditions across the border. The outcome of elections in the United States has heightened uncertainty in Canada, especially for exporting firms that would be impacted if the United States were to introduce any changes to existing trade agreements. This heightened uncertainty is expected to delay a recovery in investment in Canada. Real non-residential investment in Canada dropped by 10 per cent in 2015 and by a similar magnitude in the first half of 2016 (figure IV.2), largely driven by cutbacks in extraction and oil-related sectors.

The persistent weakness of investment in both the United States and Canada is symptomatic of the broader global trend that continues to hamper productivity growth. Labour productivity in the United States, measured as output per hour in the non-farm business sector, rose by less than 1 per cent in 2015 and declined at an annual rate of 0.6 per cent in the first half of 2016. Given the protracted period of weak investment in the United States and other large developed economies, as discussed in chapter I, a substae(k11.1(t)1.26

Canada out as one of the few developed economies to introduce a more expansive fiscal stance. While the shift in policy will allow the general government deficit to deteriorate towards 3 per cent of GDP in 2016-2017, it will offer support to the flagging economy.

Coupled with the modest revival in commodity prices and some competitiveness gains from the exchange rate depreciation, GDP growth in Canada is forecast to accelerate from 1.2 per cent in 2016 to 2.4 per cent in 2017, although heightened uncertainty will prevent a more pronounced rebound.

The direction of fiscal policy in the United States remains unclear. The new Admini stration may propose an expansion of infrastructure investment and significant tax cuts, especially for corporations. A rise in infrastructure spending could raise growth prospects for 2018, but may also entail a large increase in the federal deficit. Other potential policy

Nationwide consumer price inflation in Japan is estimated to have averaged -0.1 per cent in 2016 and is projected at 0.6 per cent in 2017, and will remain below the central bank's target of 2 per cent in 2018. The significant drag on the overall price level arising from low oil prices — with energy prices reducing the overall consumer price by 1 per centage point in June 2016 — will dissipate towards the end of the year. Nevertheless, the strong yen and weak wage growth will continue to exert downward pressure on inflation.

In reaction to the stalled progress towards achieving the target of 2 per cent inflation, the Bank of Japan (BoJ) announced a new set of unconventional monetary policy measures 4(0)49.1(1)6n <<ve1 By pstint inflation anreveeine growtp. ThBop'el monetary policstratJgs

business advantage, but the Brexit has upended the institutional framework for business decisions.

While the United Kingdom has not yet given formal notice of leaving the EU, any

The economic outlook is subject to downside risks, especially in the case of the CIS. Since commodity prices are expected to remain fairly low, the region's economies will need to find new drivers of growth. Geopolitical tensions in the region, along with a number of structural constraints, continue to limit countries' ability to reduce dependence on primary commodities and low-tech exports. South-Eastern Europe, in turn, remains heavily dependent on the EU and vulnerable to a possible intensification of the refugee crisis or deterioration in global financing conditions.

The Commonwealth of Independent States: tentative recovery amid persistent uncertainty

Following the severe terms-of-trade shock of 2014/15 and the consequent economic contraction in most of the CIS energy exporters (figure IV.5), the region's economies have entered a period of tentative stabilization. Economic activity in parts of the CIS continued to decline in 2016, but at a much reduced pace. As a result of the more moderate contraction in the Russian Federation and the return to sluggish growth in Ukraine, the aggregate indicators of the region improved. Some Central Asian economies, such as Tajikistan and Uzbekistan, continued to register strong growth. The aggregate GDP of the CIS is estimated to have fallen by 0.3 per cent in 2016, following a decline of 3 per cent in 2015. In 2017, the region is expected to return to growth, but amid continued fragilities the expansion will be muted, projected at 1.4 per cent. Growth is forecast to pick up to 2.0 per cent in 2018. Still depressed commodity prices and persistent geopolitical tensions, along with structural constraints, such as an outdated capital stock, deindustrialization in Ukraine, demographic pressures in the European part of the CIS, inadequate energy generation in Central Asia and the challenging business conditions, will continue to generate an inauspicious growth environment and the region's larger economies are expected to remain on a low-growth trajectory.

