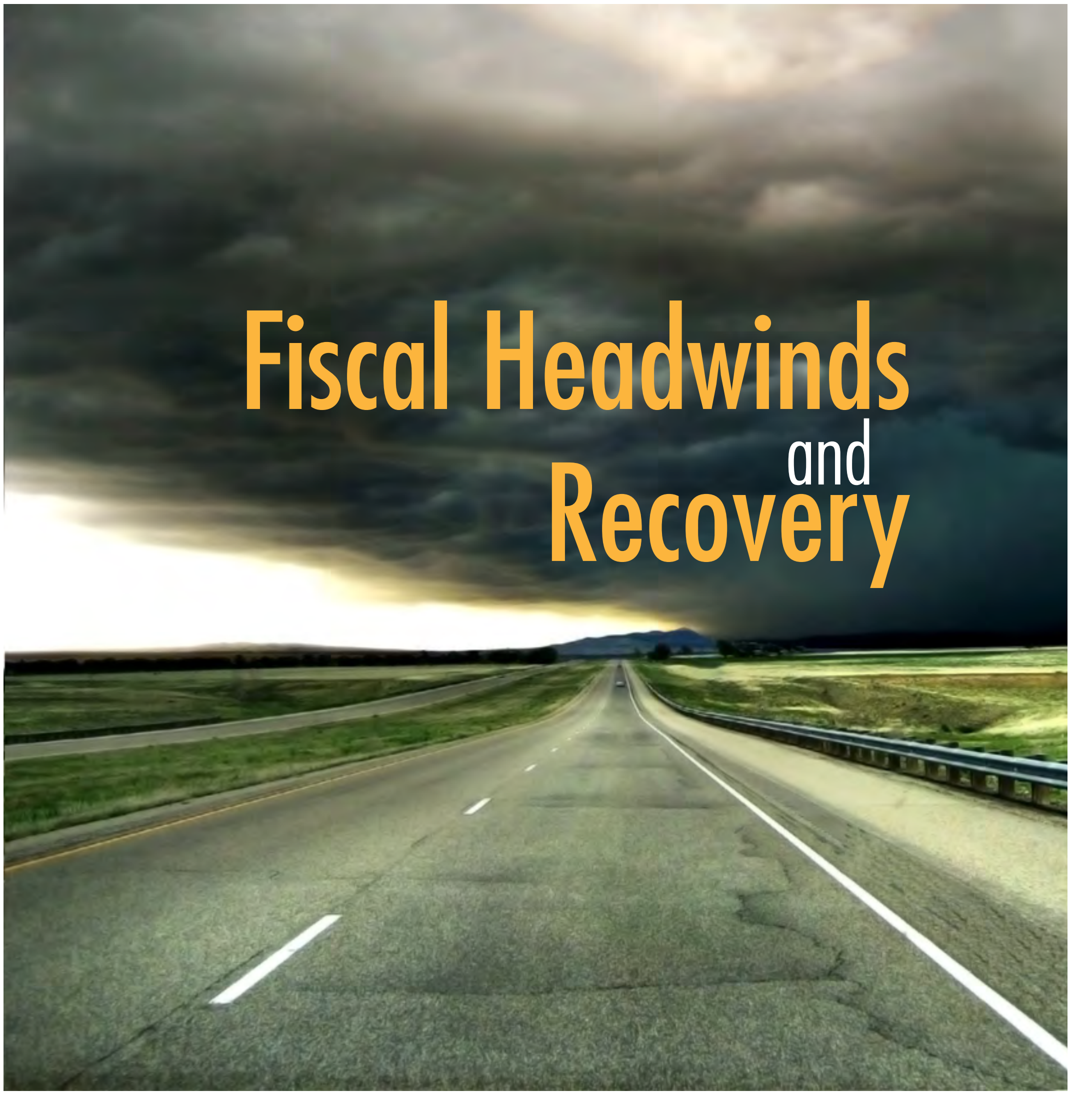
Global Economic Prospects

Volume 1 | Summer 2010



THE WORLD BANK

Global Economic Prospects Summer 2010: Fiscal Headwinds and Recovery

Key messages

- Market nervousness concerning the fiscal positions of several European high-income countries poses a new challenge for the world economy. This arises as the recovery is transitioning toward a more mature phase during which the influence of rebound factors (such as fiscal stimulus) fades, and GDP gains will increasingly depend on private investment and consumption.

- So far evolving financial developments in Europe have had limited effects on financial conditions in developing countries. Although global equity markets dropped between 8 and 17 percent, there has been little fallout on most developing-country risk premia. And despite a sharp deceleration in bond flows in May, year-to-date capital flows to developing countries during the first 5 months of 2010 are up 90 percent from the same period in 2009.

- Little real-side data is available to evaluate the impact of the European fiscal/debt crisis on economic activity. Existing data suggests that through the end of March, the recovery remained robust in most developing and developed countries, with the exception of high-income Europe where it has stagnated.

- Assuming that measures in place prevent today's market nervousness from slowing the normalization of bank-lending, and that a default or restructuring of European sovereign debt is avoided, global GDP is projected to increase by 3.3 percent in 2010 and 2011, and by 3.5 percent in 2012. Private capital flows to developing countries are projected to increase from 2.7 percent of their GDP in 2009 to 3.2 percent in 2012 (Table 1). Reflecting stronger productivity growth, and less-pronounced headwinds than in high-income countries, GDP in developing countries is expected to grow by 6.2, 6.0, and 6.0 percent in 2010, 2011 and 2012. This is more than twice as quickly as in high-income countries, where growth is projected to strengthen from 2.3 percent this year to 2.7 percent in 2012.

- However, should current uncertainty regarding developments in Europe persist, outturns could be weaker. A high probability alternative baseline, characterized by an accelerated tightening of fiscal policy across high-income countries, would see a more muted recovery, with global GDP expanding by 3.1 percent in 2010 and by 2.9 and 3.2 in 2011 and 2012. The easing of momentum would be concentrated in high-income countries, where GDP might rise 2.1, 1.9, and 2.2 percent during each of the three years. Under these conditions growth in developing countries could average 5.9 percent during the projection period.

- Deeper and more widespread effects might arise if the situation causes investors to become significantly more risk averse; or in a less likely scenario, if there is a major crisis of confidence, prompted by (or causing) a default or major restructuring of high-income sovereign European debt.

  - Simulations suggest that an increase in risk aversion that caused long-term yields on U.S. government bonds to rise by 100 basis points could slow global growth by 0.5 percentage points.

  - A serious loss of confidence in the debt of five EU countries combining high fiscal deficits and high government debts that led to a freezing -up of credit in those countries could cause GDP growth to slow by as much as 2.4 percent in 2011—pushing high-income countries into recession.

  - A default or major restructuring among the EU-5 (Greece, Ireland, Italy, Portugal and Spain) could threaten the solvency of several banks outside the EU-5, with potentially far-reaching consequences for the global financial system.

  - Because of significant presence of EU-5 banks, international capital flows to Europe and Central Asia and to a lesser extent to Latin America and the Caribbean might be seriously affected in the event of a default or restructuring of high-income sovereign debt.

- To ensure longer-term sustainability, fiscal policy in many high-income countries needs to be tightened sharply over the next several years. Although politically difficult, a policy that favors a more aggressive reining-in of deficits will, by reducing high-income country borrowing costs, favor medium-term growth in both developing and high-income countries.

- Limited fiscal space in low-income countries means that if official development assistance were to decline, policymakers in low-income countries could be forced to cut growth enhancing infrastructure and human capital investments. As a result, the number of people living on $2 or less per day in 2020 could be higher by as much as 79 million.

So far, the fall-out from the high-income European debt crisis has been contained.

Concerns about the sustainability of Greece's fiscal position spilled over into global financial markets in early May 2010. Although there was a sharp increase in risk premia and a steep decline in stock markets worldwide, there are only limited indications of contagion – at least so far.[1]

Following the announcement of a €750 billion, or nearly $1 trillion aid package by the European Union, the International Monetary Fund, and the European Central Bank, the initial sharp uptick in the price of credit default swaps (CDSs) on the sovereign debt of select European countries receded before rebounding partially in the following weeks (Figure 1). LIBOR-OIS spreads have increased to 32 basis points**,** suggesting that commercial banks are concerned that the ability of counterparties to repay even short loans might be affected by a default or restructuring of high-income sovereign debt. Moreover, anecdotal evidence suggests that some European banks are having trouble getting funding. Nevertheless, LIBOR-OIS spreads remain well below the values observed during the initial phases of the sub-prime crisis, and suggest that for the moment, markets are not overly concerned.

The credit ratings of most developing country sovereigns have not been affected by the crisis. Since the end of April, though May 24, the credit ratings of 5 countries (Azerbaijan, Bolivia, Nicaragua, Panama and Ukraine) have been upgraded, and none have been downgraded. For the year to date, there have been 22 upgrades and only 4 downgrades. EMBI spreads for major developing countries, after rising much less than in September 2008 (Figure 1 bottom panel), have declined again and are only a little higher than in January 2010 (less than 10 basis points in the case of Brazil and Russia, and 27 and 40 basis points in the case of South Africa and Turkey). Indeed, a recently developed index of the deterioration in financial conditions[2] for a sample of 60 countries (31 high-income, 27 middle-income, and 2 low-income countries), shows that as of early June 2010, only 8 of the 23 countries displaying relative deterioration in market conditions since March 31st were developing counties. Four of the 8 countries where the deterioration in the aggregate index exceeded 0.5 were developing countries. However, in two cases, the deterioration reflected rising interest rates following a tightening of monetary policy in response to improving economic conditions, rather than a reaction to the situation in Greece**.**

Table 1. The global outlook in summary

(percentage change from previous year, except interest rates and oil price)

	2008	2009e	2010f	2011f	2012f
Global Conditions					
World Trade Volume (GNFS)	3.2	-11.6	11.2	6.8	7.2
Consumer Prices					
G-7 Countries [1,2]	3.1	-0.2	1.5	1.6	1.8
United States	3.8	-0.3	2.0	2.2	2.4
Commodity Prices (USD terms)					
Non-oil commodities	0.0	-21.6	16.8	-4.0	-5.4
Oil Price (US$ per barrel) [3]	97.0	61.8	78.1	74.6	73.9
Oil price (percent change)	36.4	-36.3	26.4	-4.5	-0.9
Manufactures unit export value [4]	5.9	-4.9	0.0	-3.7	0.0
Interest Rates					
$, 6-month (percent)	3.2	1.2	0.8	2.2	2.2
€, 6-month (percent)	4.8	1.5	1.0	1.5	2.8
International capital flows to developing countries (% of GDP)					
Developing countries					
Net private and official inflows	4.7	3.4			
Net private inflows (equity + debt)	4.3	2.7	3.0	3.1	3.2
East Asia and Pacific	3.1	2.2	2.1	2.2	2.5
Europe and Central Asia	7.8	2.6	4.0	4.2	4.1
Latin America and Caribbean	4.0	3.0	3.5	3.2	3.3
Middle East and N. Africa	1.9	1.8	2.5	2.8	2.6
South Asia	3.6	3.9	3.4	3.2	3.4
Sub-Saharan Africa	3.0	4.0	3.6	3.8	4.2
Real GDP growth [5]					
World	**1.7**	**-2.1**	**3.3**	**3.3**	**3.5**
Memo item: World (PPP weights) [6]	1.3	-0.4	4.2	4.0	4.3
High income	**0.4**	**-3.3**	**2.3**	**2.4**	**2.7**
OECD Countries	0.3	-3.4	2.2	2.3	2.6
Euro Area	0.4	-4.1	0.7	1.3	1.8
Japan	-1.2	-5.2	2.5	2.1	2.2
United States	0.4	-2.4	3.3	2.9	3.0
Non-OECD countries	3.0	-1.7	4.2	4.2	4.5
Developing countries	**5.7**	**1.7**	**6.2**	**6.0**	**6.0**
East Asia and Pacific	8.5	7.1	8.7	7.8	7.7
China	9.6	8.7	9.5	8.5	8.2
Indonesia	6.0	4.5	5.9	6.2	6.3
Thailand	2.5	-2.3	6.2	4.0	5.0
Europe and Central Asia	4.2	-5.3	4.1	4.2	4.5
Russia	5.6	-7.9	4.5	4.8	4.7
Turkey	0.7	-4.7	6.3	4.2	4.7
Poland	4.8	1.7	3.0	3.7	4.0
Latin America and Caribbean	4.1	-2.3	4.5	4.1	4.2
Brazil	5.1	-0.2	6.4	4.5	4.1
Mexico	1.8	-6.5	4.3	4.0	4.2
Argentina	7.0	-1.2	4.8	3.4	4.4
Middle East and N. Africa	4.2	3.2	4.0	4.3	4.5
Egypt [7]	7.2	4.7	5.0	5.5	5.7
Iran [7]	2.3	1.8	3.0	3.2	3.2
Algeria	2.4	2.1	4.6	4.1	4.3
South Asia	4.9	7.1	7.5	8.0	7.7
India [7, 8]	5.1	7.7	8.2	8.7	8.2
Pakistan [7]	2.0	3.7	3.0	4.0	4.5
Bangladesh [7]	6.2	5.7	5.5	5.8	6.1
Sub-Saharan Africa	5.0	1.6	4.5	5.1	5.4
South Africa	3.7	-1.8	3.1	3.4	3.9
Nigeria	5.3	5.6	6.1	5.7	6.4
Kenya	1.7	2.6	4.0	4.9	5.4
Memorandum items					
Developing countries					
excluding transition countries	5.7	3.0	6.6	6.2	6.2
excluding China and India	4.3	-1.8	4.5	4.4	4.6

Source: World Bank.

Notes: PPP = purchasing power parity; e = estimate; f = forecast.

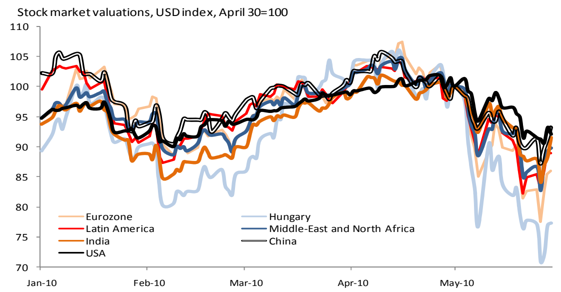
1. Canada, France, Germany, Italy, Japan, the UK, and the United States.
2. In local currency, aggregated using 2005 GDP Weights.
3. Simple average of Dubai, Brent and West Texas Intermediate.
4. Unit value index of manufactured exports from major economies, expressed in USD.
5. Aggregate growth rates calculated using constant 2005 dollars GDP weights.
6. Calculated using 2005 PPP weights.
7. In keeping with national practice, data for Egypt, Iran, India, Pakistan and Bangladesh are reported on a fiscal year basis. Expressed on a calendar year basis, GDP growth in these countries is as in the table on the right.
8. Real GDP at market prices. Growth rates calculated using real GDP at factor cost, which are customarily reported in India, tend to be higher and are, for 2008-12: 6.7, 7.4, 8.5, 9.0, and 8.5 percent – see Table B5.4 in the regional annex and the South Asia Economic Update (http://go.worldbank.org/6BU9N0AZM0) for more detail.

	2009e	2010f	2011f	2012f
Egypt	5.6	5.0	5.3	5.5
Iran	1.8	3.0	3.2	3.2
India	5.7	8.3	8.6	8.2
Pakistan	3.3	3.5	4.2	4.5
Bangladesh	5.6	5.7	6.0	6.1

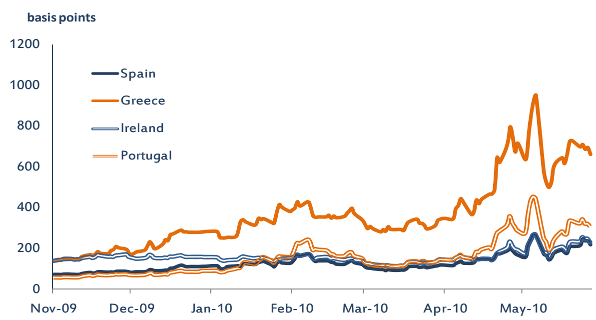
While market conditions have improved—the size of the EU/IMF rescue package (close to $1 trillion); the magnitude of the initial market reaction to the possibility of a Greek default and eventual contagion; and continued volatility, are indications of the fragility of the financial situation. As discussed in the risks section below, a further episode of market uncertainty

Figure 1. Limited signs of contagion crisis so far

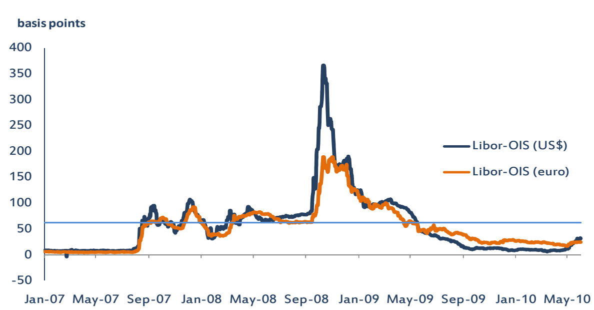
Stock market valuations worldwide have been affected



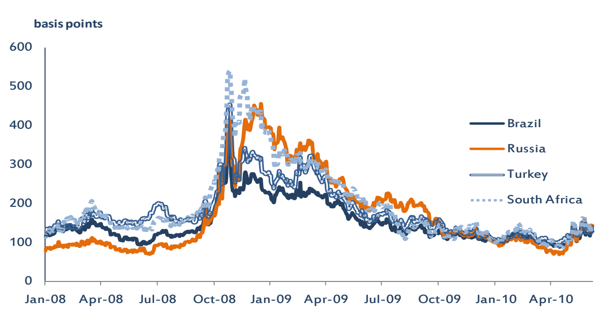
Greek anxieties spread to other euro-zone economies with precarious fiscal positions, but markets are calmed by the EU package



Funding cost pressures up– but well below the average of early stages of sub-prime crisis



Spreads have returned to close to earlier levels



Source: World Bank, Datastream, Bloomberg

could entail serious consequences for growth in both high-income and developing countries.

Stock markets worldwide lost between 8 and 17 percent in May, with losses generally larger in high-income Europe and developing Europe than in markets further removed from Greece. Moreover, data for May indicate a significant decline in capital inflows toward developing countries (Table 2), although year-to-date flows are 90 percent higher than in 2009. Most of the decline was concentrated in bond issuance by developing countries, with more modest declines in bank-lending and equity flows. Although it is difficult to determine with precision to what extent this reflects a normal seasonal decline in flows, or a temporary reduction in issuance prompted by elevated spreads at the beginning of the month,[3] these developments could signal a further tightening of capital markets.

Table 2. A sharp fall of in bond issues in May

$ billion	2008		2009		2010					
	Q1	Total	Q1	Total	Q1	Jan	Feb	Mar	Apr	May
Total	103	390	48	353	104	41	17	47	45	15
Bonds	12	65	18	115	48	21	5	21	26	3
Banks	71	257	22	129	30	12	5	13	8	6
Equity	20	68	8	109	26	7	7	12	11	6
Lat. America	19	90	21	137	31	9	4	17	15	3
Bonds	5	20	10	62	19	8	2	10	9	0
E. Europe	36	157	6	72	26	13	2	10	14	2
Bonds	2	35	4	33	17	7	1	8	11	1
Asia	38	98	18	122	38	16	7	15	11	10
Bonds	3	7	5	16	9	7	2	0.3	3	2
Others	11	45	3	22	10	2	3	5	4	1

Source: World Bank, Dealogic.

The recent bout of market nervousness arose as the recovery is moving into a more mature phase characterized by significant headwinds

Financial markets in developing and high-income countries have staged a remarkable recovery from the worst of the crisis. Notwithstanding recent turmoil, interbank lending rates and developing country bond spreads have returned to close-to-normal levels; stock markets in high-income and emerging economies have recovered much of the value they lost, and most developing-country currencies have regained their pre-crisis levels against the dollar, with some having appreciated. The real-side of the global economy is also recovering. In the first quarter of 2010, global industrial production was expanding at an 11 percent annualized pace (Figure 2), while merchandise trade, was growing even more briskly (20 percent annualized pace). Still the level of industrial production remains 10 percent or more below potential in many developing countries and unemployment is high.

While the downturn and recovery of the global economy was remarkable for both its depth and its similarity across countries, the recovery is now more than a year old and its character is changing. Bounce-back factors (including the deep inventory cycle, and the growth impetus from fiscal and monetary stimulus) that contributed to very rapid quarterly growth rates are fading. Increasingly, the pace of the recovery at the national and regional level will depend on the extent to which private-sector activity recovers, and measures taken to address longer-term structural factors (including fiscal sustainability, banking-sector restructuring, and underlying productivity).

Fiscal policy poses challenges

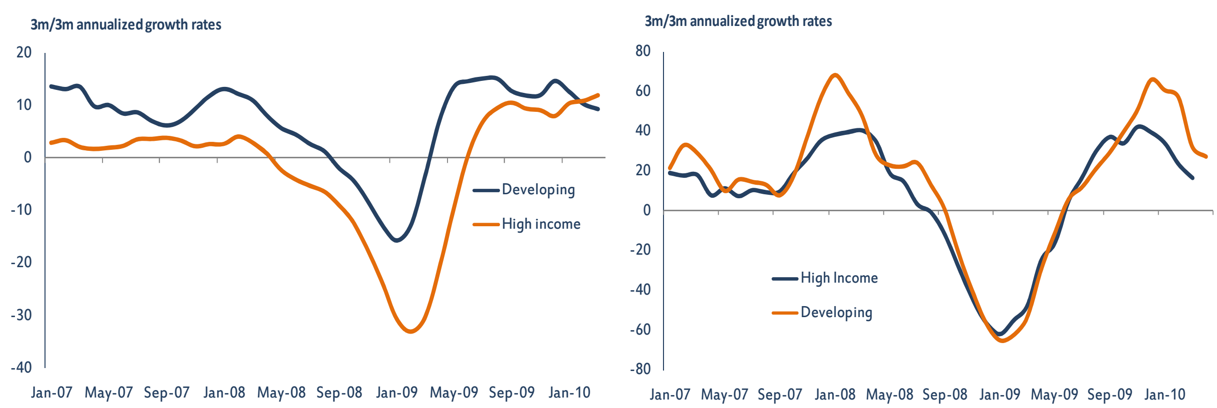
Medium-term prospects for both high-income and developing countries face serious headwinds. High-income countries will continue to be plagued by weak financial sectors, waning growth effects from fiscal and monetary stimulus, and an increasingly pressing need to set public finances on a sustainable path.

The need to tighten fiscal policy extends well beyond those countries most in the headlines, and the immediate challenge of unwinding the crisis-related stimulus measures that were put into place. This is a problem for many high-income countries, where fiscal deficits and debt to GDP ratios have reached unsustainable levels. The G-7's debt is expected by the IMF to reach more than 113 percent of the group's GDP in 2010 (Figure 3), a level not seen since 1950. Bringing debt levels down will be more challenging now than earlier because, in contrast with the war-related debt of the 1950s, today's debt reflects ongoing demands on government coffers that are likely to grow as pension and health liabilities expand with aging populations. The IMF (2010) estimates that high-income countries will need to cut government spending (or raise revenues) by 8.8 percent of GDP for a 20 year period in order to bring debt levels down to 60 percent of GDP by 2030.