Figure IV.5
Oil price and the terms of trade of selected CIS energy exporters, 2010–2017

Source: UN/DESA, based on data from Project LINK. Figures for 2016 are partially estimated and figures for

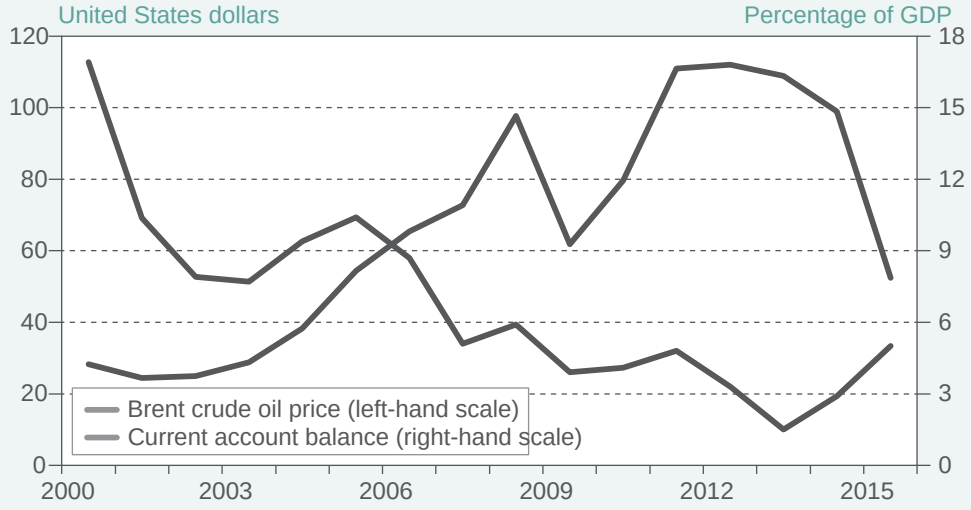
lapse in bilateral trade. A similar agreement with the EU for Georgia (not a CIS member) and the Republic of Moldova came into force in July 2016. This leads to further fragmentation of trade in the CIS area. Armenia, Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation are members of the Eurasian Economic Union (EEU) — a free trade area and a customs union aiming at free movement of production factors (including labour) and policy harmonization.

Inflation subsided throughout the CIS in 2016, as the impact of past currency depreci

On the fiscal policy front, even in those CIS energy producers that entered the down turn with significant fiscal buffers, consolidation measures were required to maintain sta

Box IV.1 (continued)

Figure IV.1.2
Oil price and current account balance of the Russian Federation, 2000–2015



Source International Monetary Fund and Central Bank of the Russian Federation.

typical strong correlation between foreign inflows and outflows of Russian money has now been broken for some time.

The deterioration in the terms of trade since 2014 has taken place together with a widening of the current account surplus. This is partly explained by the weaker rouble and contraction in imports; however, the reduction of the investment income deficit in 2014-2015 accounts for most of the observed increase in the current account surplus. In 2016, a smaller current account surplus was accompanied by much lower net private capital outflows.

The initiatives to “de-offshorise” the Russian economy and the measures to reduce shadow capital transactions have also played an important role in reducing outflows, resulting in lower dependency on external financing. The Central Bank of the Russian Federation provides estimates of fictitious transac

Figure IV.1.3
Net incurrence of liabilities by Russian residents, by investment category, 2008–2015

Source Central Bank of the Russian Federation.

(continued)

Financing of infrastructure remains a significant source of outlays in the former Yugoslav Republic of Macedonia and Montenegro.

With the notable exception of Serbia, the current account deficit widened in almost all countries; in Albania (where low oil prices continued to weigh on the value of exports) and Montenegro, the deficit-to-GDP ratios reached double-digit figures. Growing foreign investment in the region translates into large profit repatriation. At the same time, remittance inflows are on a declining trend as the ties between emigrant workers and their countries of origin continue to weaken. FDI remains the main source of financing for the current account deficits.

The region remains closely linked with the EU, which will continue to influence economic prospects. A possible intensification of the refugee crisis would have negative implications, as it may result in disrupting trade flows. The region still remains highly dependent

tries, including Algeria, Angola and Nigeria, appears unlikely. In contrast, the growth outlook is more favourable for countries in the East African Community, including Ethiopia, Kenya and the United Republic of Tanzania, as well as the Western African economies of Côte d'Ivoire, Ghana and Senegal. Growth in these economies will continue to be driven by robust private consumption and the continued implementation and completion of large infrastructure projects.

Buffeted by strong external and domestic headwinds, growth in Africa experienced a significant slowdown in 2016. For the highly commodity-dependent economies in the region, persistently low commodity prices weighed on economic activity. Modest global growth and fragile investor sentiments worldwide also contributed to weaker external demand for the region. These global headwinds were compounded by an increasingly challenging domestic climate in several African countries, including unfavourable weather conditions, higher political and policy uncertainty and an escalation of security concerns.

Africa as a whole is expected to have expanded by a modest 1.7 per cent in 2016, marking one of the slowest rates of expansion in more than two decades. The economic picture, however, was one of multi-speed growth. While growth in the oil-exporting and

Ethiopia and Uganda is expected to dissipate in 2017. A potential escalation of social unrest in Ethiopia may however weigh on the short-term growth outlook.

Growth in West Africa is expected to rebound modestly to 3.1 per cent in 2017, as the projected increase in oil prices eases severe fiscal and external pressures in Nigeria. In 2016, the subregion's aggregate GDP virtually stagnated, growing only by 0.1 per cent due to a contraction in the Nigerian economy. Nigeria's growth was adversely affected by declining oil revenues, amid low oil prices and disruptions to oil production. Heightened financial market volatility and an escalation of security issues also affected investment flows. In contrast, the growth outlook for Côte d'Ivoire, Ghana and Senegal remains strong, underpinned by ongoing large infrastructure investments and progress on structural policies to improve the domestic business climate. In Guinea and Liberia, growth in 2017 is expected to strengthen further given the diminishing impact of the Ebola outbreak on economic activity.

Growth in North Africa is projected to increase to 3.5 per cent in 2017, contingent on a gradual improvement in the security situation. In 2016, growth in the subregion slowed to 2.6 per cent. Security threats and social unrest weighed on investor sentiments and adversely affected the subregion's vital tourism industry, particularly in Egypt and Tunisia. In Egypt, the sharp decline in tourism revenues contributed to a severe foreign currency shortage. This prompted the Central Bank of Egypt to devalue the Egyptian pound by more than 30 per cent against the United States dollar and announce a free-float of the currency. The Libyan economy also continued to face significant political challenges and unrest, with spillover effects to its neighbouring countries. Given its high dependence on crude oil revenues, Algeria's growth slowed in 2016. Growth in the Algerian economy is expected to remain subdued in 2017 as planned cuts to government spending offset the boost from higher oil prices. Going forward, greater stability in the subregion will support a rebound in exports and a recovery in tourist arrivals.

The growth outlook for Southern Africa is relatively subdued, with economic activity projected to improve modestly to 1.8 per cent in 2017 and 2.6 per cent in 2018. In 2016, growth in the subregion slowed to 1.0 per cent, as severe droughts adversely affected growth in several countries, including Botswana, Lesotho, Malawi, Namibia and South Africa. In South Africa, growth is projected to improve going forward as the agriculture and mining sectors recover while inflationary pressures subside. However, renewed global financial market volatility may dampen investor sentiments in the short term. Domestically, higher political uncertainty may also weigh on investment in South Africa. Meanwhile, an improvement in oil revenues will support a modest recovery in Angola.

For a few countries, the rapid deterioration in public finances has prompted Governments to introduce measures to preserve fiscal sustainability. Large oil exporters, including Algeria and Angola announced significant cuts to budget plans, while Nigeria removed fuel subsidies. In addition, countries such as Nigeria and Zambia sought financial assistance from international organisations to alleviate growing budget shortfalls.