The need to unwind stimulus measures among developing countries is generally less pressing; because both fiscal deficits and debt-to-GDP

Figure 2. The real-side recovery is showing some signs of maturing

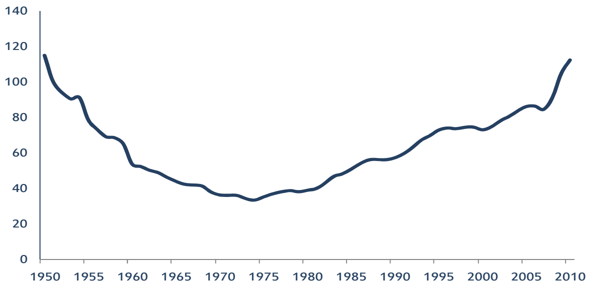
Industrial production is growing rapidly | Trade is recovering at very rapid rates



Source: World Bank

Figure 3. G-7 debt is close to post-war highs

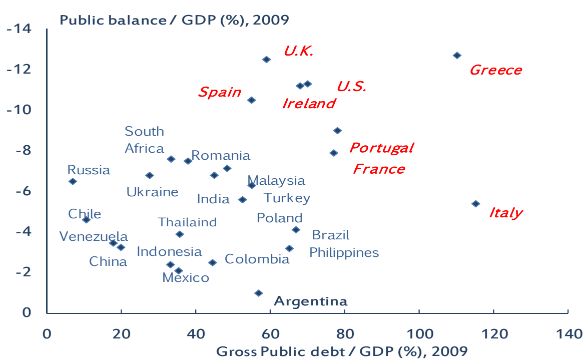
Gross public debt as a % of GDP



Source: IMF

ratios are much lower (Figure 4). Overall, general government deficits as a percent of GDP in developing countries have increased by 4.5 percentage points between 2007 (before the crisis) and 2009. Due to binding financing constraints facing low-income countries, their deficits increased by only 1.3 percentage points of GDP.

Figure 4. Most developing countries are not beset by concerns about fiscal sustainability



Source: World Bank

Several developing countries do face fiscal challenges, including India whose fiscal deficit is estimated to have reached 9.5 percent of GDP in 2009/10, and whose debt represents 77 percent of its GDP. Recognizing the challenge, the government has announced a medium-term adjustment path, which is expected to reduce India's debt-to-GDP ratio to at most 68 percent of GDP by FY2014/15. China also put in place a large stimulus package, but its finances are on a firmer footing, so there is less urgency to unwinding stimulus (although overheating could be a strong macroeconomic argument for doing so).

Lower tax and commodity revenues, weaker aid flows, and more competition for global savings could squeeze government and private-sector investment…

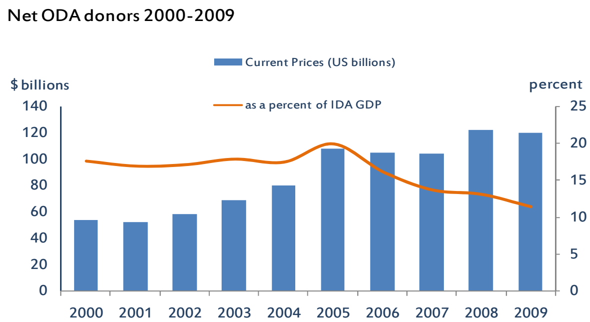
Developing countries, particularly low-income countries that rely on official development assistance (ODA) for budgetary support, could come under severe pressure if the crisis results in reduced aid flows. So far, the crisis has caused government deficits in low-income countries to increase by an average of 1.3 percent of GDP, suggesting that many were able to take advantage of relatively good fiscal positions, and ample reserves going into the crisis to buffer its effects on spending. However, the initial cushions have been exhausted, and the ability of low-income countries to maintain spending in the face of a slow recovery is unclear – especially if, as is likely, ODA declines in coming years.

Extrapolating from trends in aid flows during previous recessions from 1977 through 2007—and given the extent of fiscal consolidation and lower potential output faced by donor countries—recent research (Dang, Knack, Rogers, 2009) suggests that ODA could fall by as much as 20 to 25 percent in the current crisis, and that it could take about a decade for flows to recover. This probably represents a worst-case scenario, and aid flows are unlikely to fall so much this time around. Nevertheless, aid flows will likely be tighter than in the past. Indeed, though bilateral aid did increase modestly in real terms during 2009 (Figure 5), it has fallen short of commitments and is declining as a share of recipient GDP.

In addition to potentially weaker aid flows, ongoing restructuring in the international financial sector implies significantly less and more expensive financial capital for developing countries for years to come (Table 3). Private capital flows to developing countries are projected to recover only modestly from $454 billion (2.7 percent of GDP) in 2009 to $771 billion (3.2 percent of GDP) by 2012 (Figure 6).

If the rebound in net capital flows remains muted as expected, there is a real risk that many of the private firms that borrowed heavily internationally in the boom period will not be able to rollover their loans, potentially generating a second-round region-specific crisis. For example, in Kazakhstan, Latvia, Lithuania, and Ukraine, where the repayment on corporate external debt is anticipated to exceed 8 percent of GDP in 2010.

Figure 5. Official assistance is declining as a share of recipient GDP



Source: World Bank, OECD

Increased borrowing of high-income sovereigns on international capital markets will increase demands on global savings, raise borrowing costs and potentially crowd-out developing country borrowers. Already in 2009, the G-3 issued 5-times more bonds than they did in each of 2005 and 2006. The group's total draw on global saving exceeded $2.5 trillion—more than 7-times the net capital flows to developing countries in that year. Partly as a consequence of this increased borrowing and also because the Federal Reserve has stopped purchasing U.S. long-term corporate bonds and residential mortgages, long-term yields on U.S. treasury securities had been rising, though with the onset of the Greek crisis they have eased in response to "safe-haven" inflows (Figure 7).

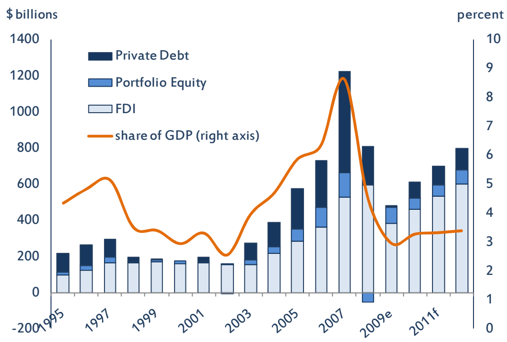
Table 3. Net International capital flows to developing countries

$ billions	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Net private and official inflows	**501.8**	**659.8**	**1222.8**	**780.5**	**523.5**			
Net private inflows (equity+debt)	**573.3**	**732.1**	**1223.7**	**752.4**	**454.0**	**589.5**	**670.2**	**770.8**
Net equity inflows	349.9	469.0	663.8	536.5	445.9	497.5	564.2	652.8
..Net FDI inflows	281.1	363.2	528.4	593.6	358.3	438.0	501.0	575.0
..Net portfolio equity inflows	68.8	105.8	135.4	-57.1	87.5	59.5	63.2	77.8
Net debt flows	151.9	190.8	559.0	244.0	77.6			
..Official creditors	-71.5	-72.3	-0.9	28.1	69.5			
....World Bank	2.7	-0.5	4.8	7.1	21.1			
....IMF	-40.2	-26.7	-5.1	10.8	27.5			
....Other official	-34.0	-45.1	-0.6	10.2	20.9			
..Private creditors	223.4	263.1	559.9	215.9	8.1	92.0	106.0	118.0
....Net M-L term debt flows	137.8	168.3	315.4	228.6	-2.7			
......Bonds	56.8	31.7	87.4	15.0	54.8			
......Banks	85.8	141.5	231.0	217.2	-52.9			
......Other private	-4.8	-4.9	-3.0	-3.6	-4.6			
....Net short-term debt flows	85.6	94.8	244.5	-12.7	10.8			
Balancing item	**-414.1**	**-446.5**	**-617.9**	**-808.4**	**-292.9**			
Change in reserves (- = increase)	**-393.6**	**-643.5**	**-1081**	**-439.0**	**-561.0**			
Memorandum items								
Net FDI outflows	61.6	130.5	148.7	207.5	153.9	210.0	250.0	275.0
Workers' remittances	193.0	235.0	290.0	336.0	316.0	335.0	359.0	

As a percent of GDP (%)	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Net private and official inflows	**5.03**	**5.59**	**8.45**	**4.51**	**3.09**			
Net private inflows (equity+debt)	**5.74**	**6.21**	**8.46**	**4.35**	**2.68**	**3.02**	**3.05**	**3.15**
..Net FDI inflows	2.82	3.08	3.65	3.43	2.12	2.24	2.28	2.35
..Net portfolio equity inflows	0.69	0.90	0.94	-0.33	0.52	0.30	0.29	0.32
..Private creditors	1.5	1.6	3.9	1.4	0.5	0.5	0.5	0.5

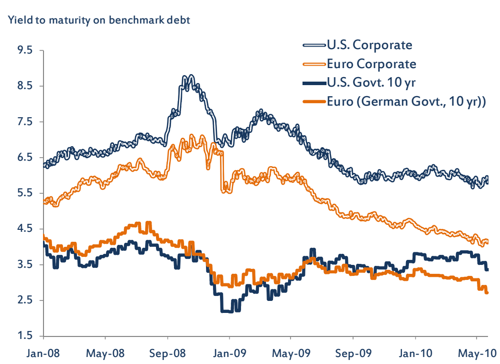
Source: World Bank.

Figure 6. Net private capital inflows will stage a modest recovery



Source: World Bank.

Figure 7. Long-term corporate yields have held relatively steady even as flight-to-safety causes U.S. and German government bonds to fall



Note: Corporate yields based on A-AAA 10 year Merrill Lynch indices

Weaker aid flows could translate into slower growth and increased poverty over the long-term

The economic impact on long-term growth in developing countries of a forced pullback from growth-enhancing infrastructure and human-capital investment due to lower fiscal revenues, weaker ODA, and sluggish capital flows, are difficult to gauge, as are the effects on private sector growth of tighter financial sector regulations, and increased competition for capital from high-income sovereigns. *Global Economic Prospects: Crisis, Finance and Growth* (World Bank, 2010) estimated that just the latter two factors could reduce developing country growth rates by between 0.2 and 0.7 percent for a period of 5 to 7 years.

Although the effects on trend growth of a deterioration in financing conditions, or in the capacity of developing countries to invest in their future production, may appear small, their cumulative impact on poverty and poverty reduction could be large. Even a relatively small 0.5 percentage point decline in the rate of growth of potential output in low income countries would—over a 10 year period—increase the number of people living on $2 dollars per day or less, by as much as 79 million (Table 4).

Medium-term prospects are for a modest recovery, with global growth dependent on prospects for developing countries

Overall, global GDP is expected to expand by 3.3 percent in 2010 and 2011, rising somewhat thereafter to 3.5 percent in 2012 (see earlier Table 1). Reflecting much higher productivity and population growth, the economies of the developing world are expected to grow by about 6 percent in all three years, while high-income country growth is limited to 2.3 percent in 2010 and 2.4 and 2.7 percent in 2011 and 2012 respectively. Because of these large growth differentials, developing countries will be a major source of global growth (Figure 8). Close to half of the increase in global

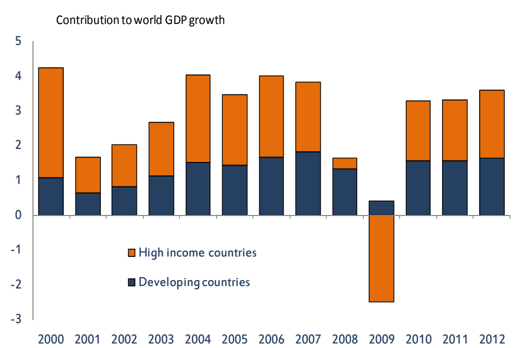
Table 4. A 0.5 percentage point decrease in the rate of growth could increase poverty by 79 million in the long term

	Impact on poverty of a 0.5 percent decline in growth as of 2015			
	Poverty Line $1.25 Change in head count		Poverty Line $2.00 Change in head count	
Region	millions	% points	millions	% points
East Asia and Pacific	4.1	0.2	12.9	0.7
Europe and Central Asia	0.4	0.1	1.4	0.3
Latin America and Caribbean	0.8	0.1	3.0	0.6
Middle East and North Africa	0.3	0.1	1.4	0.6
South Asia	10.0	0.7	30.1	2.1
Sub-Saharan Africa	6.7	1.0	7.6	1.1
Developing Countries	22.4	0.4	56.4	1.0

	Impact on poverty of a 0.5 percent decline in growth as of 2020			
	Poverty Line $1.25 Change in head count		Poverty Line $2.00 Change in head count	
Region	millions	% points	millions	% points
East Asia and Pacific	1.0	0.7	14.1	0.78
Europe and Central Asia	0.4	0.3	1.7	0.37
Latin America and Caribbean	1.6	0.6	3.2	0.59
Middle East and North Africa	0.5	0.6	2.1	0.89
South Asia	9.3	2.1	42.5	2.95
Sub-Saharan Africa	13.5	1.1	15.3	2.30
Developing Countries	26.3	0.4	78.8	1.4

Source: World Bank

Figure 8. Almost half of global growth is due to increased demand in developing countries



Source: World Bank

demand in each of 2010 through 2012 will come from developing countries, and their rapidly rising imports will be responsible for more than 40 percent of the increase in global exports.

High-income countries

Growth in the *United States* is expected to remain strong in the second and third quarters of 2010, with growth of 3.3 percent for the year as a whole (see Table 1). GDP gains are projected to ease in 2011 to 2.9 percent, reflecting both a gradual tightening of fiscal policy and an end to the boost to growth from stock-building. *Japanese* growth is anticipated to rebound to 2.5 percent in 2010, but to slow thereafter to 2.1 percent. On balance, growth in the Euro area is forecast to remain weak at 0.7 percent in 2010, with some strengthening to 1.3 and 1.8 percent in 2011 and 2012 respectively. However over the medium to long(er) terms, trend growth in high-income Europe will trail that of the United States (and *ex fortiori* developing countries), principally because of slower working-age population growth, but also because of the large fiscal adjustments that countries in the region will begin, and the region's heavier reliance on banking (as opposed to bonds or stock markets) to finance private-sector investment.[4]

Developing countries

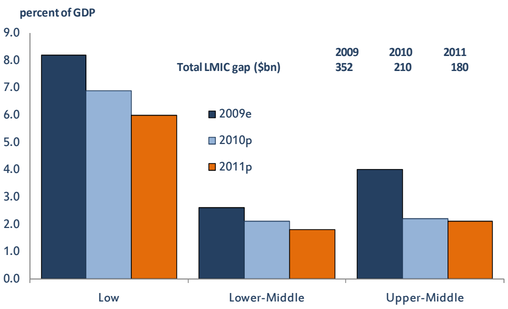
Developing country growth is projected to pick up from an estimated 1.7 percent in 2009 to around 6 percent in each of 2010, 2011 and 2012. The apparent steadiness of growth in each of these years belies an anticipated slowing of growth in China, the largest developing economy (from 9.5 in 2010 to 8.5 percent in 2011), as the fiscal stimulus put in place in 2009 begins to be unwound. Excluding China and India, developing country GDP is projected to increase by 4.5, 4.4, and 4.6 percent in

2010, 2011, and 2012 respectively.

High external financing needs in a time of sharp retrenchment in capital flows led to significant current account adjustments and slower growth in several developing countries during 2009. As a consequence, financing needs are forecast to decline from $1.2 to $1.1 trillion in 2010. Most of the decline in 2010 is due to reductions in current account deficits forced on developing countries by a 40 percent decline in international capital flows during 2009. Current account balances in deficit countries were almost halved from -$283 to -$128 billion in 2009. In several developing countries in Europe and Central Asia, deficits narrowed by more than 50 percent. Medium and long term debt coming due declined somewhat, thereby reducing financing requirements, but short-term debt has increased – leading to an overall rise in scheduled debt repayments. Based on the assumption that current account deficits remain at their 2009 levels as a percent of GDP, the total external financing needs of developing countries is projected to be on the order of $1.1 trillion for 2010 through 2012.

Private capital flows to developing countries are forecast to recover modestly from $454 billion (2.7 percent of GDP) in 2009 to $771 billion (3.2 percent of GDP) by 2012 (see above). As a result, the ex-ante estimates of the financing gap will halve to $180 billion by 2012 from $352 billion in 2009. As a share of GDP, the decline in the financing gap is expected to be most marked for the upper-middle-income countries 1.5 percent and low income countries 1.3 percent (Figure 9).[5] The financial markets annex provides more detail on recent developments.

Figure 9. Nevertheless external financing gaps will persist



Source: World Bank DEC Prospects Group staff estimates

The **East Asia and Pacific** region fared relatively well during the recession. The region is expected to grow by 8.7 percent in 2010 and 7.8 and 7.7 percent in 2011 and 2012. East Asia has benefitted from close links with China, which led the regional (and global) recovery. However, the earlier strong momentum in regional exports and production is waning, and output gaps are closing rapidly. Coupled with strong capital inflows and rising liquidity, this may put pressure on both goods and asset price inflation. Reflecting these factors, regional and Chinese growth are projected to slow to an average 7.8 and 8.4 percent respectively over 2011 to 2012 (see also the Regional Annex to this Report).

The recovery in **Europe and Central Asian** countries is the least advanced among developing regions, with industrial activity still some 11 percent below January 2008 levels, with GDP continuing to decline in several countries during the fourth quarter of 2009. Regional demand remains hobbled by large household foreign-currency debt obligations and significant negative wealth effects due to the earlier collapse in real estate and equity markets. The compression in remittances inflows remains a challenge for smaller economies.

Economies in the region that weathered the crisis relatively well (Poland) are projected to rebound more strongly, supported by a return of capital inflows and global trade normalization. But countries that faced the crisis with unsustainable domestic booms - characterized by large current account deficits – (Bulgaria, Latvia, Lithuania) and those with vulnerable private or public balance sheets (Hungary, Romania) are expected to recover more slowly, due to limited room for policy maneuver. Overall, growth is forecast to average 4.5 percent over 2011-2012, compared with an average 7 percent during the boom years. Despite the recovery in growth rates, the large loss of output in 2009 means that even in 2012 many economies in the region will continue to be characterized by high unemployment and large quantities of spare capacity.

The recovery in **Latin America and the Caribbean**, a region dominated by middle-income countries and commodity exporters, entered a strong cyclical rebound during the second half of 2009, benefitting from a robust rebound in external demand, renewed capital inflows, higher commodity prices (see Box 1), a turn in the inventory cycle, and a significant boost to domestic demand from substantial monetary and fiscal stimulus. After contracting by an estimated 2.3 percent in 2009, output in the region is forecasted to expand by around 4.3 percent over the projection period, somewhat slower than during the boom period.

The outlook for the **Middle East and North Africa** region will continue to be driven by oil prices and economic activity in the European Union (the region's main trade partner). The oil price collapse at the onset of the financial crisis together with OPEC production restraints significantly reduced oil revenues, cut into intra-regional FDI flows, remittances and tourism receipts. However, exports are showing signs of life, with a gradual increase in oil revenues and a pick-up in goods shipments (the latter bound to Europe). Though headwinds from Europe places regional growth at some risk, recovery is anticipated to strengthen, with growth firming from 4.0 percent this year to 4.3 and 4.5 percent in 2011 and 2012 respectively.

GDP in **South Asia** has benefitted from stimulus measures (notably in India, and to a lesser extent in Bangladesh and Sri Lanka), relatively robust remittance inflows, which continued to expand (in contrast to declines elsewhere), and the recovery in global demand.

The region also benefitted from relatively resilient capital inflows, which increased as a share of GDP—from 3.6 percent in 2008 to 3.9 percent in 2009—and was supported by long-standing capital account restrictions. A combination of slower global growth, tighter financial conditions and a consolidation of fiscal policy in some countries in the region is expected to cause growth to average 8.4 percent over 2010-2012, compared with the pre-crisis rate of 9.2 percent in 2007 (calendar year basis).

Sub-Saharan Africa weathered the global crisis better than previous, milder economic cycles. In part this is because the hardest hit global markets (consumer durables and investment goods) are relatively small sectors in the region. At the same time, the region's limited financial integration, normally a negative factor, diminished the size of the initial shock. GDP growth for the region—is expected to continue to strengthen slowly, driven by higher commodity prices and stronger external demand. Overall the region is forecast to grow by 4.5, 5.1 and 5.4 percent respectively over 2010 – 2012, up from an estimated 1.6 percent gain in 2009.

Box 1. Recent developments and prospects for commodity markets

Commodity prices started to rebound in early 2009 and into 2010 as the global recovery intensified. Increased demand from China, significant production cuts (metals and oil), and some weather-related factors (agriculture) contributed to higher prices. By the end of April 2010, energy prices were up 80 percent from the lows in February 2009, while metal prices more than doubled. Agricultural prices increased by 20 percent over this period, with most of the gains in raw materials, e.g. rubber and cotton. Food prices rose just 7 percent on generally abundant global supplies. Mainly reflecting the gains already recorded, non-energy commodity prices are projected to increase 16.8 percent in 2010, before declining in 2011-12.

Prices for industrial commodities fell sharply during May in the wake of the Euro debt crisis, on concerns about economic growth and commodity demand. Industrial commodities fell most, with oil prices plunging nearly $20/bbl to $68/bbl, and a number of metals prices fell more than 20 percent from their mid-April highs. Among agriculture commodities, only rubber prices recorded a large decline, reflecting the plunge in the price of oil. Commodity prices appeared to stabilize at end-May, but uncertainty about demand remains.

After five consecutive quarters of decline, world oil demand rose in the final quarter of 2009, led by strong demand in China—up 1.3 mb/d or 17 percent (year-on-year). Nevertheless, global supplies are ample. Following previous production cuts to support prices, OPEC's spare capacity has increased to around 6.5 mb/d, roughly the same level as in 2002 when oil prices were $25/bbl. Moreover, inventories in the U.S. and in Europe are high. Over the medium term, oil demand is expected to grow only slowly – about 1.5 percent per annum, while non-OPEC oil supplies should continue to rise modestly, by about 0.5 percent a year, while OPEC countries continue to develop additional capacity. As a result, markets should remain well supplied. While prices are expected to average $75/bbl in real terms in the long run, they are likely to remain volatile, reflecting the inherent difficulties associated with OPEC's efforts to guide global prices through supply management. The tragic oil spill in the Gulf of Mexico has not affected oil production, but will likely have a long-term impact on the industry in terms of regulation and costs.

China has been the primary driver of metal demand during this decade. Its consumption of main base metals (aluminum, copper, lead, nickel, tin and zinc) rose on average by 17 percent per year, while demand in the rest of the world fell 1.1 percent per year. China imported large volumes of metals in 2009, much of which went into private and government controlled stocks, which propelled prices higher. Demand in 2010 is starting to recover outside of China, and over the next two years, metals prices are expected to continue to rise moderately as the global recovery progresses and metal demand expands. However, prices are not expected to rise substantially, because of the large idle capacity in many sectors that can be profitably brought back into production at current prices. However, in some areas industry will have to contend with declining ore grades, environmental and land rehabilitation, as well as water, energy and labor pressures, which may result in upward pressure on prices.

Agricultural prices have rebounded less

strongly than energy and metals, having increased 27 percent from their December 2008 trough. The gains have been centered in specific (mostly tropical) commodities. Edible oil prices gained 28 percent while grain prices have fallen 8 percent. Fertilizer prices, a key input into agriculture, especially in grain production, moderated and have declined by about two thirds since the record highs of the third quarter of 2008. Among other commodities, coffee (arabica) prices increased 46 percent due to strong demand and a weather-induced supply shortfall in Colombia, while cocoa prices are up 33 percent largely because of Côte d'Ivoire's difficulty in supplying the global market. Rice production shortfalls in India and the Philippines during 2009 put upward pressure on prices, but good prospects for the current crop have helped lower prices in May 2010 to their lowest level in 27 months. Overall agricultural markets, especially grains, appear to be well-supplied and are likely to remain so over the forecast period. Food commodity prices are projected to be marginally higher in 2010 compared with 2009, but to decline by 3 and 1 percent in 2011 and 2012 respectively.