Against a backdrop of high capital flow volatility and declining international reserves, exchange rates of commodity-dependent countries faced downward pressure in 2016. Reflecting the collapse in export income and rising concerns over fiscal sustainability, the domestic currencies of Angola, Mozambique and Zambia depreciated significantly during the year. For South Africa, global financial market volatility, domestic political uncertainty and concerns over the risk of a sovereign rating downgrade contributed to a further weakening of the rand. Faced with severe foreign currency shortages, Nigeria removed its currency peg to the United States dollar in June. The Nigerian naira subsequently depreciated sharply, losing more than 40 per cent of its value over just a few months.

Across the African region, growth and inflation dynamics varied considerably in 2016

in the conduct of monetary policy in these economies. In contrast, inflation in the net oil importers in the region stabilised or declined in 2016, with inflationary pressures expected to remain subdued going forward. In a few of these countries, such as Botswana, Kenya and Morocco, central banks reduced policy rates during the year, reflecting the availability of policy space.

Several risks and challenges remain to the growth outlook for the African region. On the external front, a reversal of the recent upward trend in global oil prices would result in further growth deterioration in oil-exporting countries. A sharper-than-expected growth moderation in China would weigh on the region's commodity exports (box IV.2). In addition, the uncertainties associated with the coming process of Brexit, with deterioration in the growth outlook for the United Kingdom and Europe, would pose a risk to the trade performance of countries such as Kenya and South Africa, given the importance of Europe as a major export destination.

Domestically, an escalation of security concerns, particularly in the Central, North and West African subregions could deter foreign investment and severely disrupt economic activity. Growing political unrest such as in Burundi, the Democratic Republic of the Congo, Gabon and Zimbabwe could also impact growth. For the highly agriculture-dependent economies such as Ethiopia and Malawi, growth will remain susceptible to weather-related shocks.

Importantly, the growth outlook for Africa is contingent on the ability of countries to mitigate the impact of external risks while containing domestic vulnerabilities. Although debt levels in Africa are still relatively low, the sharp widening of fiscal deficits has con

Box IV.2

The impact of China's economic slowdown on Africa

The Chinese economy has been on a moderating growth path since 2010. Ongoing structural reform measures to rebalance growth have resulted in slower investment, particularly in the industrial sectors with excess capacity. China's economic transition from investment to consumption-led growth will contribute to more robust and more sustainable growth prospects going forward. Nevertheless, the Chinese economy is projected to expand at a pace well below the double-digit growth rates experienced in the past decades. Given China's significant influence on global growth and trade developments, the slowdown in China's economic growth and changing demand composition have important implications for the rest of the world, including Africa.

China's economic rebalancing is affecting the growth outlook for the African economies through three key transmission channels. The first and most important channel is the trade channel. Slowing growth in China has been accompanied by deceleration in its overall import volume growth in recent years (figure IV.2.1).

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In the last decade, the value of China's imports from Africa has risen more than 20–fold, reaching a peak of $116 billion in 2013 (figure IV.2.2). The rapid expansion in trade activity between China and the African economies was largely fuelled by China's trade liberalisation measures as well as its rapid growth in demand for natural resources and primary commodities. Amid the collapse in global commodity prices, the value of China's imports from Africa has contracted since 2013, falling by almost 50 per cent to $69 billion in 2015.

While this to a certain extent reflects the large decline in commodity prices, it is also indicative of weaker Chinese demand, given that China's import volume growth has also slowed. The sharp decline in trade value is also associated with a fall in income for the African economies, with adverse effects on both the public and private sectors.

The impact of China's slowdown will vary from country to country. For several economies, including Angola, Congo, Mauritania, South Africa and Zambia, weaker Chinese demand significantly affects their trade outlook, given that China is the largest export destination for these economies, representing

between 8 and 44 per cent of total exports. In addition, China's shift away from imports of investment-related goods will lower its demand for raw materials and intermediate inputs for the industrial sector. This will have a disproportionately large negative impact on the African economies given that about 90 per cent of Africa's total exports to China are composed of primary commodities, in particular mineral fuel and oils (64 per cent), ores (14 per cent) and copper (6 per cent).

China's slower growth is also exerting downward pressure on global commodity prices, indirectly

East Asia: domestic demand continues to drive positive near-term outlook amid weak export performance

Growth in East Asia is estimated to have moderated slightly to 5.5 per cent in 2016, from 5.7 per cent in 2015 (figure IV.10), with a marginal pick up to 5.6 per cent projected for both 2017 and 2018. Domestic demand, in particular private consumption and public investment, remained the key driver of regional growth. However, the region continued to experience exceptionally weak export growth in 2016, contributing to the underperformance of several larger economies. The prolonged sluggish performance of the external sector has had negative spillover effects on consumer sentiments, which is weighing on household spending in several economies in the region. Inflation remains generally subdued, largely as a result of low energy and food prices. There are however encouraging signs of the region emerging from the two-year stretch of producer-price deflation. This could have a positive impact on corporate profits and investment.

Private output growth stabilizes

China's growth figures for the first three quarters of 2016 have somewhat alleviated near-term concerns over a drastic output slowdown. The Chinese economy is estimated to have grown by 6.6 per cent in 2016, which is 0.2 percentage points above the forecast in WESP 2016 (United Nations, 2016a). Growth has been supported by robust private consumption, as reflected in stable retail sales growth throughout the year. Growth of fixed investment, particularly infrastructure investment, also provided solid support to overall growth.

A notable development is that fixed investment has been predominately driven by state-owned enterprises. Private investment decelerated due to overcapacity in several industrial sectors, sluggish market demand, and higher corporate financing costs. While industrial profits have seen some overall recovery, there are also rising defaults on corporate debt. The Chinese economy is expected to grow by 6.5 per cent in both 2017 and 2018, supported by favourable domestic demand and accommodative fiscal measures, including off-budget fiscal support through policy banks and public-private partnerships. Neverthe

less, the implications of China's ongoing economic rebalancing will inevitably be felt by

year. Growth in both economies is expected to recover in 2017 and 2018, conditional on improvements in external demand conditions.

Policy rates across major economies in the region approached or reached historic low levels in 2016. With few exceptions, there remains some but limited room for further rate cuts, especially given the overall low inflationary environment. However, concerns regarding large capital outflows have weighed on central banks' rate-cut decisions, as the region saw the greatest annual net capital outflow on record in 2015. High levels of household and corporate debt and possibly narrowing banks' profit margins have also factored into central banks' decisions. The effectiveness of monetary easing also appears to be waning as domestic credit growth has not increased significantly despite the overall loose monetary stance across the region.

As domestic credit growth did not see much acceleration, regional financial markets were broadly stable in 2016. The Renminbi's exchange rate against the United States dollar and its effective exchange rate depreciated consistently during 2016, with the former reaching the lowest level since 2010. For most of the other major currencies in the region, the effective exchange rate experienced less volatility in 2016 than in 2015.

With many economies facing relatively limited room for furthering monetary easing, the fiscal stance in East Asia has been mostly expansionary and countercyclical to support growth. Overall fiscal balances worsened in 2015 acrog leralico 0 fl srrny ind coun l mark75. be>4 1(r)-21.9(ta)[TJ

adequately addressed, this could further add to Governments' contingent liabilities, curbing engagement in supportive fiscal measures.

South Asia: positive economic outlook supported by robust private consumption

South Asia is the fastest-growing developing region and its economic outlook remains largely positive, benefiting from robust private consumption, a modest pickup in inveow p .9(p(e)0.68(a)-9.2(a)-26.1(n)-5.2

is to generate a crowding-in of private investment. This is particularly important given the large infrastructure and energy deficits, which remain a major structural barrier to a more inclusive and sustained growth across the region. Meanwhile, exports remain constrained in many countries owing to subdued global growth and trade flows, uncompetitive real exchange rates in smaller economies, and structural impediments to increase production.

Economic activity in India is further benefiting from domestic reforms

Among the largest countries, India has positioned itself as the most dynamic emerging economy. India's economy is projected to expand by 7.7 per cent and 7.6 per cent in 2017 and 2018, respectively, benefiting from strong private consumption. Investment demand is expected to slightly pick up, helped by monetary easing, government efforts towards infrastructure investments and public-private partnerships, and the implementation of domestic reforms such as the introduction of the Goods and Services Tax (GST) Bill. This reform constitutes a major change by establishing a new uniform tax rate, and it should promote investment in the medium term through lower transaction and logistic costs and efficiency gains. Importantly, an effective GST implementation also requires adequate capacity building of the tax administration. Nevertheless, low capacity utilization and stressed balance sheets of banks and businesses will prevent a strong investment revival in the short term.