See the Commodity annex for more on recent developments and forecasts.

A slower-growth alternative baseline

The uncertainty emanating from Europe and as yet unknown policy reactions to the volatility that erupted in May, makes projecting short-term growth particularly difficult. Increased equity market volatility may lead investors to hold back on investment projects or cause consumers to delay durable goods purchases, potentially slowing growth and even leading to a double dip recession in selected countries. By the same token, how policy reacts to the current situation will also affect prospects. The rapid rise in the price of CDSs for highly indebted high-income countries, and the potential for reduced market access for these countries, may prompt both them and other governments to speed up fiscal consolidation programs. Table 5 presents an alternative baseline that is consistent with a more constrained lending environment, more cautious investment and consumer behavior, and with governments assumed to speed up fiscal consolidation efforts by half the amount required to bring debt to GDP ratios to 60 percent of GDP by 2030 (see IMF, 2010).

In this alternative baseline scenario, global growth expands between 0.2 (2010) and 0.4 (2011 and 2012) percentage points slower than in the primary base case (Table 1, earlier). Most of the slower growth is explained by a weaker expansion in high-income countries, where GDP is projected to grow by 2.1, 1.9 and 2.2 percent in 2010 through 2012—lower by 0.1, and 0.5 points of growth over the period. The more constrained environment also affects growth in developing countries, but to a lesser extent – in part because only a few countries are assumed to implement sharper fiscal consolidation. The weaker growth in this scenario slows the pace of the expansion in global trade, and results in a somewhat lower price for commodities and lower inflation. Because the slowdown is concentrated in high-income countries, the share of developing countries contribution to global growth rises from 47 to 50 percent.

The expected confirmation of developing countries as a major growth pole does not mean that their prospects are divorced from those in high-income countries. To the contrary, slower growth in high-income countries will imply slower growth than might have otherwise been expected in developing countries in the short-term. Moreover, their long-term growth prospects are intimately tied to those of high-income countries. Failure to deal with high-income indebtedness could deprive developing countries of healthy markets for their goods. And, increasing developing-country borrowing costs and sharper competition for global savings—due to persistent debt problems in high-income countries—could cut into developing-country investment and growth.

Table 5 A slower growth baseline
(percentage change from previous year)

	2008	2009e	2010f	2011f	2012f
World	**1.7**	**-2.1**	**3.1**	**2.9**	**3.2**
High income	**0.4**	**-3.3**	**2.1**	**1.9**	**2.2**
OECD Countries	0.3	-3.4	2.0	1.9	2.1
Euro Area	0.4	-4.1	0.5	0.9	1.5
Japan	-1.2	-5.2	2.2	1.4	1.5
United States	0.4	-2.4	3.0	2.3	2.5
Non-OECD countries	3.0	-1.7	4.1	4.1	4.4
Developing countries	**5.7**	**1.7**	**6.1**	**5.7**	**5.8**
East Asia and Pacific	8.5	7.1	8.6	7.5	7.4
Europe and Central Asia	4.2	-5.3	4.0	4.1	4.3
Latin America and Caribbean	4.1	-2.3	4.4	3.9	4.0
Middle East and N. Africa	4.2	3.2	4.0	4.2	4.4
South Asia	4.9	7.1	7.3	7.8	7.5
Sub-Saharan Africa	5.0	1.6	4.4	4.9	5.2

Source: World Bank.
e = estimate; f = forecast.
1. Aggregate growth rates calculated using constant 2005 dollars GDP weights.
2. Calculated using 2005 PPP weights.

Potential impacts for developing countries from the sovereign debt crisis in Europe

Although a gradual, smooth resolution of the fiscal issues in high-income Europe is the most likely scenario, should a disorderly adjustment occur, it could have serious consequences for both high-income and developing countries. But even in the absence of a disorderly adjustment, developing countries and regions with close trade and financial connections to highly-indebted high-income countries, may face important repercussions.

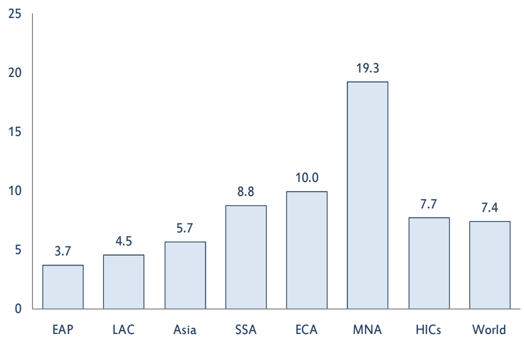
The Middle-East and North Africa, Europe and Central Asia and Sub-Saharan Africa regions have the closest trade ties with the heavily-indebted high-income European countries (EU-5) that are most likely to undergo a significant fiscal contraction (Figure 10). At the country level, these economies account for 20 percent or more of the exports of Albania, Azerbaijan, Cameroon, Cape Verde, Morocco, Tunisia, and Namibia. How hard these developing countries are hit, will depend on the extent of the fiscal contraction initiated, and how successful they are in shifting sales to other markets.

According to IMF (2010) fiscal consolidations, ranging between 9.2 (Greece) and 4.1 (Italy) percent of GDP, need to be implemented between 2010 and 2020 if these countries are to bring debt-to-GDP levels down to 60 percent by 2030. There is precedent for such large cuts in spending, but achieving them will require significant political sacrifices.[6]

Also at risk are countries whose financial sectors are closely linked to these highly indebted countries. Albania, Bulgaria, Romania, and Serbia are economies that have benefitted in the past from heavy capital inflows from Greek financial institutions. Similarly, banks in Portugal and Spain are an important source of finance in Latin

Figure 10 Developing regions with high trade exposure to heavily indebted European economies

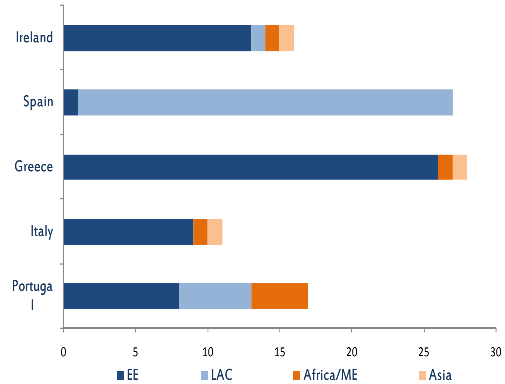
Share of Greece, Italy, Portugal, and Spain in Exports, percent



Source: World Bank, UN-COMTRADE.

Figure 11 Outstanding claims of banks in heavily-indebted European countries on developing countries

% of lender's GDP percent



America. Overall, the public and private sectors in Latin America have borrowed some $320 billion or 8 percent of GDP, while those in emerging Europe owe some $400 billion or 13 percent of GDP. And, Spanish banks own over 25 percent of bank capital in Mexico, Chile, and Peru. Portuguese banks are also important in African countries such as Angola and Mozambique. Beyond banking, FDI flows may also be affected, in particular to Latin America—12 percent of FDI flows to Brazil in 2009 came from Spain and Portugal. Should banks in the EU-5 be forced to re-capitalize or retrench, capital flows to the developing regions noted could contract heavily, potentially imposing further significant cuts to domestic demand—particularly among those that still have large external financing needs.

The global consequences of a default or major restructuring could be far reaching

A crisis of confidence, a default or major restructuring of EU-5 debt could have serious consequences for the global economy, both because of the large-scale recession that the directly affected countries are likely to enter into, but also because of the potential knock-on effects of the default on the financial health of creditor banks elsewhere in the globe.

The scenario outlined in Table 6, which takes as a starting point the slower growth baseline, illustrates the potential impacts on GDP, if a failure to take forceful action to restore fiscal policy onto a sustainable path were to increase investors' risk aversion towards economies with high debts.[7] In this scenario, increased risk aversion is assumed to cause the yield on 10 year U.S. government bonds to rise by 100 basis points and that of other sovereigns depending upon the degree of their indebtedness.[8] The increase in long-term interest rates has an almost immediate effect on investment decisions. In this scenario, global growth slows by about ½ a percentage point throughout the forecast period. The impact on growth is more severe in high- and middle-income countries, reflecting lower interest rates (and therefore a bigger percentage shock) and in countries/regions with strong trade linkages to the most affected high-income countries.

Table 6. Impact from a 100 basis point increase in risk aversion

	2009	2010	2011	2012
	(Percent change in GDP from baseline)			
World	**0.0**	**-0.4**	**-0.9**	**-1.4**
High-income	**0.0**	**-0.4**	**-1.0**	**-1.5**
High-income (ex EU-5)	0.0	-0.4	-0.9	-1.4
Developing countries	**0.0**	**-0.3**	**-0.8**	**-1.3**
Middle-income	0.0	-0.3	-0.8	-1.3
Low-income	0.0	-0.4	-1.0	-1.6
East Asia and Pacific	0.0	-0.4	-1.0	-1.5
Europe and Central Asia	0.0	-0.2	-0.6	-0.8
Latin America and Caribbean	0.0	-0.4	-1.0	-1.6
Middle East and N. Africa	0.0	-0.3	-0.6	-0.9
South Asia	0.0	-0.4	-0.8	-1.1
Sub-Saharan Africa	0.0	-0.2	-0.5	-0.7
Post shock [1]	(annual percentage growth)			
World	**-2.1**	**2.7**	**2.4**	**2.7**
High-income	**-3.4**	**1.6**	**1.3**	**1.7**
High-income (ex EU-5)	-3.3	1.9	1.5	1.8
Developing countries	**1.9**	**5.8**	**5.2**	**5.1**
Middle-income	1.8	5.8	5.2	5.1
Low-income	4.5	4.7	5.6	5.6
East Asia and Pacific	7.1	8.2	6.9	6.4
Europe and Central Asia	-5.2	3.8	3.8	4.0
Latin America and Caribbean	-2.3	3.9	3.2	3.4
Middle East and N. Africa	3.2	3.7	3.8	4.1
South Asia	7.1	7.1	7.5	7.3
Sub-Saharan Africa	1.6	4.2	4.6	4.9

Source: World Bank.
1. Percentage growth after shock

A less likely scenario might see confidence levels fall so far as to cause a freezing up of both domestic and external credit to heavily indebted countries. In such a scenario, a sharp and sudden reduction in domestic demand in affected countries might be anticipated. Should such a crisis engulf all of the EU -5 countries, it would have significant impacts on EU-5 exports and on activity in the rest of Europe and indeed the rest of the world.

Table 7 presents the results of a simulation that combines the generalized increase in risk premia of the earlier scenario, with the impact of an acute crisis in confidence that hits the EU-5 in the second half of 2010. The impact of the confidence crisis on domestic demand in EU-5 countries is modeled on the East Asia Crisis, and assumes that, either following a default, or based on market expectations of a default, credit (both international and domestic) to the EU-5 countries dries up and that a brutal fiscal adjustment and credit crunch ensues. GDP in EU-5 countries declines by as much as 15 percent, which has serious knock-on effects to the exports and activity levels in the rest of the EU and the rest of the world. Although the world economy escapes a recession in this scenario, global growth declines by about 2 percent in 2011.

Growth begins to recover in 2012, but overall world GDP is some 4 percentage points lower than it would have been in the baseline no crisis scenario. Because the shock runs through the trade channel, the hardest hit economies are those where export value-added is a large share of GDP and those with tight trade connections to the hardest hit countries. East Asia and the Pacific is particularly hard hit because of the importance of exports to its overall economy; likewise South Asia's still relatively low export-to-GDP ratios insulate it from the worst effects of the shock. Impacts in Sub-Saharan Africa and the Middle-East and North Africa are relatively muted despite the high concentration of EU-5 countries in their exports, because of low export to GDP ratios overall.

Table 7. Impact of a 100 basis point increase in risk aversion combined with the a severe debt crisis in EU-5 countries

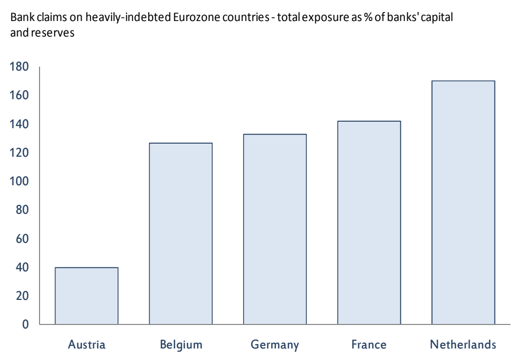
	2009	2010	2011	2012
	(Percent change in GDP from baseline)			
World	**0.0**	**-1.0**	**-3.1**	**-4.1**
High-income	**0.0**	**-1.1**	**-3.5**	**-4.6**
High-income (ex EU-5)	0.0	-0.9	-2.4	-3.5
Developing countries	**0.0**	**-0.8**	**-2.0**	**-2.9**
Middle-income	0.0	-0.8	-2.0	-2.9
Low-income	0.0	-0.6	-1.6	-2.2
East Asia and Pacific	0.0	-0.9	-2.3	-3.4
Europe and Central Asia	0.0	-0.6	-1.6	-2.1
Latin America and Caribbean	0.0	-0.9	-2.2	-3.4
Middle East and N. Africa	0.0	-0.7	-1.9	-2.4
South Asia	0.0	-0.8	-1.9	-2.5
Sub-Saharan Africa	0.0	-0.4	-1.1	-1.3
Post shock [1]	(annual percentage growth)			
World	**-2.1**	**2.0**	**0.7**	**2.1**
High-income	**-3.4**	**0.9**	**-0.6**	**1.0**
High-income (ex EU-5)	-3.3	1.4	0.5	1.2
Developing countries	**1.9**	**5.3**	**4.4**	**4.6**
Middle-income	1.8	5.3	4.4	4.6
Low-income	4.5	4.4	5.1	5.7
East Asia and Pacific	7.1	7.7	5.9	5.7
Europe and Central Asia	-5.2	3.4	3.0	3.7
Latin America and Caribbean	-2.3	3.5	2.5	2.7
Middle East and N. Africa	3.2	3.3	2.9	4.0
South Asia	7.1	6.6	6.8	7.0
Sub-Saharan Africa	1.6	4.0	4.2	4.9

Source: World Bank.
1. Percentage growth after shock

The financial channel has the potential to be even more disruptive to global growth. A default or major restructuring among heavily indebted European sovereigns could have serious knock-on effects among the banks of other European countries. Banks located in Austria, Belgium, France, Germany, and the Netherlands have loan exposures to heavily-indebted European countries totaling €1.4 trillion at end-2009 (Figure 12), with those exposures exceeding the capital of these banks in many countries. A sharp decline in the value of such assets could threaten the solvency of some of these banks, with potentially far-reaching consequences for the overall banking system and the global economy.

Ex ante, there is little that developing countries can do to insulate themselves from the possibility of a widening of the sovereign debt crisis. Clearly countries are well advised to improve their own fundamentals to ensure that markets continue to distinguish between their risks and those of these high-income countries. Countries that have run-down their reserves to dangerous levels should institute policies now that help to rebalance domestic demand (fiscal austerity in some cases, enhanced exchange rate flexibility in others) so as to engineer a relatively smooth current account adjustment rather than a sudden and disruptive market driven one.

Figure 12. European Banks are also at risk from a default or restructuring



Source: World Bank, JP Morgan

A faster fiscal consolidation would be better for both high-income and developing countries

Even in the event of a smooth resolution of the fiscal challenges in high-income countries, how they are resolved may have important implications for outcomes in developing countries. In particular, simulations suggest that a policy that sought to unwind the fiscal challenges of high-income countries relatively quickly would benefit developing countries, more than a policy that sought o unwind them only slowly.

Table 8 presents the results of simulations using the G-cubed dynamic general equilibrium model. The simulations compare GDP outcomes from two fiscal consolidation scenarios. In the baseline scenario, which is based on IMF (2010), countries slowly increase their primary balances between 2010 and 2020 to a level, which if maintained until 2030, would bring their debt-to-GDP ratios down to 60 percent by this time.[9] Table 8 reports the changes in the level of GDP that would be observed at two points in time if the same fiscal consolidation (increase in primary balance) were undertaken more within four years and maintained until 2030.[10] Two main factors are at work in these simulations. First, reduced government expenditure tends to lower GDP and import demand in the G-20 countries undertaking a consolidation. This effect is offset by the influence of lower interest rates due to decreased demand for global savings.

Among consolidating high-income countries, the first effect dominates for the first few years, so that GDP comes in as much as 1.8 percent lower than in the baseline for the United Kingdom. In Germany, however, where less fiscal consolidation is required, the second effect dominates and GDP is actually higher by 1.1 percent in 2014. For developing countries and high-income countries that do not need to undertake consolidation, the impact of the consolidation is positive even in the short-run because the negative effects from weaker demand for their exports is more than offset by the benefits to be derived from lower real interest rates because of the fiscal tightening. Real interest rates in developing countries could be as much as 300 basis points lower in the short-run. The simulation assumes that interest rates in developing countries respond to international market conditions. To the extent that developing country interest rates do no react, perhaps because of market controls, this simulation will over-estimate the positive effects for growth of lower interest rates.

Table 8. Impact of a faster fiscal consolidation

	2010	2014	2022
	(Per cent of GDP)		
World	0.0	0.6	1.2
High-income	0.0	-0.3	1.3
United States	0.0	-0.9	1.1
Japan	0.0	-1.6	1.3
United Kingdom	0.0	-1.8	2.9
Germany	0.0	1.1	0.5
Euro Area	0.0	0.5	1.6
Canada	0.0	2.0	0.5
Australia	0.0	1.7	0.7
New Zealand	0.0	1.4	1.7
ROECD	0.0	1.1	0.8
Low- and Middle-income	0.0	2.3	1.0
Low- and middle income (ex. China and India	0.0	2.7	1.2
Low- and middle-income (ex. China, India, Europe and Central Asia)	0.0	3.4	0.9
China	0	2.9	0.9
India	0	2.3	1.2
Other Asia	0	3.4	1.1
Latin America	0	2.9	0.9
Other developing countries	0	4.1	0.6
Europe & Central Asia	0	2.3	1.1
OPEC	0	0.3	2.4

Source: World Bank. Simulations using the G-cubed model.

Overall, although a more rapid consolidation policy would imply (at least for the United States) a bigger short-term cost in terms of reduced GDP, in the long run such a policy would be a win-win. Lower interest rates and the stronger projected growth in developing countries in the quick adjustment scenario cause GDP in high-income countries to be higher in the long run, and even in the short-run in the case of high-income countries that do not have to undertake a large fiscal adjustment.

Interestingly, in addition to alleviating the fiscal imbalances that currently characterize the global economy, the simulations suggest that this needed consolidation will also go a long way to reducing global imbalances. For example, in the short-run a quick adjustment scenario would see the U.S. trade deficit decline by about 3 percent of GDP and China's trade surplus decline by more than 6 percent of its GDP. In the longer run, the adjustments are more muted 1.6 and 4.5 percent respectively.

The conduct of monetary policy in high-income countries may also pose challenges for developing countries. For the moment, inflationary pressures have been on the wane in the vast majority of developing countries, reflecting both lower food and fuel prices and the extended bout of spare capacity brought about by recession (see the Appendix on inflation for more). As a result, monetary policy has been broadly expansionary. However, the recovery is much more advanced in many developing countries, and central bankers in many have begun to tighten monetary policy, including in Brazil and China. As a result, the spread between their short-term interest rates and those in several high-income countries are growing. This increases the financial incentive to make short-term investments in these countries, and associated capital inflows have the potential to be de-stabilizing for their economies.

The depth and duration of the crisis in Europe and Central Asia continues to be a source of concern

The expected duration and depth of the crisis will complicate matters further, especially for countries in the Europe and Central Asia region. As the recession wears on, firms are increasingly likely to have difficulty meeting their debt obligations. Non-performing loans are rising, and in some countries: Ukraine, Croatia, and Romania, bank provisioning is lagging more than 50 percent of the non-performing loans. Banking-sector fragility is accentuated in several countries that have significant exposures to Greek Banks. Should difficulties in Greece become more serious, these banks may be forced to cut activities or extract capital from their subsidiary operations – which could have serious knock-on effects for countries in the region.

Moreover, many companies in the region borrowed heavily during the boom period. Private companies borrowed $418 billion dollars over the 2003-2008 period, with as much as $133 billion expected to come due in 2010. Tighter global financial conditions may result in a reduction in rollover rates (international financial institutions and high-income Central European countries exercised considerable moral suasion on banks to renew loans in 2009), which could cause individual firms in the region to default – potentially putting them into bankruptcy and adding to pressure on regional banks.

Concluding remarks

The strong recovery that currently characterizes monthly data for the global economy is expected to lose some steam in the coming months; but annual growth rates should continue to strengthen—especially among developing countries. These countries are responsible for a growing share of global growth, a trend that is expected to continue in the years and decades to come. The outlook, nevertheless remains fragile and significant challenges stand in the way of a smooth recovery.

Chief among these are the problems in Greece and other highly indebted high-income countries—problems which continue to have the potential to widen. Although developing country finances are much stronger, a widening of the Greek crisis to other much larger high-income economies with serious fiscal difficulties could generate significant disruption to developing country export and GDP growth. If markets lose confidence in the credibility of efforts to put policy on a sustainable path, global growth could be significantly impaired and a double-dip recession could not be excluded.

More generally, significant fiscal consolidation is necessary to ensure the long-term sustainability of public finances in many high-income countries. While the domestic motivations for bringing government accounts back onto a sustainable path should be sufficient, more than the economic well-being of high-income countries is at stake. A prolonged period of rising high-income country indebtedness would raise global borrowing costs for developing countries, reducing investment and growth and ultimately resulting in more poverty.

The fiscal challenges facing developing countries are less marked, but if aid flows are compromised, as they have been following past high-income recessions, then the consequences for developing-country investment and long-term growth prospects could be serious.

Continued very relaxed monetary policy in high-income countries could also pose challenges for developing countries, especially as they move to tighten their own policy stance. Rising interest rate differentials could induce significant capital inflows that could serve to regenerate some of the asset bubbles that created the conditions of the crisis in the first place.

Notes

1. In particular, while movements in global equity markets were highly correlated in May, they have been much less so than in the fall of 2008. Moreover, current correlations are lower than those observed in early 2010. Co-movements in other asset classes (CDS spreads for example) are also stronger, but they remain well below levels seen during the fall of 2008.

2. The index combines information on the changes since March 30th in sovereign spreads; domestic 3-month commercial interest rates; stock-market indices; and nominal exchange rates into a single index. The raw data are normalized by expressing them as the deviation from the average change, divided by the standard deviation of those deviations, such that each measure contributes equally to the overall index. Because of the normalization procedure, the index is a relative index. If financial conditions in all countries deteriorated, the index would show no change.

3. Several sovereign borrowers (including Argentina, Albania, Angola, Kenya, FYR Macedonia, Poland, and Tanzania) have delayed issuance plans likely due consideration of current market conditions.

4. Over the next 10 years, the United Nations predicts that the working-age population in Western Europe will decrease 0.42 percent per annum – in stark contrast to growth of 0.54 and 1.44 percent per annum in the United States and developing countries respectively.

5. The aggregate financing gap is defined as the sum of the difference between the estimated financing needs and projected private capital flows for all countries whose country-specific gap is negative. Thus, if *ex ante* projected financing exceeds the requirements of some countries, this positive gap is not used to offset the negative gap of countries with unmet needs.

   Developing countries' external financing needs, are defined as the current-account deficit (assumed to be a constant at its 2009 level as a percent of GDP) plus scheduled principal payments on private debt (based on information from the World Bank's Debtor Reporting System). Private capital flows include disbursements on private debt, net equity flows (inflows minus outflows), and net unidentified capital outflows, which are projected at the country level.

   Previous calculations utilized current account projections. Earlier estimates of the financing gap for 2009 used forecasts for current account deficits in 2009. Had a similar methodology been employed as reported here, the ex ante financing gap for 2009 would have been around $460 billion rather than $350 billion as estimated using the projections.

6. Ireland increased its primary balance in the 1980s by 20 percent of GDP, while nine countries have engineered improvements in excess of 10 percent of GDP over a time period ranging from 3 to 15 years (IMF, 2009).

7. Although during periods of heightened uncertainty there is a tendency for bond yields in safe-haven currencies to fall as money is repatriated, over the longer-run, once these portfolio adjustments occur, long-term rates even in safe-haven countries tend to rise once again. Indeed, prior to the EU-5 debt concerns dominating market attention, long-rates in the United States were rising. The simulations presented here examine this long-term behavior and abstract from the short-term fluctuations associated with short-term portfolio adjustments.

8. The scenario assumes short-term investment to long-term interest rate elasticities broadly consistent with Hervé et al. (2010). Following Kinoshita (2006) it assumes that countries risk premia rise or fall with the rate of the risk-free interest rate linearly (2 basis points per 1 percent of Government debt-to GDP ratio). Following, a 10 basis point increase in the risk-free interest rate would result in a 10.2 basis point increase in the interest rate paid by a country with a 1 percent debt-to GDP ratio and a 14 basis point increase in a country with a 20 percent of GDP debt ratio. In this scenario, where the long-term yield in the U.S. where Government debt-to-GDP is 71 percent (2008), interest rates rose by 100 basis points; the yield for Brazil, whose debt-to-GDP ratio is 65 percent (2008), would rise by 95 basis points.

9. This is a simplification of the IMF scenario. The degree of adjustment in most countries is as described. In the case of Japan, however, the scenario is adjusted to bring the net government debt-to-GDP ratio to 80 percent by 2030 (equal to about 200 percent in gross terms), while for Greece the 7.6 percent of GDP tightening announced for 2010 is assumed to occur.

10. In the second scenario, debt-to-GDP ratios are lower in 2030 than in the first scenario because the adjustment in primary balances is the same, but occurs 6 years earlier.

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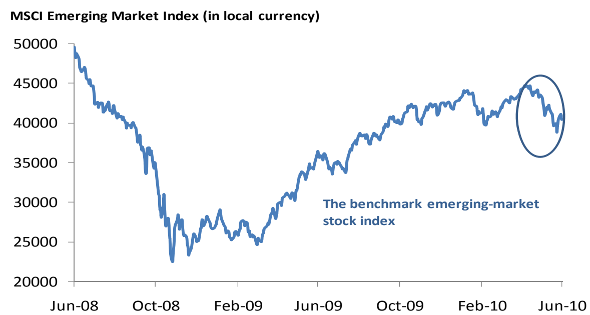
Topical Appendix

Recent developments in financial markets

As discussed in the main text, the very high government deficits and debt levels in several high-income countries (notably, Greece, Ireland, Italy, Portugal and Spain) has provoked a great deal of volatility in international financial and commodity markets—notably oil and metals. So far, the main impacts for developing countries have been limited to a generalized decline in stock-market valuations (Figure A1.1), a significant fall in bond issuance in May (some due to seasonality), and an increase in volatility and realignment of global currencies, as the euro has depreciated against the dollar—to the benefit of exporters in countries tied to the euro, but to the detriment of those tied to the dollar.

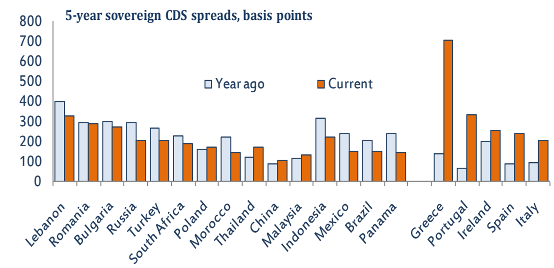
Figure A1.1 Emerging market equities experienced declines recently



Source: Morgan-Stanley through Bloomberg.

For the moment, the crisis has not impacted sovereign risk premia of developing countries that do not have fiscal sustainability issues of their own. Most developing countries have much lower deficits and debt to GDP ratios than high-income countries. As a result, the price of insurance against a sovereign credit default (credit default swaps, or CDS) for most developing countries has remained relatively stable even as this same indicator has jumped substantially for the EU-5 (Figure A1.2). Despite the sharp increase in sovereign CDS spreads for Venezuela and Argentina (not shown in the figure) in May, spreads for these countries actually declined slightly compared with a year ago after they had skyrocketed to more than 3,000 basis points in October 2008 and have remained high from that time on.

Figure A1.2 Sovereign risk premia for developing countries remain relatively stable



Source: Bloomberg and DECPG staff calculation

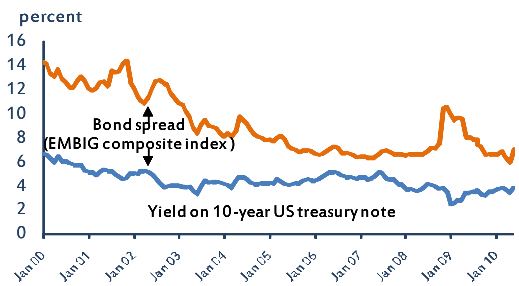
A recovery in credit conditions

Data on capital flows to developing countries do not, as yet, indicate that the crisis in Europe has had a major effect on developing country access to capital.

And even with the deterioration observed since the end of April, developing country stock markets are up since their post-Lehman lows of March 2009. Although developing-country sovereign interest rate premiums have widened to 325 basis points in May, they are still lower than the peak of more than 800 in October 2008 (Figure A1.3). And most developing-country currencies have regained pre-crisis levels, with some even appreciating against the dollar.

Both developing-country sovereign and corporate borrowers have taken advantage of improved market conditions, with bond issuance reaching $115 billion in 2009, up almost $65 billion over 2008. Developing-country borrowers have issued $73 billion in bonds in the first four months of 2010, well ahead of the pace seen in periods of previous peak performance (Figure A1.4). In particular, developing-country

Figure A1.3 Emerging market sovereign bond spread and yields, January 2000-May 2010

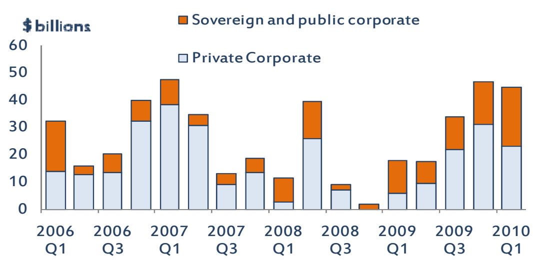


Source: JP Morgan

corporate borrowers, after having been shut out of the market for three quarters following the crisis, succeeded in issuing $43 billion since the beginning of 2010. However, in February—when the European debt problem affected the markets for the first time, and in May, when effects intensified, international bond issuances by developing countries were historically low, at $5 and $3 billion, respectively. There was only one sovereign issuance placed by Malaysia for $1.25 billion in May. In fact, several sovereign borrowers (such as Argentina, Albania, Angola, Kenya, FYR Macedonia, Poland, and Tanzania) have likely delayed issuance plans due to current market conditions. It is difficult to determine with precision to what extent these reflect a normal seasonal decline, or a temporary reduction in issuances prompted by elevated market volatility related to European debt problems.

Bank lending to developing countries remains depressed, as high-income banks continue to re-

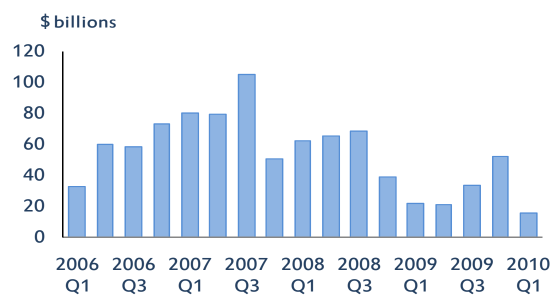
Figure A1.4 Increased bond issuance by developing countries 2006 Q1-2010Q1



Source: Dealogic.

capitalize and strengthen their balance sheets (indeed, cross border lending to both developed and developing countries is down). As a result, net international bank lending in 2009 (disbursements minus repayments), amounted to negative $53 billion. New (syndicated, bilateral and intra-bank) loans more than halved from $531 billion in 2008 to $258 billion, less than the $311 billion in maturing debt that was repaid. Syndicated bank-lending totaled only $123 billion in 2009—half its 2008 level. There has not been any sign of a rebound so far in 2010, with only $46 billion in syndicated lending between January and May (Figure A1.5).

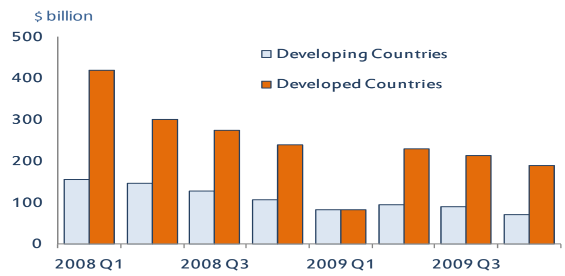
Figure A1.5 Syndicated bank lending continues to be limited



Source: Dealogic.

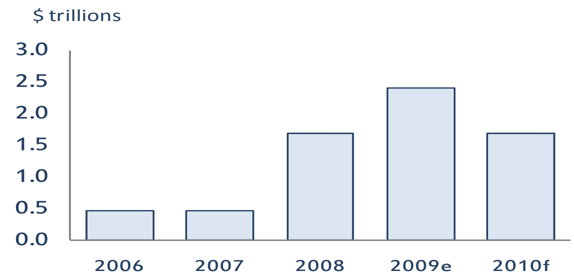
FDI inflows to developing countries fell 40 percent in 2009 (Figure A1.6). Flows declined from $594 billion (3.4 percent of GDP) in 2008 to $358 billion (2.1 percent of GDP)—the sharpest decline in 20 years. Even China experienced a 45 percent drop in FDI flows to an estimated $78 billion, partly because of high disinvestments in the financial sector. Similarly, FDI inflows to other developed countries declined by another 40 percent in 2009 as they did in 2008. Multinational firms were hit hard by the global economic recession and financial crisis of the last year. Slower global growth squeezed their profitability, and at the same time economic uncertainty and weak global demand reduced their willingness (and ability) to expand abroad. Energy-oriented FDI was less affected as many companies with expertise in energy exploration still had strong cash positions, while falling prices of developing-country energy assets raised investment attractiveness.

Figure A1.6 Global net FDI flows recovered from trough in Q1-2009, but remain below 2008 levels



Source: Country sources and World Bank.

Figure A1.7 Sovereign debt issuance by HICs 2006-2010



Source: IMF

Overall, despite the rebound in bond issuance, portfolio equity flows and short-term debt flows (mostly trade related); international capital flows to developing countries fell sharply for a second year in 2009. Net private capital flows fell by a further 40 percent in 2009 to $454 billion (2.7 percent of GDP) compared with $752 billion (4.4 percent of GDP) in 2008 (see Table A1.1). This represents a dramatic reversal from peak levels of $1.2 trillion in 2007 (8.5 percent of GDP).

Recent developments in international capital flows

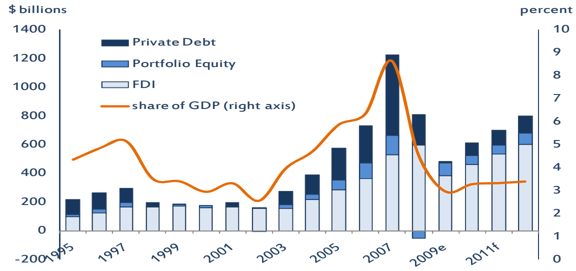
The recovery in international capital flows to developing countries is expected to face headwinds from increased competition for global savings, as increased debt of high-income countries put pressure on developing countries. The five-fold increase in public sector financing requirements of high-income countries will enhance competition for funds and raise borrowing costs for developing-country borrowers going forward (Figure A1.7). In addition, the need for banks to rebuild their balance sheets, as well as increased risk aversion on the part of investors, should result in less abundant and more expensive capital.

The possibility of G3 policy tightening over the coming months (or years) could have a significant impact on emerging market bonds. For example, the last time that the U.S. Federal Reserve began to raise rates after a protracted easing cycle in 2004, it triggered a large widening of emerging market bond spreads, while leading to only a shallow and short-lived spread-widening for U.S. corporate bonds. All of these elements will raise the cost of capital for developing countries. This, even if developing country risk premiums decline somewhat due to a relative improvement in emerging country risk vis-à-vis developed countries. However, if real interest rates in high-income countries were to return to pre-boom levels, and if the historical relationship between base rates and interest rate spreads remains unchanged, borrowing costs in developing countries could rise by between 110 and 220 basis points.

Net private capital flows to developing countries are projected to recuperate in 2010 as the global recovery continues; but they are not expected to reach pre-crisis levels in the medium term. Debt flows may be constrained by (rising) risk aversion (related to sovereign debt sustainability concerns), tighter regulations and increased competition for funding. While cross-border bank lending is expected to remain muted in the medium-term, several upper-middle income countries may opt to continue relying on international bond markets to raise capital. Most developing countries—poor countries in particular—have limited access to international bond markets. FDI is expected to rebound more readily, reflecting relatively strong growth prospects for developing countries, which will continue to push multinationals to undertake efficiency and market-enhancing investments in developing regions. As a result, private capital flows to developing countries are forecasted to recover from $454 billion (2.7 percent of GDP) in 2009 to $771 billion (3.2 percent of GDP) by

2012, still far below the $1.2 trillion (8.5 percent of GDP) in 2007 (Figure A1.8).

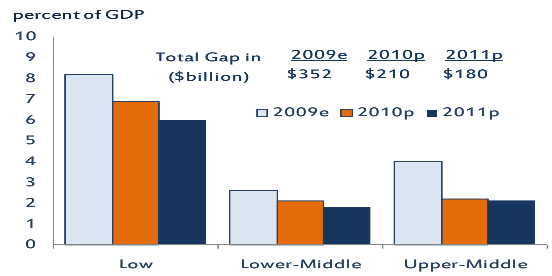
Figure A1.8 Prospects for private capital inflows to developing countries



Source: World Bank

Financing gaps are expected to decline, but remain substantial for a number of countries. In 2009, high financing gaps led to significant current account adjustments and slower growth in several developing countries. Based on the assumption that the current account deficit to GDP ratios remain, at 2009 levels, and with the projected rise in international capital flows, the ex-ante financing gap is projected to decline gradually to $180 billion in 2011 from $352 billion in 2009. As a share of GDP, the decline in the gap was most marked for upper-middle-income countries (1.5 percent) and lower-middle income countries (1.3 percent) (Figure A1.9). For low income countries—given still-depressed bank-lending and limited access to bond markets—financing the projected gap of 6.5 percent of GDP in 2010 will prove challenging, especially should ODA flows decline.

Figure A1.9 External financing gaps for developing countries, 2009-2011



Source: World Bank

Table A1.1 Net capital flows to developing countries
$ billions

	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Net private and official inflows	**501.8**	**659.8**	**1222.8**	**780.5**	**523.5**			
Net private inflows (equity+debt)	**573.3**	**732.1**	**1223.7**	**752.4**	**454.0**	**589.5**	**670.2**	**770.8**
Net equity inflows	349.9	469.0	663.8	536.5	445.9	497.5	564.2	652.8
..Net FDI inflows	281.1	363.2	528.4	593.6	358.3	438.0	501.0	575.0
..Net portfolio equity inflows	68.8	105.8	135.4	-57.1	87.5	59.5	63.2	77.8
Net debt flows	151.9	190.8	559.0	244.0	77.6			
..Official creditors	-71.5	-72.3	-0.9	28.1	69.5			
....World Bank	2.7	-0.5	4.8	7.1	21.1			
....IMF	-40.2	-26.7	-5.1	10.8	27.5			
....Other official	-34.0	-45.1	-0.6	10.2	20.9			
..Private creditors	223.4	263.1	559.9	215.9	8.1	92.0	106.0	118.0
....Net M-L term debt flows	137.8	168.3	315.4	228.6	-2.7			
......Bonds	56.8	31.7	87.4	15.0	54.8			
......Banks	85.8	141.5	231.0	217.2	-52.9			
......Other private	-4.8	-4.9	-3.0	-3.6	-4.6			
....Net short-term debt flows	85.6	94.8	244.5	-12.7	10.8			
Balancing item	**-414.1**	**-446.5**	**-617.9**	**-808.4**	**-292.9**			
Change in reserves (- = increase)	**-393.6**	**-643.5**	**-1081**	**-439.0**	**-561.0**			
Memorandum items								
Net FDI outflows	61.6	130.5	148.7	207.5	153.9	210.0	250.0	275.0
Workers' remittances	193.0	235.0	290.0	336.0	316.0	335.0	359.0	

As a percent of GDP (%)

	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Net private and official inflows	**5.03**	**5.59**	**8.45**	**4.51**	**3.09**			
Net private inflows (equity+debt)	**5.74**	**6.21**	**8.46**	**4.35**	**2.68**	**3.02**	**3.05**	**3.15**
..Net FDI inflows	2.82	3.08	3.65	3.43	2.12	2.24	2.28	2.35
..Net portfolio equity inflows	0.69	0.90	0.94	-0.33	0.52	0.30	0.29	0.32
..Private creditors	1.5	1.6	3.9	1.4	0.5	0.5	0.5	0.5

Recent developments in trade

As the global recovery gained momentum, trade also rebounded and global merchandise exports accelerated sharply in recent months. Global goods exports in value terms advanced at a 47 percent annualized pace (saar) by the end of 2009; developing countries reported growth at 65 percent, while high income countries' exports gained 39 percent in December. However, this brisk pace is now slowing, as exports from developing countries eased to 32 percent, and shipments from high-income countries dropped to 16 percent during the first quarter of 2010. Of note, exports from Germany fell, as the pace of export growth dropped from 46 percent in December to negative territory in the first quarter.

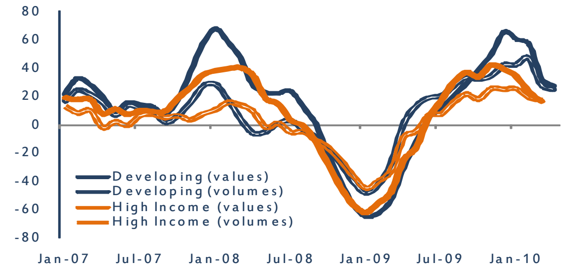
In volume terms, global exports have been growing at an annualized pace of 20 percent during the first quarter of 2010, with developing countries posting annualized gains of 26 percent, and high income economies 17 percent in most recent observations. However, in contrast with other high-income countries, Japanese exports accelerated in the first two months of 2010, growing at an annualized pace of 56 percent in January, before slipping to a still robust 40 percent growth in April–indicative of continued strong demand in the East Asia and Pacific region.

As is the case with output and industrial production growth, export growth is also becoming more differentiated among the various developing regions. In developing Europe, annualized growth reached 65 percent in the early phase of the recovery, but has since subsided to 24 percent in April. Exports from South Asia, Latin America and East Asia and Pacific remain strong, in fact on the edge of a second wind, even when China is excluded from the calculations.

Strong import demand from developing countries was responsible for the majority of the acceleration in global import volumes, which increased to an annualized pace of 25 percent in January. The pace of import growth has remained strong in developing countries, at 30 percent in April, but receded in high income countries to 5 percent contrasted with 38 percent in September 2009. The growth in imports has decelerated sharply in the Euro Zone, to annualized negative growth of 12 percent by March. As several high income European countries launch austerity measures to rein in fiscal deficits, further weakness in domestic demand will undoubtedly lead to a reduced appetite for imports. In contrast, import demand in the United States, remains close to peak recovery rates of 20 percent annualized growth in March.

Figure A2.1 Trade rebound is slowing

Merchandise exports, 3m/3m saar % change



Source: World Bank

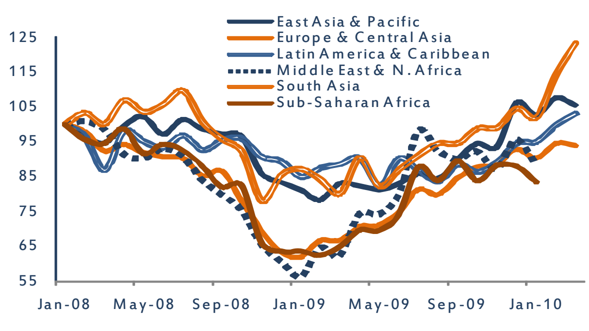
The importance and resilience of domestic demand is becoming evident among the patterns of import demand among developing countries. In South Asia, import volumes were growing at an annualized pace of 116 percent in February, influenced by a resurgence in demand from India. Similarly in Latin America, import demand has continued to accelerate, with annualized growth peaking at 61 percent in April. East Asian import demand appears to be stabilizing at very high growth rates in a 70 percent range: 40 percent (excluding China). In contrast, import demand in developing Europe has moderated from 50 percent at the end of 2009 to 15 percent by March.

In value terms, global merchandise exports remained 10.6 percent below January 2008 values in March 2010, with the shortfall measuring 12.5 percent in high income countries and 6.2 percent in developing countries, with the latter benefitting from the recent resurgence in commodity prices. In volume terms, global exports are just 4 percent below pre-crisis levels, with high income countries trade still 6 percent below January 2008 levels. In contrast, the volume of developing country exports has rebounded to 1.7 percent above pre-crisis levels by March 2010. This was largely due to South and East Asia, where export volumes have made a robust recovery, and were 14.5 and 5.3 percent above the pre-crisis levels of January 2008. In developing Europe, both merchandise export values (-16 percent) and volumes (-6 percent) remain below pre-crisis levels observed in January 2008.

The overall value (volume) of global merchandise imports remains 9 (6) percent below January 2008 levels, with a shortfall of 13 (10) percent in high income countries, and with developing regions 2 (6) percent above pre crisis levels. East Asia, South Asia and the Middle East were all importing more in volume terms by March 2010 than they were two years earlier, with South Asian import volumes up 21 percent from January 2008. Import demand has been very weak in developing Europe, remaining 16 percent below pre-crisis levels in volume terms in March.

Figure A2.2 Rapid developing-country import growth drives recovery in trade

Merchandise export volumes, Jan 2008 = 100

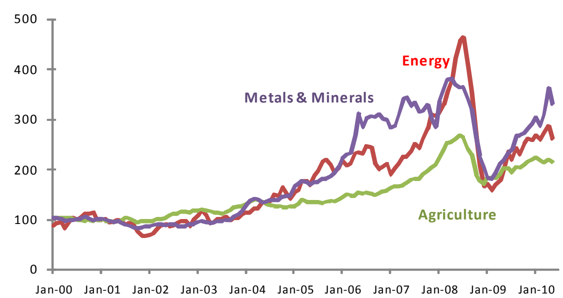


Source: World Bank

Recent developments in commodity markets

The rebound in commodity prices that started at the beginning of 2009 continued into 2010 as the global economy recovered. Increased demand from China, significant production cuts (metals and oil), and some weather-related factors (agriculture) also contributed to higher prices. As a result, energy prices increased by 60 percent in the first quarter of the year (compared with year-earlier levels) while metals and agricultural prices increased by 62 percent and 19 percent respectively (Figure A3.1).

Figure A3.1 Commodity price indices (Nominal US$, 2000=100)



Source: World Bank

Following the outbreak of the Euro debt crisis, industrial commodities fell sharply during May due to concerns about economic growth and weakening commodity demand. Oil prices dropped from a high of $87/bbl to $68/bbl during May, and some metals prices fell more than 20 percent from their highs in April. The declines occurred amid recovering global demand, particularly outside of China, which had provided much of the initial demand strength during the recovery. Agriculture prices have not been impacted during the debt crisis. Furthermore, markets are generally well supplied and crop prospects are good. The only large decline was for rubber, and this mainly due to the plunge in oil prices.