The outlook for the Islamic Republic of Iran is strengthening visibly. This can be attributed to the strong expansion of oil production and exports (international sanctions were lifted by early 2016), lower inflation, increasing business confidence, and a surge in foreign investments. GDP growth is estimated to have accelerated to 4.3 per cent in 2016, with an expected further pickup to 4.7 per cent and 4.4 per cent in 2017 and 2018, respectively.

In Pakistan, economic growth is also projected to remain robust, above 5.0 per cent. Economic activity will be driven by strong consumption, a supportive monetary policy stance and rising investment and infrastructure projects boosted by the China-Pakistan Economic Corridor. Against this backdrop, youth unemployment is expected to slightly decline in the near term. Among smaller economies, the outlook for Sri Lanka's economy has recently improved after serious balance of payments and debt turbulences in early 2016. Economic activity will, however, likely remain constrained by fiscal consolidation measures and a tight monetary stance implemented to contain external risks.

Accommodative monetary policies are expected to continue in the near term

Amid relatively low inflationary pressures, monetary policies in South Asia are moderately accommodative. The supportive monetary stance is expected to continue in the near term, with potential further easing in India, the Islamic Republic of Iran and Pakistan. However, credit growth remains below trend in several countries, especially in industrial and infrastructure sectors in India. Fragilities in the banking sector and stressed balanced sheets of corporates remain important challenges for some economies. For instance, the Government of India committed to a $3.7 billion package to recapitalize state-owned banks, and various regulations have been introduced in order to reduce banks' financial exposures and to encourage private participation in the banking sector. Although countries should try to avoid a sudden tightening of monetary and liquidity conditions in the outlook period, policy measures will critically depend on the evolution of external factors, such as oil prices.

Despite high deficits, fiscal policy shows some flexibility in several countries…

Most South Asian Governments have announced relatively tight fiscal stances. However, during the implementation, Governments have tended to provide more support for their economies, responding to large development needs and political pressures. In India, in spite of a strong emphasis on rural areas and infrastructure investments on the expenditure side, fiscal policy has largely followed a cautious approach and the budget deficit is expected to further decline gradually. For 2016/17, the deficit is projected to reach 3.5 per cent of GDP and is on track to meet the medium-term target of 3.0 per cent of GDP.

In Bangladesh and Pakistan, fiscal policy is gradually becoming more expansionary, and thus deficits are expected to remain elevated. In Sri Lanka, the fiscal deficit is relatively high and the efforts to reduce it are tilted to the revenue side, as the country has one of the lowest tax-to-GDP ratios in the world. Sri Lanka recently received a three-year Extended Fund Facility (EFF) of $1.5 billion from the International Monetary Fund (IMF) to support the reform agenda.

Against this backdrop, fiscal deficits are expected to remain elevated in most economies, and recent large increases in wages and other benefits in the public sector are likely to further reduce fiscal space. From a medium-term perspective, key fiscal challenges for the region are to improve tax revenues and to promote a supportive environment for the private sector, which together can enhance the capacity to implement counter-cyclical policies.

In fact, most economies are constrained by very low tax-to-GDP ratios in comparison to other developing regions and high debt-to-GDP ratios (figure IV.14). Despite increasing efforts to strengthen tax revenues and the efficiency of the whole tax system, significant delays and problems remain. For instance, high levels of informality represent a major challenge to the implementation and potential benefits of tax reforms across the region.

Despite the favourable outlook, South Asian economies face several downside risks.

Box IV.3

The impact of unrest and con ict in the Arab region

The collective political changes and movements that began across the Arab region in 2011 have had

on the balance-of-payments in Egypt; falling oil revenues, weaker domestic demand and exodus of foreign labour in Libya; and insufficient financial resources to host refugees in Jordan and Lebanon.

The fiscal accounts have also been severely affected. In particular, the cumulative fiscal deficit for countries in and affected by conflicts is $218 billion larger than was previously projected. The fiscal balance had been projected to achieve a 1.1 per cent surplus in terms of nominal GDP in 2015, but actually registered a deficit of 11.7 per cent of GDP. Budget difficulties arise for a number of reasons, including the need for higher spending to mitigate the effects of conflicts on security and to provide services for vulnerable and displaced populations. Tax revenues declined due to uncertainties, and a poor business climate also came into play.

The negative economic impact has been compounded by a large-scale displacement of the population in Iraq, Libya, the Syrian Arab Republic and Yemen. Matching skills and production facilities became immensely difficult due to the dislocation of talented workers and the destruction of factories and infrastructure. In short, the labour market ceased functioning, negatively impacting the level and growth of productivity of economic sectors and activities that have managed to survive. Thus, in addition to the humanitarian sufferings of individual refugees and the internally displaced population, the productive sector has severely suffered from labour market disruptions.

ly affect the economic situation in the oil-exporting economies. The regional outlook will also be affected by external developments. For instance, higher interest rates in the United States might lead to tighter global credit conditions, making it even more difficult to revive investment demand in the GCC countries.

Latin America and the Caribbean: a return to positive growth is projected for 2017

After contracting for two consecutive years, the economy of Latin America and the Caribbean is expected to return to positive growth in 2017. The region's aggregate GDP is projected to increase by 1.3 per cent in 2017 and by 2.1 per cent in 2018, following an estimated decline of 1.0 per cent in 2016. While the region continues to face significant internal and external headwinds, economic growth is forecast to gradually pick up in most countries. South America is expected to see a modest cyclical recovery from the severe downturn of 2015 and 2016, with Argentina and Brazil, the subregion's two largest economies, set to emerge from recession. Several factors are likely to support this recovery, including a strengthening of external demand, an increase in international commodity prices, a decline in political uncertainty, and some monetary easing amid lower inflation. Average growth in South America will, however, remain fairly weak, weighed down by a rise in unemployment and ongoing fiscal consolidation (box IV.4).

The economic situation and prospects in Mexico and Central America and the Caribbean are generally more favourable as most countries depend less on commodity exports. However, growth projections for both subregions have been downgraded from earlier forecasts in the face of weaker-than-expected activity in the United States, persistent structural constraints (including high debt and unemployment, low productivity growth, and weak institutional capacity) and limited macroeconomic policy space.

The outlook for Latin America and the Caribbean is subject to significant downside risks. These include a sharper-than-expected deceleration in China, the adoption of protectionist measures by the new Administration in the United States and renewed financial market turbulences. The latter could, for example, be triggered by a faster-than-expected pace of interest rate hikes in the United States. A rebound in commodity prices and unexpectedly strong demand from developed economies, in particular the United States, present upside risks for many countries.

The subdued medium-term outlook for Latin America and the Caribbean poses a threat to the social achievements of the past decade and could significantly complicate the region's path towards the realization of the SDG3.1(. .6(t(c)-20.9DC c)-2.6(a)-332(c)-3.8(i)-5.8(a31 1 Tf 0.104 Tk f)-

Box IV. 4

Fiscal challenges in Latin America and the Caribbean

Fiscal positions in Latin America and the Caribbean diverged in 2015 and 2016. In the South American countries, fiscal deficits increased as reductions in public expenditures were more than offset by declines in revenues amid faltering economic growth and plummeting commodity-related revenues. In contrast, in Central America and parts of the Caribbean, including the Dominican Republic, fiscal deficits declined moderately from 2014 to 2016 owing to reduced government outlays and slightly higher revenuen6 e6(a h-1.9(, i3

region are the Plurinational State of Bolivia and Peru, which defied the regional downturn, largely owing to strong private and government consumption.

A closer examination of the expenditure components across South America reveals broad-based weakness, underscoring the challenges for the subregion going forward (figure

public investment. Tight monetary policies, elevated corporate debt levels as well as weak business and consumer sentiments have also weighed on investment activity in the region.