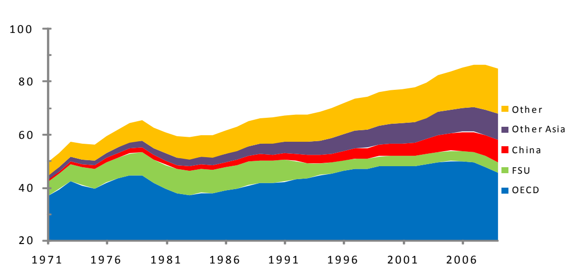
Energy prices are projected to increase 25.1 percent in 2010, while non-energy commodity prices are expected to rise 16.8 percent in the year—with the bulk of the gains in non-food sectors. However as the recovery in global growth peters out and output stabilizes at levels closer to potential growth rates, energy and non-energy prices are projected to decline by 4.5 percent and 4 percent, respectively, in 2011 and another 1.0 percent and 5.4 percent in 2012. Both energy and non-energy prices will remain well below their 2008 highs over the forecast period.

Crude Oil

After five consecutive quarters of decline, world oil demand rose in the final quarter of 2009—led by strong demand in China, up 1.3 mb/d or 17 percent (year-on-year). However, much of China's growth was feedstock (naphtha) for new petrochemical capacity, and thus represents a one-off source of growth. All of the projected growth in demand during 2010 (1.6 mb/d or 1.9 percent) will be from developing countries, as OECD demand is expected to remain flat following four years of decline (partly reflecting the impact of higher prices). In the medium term, world oil demand is expected to grow moderately, owing to efficiency improvements in transport and ongoing efforts by governments and industry to reduce carbon emissions, particularly in high-income countries.

In response to the large fall in global demand that began in 2008H2—as well as the precipitous drop in oil prices—OPEC reduced production by 4 mb/d in late-2008/early-2009 in an effort to raise prices to its target range of $70-80/bbl. As a result, OPEC's spare capacity has increased to more than 6 mb/d, roughly the same level as in

Figure A3.2 World oil demand (mb/d)



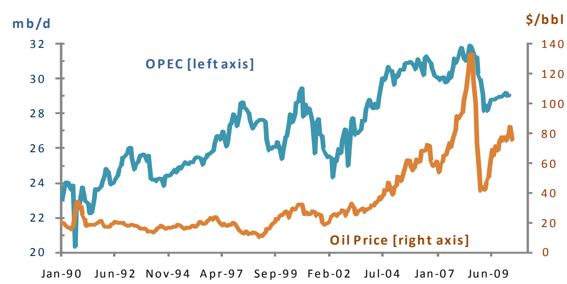
Source: International Energy Agency

2002 when oil prices were $25/bbl. Even though oil inventories have fallen significantly from peak levels in early 2000, they remain relatively high.

Over the medium term, oil prices are expected to remain volatile, but on average are expected to remain in a $70-80 range as OPEC seeks to put a floor under prices via production restraint. But the group will be wary of allowing prices to rise much above that level due to the impact on demand.

Growth in global oil demand is expected to remain moderate at 1.5 percent per year, with virtually all of the growth in developing countries and North America. Non-OPEC oil supplies should continue to rise modestly, as production increases in Brazil, Canada, the Caspian and West Africa, are offset by declines in yields from older fields, especially in the North Sea and Mexico. Globally there are no resource constraints, and our long-term forecast of $75/bbl in real terms is commensurate with the higher end cost of developing additional oil capacity, notably from oil sands in Canada.

Figure A3.3 OPEC crude oil production and oil prices



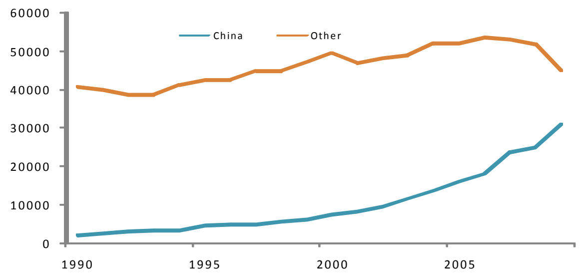
Source: International Energy Agency, and World Bank

Metals

China has been the primary driver of metal prices this decade, as Chinese consumption of the main base metals (aluminum, copper, lead, nickel, tin and zinc) rose by 17 percent per year, while demand in the rest of the world fell 1.1

percent per year (Figure A3.4). In 2009, Chinese demand rose 23 percent, while demand in the world outside China fell 13.5 percent (and by 20.4 percent in the OECD). Much of the rise in Chinese demand went into stocks (both private and government) but there was also strong stimulus-led consumption for construction and infrastructure.

Figure A3.4 World metal consumption ('000 tonnes)



Source: World Metal Statistics, and World Bank

Because of the large drop in demand and prices following the onset of financial crisis in 2008, there were significant cutbacks at mines and smelters. With the sharp recovery in demand (mainly in China) prices more-than doubled from their troughs of early 2009. Over the next two years, prices are not expected to rise substantially, partly given the large price gains to date, but mainly due to substantial idle capacity. Further large price increases would require idle capacity being reabsorbed over the longer-term, but with demand growth slowing toward trend, pressures for real price increases should be moderate. Over the longer term, declining ore grades, environmental and land rehabilitation, as well as water, energy and labor pressures, may result in upward pressure on prices.

Agriculture

Agricultural prices have rebounded less sharply than energy and metals, having gained 28 percent between December 2008's trough and the first quarter of 2010. Most of the gains reflect large price increases in specific commodities, rather than a broader trend. Grain prices, for example, remained unchanged during this period while edible oil prices—traditionally the fastest growing food group in terms of consumption—gained 31 percent. Fertilizer prices, a key input into agriculture, especially in grain production, declined 38 percent, and prices are now less-than half the 2008 average and about one-third the 2008Q3 record highs.

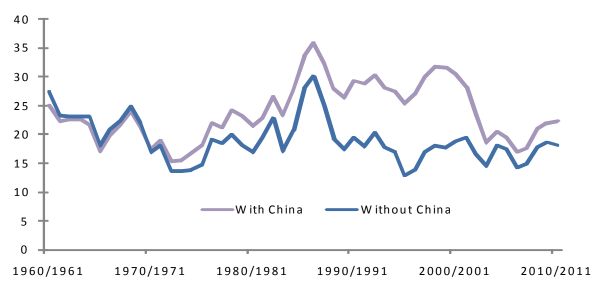
For the most part, the gains in agricultural prices reflect price increases for certain tropical commodities. Coffee (arabica) prices, for example, have traded above $3.00/kg during the past 12 months, reflecting strong demand and a weather-induced supply shortfall in Colombia, the world's second largest arabica supplier. Natural rubber prices reached record highs on the back of strong import demand following the recovery of the global economy (most natural rubber goes to tire manufacturing), higher crude oil prices (key input to competing synthetic rubber), as well as weather problems in key SE Asian rubber producing countries.

Cocoa's strength is largely due to Côte d'Ivoire's inability to supply the global market. Côte d'Ivoire, which accounts for one-third of global cocoa supplies, faces deteriorating infrastructure due to prolonged civil conflict, thus making the transport of inputs and output to and from cocoa producing areas very costly. In addition, diseases affecting cocoa trees have not been adequately addressed due to the poor state of its agricultural research system. These conditions combined with steady demand growth have exerted pressure on global markets. Sugar prices doubled between December 2008 and August 2009 reflecting a weather-induced shortfall in India, the world's second largest sugar supplier after Brazil. Interestingly, with the exception of natural rubber, these commodities did not participate in the 2008 commodity price spike.

Rice production shortfalls—in India earlier in 2009 and in the Philippines later in the year—put upward pressure on prices towards the end of 2009. This in turn led the Philippine government to announce large tenders for rice imports. However, prices receded in 2010 in view of the large stockpiles accumulated by many countries during the 2008 food price spike as well as good prospects for the current crop, and April 2010 rice prices recorded the lowest monthly average of the past 26-month period.

Overall agricultural markets, especially grains, appear to be well-supplied and, barring unforeseen (weather related) production problems—such as those affecting some tropical commodities—are likely to remain ample over the forecast period. Moreover, food security concerns have subsided. Most countries have reduced or eliminated trade restrictions introduced by the 2008 price spike. According to the latest U.S. Department of Agriculture's update, the global stocks-to-use ratio (including China) for key grains currently stands at 22

Figure A3.5 Global grains stocks-to-use ratio (percent)

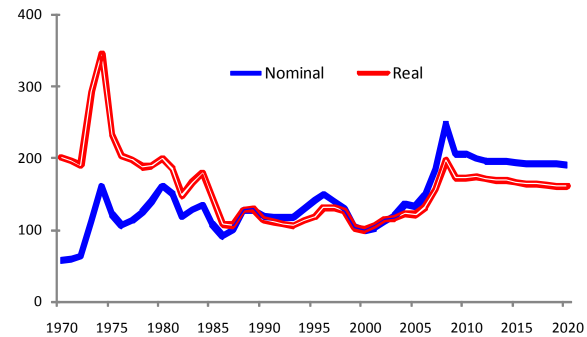


Source: US Department of Agriculture

percent (Figure A3.5), the highest ratio in the past 7-years and close to the historical average of 24 percent. As a result, food prices are projected to be essentially unchanged in 2010 compared with 2009, and to decline by 3 percent in 2011 (Figure A3.6).

Rising and volatile domestic staple food prices are an increasing concern in several Sub-Saharan African and South Asian countries. A recent study (World Bank, Food Price Watch, May

Figure A3.6 Food price indices (US$, 2000=100)



Source: World Bank

2010) shows that in Tanzania the price of maize increased by 21 percent in the year ending February 2010 and in Kenya the price of maize rose by 16 percent in the same period. Also, the DRC, Uganda and Zimbabwe were among the countries with the sharpest fluctuation in prices of main food staples. Food price increases contribute to undernourishment and hunger and heighten the importance of food security policies. The upward trend in price of staples in domestic markets is, therefore, worrisome as it poses a significant threat to both food security and nutrition in the region. For example, in countries where staple food prices have risen sharply, estimates suggest that hunger could increase by between 2-3 percent.

Recent developments in inflation

Core inflation in the Euro zone has eased to very low levels, raising the specter of deflation – which is already visible in some countries. This is largely reflective of weak domestic demand, excess capacity and continued high unemployment, which has reduced the pricing power of both producers and labor. In April

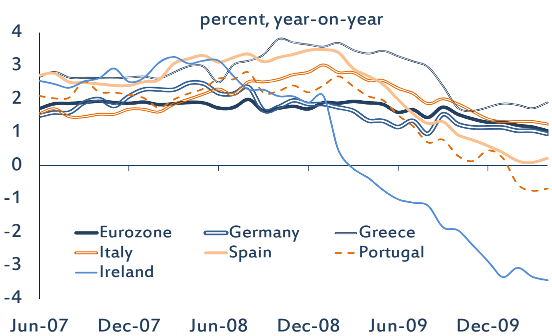
Table A3.1 Key nominal commodity price indices (actual and forecast, 2000=100), 2004-11

	Actual						Projection	
	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
Energy	136	188	221	245	342	214	268	257
Non-Energy	133	149	192	225	272	213	249	239
Agriculture	130	133	150	180	229	198	211	196
Food	136	134	147	185	247	205	206	199
Beverages	120	137	145	170	210	220	233	196
Raw Materials	120	131	160	175	196	169	215	190
Metals & Minerals	139	179	280	314	326	236	329	330
Fertilizers	137	163	169	240	567	293	259	209

Source: World Bank

2010, core inflation for the euro area was down to 0.8 percent year-on-year, the lowest core inflation rate since at least 1991. In Germany core inflation dropped to 0.3 percent, while in Spain, Portugal, and Ireland core prices were falling for the first time since the euro was introduced–a development that should help competitiveness issues in these countries (Figure A4.1). A weaker euro, the result of the lingering sovereign stress, could prevent a further slide toward deflation even in the event of weak private consumption in the euro area.

Figure A4.1 Core inflation in high-income countries (% change yoy)

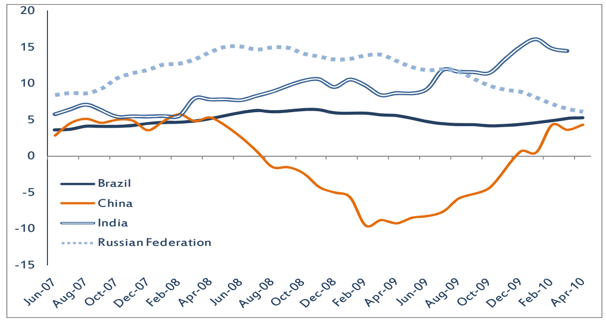


Source: Datastream and World Bank calculations

Among developing countries, the BRICs have generally registered very strong recoveries following the financial crisis. This has supported renewed (mostly portfolio related) capital inflows, which has raised domestic liquidity and a revival of asset price inflation. Compared to other countries, BRICs are also operating at levels that are much closer to full capacity, implying higher domestic demand price pressures relative to other countries. As a result, inflation pressures have been rising recently – notably in China and India (Figure A4.2). The only exception among BRICs has been Russia, where a strengthening rouble has contributed to a decline in inflation.

In other low and middle-income countries, there are also signs of a pick-up in inflation (albeit from very low levels). In low-income countries, headline inflation has steadily increased after a rebound from 1.3 percent in October 2009 to

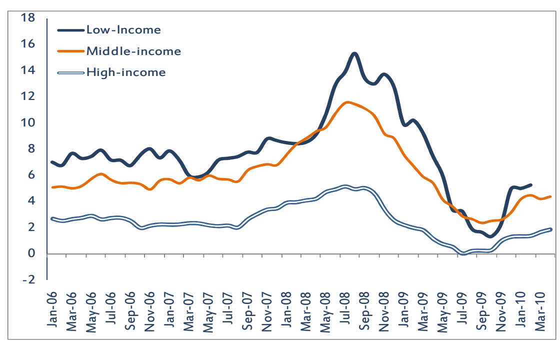
Figure A4.2 Headline inflation in BRICs
(% change yoy)



Source: Global Economic Monitor and World Bank calculations

more-than 5 percent in February 2010—but still remaining below the 7 percent average registered during the January 2006 – July 2007 period (Figure A4.3). In middle-income countries, inflation followed a similar, but less steep trend. It bottomed at 2.3 percent in September 2009 and has gained nearly 2 percentage points since then. This compares with a pre-crisis peak of 11.5 percent in July 2008.

Figure A4.3 Headline inflation in low-, middle-, and high-income countries, medians
(% change yoy)



Source: Global Economic Monitor and World Bank calculations

Global Economic Prospects Summer 2010: Fiscal Headwinds and Recovery

East Asia and the Pacific

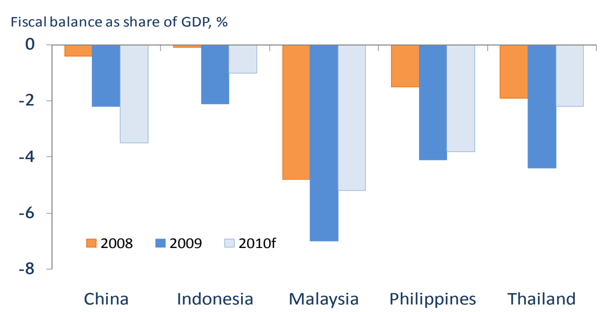
Recent developments

GDP in the East Asia and Pacific region grew 7.1 percent in 2009, a moderate falloff from the strong 8.5 performance of 2008. But, excluding China from the East Asia aggregate, growth slowed sharply from 4.7 percent in 2008 to 1.5 percent in 2009 (Table B1.1). Across countries results were mixed, ranging from an impressively resilient 8.7 percent gain for China to decline of 2.5 percent for Fiji. GDP also fell in Malaysia and Thailand, among middle income countries, and Cambodia among low-income countries. The dispersion of growth was a reflection of initial conditions across countries going into the financial crisis and the recession that followed. Given the importance of trade in East Asia's global presence, these included trade partner orientation and the product composition of a country's exports—and more fundamentally—the magnitude of fiscal and monetary stimulus applied. Lessons learned from the East Asia crisis of the late 1990s were also not forgotten in the region, and stability was supported by widespread reforms of the financial sector and private businesss environment; earlier fiscal adjustment to bring down excessive deficits, and a newfound (and healthy) caution regarding the capital account.

China's massive stimulus package was a major factor in the country's and region's economic resilience. The program was centered in government infrastructure spending, combined with increases in transfers, consumer subsidies and tax cuts. The surge in government-led investment boosted overall GDP by 5.9 points in 2009, though most of the spending was financed through quasi-fiscal measures such as lending by state-owned banks. Indeed, bank lending reached 30 percent of GDP in the year and financed almost two-thirds of the stimulus.

Fiscal packages elsewhere in the region helped cushion effects of the crisis. Many countries went into recession with sufficient fiscal space to respond pro-actively using both fiscal and monetary measures. Fiscal stimulus measures amounted to 2 percent of GDP for the region in 2009. But fiscal deficits (2.9 percent of GDP for 2009) and government debt grew by much less than in other developing regions, reflecting a smaller deterioration in overall growth in East Asia and the relative absence of automatic stabilizers in the region. For Indonesia, where GDP advanced 4.5 percent in 2009, government spending contributed about 1 percentage point of growth. Malaysia's fiscal deficit climbed to near 7 percent in 2009 in part due to weaker revenues, but also to large stimulus measures; while the Philippines and Thailand both undertook fiscal easing (Figure B1.1). Even low-income countries Cambodia, Lao PDR and Vietnam injected discretionary fiscal stimulus of about 3-4 percent of GDP or more each in 2009, helping to cushion the impact of the crisis on domestic activity.

Figure B1.1 Fiscal adjustment will be a challenge



Source: World Bank

Recently, a number of central banks (notably Malaysia) have started to tighten interest rates in the face of strengthening economic activity and rising inflation expectations. But as for all developing-and high-income countries, adjustment of fiscal balances in the post-crisis era will present a challenge for policymakers and play a large role in shaping the outlook to 2012.

The rebound in trade is slowing…East Asian exports and production of capital-, high-tech and durable consumer goods, in which the region is well specialized, dropped off sharply with the global collapse of investment spending and retrenchment by households. At its lowest point industrial production in the region (excluding China) was 9 percent below pre-crisis levels, while trade volumes declined by 21 percent. As the global recovery gathered momentum, regional industrial production and trade levels have recovered much of the loss. The stimulus-charged surge in China's investment led to a sharp increase in imports for domestic use, notably from East Asian trade partners (developing as well as high-income, e.g. Australia, Japan and the Republic of Korea). Chinese demand underpinned exports, production and incomes for partner countries throughout the region in 2009. Though the pace of import growth in China has slowed in the first months of 2010, China's demand continues to grow and support double-digit export growth among partners.

Among regional sources for energy and raw materials, imports into China from Indonesia moved higher by a full 105 percent by March 2010 (y/y) amounting to $14 billion during 2009; and imports from Malaysia, a country with a mix of energy, materials and high-tech goods also gained over 100 percent by early 2010. Regional exports to China helped to shift the contribution of trade to GDP to positive during the second half of 2009 for a large number of countries. East Asian imports also increased rapidly, with the result that the external sector provided a net 3.2 percent drag on regional growth during 2009.

Export volumes bottomed-out toward the end of 2008 and early 2009, but have recovered rapidly since that time, expanding at more than 30 percent annualized rates for much of 2009 (Figure B1.2). Growth rates are beginning to slow, as spare capacity is absorbed and demand subsides. By the end of the first quarter of 2010, exports had regained pre-crisis levels in most countries, though "only just" in the cases of Thailand and the Philippines. These developments, plus a deterioration of the

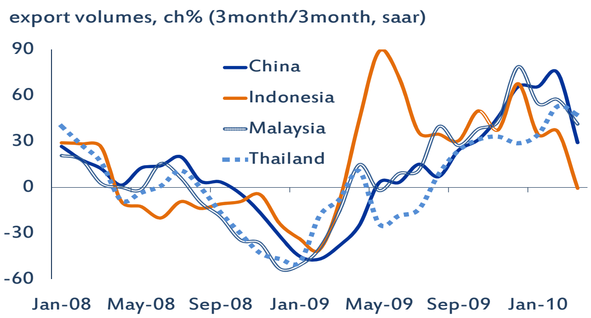
Table B1.1 East Asia and Pacific forecast summary
(annual percent change unless indicated otherwise)

	95-05 [1]	2007	2008	Est. 2009	Forecast 2010	Forecast 2011	Forecast 2012
GDP at market prices (2005 USD) [2]	7.4	11.4	8.5	7.1	8.7	7.8	7.7
GDP per capita (units in USD)	6.3	10.5	7.6	6.2	7.9	7.0	6.8
PPP GDP [3]	7.3	11.3	8.4	7.0	8.7	7.8	7.7
Private consumption	5.7	7.8	6.6	5.9	7.7	7.4	7.2
Public consumption	8.1	9.0	10.1	11.1	9.4	8.2	7.0
Fixed investment	8.1	9.8	10.1	18.8	10.5	7.7	7.9
Exports, GNFS [4]	12.5	15.7	7.6	-10.8	10.7	9.8	9.0
Imports, GNFS [4]	9.7	11.4	5.8	-5.4	12.1	9.0	8.3
Net exports, contribution to growth	0.7	2.9	1.5	-3.2	0.2	0.9	0.9
Current account bal/GDP (%)	2.2	9.6	8.7	6.0	4.3	4.2	4.2
GDP deflator (median, LCU)	5.9	4.8	7.3	4.9	3.5	3.0	2.8
Fiscal balance/GDP (%)	-2.1	0.4	-0.7	-2.9	-2.6	-2.0	-1.7
Memo items: GDP							
East Asia excluding China	3.5	6.2	4.7	1.5	5.8	5.3	5.6
China	9.1	13.0	9.6	8.7	9.5	8.5	8.2
Indonesia	2.7	6.3	6.0	4.5	5.9	6.2	6.3
Thailand	2.7	4.9	2.5	-2.3	6.2	4.0	5.0

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars. 3. GDP measured at PPP exchange rates.
4. Exports and imports of goods and non-factor services.
Source: World Bank

region's terms of trade led to narrowing of the regional current account surplus from $470 billion in 2008 (8.7 percent of GDP) to $355 billion (6 percent of GDP) in 2009, with most of the decline stemming from China (Table B1.1).

Figure B1.2 Export growth is easing



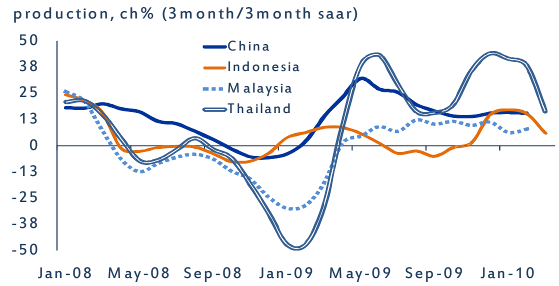
Source: World Bank

The recent decline in the pace of export growth across the region from a peak of 68 percent in February, to 24 percent by April 2010 (saar) reflects, in part, an end to the "rebound factors" from recession (including the pronounced inventory cycle, and onset of fiscal support) that have been driving growth in the final months of 2009. Looking forward, export growth is expected to ease to more sustainable rates, as China's import demand eases and growth in the OECD (notably Europe) continues to disappoint.

… and growth in industrial production is also easing to a more sustainable pace

The collapse in global demand and exports of investment and durable goods was reflected in an 11 percent decline in regional industrial production between August 2008 and January 2009. If China is excluded, production echoed the pattern of export volumes, contracting at a 22 percent annualized rate in January 2009 (saar), then rebounding to a positive 22 percent pace a year later. The trajectory of output growth also displays a tailing off during the first months of 2010 to 17.5 percent by April (saar), in part as spare capacity has been re-absorbed and- with the exception of Malaysia-, all countries in the region have reached or exceeded their pre-crisis peak levels (Figure B1.3).