In addition, South America's labour markets, which had shown some resilience in the early stages of the economic downturn, deteriorated considerably in 2016. Brazil's unemployment rate reached 11.8 per cent in the third quarter of 2016, up from 6.5 per cent in late 2014. Argentina, Chile, Colombia and Ecuador also registered increases in unemployment. Although unemployment declined in Mexico and most Central American and Caribbean countries, the average urban unemployment rate in the region rose sharply from 7.6 per cent in the first half of 2015 to 9.2 per cent in the first half of 2016. In the face of rising unemployment, elevated inflation and restrictive credit conditions, household-consumption in South America weakened notably. Brazil suffered a particularly severe contraction in private consumption of about 5 per cent in 2016.

Since the commodity super cycle has come to an end, government budgets across Latin America have been under significant pressure, with primary deficits rising rapidly (figure IV.19). To offset declining revenues, several Governments, particularly in South America, implemented fiscal tightening measures in 2016, compounding the slump in private demand (figure IV.17).

Given the large decline in domestic demand — both private and public —, only a pos

domestic currencies, have recovered, following the slump in 2015. These positive trends reflect firmer commodity prices and a search for yield among international investors. At the same time, inflation has started to moderate in almost all South American countries owing to stronger domestic currencies, a diminishing impact of El Niño and the lack of demand

outlook remains clouded by long-standing structural weaknesses, including a strong dependence on commodities and low productivity growth.

Average growth in Mexico and Central America is projected to remain subdued in the forecast period. The subregion's GDP is projected to grow by 2.3 per cent in 2017 and 2.2 per cent in 2018, following estimated growth of 2.3 per cent in 2016. The slow growth trajectory primarily reflects a weak performance of the Mexican economy. Amid low oil prices, sluggish industrial production in the United States and tight monetary and fiscal policy, Mexico's GDP is estimated to have grown by only 2 per cent in 2016. The outcome of the elections in the United States has further complicated the short to medium-term outlook for Mexico's economy, raising the uncertainty around the baseline forecasts. Since nearly 80 per cent of Mexico's exports are destined for the United States, any protectionist trade measures by the new Administration in the United States would have a severe impact on growth. Remittance inflows could also take a hit if the new Administration were to introduce a tax on outward remittance flows.

Increasing concerns over the outlook for Mexico's economy reinforced downward pressure on the peso, causing a sharp decline in the aftermath of the election in the United States. The peso's weakness could further drive up inflation, which has increased steadily since mid-2016, exceeding the central inflation target level of 3 per cent in October. The combination of a weaker peso, rising inflation and a subdued growth outlook poses a major challenge for Mexico's central bank. After raising interest rates considerably over the past year, further tightening is expected for 2017. Given a high degree of macroeconomic uncertainty and tight fiscal and monetary policy, investment growth is projected to further slow during the outlook period. As a result, GDP growth in Mexico is forecast to remain subdued at about 2 per cent in 2017 and 2018 amid a still negative output gap.

In Central America and the Caribbean, the economic situation and prospects vary widely across countries. Strong domestic demand continues to boost economic activity in Costa Rica, the Dominican Republic, Nicaragua and Panama. To varying degrees, these countries are benefiting from buoyant public investment (particularly in infrastructure), robust private consumption (supported by remittance inflows), and dynamic tourism industries. During the forecast period, they will remain among the region's fastest-growing countries, with annual growth projected to exceed 4 per cent.

In contrast, Cuba, Haiti and Jamaica recorded weak growth in 2016. Cuba's economy has suffered from reduced support from the Bolivarian Republic of Venezuela and low prices for major export goods, including petroleum and nickel. Economic activity in Haiti and Jamaica was adversely affected by drought conditions as well as structural obstacles, including institutional weaknesses, tight fiscal budgets and high unemployment and underemployment. Suriname and Trinidad and Tobago experienced significant contractions of GDP in 2016 as both countriea849.1nonre.4(m)-14.6(i)8(c a)-5.8(c)-14.1(t)-16.5(i14(x)-9.6(p)e9x)-9.6(p)e9