Figure B1.3 Industrial production growth is slowing



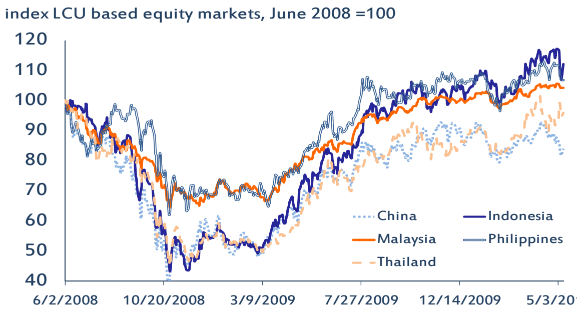
Source: World Bank

Financial markets in East Asia avoided the worst effects of the crisis

To a large degree, financial markets in developing East Asia were insulated from the direct effects of the global (read 'high-income') financial crisis. Commercial banks and other institutions in the region were only small holders of toxic CDOs and related derivatives, and carried little direct exposure to the worst-hit institutions in the high-income world. Nevertheless, markets in East Asia were roiled by the (almost immediate) second-round effects of the crisis. Both equity markets and currencies were hard hit as international capital fled to perceived safety, and/or given mammoth losses by financial institutions, assets were reclaimed to shore-up balance sheets. Stock valuation in local currency dropped 52 percent in Thailand and 56 percent in Indonesia (Figure B1.4). Exchange rates also depreciated sharply vis-à-vis the dollar with the outflow of foreign funds, pressuring currencies to 15-to 20 percent declines by early 2009, before capital began to reflow to the region and currencies stabilized—then appreciated once more. Since that time, as elsewhere, markets recovered as investor's confidence returned.

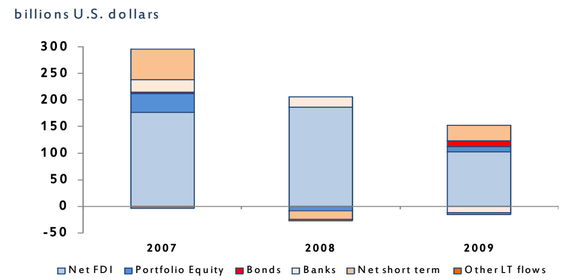
Capital flows to the region fell off sharply in 2009. Overall international capital flows to East Asia fell from a peak of $295 billion in 2007 (6.5 percent of regional GDP) to an estimated $138 billion in 2009 (Table B1.2 and Figure B1.5). Key to the decline was a large 45 percent fall in FDI flows to the region, from $187 billion

Figure B1.4 Most regional equity markets have recouped pre-crisis levels



Source: World Bank

Figure B1.5 Capital flows to East Asia have declined



Source: World Bank

in 2008 to $102 billion during 2009, and a $31 billion turnaround in net bank lending, as high-income banks sought to redress their balance sheets). Capital flows continued to strengthen during the first four months of 2010, with bond flows at $11 billion almost twice as strong as in the same period of 2009, while syndicated bank loans came in at $9.8 billion—80 percent higher than a year earlier. First-time IPOs and new equity issues, on the other hand, were off by about 20 percent from the pace set in early 2009.

Inflation pressures building

As spare capacity has been absorbed and with growth at double-digit rates, there are increasing signs of supply-bottlenecks and incipient evidence of localized asset-bubbles emerging. For the region as a whole, the median inflation rate increased from 3.2 percent to 5.7 percent between January 2009 and March 2010. Asset price bubbles appear to be forming in the housing sector in China, partly reflecting easy financing but also tied to the massive expansion

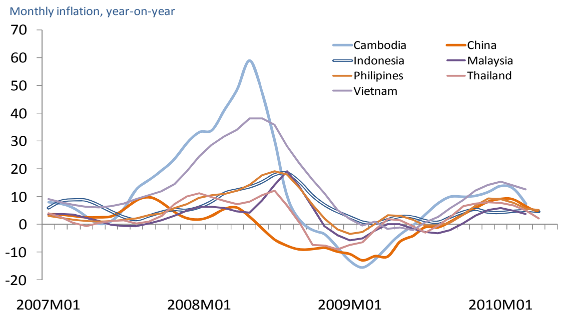
Table B1.2 Net capital flows to EAP
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**76.0**	**127.1**	**184.1**	**193.9**	**291.8**	**178.7**	**136.6**			
Net private inflows (equity+debt)	**83.2**	**132.3**	**187.0**	**203.5**	**294.9**	**179.2**	**137.6**	**147.6**	**176.4**	**224.1**
..Net private inflows (% GDP)	3.6	5.0	6.1	5.6	6.5	3.1	2.2	2.1	2.2	2.5
Net equity inflows	69.3	89.7	130.0	161.8	212.1	179.0	112.3			
..Net FDI inflows	56.8	70.4	104.4	105.7	177.0	187.1	101.9			
..Net portfolio equity inflows	12.5	19.3	25.7	56.2	35.1	-8.1	10.4			
Net debt flows	6.7	37.4	54.1	32.1	79.7	-0.3	24.3			
..Official creditors	-7.2	-5.2	-2.9	-9.6	-3.1	-0.5	-1.0			
....World Bank	-1.5	-1.9	-0.6	-0.4	-0.3	1.2	2.2			
....IMF	-0.5	-1.6	-1.6	-8.5	0.0	0.0	0.1			
....Other official	-5.2	-1.7	-0.7	-0.7	-2.8	-1.7	-3.3			
..Private creditors	13.9	42.6	57.0	41.7	82.8	0.2	25.3			
....Net M-L term debt flows	-9.9	9.1	13.9	14.2	26.0	15.8	-3.4			
......Bonds	1.8	9.6	12.1	6.0	2.3	-0.5	10.8			
......Banks	-8.6	1.6	3.8	9.8	24.1	18.6	-12.3			
......Other private	-3.1	-2.1	-2.0	-1.6	-0.4	-2.3	-1.9			
....Net short-term debt flows	23.8	33.5	43.1	27.5	56.8	-15.6	28.7			
Balancing item	**-6.4**	**21.8**	**-141.2**	**-196.5**	**-180.5**	**-209.8**	**11.7**			
Change in reserves (- = increase)	**-139.7**	**-237.1**	**-217.7**	**-295.3**	**-537.3**	**-427.9**	**-491.0**			
Memorandum items										
Workers' remittances	32.7	40.3	50.5	58.0	71.0	86.0	86.0	**94.0**	**103.0**	

Source: World Bank

in infrastructure associated with the stimulus plan (Figure B1.6).

Figure B1.6 Inflation has picked up with the recovery



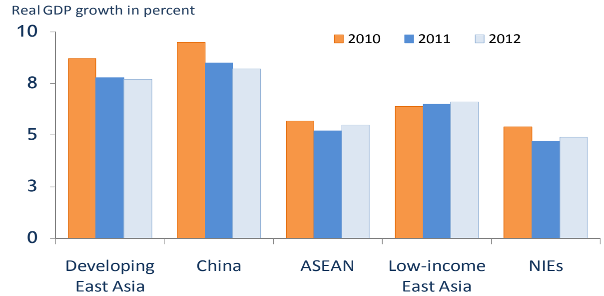
Source: World Bank and Datastream

Near-term outlook

GDP is projected to expand by 8.7 percent in 2010, led by 9.5 percent growth in China. Excluding China, GDP in the remaining developing countries of East Asia is anticipated to increase by 5.8 percent (Figure B1.7). Both for China and other countries, growth will continue to reflect strong expansion of domestic demand, which in China was responsible for 95 percent of the increase in GDP (85 percent in the rest of developing East Asia and the Pacific). Looking forward, strengthening demand in high-income countries should boost export growth. This, in addition to a gradual strengthening in capital inflows (and associated investment) will help offset some slowing in domestic demand into 2011-12, as fiscal and monetary stimulus measures are gradually withdrawn. Growth is projected to ease to a still-robust average of 7.8 percent over the final years of the forecast (8.4 percent for China and 5.5 percent for the remaining countries) (Table B1.3).

The region-wide slowing of growth and tightening of policy measures is expected to rein -in inflation pressures by 2011 and 2012. Despite strengthening export growth, and moderately weaker imports in line with slower domestic demand, the region's current account surplus is expected to remain relatively steady near 4 percent of GDP, in part because import prices are likely to increase more rapidly than export prices – reflecting productivity differentials and policy efforts to reorient production in China toward satisfying domestic demand.

Figure B1.7 Recovery expected to slow 2011



Source: World Bank

Risks

The main risk facing the global economy in the near term stems from debt sustainability issues in high-income Europe. Should these problems not be resolved in a smooth manner, global GDP could be much weaker, with the level of GDP lower by between 2-and 5 percent (see main text). For the countries of East Asia, the effects of such a cycle are potentially serious, in part because both exports and investment are large shares of regional economies, and these are precisely the two channels through which a deeper European crisis might be transmitted to developing countries.

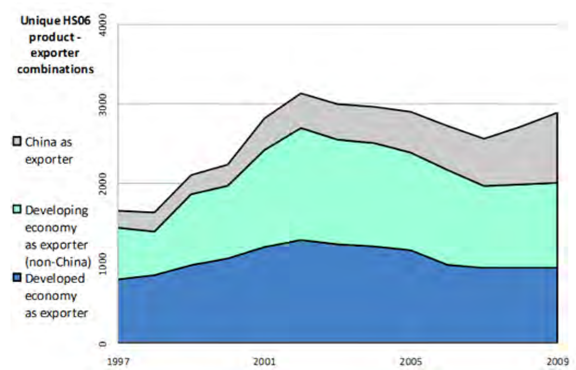
As was the case with the first phase of the financial crisis, countries in the region should be well placed to introduce macroeconomic policies to limit the impact of such a "second" crisis. Indeed, events in Europe grounded in the sovereign debt difficulties of Greece, Spain and Portugal, and the consequent EU/IMF Stabilization Package for the Euro Area have dampened several of the emerging trends of importance for the East Asia region. The economic outlook for Europe has dimmed, as austerity measures are in place among the highly -indebted countries of the Southern Euro Zone, as well as in France, Italy, the United Kingdom and others. These adjustments will work to slow near-term economic activity—and import demand—in a large market, that was worth some

$375 billion, or 18 percent of total exports for developing East Asia during 2008.

Just as the larger countries of East Asia are recognizing that—in the new "post-crisis world" concerns may include slower growth of high-income economies, tighter global financing conditions, high and rising high-income debt levels and a more difficult environment for trade**—**the growth of export markets and trade for East Asia may be less robust than in previous decades. In this overall environment the *risk of protectionism* may come more prominently to the fore. In the post-crisis period, developing countries have emerged as the most active users of trade remedies in the crisis, initiating three-quarters of all investigations since 2008, with India and Argentina as the most active users, followed by Turkey, Brazil, and China. Should this trend intensify, it could have serious implications for countries in the region; especially if, as appears to be the case, the implementation of trade measures is prompting the retaliatory actions (Figure B1.8).

Other elements of risk for East Asia are financial, including the challenge of shifting into a prudent "exit" strategy for fiscal accounts that is not premature, and which allows private sector activity to become more self-sustaining. Moreover, avoidance of "hot" capital inflows that could risk economic stability and damage exchange rate regimes is important; and of note is potential competition in international bond markets with the issuance of high-income sovereign debt, funding the stimulus packages of the financial crisis years.

Figure B1.8 Post-crisis use of trade remedies



Source: Global Antidumping Database and World Bank Calculations

Table B1.3 East Asia and Pacific country forecasts

(annual percent change unless indicated otherwise)	95-05 ¹	2007	2008	Est. 2009	Forecast 2010	2011	2012
Cambodia							
Real GDP at market prices	8.3	10.2	6.7	-2.0	4.8	6.0	6.5
Current account bal/GDP (%)	-4.4	-5.8	-9.9	-7.8	-11.1	-10.3	-9.7
China							
Real GDP at market prices	9.1	13.0	9.6	8.7	9.5	8.5	8.2
Current account bal/GDP (%)	2.6	11.1	10.6	6.4	4.7	4.7	4.8
Fiji							
Real GDP at market prices	2.3	-6.6	-0.1	-2.5	2.0	2.2	2.4
Current account bal/GDP (%)	-3.3	-14.3	-18.3	-8.6	-15.8	-17.7	-17.9
Indonesia							
Real GDP at market prices	2.7	6.3	6.0	4.5	5.9	6.2	6.3
Current account bal/GDP (%)	1.5	2.4	0.0	2.1	0.4	0.1	0.1
Lao PDR							
Real GDP at market prices	6.2	7.9	7.5	6.7	7.7	7.5	8.0
Current account bal/GDP (%)	-9.8	2.5	2.7	1.9	1.0	1.8	1.6
Malaysia							
Real GDP at market prices	4.8	6.3	4.7	-1.8	5.7	5.3	5.5
Current account bal/GDP (%)	6.5	15.7	18.3	15.7	15.2	15.1	14.9
Papua New Guinea							
Real GDP at market prices	0.7	6.2	6.7	4.5	6.5	4.2	4.5
Current account bal/GDP (%)	3.0	16.9	14.0	-3.1	0.3	2.0	-0.1
Philippines							
Real GDP at market prices	4.2	7.1	3.7	1.1	4.4	4.0	4.0
Current account bal/GDP (%)	-1.4	4.9	2.2	5.3	3.8	3.4	2.8
Thailand							
Real GDP at market prices	2.7	4.9	2.5	-2.3	6.2	4.0	5.0
Current account bal/GDP (%)	1.9	6.6	0.6	7.3	2.5	1.5	0.7
Vanuatu							
Real GDP at market prices	1.5	6.8	6.6	4.2	4.5	5.5	5.5
Current account bal/GDP (%)	-9.8	-10.6	-9.6	-8.4	-6.4	-6.9	-6.0
Vietnam							
Real GDP at market prices	7.2	8.5	6.2	5.3	6.5	6.5	6.5
Current account bal/GDP (%)	-2.5	-10.0	-11.9	-12.8	-11.1	-10.2	-10.4

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. Micronesia, Fed. Sts., Kiribati, Marshall Islands, Myanmar, Mongolia, Palau, Korea, Dem. Rep., Samoa, Solomon Islands, Timor-Leste, Tonga are not forecast owing to data limitations.

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Europe and Central Asia

Recent developments

After an estimated 5.3 percent contraction in economic activity in 2009—the sharpest slowdown of any region—the recovery in real GDP in Europe and Central Asia in 2010 is projected at 4.1 percent. With the exception of the Middle East and North Africa, this is the slowest pace of growth projected among the developing regions—and is 3.2 percentage points slower than the region's pre-crisis five-year average. The recovery largely reflects the strong growth rebound in the region's two largest economies (Russia and Turkey), which account for 62 percent of regional GDP, and are projected to grow 4.5 percent and 6.3 percent, respectively. The recovery in activity in the next four largest economies is weak (Poland, Kazakhstan and Ukraine) or remains negative (Romania). And for the remaining 16 countries in the region, growth is expected to register 3 percent or less for 13 economies.

Regional growth has been held back relative to other regions because of the intense domestic adjustments that some countries have had to undergo as a consequence of their dependence on debt-creating flows and associated large current account imbalance with which they entered the crisis. Heightened uncertainty—tied to the sovereign-debt crisis in some of the high-income European countries (Greece, Ireland, Italy, Portugal, and Spain) and their related diminished growth prospects—has also created additional headwinds for developing Europe and Central Asia, including weakened external demand for exports as high-income Europe tightens fiscal policy to reduce its debt burden.

More so than elsewhere, the global financial crisis had a severe impact on domestic output reflecting the pre-crisis dependence of many countries on international bank and bond-lending to finance domestic expenditure (and associated current account deficits). The drying up of capital flows to the region has forced large-scale cutbacks in spending. Overall, net private inflows to the region declined by more than two-thirds, and net debt flows (international bank and bond-lending) were decimated, falling from $153.8 billion to an estimated $13.7 billion between 2008 and 2009 (Table B2.1). With the drying up of financial flows, the region's current account balance shifted from a $34.9 billion deficit in 2007 to an estimated surplus of $13.6 billion in 2009.

As global import demand was falling (and did not permit adjustment through higher exports), most of the adjustment came through reduced imports, which fell by 13.7 percent during 2009. More generally domestic demand fell sharply, as fixed investment spending contracted 16 percent and private consumption contracted 3.9 percent. Within the region, the macro-impacts of the crisis were most severe for those countries with large current account deficits and vulnerable external debt dynamics at the onset, including Bulgaria, Latvia, Lithuania, and Ukraine. The plunge in capital inflows and contraction in trade following the crisis, given large internal and external imbalances, led nine of the 24 developing ECA countries to enter IMF programs (since September 2008).[1]

Countries with significant reliance on petroleum exports—notably Russia, Azerbaijan and Kazakhstan—also saw sharp contractions in GDP growth, as lower oil revenues led to pronounced fall-off in economic activity through fiscal linkages.

The impact of the crisis was exacerbated by falling remittances, which in aggregate dropped by an estimated 20 percent in 2009 for the region as a whole, the sharpest decline of any developing region. The impact of Russia's weak growth performance in 2009 was felt, in particular, by regional economies dependent on remittances inflows from Russia. The decline has been especially acute in Tajikistan, where remittances inflows represent 50 percent of GDP. Notably, while recorded worker remittances outflows from Russia to other CIS member countries declined 26% to $5.3 billion in 2009 over 2008, on a quarterly basis they have begun to recover to over $1.5 billion in both the third and fourth quarters of 2009, reflecting

Table B2.1 Net capital flows to ECA
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**77.9**	**120.9**	**155.4**	**279.9**	**485.8**	**312.8**	**115.9**			
Net private inflows (equity+debt)	**84.5**	**131.2**	**191.4**	**312.5**	**491.2**	**303.9**	**84.0**	**151.6**	**178.0**	**195.8**
..Net private inflows (% GDP)	6.8	8.2	9.5	12.8	15.8	7.8	2.6	4.0	4.2	4.1
Net equity inflows	29.4	58.7	69.6	123.9	183.3	159.0	102.2	124.1	138.1	155.6
..Net FDI inflows	28.6	55.3	61.6	113.8	156.8	173.6	97.2			
..Net portfolio equity inflows	0.7	3.5	8.0	10.2	26.5	-14.6	4.9			
Net debt flows	48.5	62.2	85.8	156.0	302.5	153.8	13.7			
..Official creditors	-6.6	-10.3	-36.0	-32.6	-5.4	8.9	31.9			
....World Bank	-0.6	0.4	-0.6	0.2	-0.1	0.6	5.9			
....IMF	-2.0	-5.9	-9.8	-5.8	-5.0	7.0	21.1			
....Other official	-4.0	-4.8	-25.6	-27.0	-0.3	1.3	4.9			
..Private creditors	55.1	72.5	121.8	188.6	307.9	144.9	-18.2			
....Net M-L term debt flows	21.5	52.8	100.6	134.5	204.2	154.2	-7.6			
......Bonds	11.2	19.1	28.1	34.6	58.7	19.3	9.6			
......Banks	10.7	35.0	73.8	100.8	146.6	135.5	-16.7			
......Other private	-0.4	-1.3	-1.3	-0.9	-1.1	-0.6	-0.5			
....Net short-term debt flows	33.6	19.7	21.2	54.1	103.7	-9.3	-10.6			
Balancing item	**-40.0**	**-75.7**	**-107.4**	**-125.6**	**-213.7**	**-355.0**	**-101.3**			
Change in reserves (- = increase)	**-53.5**	**-72.1**	**-93.1**	**-179.7**	**-237.2**	**61.0**	**-15.7**			
Memorandum items										
Workers' remittances	14.4	21.0	30.1	37.0	51.0	58.0	46.0	**48.0**	**52.0**	

Source: World Bank

higher oil prices—this after having reached a post-crisis low of $871 million in the first quarter of the year (versus $2 billion in both the third and fourth quarters of 2007).[2] Remittances inflows to Romania and Poland also fell sharply in 2009, but this primarily was a reflection of economic weakness and higher unemployment in the European Union.

The region started to recover during the second half of 2009, initially responding to rebound factors, including a recovery from exceptionally depressed bases, and strengthening external demand. As global growth gained momentum, prices and demand for commodities (particularly oil) also rebounded and provided a further fillip to incomes and foreign currency earnings for regional commodity exporteres.

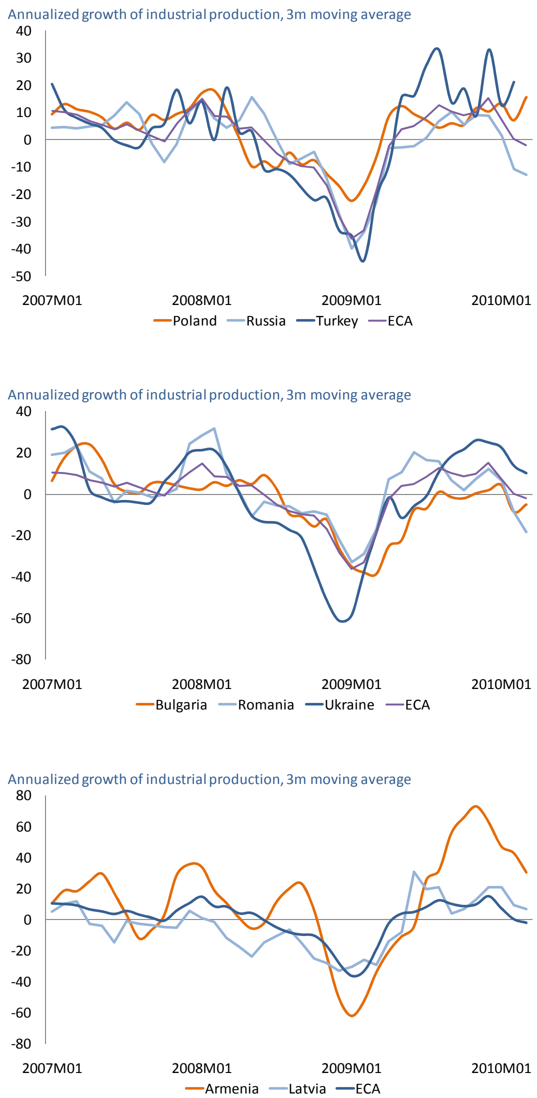
The recent rebound in output was also supported by countercyclical monetary policy actions, with policy interest rate cuts across much of the region (where countries have independent monetary policy), as inflationary pressures diminished significantly, given the marked compression in demand and economic activity. For instance, Hungary, Poland, Romania, Russia, Turkey, among others, introduced policy rate cuts since the onset of the crisis and have yet to begin to introduce rate hikes to normalize monetary policy stances.

Similarly, the recovery has been supported by fiscal stimulus measures, in countries with sufficient fiscal space, such as Russia. These higher outlays, combined with increased transfer payments through automatic stabilizers, and lower revenues (given the contraction in economic activity), with increased liabilities (as governments absorbed problem private sector assets) led to a shift from a regional fiscal surplus of 0.3 percent of GDP in 2008 to a deficit of 6 percent in 2009—the largest among developing regions with the exception of South Asia.

The growth rebound has primarily been driven by recovery in the largest economies of the region, masking continued weak growth in many of the smaller economies. This is particularly evident in the evolution of industrial production over the past two years (Figure B2.1). In the three largest economies, i.e. Russia, Poland and Turkey, growth rates in industrial production have bounced back strongly and have returned to pre-crisis growth rates. Indeed, Poland was the only European Union member state for which GDP did not decline in 2009.

The contraction in industrial production was more pronounced in smaller countries, particularly those that entered the recession with large current account deficits that were supported by rapid credit expansion and financed through debt-creating flows (Armenia, Belarus, Bulgaria, Latvia, Lithuania, Montenegro, Moldova, Romania and Ukraine). GDP growth in these countries decelerated or fell by 10 percentage points or more in 2009. Indeed, in Armenia, industrial production had fallen by 31.5 percent by April 2009 from September 2008, although it has since bounced back to pre-crisis levels. While industrial production fell less deeply in Lithuania and Bulgaria, for example, because of the sharp contraction in domestic demand required as financing of large current accounts dried up, output has not recovered to the same degree and remains 11 percent and 21 percent, respectively, below pre-crisis peaks.

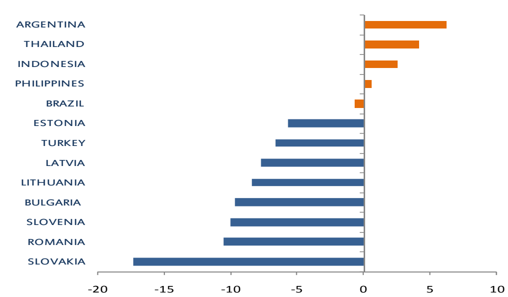
Figure B2.1 Industrial production after easing is rebounding fast



Source: World Bank

The combination of extremely deep falls in output in 2009 and a relatively modest recovery means that many countries in the region continue to be characterized by ample spare capacity and high unemployment. Indeed, capacity utilization rates have not recovered to the extent that other developing markets have done (Figure B2.2). Moreover, unemployment continues to rise in many economies. Registered unemployment has risen by 3 million and exceeded 10 percent of the labor force in several countries, including Latvia, Turkey, Estonia, Lithuania, Slovakia and Hungary. Rising joblessness is pushing households into poverty and creating greater challenges for those already in poverty. The number of poor and vulnerable has risen by an estimated 12 million since the onset of the crisis, with Armenia, Georgia and Moldova particularly hard hit.

Figure B2.2 Change in capacity utilization rates since June 2008



Source: World Bank and Datastream

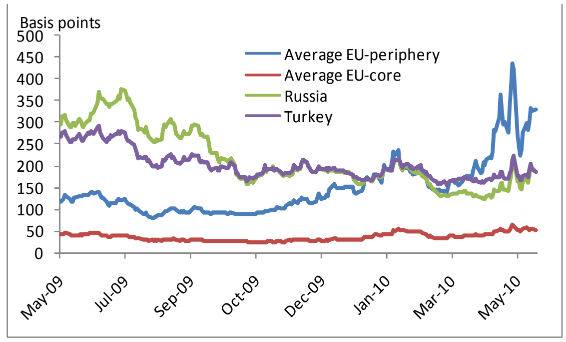
The recovery in the Commonwealth of Independent States appears to be somewhat more robust than in the rest of the region, GDP is projected to rise 4.2 percent in 2010. In contrast, countries in Central and Eastern Europe are expected to grow at a very modest 1.8 percent.[3] Despite signals of a pick-up in activity (retail sales, industrial production, business and consumer confidence surveys), GDP in the EU-10 is projected to rise only 1.6 percent in 2010, weighed down by sluggish growth in the rest of the European Union, where growth is projected at a tepid 0.8 percent in 2010, as these economies are vulnerable to heightened economic uncertainty following the crisis in Greece.

GDP in Uzbekistan is projected to increase 8.3 percent, reflecting a massive program of public infrastructure construction, supported by a rebound in international energy prices since early-2009. Other energy exporters are benefitting from strong oil prices. Growth in Russia is expected to reach 4.5 percent, following a 7.9 percent contraction in 2009, while Poland and Turkey are forecast to grow by 3 and 6.3 percent, respectively. In contrast, Romania and Latvia are expected to experience their second and third years, respectively, of economic contraction in 2010, although the rates of decline have decelerated sharply. For example, Latvia posted an estimated 18 percent contraction in 2009 and is projected to contract by a further 3.5 percent in 2010.

The projected improvement in the region's fiscal indicators (see below) is fortuitous, as markets are increasingly becoming concerned about sovereign debt and fiscal sustainability. So far, the spread of sovereign stress in highly indebted high-income European countries to developing countries has been limited, and CDS spreads in the major countries in the region (Turkey and Russia, for example) have been relatively stable. (Figure B2.3).

With the sharp fall-off in external demand and associated hit to exports, median debt servicing charges in the region have risen from 14.6 percent of exports in 2007 to an estimated 21.4

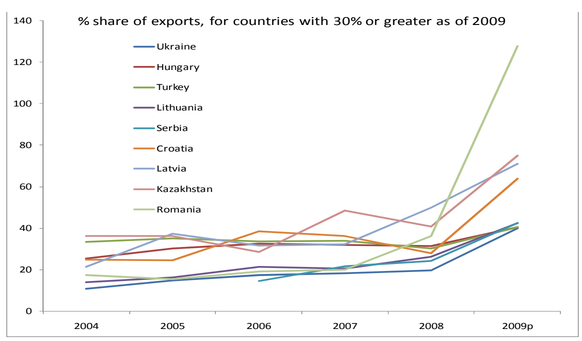
Figure B2.3 CDS spreads – EU periphery vs. selected emerging Europe and core EU countries



Source: Bloomberg

percent in 2009 (Figure B2.4). And debt servicing charges of nine reporting countries exceed 30 percent of exports (in Romania they reached an estimated 128 percent of exports in 2009). Given existing debt obligations and growth projections for 2010, external debt-to-GDP ratios are on track to increase further in 2010 to 87 percent and 47 percent, respectively, in Central and Eastern Europe, and the Commonwealth of Independent States sub-regions.

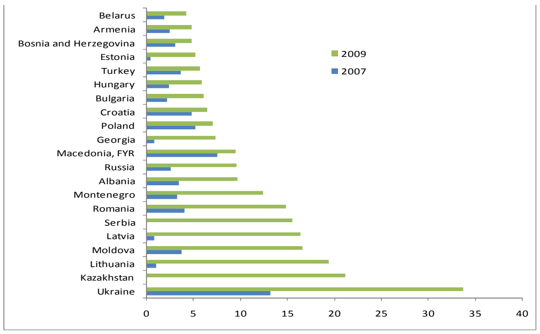
Figure B2.4 External debt-servicing burden rose sharply for ECA economies, as exports declined



Source: World Bank

The burden of household and corporate losses incurred during the financial crisis is also constraining the pace of recovery, and has contributed to a rise in non-performing loans (NPLs). Eleven of the 16 countries across the globe which reported that NPLs represented at least 9 percent of total loans outstanding, were within the ECA region (Figure B2.5). Among ECA countries with NPLs exceeding 9 percent, are Ukrainian banks (reporting provisioning for only 32 percent of NPLs), while in Albania, Latvia, Moldova, Montenegro, and Romania 50 percent to 60 percent are provisioned (as of the second half of 2009). In contrast, provisioning of NPLs is close to or exceeds 100 percent in Kazakhstan, FYR Macedonia, Russia and Serbia.

Figure B2.5 Non-performing loans in selected ECA countries in % of total loans outstanding



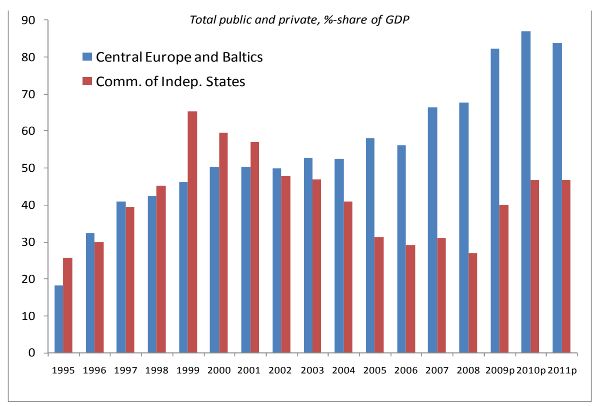
Source: IMF Global Financial Stability Report April 2010

Outlook

GDP growth in Europe and Central Asia is projected to expand 4.1 percent in 2010 and firm further by 4.2 percent and 4.5 percent in 2011 and 2012, respectively (Table B2.2). This aggregate result masks sub-regional variations, with a relatively stable 4.5 percent expansion expected for the Commonwealth of Independent States, a steady improvement in growth rates in Central and Eastern Europe from 1.8 percent in 2010 to 4 percent by 2012. Compared with other developing regions, this recovery is slower to gather momentum and more muted—with GDP growth over the entire period at rates well below the pre-crisis pace of 7.1 percent in 2007. Large household foreign-currency denominated debt obligations, significant negative wealth effects (due to the collapse in local real estate and equity markets), the sharp restructuring underway in high current-account deficit countries, and the weak recovery in high-income Europe are all factors expected to weigh on domestic demand in the region. A move toward fiscal consolidation is expected throughout the region, which will also serve to dampen growth momentum. On the plus side, private capital inflows are projected to firm, which is expected to result in a 1.1 percentage point of GDP decline in the region's financing gap, much of which is likely to be met through strong official lending over the medium-term. Moreover, inflation pressures in most of the region (with the notable exceptions of Russia and Turkey) remain muted—and are expected to remain subdued—so that monetary policy is expected to be broadly supportive of growth.

Although public debt levels remain relatively low, private-sector debt is a concern, and is expected to remain a drag on growth. The median shares of total private and public sector external debt rose to an estimated 60.5 percent for the region as a whole, with Central and Eastern Europe's share rising to an estimated 82 percent in 2009 (Figure B2.6). Moreover, in Central and Eastern Europe they are projected to increase further to 87 percent in 2010, and to 47 percent in the Commonwealth of Independent States.

Figure B2.6 External debt rose across sub-regions - led by an upswing in Central Europe



Source: World Bank

The recovery in Russia, initially export-led and fed by bounce-back factors, is expected to continue through the first half of 2010, but should lose some momentum towards the end of the year as these factors fade (Table B2.3). So far, consumer demand and investment have lagged the recovery, in part because of continued high unemployment and spare capacity, but also

Table B2.2 Europe and Central Asia forecast summary

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 USD) [2]	4.1	7.1	4.2	-5.3	4.1	4.2	4.5
GDP per capita (units in USD)	4.0	7.1	4.1	-5.3	4.0	4.2	4.4
PPP GDP [3]	4.0	7.4	4.5	-5.5	4.0	4.3	4.5
Private consumption	4.8	10.1	8.1	-3.9	3.6	4.0	4.1
Public consumption	2.0	6.0	3.4	2.9	2.2	2.6	2.6
Fixed investment	4.7	15.2	6.1	-16.0	6.4	5.4	6.6
Exports, GNFS [4]	7.9	8.0	7.3	-12.8	6.7	7.0	7.2
Imports, GNFS [4]	8.7	17.9	11.1	-13.7	6.1	6.2	6.7
Net exports, contribution to growth	0.1	-3.1	-1.5	0.7	0.1	0.2	0.1
Current account bal/GDP (%)	0.9	-1.1	-0.1	0.5	0.4	-0.7	-0.8
GDP deflator (median, LCU)	18.8	9.6	10.0	3.5	4.5	5.7	5.7
Fiscal balance/GDP (%)	-5.2	2.3	0.3	-6.0	-4.5	-3.8	-3.3
Memo items: GDP							
Transition countries [5]	4.0	5.7	2.9	-3.3	4.0	3.9	4.3
Central and Eastern Europe [6]	3.8	6.8	5.0	-2.1	1.8	3.6	4.0
Commonwealth of Independent States [7]	4.1	8.5	5.4	-7.1	4.2	4.6	4.6
Russia	3.9	8.1	5.6	-7.9	4.5	4.8	4.7
Turkey	4.3	4.6	0.7	-4.7	6.3	4.2	4.7
Poland	4.3	6.7	4.8	1.7	3.0	3.7	4.0

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars. 3. GDP measured at PPP exchange rates.
4. Exports and imports of goods and non-factor services.
5. Transition Countries: Albania, Bulgaria, Lithuania, Latvia, Macedonia, FYR, Poland, Romania, Turkey
6. Central and Eastern Europe: Albania, Bulgaria, Lithuania, Latvia, Macedonia, FYR, Poland, Romania
7. Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Ukraine, Uzbekistan

Source: World Bank

because of declining credit as the banking sector restructures. Looking forward, rising wages and oil incomes should combine with a reduced drag from the financial sector, to support an increasingly prominent role for domestic demand in the recovery. These forces, however, will be partially offset by the appreciation of the currency, which would curb export competitiveness. Overall, regional growth is expected to find itself on more sustainable footing by 2012, led by strengthening domestic demand.

Poland was the only country in the European Union to record positive growth in 2009. Partly because its economy did not decline as sharply as others, its recovery will be less marked with growth accelerating from 1.7 percent in 2009 to around 3 percent in 2010. Despite the relatively muted cycle, unemployment has risen to 9 percent of the labor force, which will weigh on consumer demand. Fiscal policy is expected to play a declining role as the government is forced to scale back on spending, given the unsustainable level of the deficit at 7.1 percent of GDP (although Poland is advantaged by its relatively low debt-to-GDP ratio). A modest strengthening of investment demand, partly reflecting EU transfers and preparations for the 2012 European football championships, plus a gradual strengthening of the labor market are expected to underpin a modest pick-up in growth in 2011 and 2012 to 3.7 and 4 percent, respectively.

The recovery in Turkey, which began in the second quarter of 2009, is more advanced than in other countries, and is overwhelmingly driven by a firming in consumer and business demand, supported by tax cuts on durables consumption as part of fiscal stimulus measures. The economy is projected to grow close to potential in 2011 and 2012—following the rebound in activity in 2010 coming out of sharply negative growth in

2009. Rising inflationary pressures could translate into appreciation of the currency through higher import costs and hurt competiveness, which along with weak demand in export markets and a tightening of monetary and fiscal policies is expected to contribute to a slowing of growth to 4.2 and 4.7 percent in 2011 and 2012, respectively, from 6.3 percent in 2010. However, recent depreciation pressure on the Turkish lira, due to concerns on financing debt in some high-income European countries, might offset some of the negative impacts stemming from weak external demand on exports.

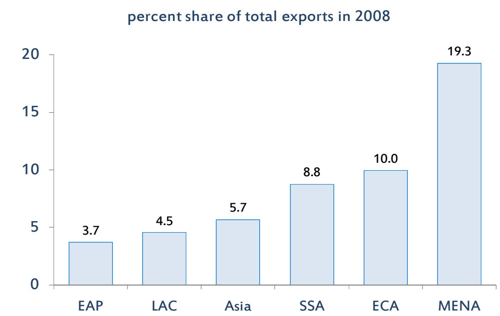
Household consumption is also projected to post a slow recovery in many smaller regional economies, (in Central and Eastern Europe, on weak employment prospects and negative wealth effects, and in the CIS, as the pace of growth in remittances inflows is expected to be lower than during the pre-crisis period). The weak recovery in high-income Europe and a generalized move toward fiscal tightening will constrain consumer and business sector activity and growth. Remittances are likely to pick up with oil prices and activity in Russia, but are likely to be more subdued than in the immediate pre-crisis era, reflecting lingering high rates of unemployment in the EU.

Risks

The outcome of the debt crisis in high-income Europe will shape conditions globally, but particularly in Europe and Central Asia, both because of its tight trade and financial linkages to countries most immediately affected, but also its increasing integration into the broader high-income European economy. Europe and Central Asia is the developing region with the second largest share in Southern Euro zone total exports (Figure B2.7). The most vulnerable countries in the region include Albania and Azerbaijan, for which Greece, Italy, Portugal and Spain represent more than 20 percent of their total exports.

The region is also dependent on financial flows from lenders in some of the most vulnerable high -income countries in Western Europe. In fact,

Figure B2.7 Share of Southern Euro-Zone in total exports



Source: World Bank, UN-COMTRADE

EU-5 banks own a large share of the banking sectors in several countries in the region. While during the crisis these banks managed to maintain their exposures, a protracted crisis in Western Europe could lead to a reassessment. Also, going forward, there might be an increased aversion to issuing new credit as loans come due. And banking systems in ECA countries might be challenged by possible withdrawals by resident and non-resident depositors. To reduce risks, countries in the region introduced liquidity support operations and strengthened deposit insurance schemes at the peak of the global financial crisis. Some countries entered into crisis management agreements with the banking sector regulators of their parent banks. Yet, risks remain. In particular, one issue to follow in coming months is the case of Greek banks that hold large shares of outstanding loans in Albania, Bulgaria, Romania, and Serbia. Should Greek banks in an effort to restore their own balance sheets choose (or are forced) not to roll-over loans, this could have significant implications for investment and economic activity in this group of countries. Area wide, the debt-burdened EU-5 (Greece, Ireland, Italy, Portugal and Spain) have supplied some $400 billion or 13 percent of ECA regional GDP as of end-2009.

Finally, the depth and prolonged nature of the crisis poses a risk to the region itself. As outlined in the main text, an extended period of high-unemployment and spare capacity risks taking its toll on the ability of consumers and firms in the region to pay back loans. Already, non-performing loans are rising rapidly and at least in some countries, banks are lagging in their efforts to provision these loans. Should the problem intensify, a second regionally based financial crisis cannot be ruled out.

Table B2.3 Europe and Central Asia country forecasts

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	2007	2008	2009	2010	2011	2012
Albania							
Real GDP at market prices	5.4	6.0	6.5	2.2	3.0	4.0	4.7
Current account bal/GDP (%)	-5.5	-10.6	-15.2	-15.7	-10.9	-9.9	-8.9
Armenia							
Real GDP at market prices	8.6	13.7	6.8	-14.4	1.2	3.5	4.5
Current account bal/GDP (%)	-11.7	-6.4	-11.6	-15.4	-13.7	-12.3	-10.8
Azerbaijan							
Real GDP at market prices	10.2	25.0	10.8	9.3	2.3	1.0	2.5
Current account bal/GDP (%)	-16.6	27.3	35.7	24.1	27.4	22.1	20.4
Belarus							
Real GDP at market prices	6.9	8.6	10.0	0.2	2.4	4.6	4.9
Current account bal/GDP (%)	-3.2	-6.7	-8.6	-13.0	-10.4	-9.2	-9.1
Bosnia Herzegovina							
Real GDP at market prices	-	6.8	5.4	-3.4	0.5	4.0	6.0
Current account bal/GDP (%)	-	-12.6	-14.9	-7.8	-8.0	-8.1	-7.9
Bulgaria							
Real GDP at market prices	2.2	6.2	6.0	-5.0	0.2	2.0	3.6
Current account bal/GDP (%)	-3.6	-25.4	-25.2	-9.4	-6.2	-5.8	-4.8
Georgia							
Real GDP at market prices	6.6	12.3	2.3	-3.9	4.5	4.0	4.7
Current account bal/GDP (%)	-10.0	-20.9	-22.7	-11.9	-12.8	-12.6	-12.4
Kazakhstan							
Real GDP at market prices	6.4	8.9	3.3	1.2	2.1	2.7	3.5
Current account bal/GDP (%)	-2.3	-7.8	5.3	-2.5	3.3	4.1	4.0
Kyrgyz Republic							
Real GDP at market prices	4.7	8.2	8.4	2.3	2.2	3.0	4.5
Current account bal/GDP (%)	-10.2	-7.0	-8.1	4.0	-6.1	-6.4	-6.5
Lithuania							
Real GDP at market prices	6.0	9.8	2.8	-14.8	0.5	3.1	2.2
Current account bal/GDP (%)	-7.9	-14.5	-12.0	3.8	1.5	-0.6	-1.0
Latvia							
Real GDP at market prices	6.9	10.0	-4.6	-18.0	-3.5	3.3	4.0
Current account bal/GDP (%)	-7.5	-22.3	-13.0	9.4	7.3	7.0	6.5
Moldova							
Real GDP at market prices	2.3	3.0	7.2	-6.5	2.5	3.6	4.5
Current account bal/GDP (%)	-7.9	-16.5	-16.7	-10.0	-9.9	-10.2	-10.0
Macedonia, FYR							
Real GDP at market prices	2.2	5.9	5.0	-1.3	1.9	3.8	3.8
Current account bal/GDP (%)	-5.9	-3.1	-12.7	-9.6	-8.5	-7.6	-4.8
Poland							
Real GDP at market prices	4.3	6.7	4.8	1.7	3.0	3.7	4.0
Current account bal/GDP (%)	-3.3	-4.8	-5.1	-1.6	-1.8	-2.6	-2.9
Romania							
Real GDP at market prices	2.2	6.3	7.3	-7.1	-0.5	3.6	4.4
Current account bal/GDP (%)	-5.8	-13.8	-12.1	-4.5	-5.0	-5.0	-5.0
Russian Federation							
Real GDP at market prices	3.9	8.1	5.6	-7.9	4.5	4.8	4.7
Current account bal/GDP (%)	7.6	6.0	6.1	3.9	4.0	2.0	2.1
Serbia							
Real GDP at market prices	-	6.9	5.5	-3.0	1.5	3.0	5.0
Current account bal/GDP (%)	-	-15.9	-17.6	-5.6	-8.5	-8.0	-7.4
Tajikistan							
GDP at market prices (2000 USD) [2]	4.6	7.8	7.9	3.4	4.0	5.0	5.0
Current account bal/GDP (%)	-4.5	-8.6	-7.7	-7.3	-8.0	-8.8	-9.1
Turkey							
Real GDP at market prices	4.3	4.6	0.7	-4.7	6.3	4.2	4.7
Current account bal/GDP (%)	-1.5	-5.7	-5.9	-2.5	-4.7	-5.2	-5.0
Ukraine							
Real GDP at market prices	2.7	7.9	2.1	-15.0	3.0	4.0	4.5
Current account bal/GDP (%)	2.7	-3.7	-7.3	-1.6	-0.9	-2.2	-2.4
Uzbekistan							
Real GDP at market prices	4.6	9.5	9.0	8.1	8.3	8.7	9.0
Current account bal/GDP (%)	3.3	17.4	13.1	7.0	7.8	8.5	8.8

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. Turkmenistan, Montenegro, Kosovo are not forecast owing to data limitations.

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.
even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Latin American and the Caribbean

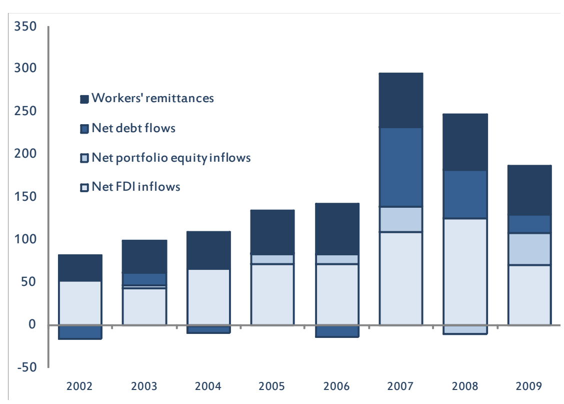
Recent developments

Countries in Latin America and Caribbean entered a strong cyclical rebound during the second half of 2009, benefitting from a robust rebound in external demand, renewed capital inflows, higher commodity prices, the turn in the inventory cycle, and a boost to domestic demand from substantial monetary and fiscal stimulus. GDP in the region, after contracting by 2.3 percent in 2009, is projected to expand by 4.5, 4.1 and 4.2 percent over 2010 - 2012, slightly below the average 5 percent recorded during the boom period.

Financial conditions improved noticeably. International capital flows to the region after declining sharply in the first half of 2009, picked up in the second half of that year and into 2010. Overall, bond, bank and equity flows to Latin American fell by 24.8 percent in 2009 to $130.3 billion. Reflecting gains already made, net private inflows are expected to pick up to about $156 billion in 2010, still some 6.2 percent lower than in 2008 and 33 percent lower than in 2007 (Figure B3.1 and Table B3.1).

Figure B3.1 Financial flows to Latin America and Caribbean dropped markedly in 2009

Billion USD

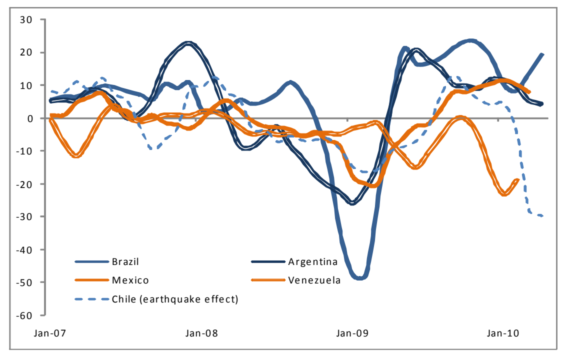


Source: World Bank.

Economic activity in the region began rebounding sharply in the second half of 2009, with industrial production growing at a 10 percent annualized rate during the fourth quarter. The pace remained relatively robust in the first quarter at 6.5 percent, stepping down marginally in selected economies. Excluding Chile from the regional aggregate, industrial production expanded at 9 percent the first quarter of this year (Figure B3.2). In Chile, following the earthquake, industrial production declined by 30 percent in the first quarter.

Figure B3.2 Industrial production is slowing in Latin America and the Caribbean

percent, 3m/3m saar

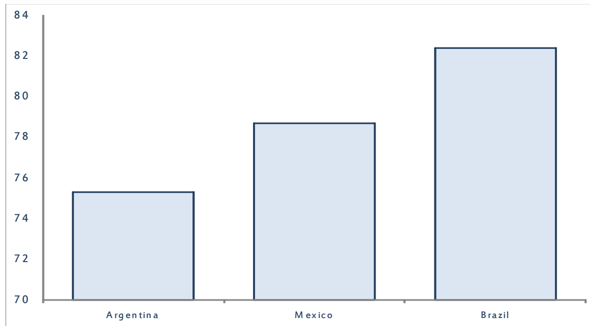


Source: World Bank

Despite the sharp bounce back in growth rates, industrial production in the region remains nearly 4 percent below its pre-crisis peak level. Compared with the level of activity that would have been expected had the crisis not intervened there is even more slack, with 10 percent or more in output gap[4] in 3 of the 10 countries for which monthly industrial production data is available (Figure B3.3). The output gap also has its reflection in labor markets. At its trough, unemployment in the region had increased by 2 million, but has since declined by 1 million.

The recovery in regional industrial production was due to both domestic demand and a global recovery in trade. After falling sharply, both the volume and value of regional exports have been rebounding at rapid rates (Figure B3.4). Nevertheless, the volume of exports is now only 10 percent higher than its August 2008 level and because of lower commodity prices, the value of trade remains 4.5 percent below its earlier peak.

Figure B3.3 Capacity utilization rates in selected countries



Source: World Bank.

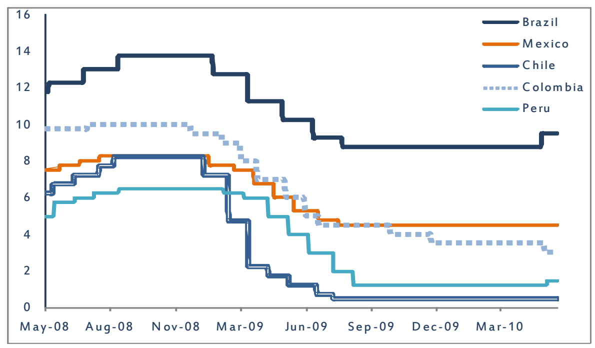
The turn in the inventory cycle has already started to make a positive contribution to growth in many countries. However, even with a solid recovery, output gaps will persist in many countries until at least 2012, translating into lingering excess capacity and high unemployment.

Despite the acceleration in growth, inflation pressures remain subdued in most countries. On a year-over-year basis, median inflation has picked up from around 2 percent to just over 4 percent in recent months, but this mainly reflects the fluctuations of commodity prices. Monthly inflation has been more stable at around 4 percent for the region as a whole.

Reflecting the benign inflation environment, still ample spare capacity and high unemployment, most central banks in the region, with the exception of Brazil and Peru (Figure B3.5), have kept their policy rates on hold. Nevertheless signs of overheating are emerging in several economies in the region, as evidenced by accelerating inflation. In Brazil, monthly inflation has picked up to a 5.22 percent rate in April 2010, prompting the authorities to raise their policy rate by 75 basis points in April. Peru's central bank raised its reference rate by 25 basis points to 1.5 percent in early May 2010, as economic growth continues at a strong pace. Conversely weak economic growth prompted the central bank of Colombia to cut its key rate by 50 basis points in early May.

Figure B3.5 Brazil and Peru started the monetary tightening

Basis points

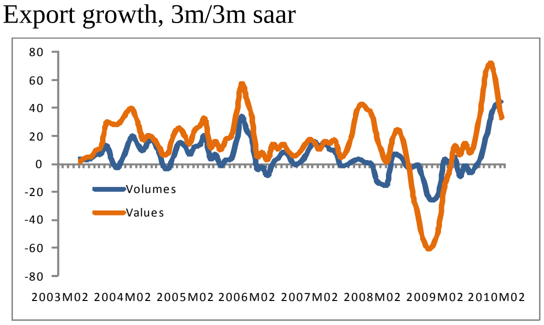


Source: Central banks.

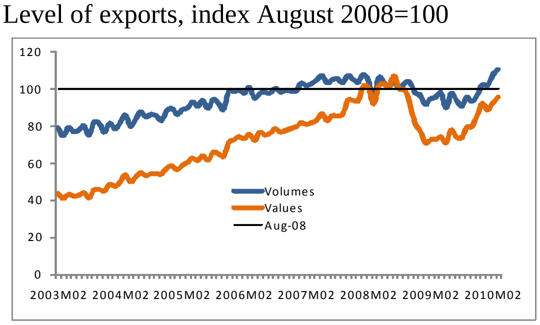
Among countries in the region, Mexico's was most affected by the crisis (and by the H1N1 flu). GDP fell by 6.5 percent in 2009, although activity began recovering in the second half of the year. Renewed demand from the U.S., stronger domestic demand and the end of the flu crisis caused industrial production to grow at a more than 10 percent pace in the second half of the year. The auto sector has rebounded particularly sharply, with output up 79 percent in the first quarter of 2010 compared with the year

Figure B3.4 Trade has not yet fully recovered

Export growth, 3m/3m saar



Level of exports, index August 2008=100



Source: World Bank

Table B3.1 Net capital flows to LAC
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**62.2**	**57.2**	**84.6**	**70.0**	**232.3**	**173.2**	**130.3**			
Net private inflows (equity+debt)	**57.4**	**67.3**	**115.8**	**90.1**	**233.1**	**166.5**	**115.4**	**156.2**	**160.1**	**171.8**
..Net private inflows (% GDP)	3.0	3.1	4.4	2.9	6.4	4.0	3.0	3.5	3.2	3.3
Net equity inflows	46.5	65.1	84.1	83.3	139.0	115.3	108.9			
..Net FDI inflows	43.2	65.7	71.9	72.1	109.4	125.0	70.8			
..Net portfolio equity inflows	3.3	-0.6	12.2	11.3	29.6	-9.7	38.1			
Net debt flows	15.7	-7.9	0.5	-13.3	93.3	57.9	21.4			
..Official creditors	4.8	-10.1	-31.2	-20.1	-0.8	6.7	14.9			
....World Bank	-0.4	-1.0	-0.7	-3.4	-0.1	2.4	6.6			
....IMF	5.6	-6.3	-27.6	-12.1	0.0	0.0	0.4			
....Other official	-0.4	-2.8	-2.9	-4.6	-0.7	4.3	7.9			
..Private creditors	10.9	2.2	31.7	6.8	94.1	51.2	6.5			
....Net M-L term debt flows	9.1	-0.8	16.0	3.6	46.9	47.8	16.1			
......Bonds	11.0	-0.7	15.6	-16.5	8.6	-4.0	33.6			
......Banks	-1.4	0.0	0.6	20.6	38.3	51.3	-16.5			
......Other private	-0.5	-0.1	-0.2	-0.5	0.0	0.5	-1.0			
....Net short-term debt flows	1.8	3.0	15.7	3.2	47.2	3.4	-9.6			
Balancing item	**-35.7**	**-53.2**	**-84.3**	**-59.1**	**-105.5**	**-95.8**	**-81.2**			
Change in reserves (- = increase)	**-35.6**	**-25.4**	**-34.4**	**-55.5**	**-137.8**	**-45.2**	**-28.3**			
Memorandum items										
Workers' remittances	36.6	43.3	50.1	59.0	63.0	64.0	57.0	**60.0**	**64.0**	

before. Stronger industrial activity, up 5.4 percent year-on-year, fueled by strong external demand, boosted GDP growth to 4.3 percent year-on-year in the first quarter. While prospects are better, unemployment in the United States remains high (especially among the low-skilled migrant population) and labor market conditions weak. As a result, tourism and remittances, which were down 15 percent in the first quarter of 2010 from a year earlier, are projected to remain weak – putting pressure both on foreign currency earnings and the incomes of the poor.

Brazil managed to navigate the crisis relatively well, with GDP declining by only 0.2 percent in 2009, in part because expansionary macroeconomic policies were able to boost domestic demand, contributing to rapid declines in spare capacity (see above) and tighter labor markets. Private consumption started the year strongly, with retail sales volumes up an impressive 14.7 percent year-on-year by March up from 5 percent growth a year earlier. However, rapid expansion in domestic demand contributed to a buildup of inflationary pressures that has prompted the monetary authorities to start tightening policy (see Figure B3.5). Fiscal policy has also moved to a tightening phase, the IPI tax rebate has been partially called back and reserve requirements were raised. Furthermore the government has announced a modest R$7.8 billion (less than 0.3% of GDP) cut in 2010 budgeted discretionary expenditures, but there are no indications yet that the large expansionary impulse of public bank credit will be withdrawn.

The recession was relatively short-lived in Chile, with GDP bouncing back at an annualized 6 percent in the second half of 2009, as stronger domestic demand supported the manufacturing and trade sectors. Overall, the economy contracted 1.5 percent in the year, with falling inventories subtracting 2.4 percentage points from GDP. As noted the earthquake in February has cut sharply into activity in the first quarter, and it is unclear how quickly the economy will bounce back. Prior to the earthquake, the recovery remained strong with retail sales and labor market developments pointing to a strong economic rebound in 2010, boosted by significant monetary stimulus. Reconstruction efforts are expected to offset this negative effect, such that growth for the remainder of the year should be relatively robust.

In both Colombia and Peru, growth decelerated significantly below potential on account of much weaker domestic demand, a marked drawdown in inventories, and, in the case of Colombia, weak net export performance. Colombia's exports rebounded in recent months, despite continued loss of market share to Venezuela, while revived investor confidence and stronger commodity prices led to a 24 percent year-on-year surge in FDI in the first quarter of 2010.

Venezuela experienced one of the sharpest recessions in the region, contracting 3.3 percent in 2009, with endemic high inflation, power shortages and electricity rationing, restricted access to foreign currency, and an unfriendly policy mix towards the private sector, delaying and weakening the recovery. Domestic demand contracted sharply, down a dramatic 7.9 percent in 2009, triggering a 20 percent contraction in imports, helping net exports to contribute a positive 4.6 percentage points to growth (even as exports declined 6.6 percent). The economy continues to contract in the first quarter of 2010, down 5.8 percent (year-on-year) as both the oil and non-oil sectors contracted by about 5 percent. To revive the economy, the government devalued the official exchange rate, and introduced a two tier exchange rate system, with the rate set at 2.6 and 4.3 bolivars against the USD from 2.147 in January 2010, as capital flight intensified (FDI outflows amounted to $3.1 billion in 2009). However the currency continued to depreciate on the unregulated markets reaching record 8.05 bolivars per USD by early May.

Growth in the Caribbean slowed to 2 percent while the Central American region, excluding Mexico contracted by 0.5 percent in 2009, as trade, tourism, FDI, and remittances were affected by recession in their main economic partners, in particular the United States and Spain. Large decline in imports, on weak private consumption and a plunge in investment, helped limit the negative impact of lower exports from the region. High unemployment domestically together with lower remittances, played a pivotal role in weakening private consumption. Furthermore the impact of the expansionary fiscal policy implemented by countries in the region was more muted than in other developing countries. On the supply side, unfavorable weather conditions took a toll on agricultural output in Central America, while construction activity had also slowed markedly, undermining growth in selected Central American economies. Stagnant tourist sectors in many countries in the Caribbean and Central America weakened the contribution of the service sector to growth. Major infrastructure projects linked to the expansion of the Panama Canal helped Panama avoid recession in 2009 despite the global downturn in trade. In the Caribbean, Jamaica experienced one of the deepest recessions, with output down an estimated 2.7 percent in 2009, mainly on account of a sharp compression in export volumes, and a 9 percent decline in remittances. In the Dominican Republic, weak bank lending, relatively low fiscal spending and revenues, high unemployment, and low exports, tourism receipts and remittances limited growth to 3.5 percent in 2009.

Medium-term outlook

After contracting 2.3 percent in 2009, output in the region is forecasted to expand by 4.5 percent in 2010, and by nearly 4.2 percent per annum over the 2011-2012 period, slightly below the average recorded in the boom period (Table B3.2). Private consumption is expected to rebound after contracting last year, supported by the lagged effects of expansionary macroeconomic policies, while the contribution to growth from government spending will weaken as policy stimuli are being withdrawn (Figure B3.6) — even as 2010 is an election year in many countries in the region. Stronger demand should fuel a cyclical rebound in fixed investment, but investment levels will remain below pre-crisis levels over the forecast horizon due to excess capacity.

Reflecting the gains already made, growth in Brazil is expected to be particularly robust this year, accelerating to 6.4 percent in 2010 on account of strong commodity demand as well as the lagged effects of expansionary demand management policies but growth should slow

Table B3.2 Latin America and the Caribbean forecast summary

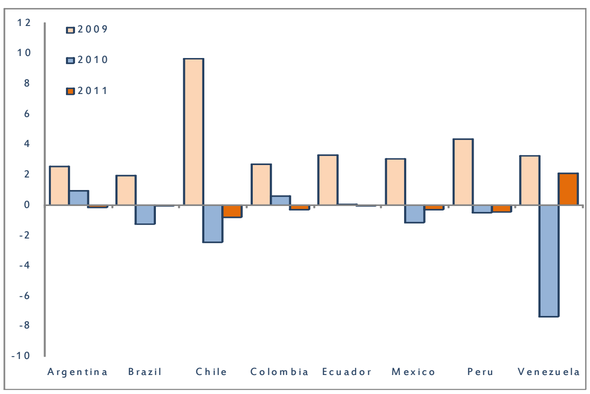
(annual percent change unless indicated otherwise)	95-05 [1]	2007	2008	Est. 2009	Forecast 2010	Forecast 2011	Forecast 2012
GDP at market prices (2005 USD) [2]	2.9	5.4	4.1	-2.3	4.5	4.1	4.2
GDP per capita (units in USD)	1.4	4.1	2.8	-3.5	3.2	2.8	3.0
PPP GDP [3]	2.9	5.6	4.3	-2.0	4.5	4.1	4.2
Private consumption	3.4	7.3	5.1	-0.6	4.7	3.8	3.9
Public consumption	2.2	4.1	4.1	3.8	3.0	2.7	2.9
Fixed investment	3.1	11.7	13.1	-14.6	7.9	7.4	7.7
Exports, GNFS [4]	6.0	5.9	2.1	-10.8	7.7	5.7	5.7
Imports, GNFS [4]	6.2	13.3	10.1	-15.2	11.4	6.8	6.6
Net exports, contribution to growth	0.2	-1.8	-2.1	1.6	-1.0	-0.4	-0.4
Current account bal/GDP (%)	-1.6	0.3	-0.8	-0.5	-1.4	-1.6	-1.7
GDP deflator (median, LCU)	7.1	6.9	7.1	7.6	4.9	5.3	5.2
Fiscal balance/GDP (%)	-3.4	-1.1	-1.0	-4.0	-2.4	-2.2	-2.3
Memo items: GDP							
LAC excluding Argentina	3.0	5.2	3.9	-2.4	4.4	4.1	4.2
Central America [5]	3.6	3.6	2.0	-5.9	4.1	3.9	4.2
Caribbean [6]	3.6	6.4	3.6	2.0	2.3	4.9	6.1
Brazil	2.4	5.7	5.1	-0.2	6.4	4.5	4.1
Mexico	3.6	3.2	1.8	-6.5	4.3	4.0	4.2
Argentina	2.3	8.7	7.0	-1.2	4.8	3.4	4.4

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars. 3. GDP measured at PPP exchange rates.
4. Exports and imports of goods and non-factor services.
5. Central America: Costa Rica, Guatemala, Honduras, Mexico, Nicaragua, Panama, El Salvador
6. Caribbean: Belize, Dominica, Dominican Republic, Haiti, Jamaica, St. Lucia, St. Vincent and the Grenadines

Source: World Bank

Figure B3.6 Fiscal stimulus withdrawal will weigh on growth

change in primary balance, percent of GDP



Source: International Monetary Fund.

over the medium term.

Mexico's growth is projected to rebound to 4.3 percent in 2010, marking the fastest growth pace in almost a decade, before easing in 2011 and 2012. Growth in 2010 will be driven by a robust recovery in exports, as demand for major export goods such as cars and electronics bounces back, and will also be fueled by recovery in private consumption. However the recovery in consumption will be to some extent curtailed by weak workers' remittances, higher taxes, administered price hikes and higher food prices which will erode the purchasing power of consumers.

Leading indicators suggest a strong and broad-based rebound in Peru's economy. Economic growth is expected to accelerate to 6.1 percent in 2010, on the back of stronger commodity prices, robust activity in the construction sector, supportive monetary policy and robust credit growth. Nevertheless growth will be much weaker than the 9.8 percent growth recorded in 2008.

Argentina and other commodity exporters in the region will benefit from terms of trade gains and stronger external demand, in particular from Asia. Argentina is expanding at a solid pace, with growth fueled by very strong demand from Brazil, which is driving the sharp recovery in

Argentina's industrial sector, as well as by lax monetary and fiscal policies. The normalization of agricultural production after the 2008/09 drought will also support growth.

Growth in Chile will be weaker than previously anticipated as a result of the massive earthquake that hit the country in February 2010. In the near term the disruptive impact of the earthquake on economic activities will outweigh the positive growth impact of the reconstruction efforts, with growth in the first and second quarters estimated to be 3 and 2 percentage points lower than initially expected. However, from the second half of 2010 onwards, the positive growth impact of the massive reconstruction activity should predominate and growth should register 4.2 percent for the year as a whole, compared to the 4.7 percent projected before the earthquake. Growth will continue to accelerate over the forecast horizon, as reconstruction efforts raise productive capacity. Potential GDP has been negatively affected given the extent of destruction to the productive capacity, in particular of the industrial base. According to central bank estimates there was a loss of 3 percent of net capital stock, which implies a negative potential GDP impact of between 1 and 1.5 percent.

In Colombia, the growth recovery will be more subdued (Table B3.3), on account of a weaker fiscal impulse and trade difficulties related to loss of market share in Venezuela. Growth should accelerate moderately to 2.8 percent in 2010, before accelerating further towards potential growth into 2012. But the acceleration in growth remains dependent on macroeconomic stimulus.

Notwithstanding a strong cyclical rebound in the region, Venezuela's economy will continue to contract in 2010, the only economy in the region besides Haiti to contract this year, as the non-commodity tradable sectors continue to suffer from an overvalued exchange rate, unproductive investment and low productivity in non-tradables while potential output continues to suffer from private sector underinvestment. Although the large devaluation of the currency in January 2010 has increased fiscal space and will ensure a continuation of the lax fiscal policy, the long(er) term growth impact is diminished by surging inflation and declining economy wide productivity. Furthermore, supply bottlenecks, energy and water supply disruptions, decelerating credit growth, and the (largely) unfriendly policy mix will continue to undermine growth over the forecast horizon, with growth forecast to contract 2.9 percent in 2010, before returning to modest growth 1.4 percent in 2011. With investment falling 12.4 percent in 2009 the country's capital stock is now significantly lower, with negative implications for potential GDP and long term growth.

Growth in the Caribbean economies will be hindered by high unemployment and weak private consumption in the United States and other high-income countries that will affect demand for tourism services, and weaken and delay the recovery in remittances. Higher commodity prices will affect growth in commodity-importing countries in the region. Growth in Dominican Republic will benefit from the U.S. rebound, stronger external demand and rising investment, while government consumption will be supported by rising revenues and multilateral support. In Jamaica the recovery will remain anemic, with austerity measures, still-weak domestic demand, and alumina output well below potential undermining the recovery. High government borrowing on the domestic markets will crowd out the private sector, undermining the recovery further. Haiti's economy is projected to recover over the forecast horizon, after contracting a dramatic 8.5 percent in 2010 due to the earthquake, boosted by reconstruction efforts financed mostly by aid flows. Excluding Haiti, growth in the Caribbean region will accelerate modestly to 3.2 percent in 2010, from 2 percent in 2009.

Central American economies (excluding Mexico) will also lag in the recovery on weak workers' remittances from the United States, with economic growth projected at 2.7 percent in 2010. In these economies the scope for recovery is also constrained by limited fiscal space to implement counter-cyclical policies. A recovery in agricultural and manufacturing exports will be supportive of growth in many economies in the region, as will growth in the service sector, particularly back-office services. Improved weather conditions and improved market access to export markets like the EU, and selected Asian markets will give a welcome boost to agricultural exports in countries like Guatemala, Nicaragua and Costa Rica. Meanwhile manufactured goods exports will benefit from stronger demand in the United States and in Central America. In Panama growth will accelerate, fueled by continued enlargement of the Panama Canal, which will bolster the contribution to growth from the construction and service sectors.

As policy makers in the region begin tightening monetary policy and interest rates rise, some currencies will see appreciation pressures, which could adversely affect external competitiveness. Furthermore higher capital inflows in response to higher interest rate differentials could lead to excess credit expansion, complicating policymakers' task of combating inflation, which is already rising in some of the advanced emerging economies.

Beyond 2010, growth in the region will likely slow as the impact of the policy stimulus is waning, while the inventory cycle's contribution to growth turns negative and financial conditions remain tight. Furthermore slower (quarterly) growth in the United States in the second half of the year, and lingering high unemployment will undermine growth in Mexico, Central America and the Caribbean, through trade, investment, remittances and tourism linkages.

Risks

The possibility of a disruptive resolution of the real or perceived lack of fiscal sustainability of a number of high-income European (EU-5) countries remains a significant risk for countries in Latin America. Financial linkages with some of these countries are extensive, with banks in the EU-5 countries having been an important source of capital for public and private sectors in Latin America ($320bn or 8% of GDP). Spanish banks own over 25% of bank capital in Mexico, Chile, and Peru. To date, these banks have relied mostly on local deposits rather than cross-border flows for funding, which has proven to be a source of resilience rather than weakness during the global financial crisis.[5] So far there have been no significant hikes in credit default swaps (CDS) for country sovereigns rated similarly as heavily indebted European countries (Colombia, Panama), and their CDS are much lower for the same rating. Should a full-scale crisis emerge in Europe, growth in Latin American and the Caribbean could slow by 1.7 percent and output to could be more than 4 percent lower in 2012. In these circumstances, countries should place a priority on ensuring that their domestic fiscal houses are in order, both to ensure that markets do not perceive them as lacking fiscal discipline (something that has not happened as yet), but also to ensure that they are in a position to react counter-cyclically if needed.

Alternatively poor economic performance in Europe if the sovereign debt crisis unfolds could result in increased capital flows to successful Latin American economies. This would put additional pressure on currencies to appreciate, hurting external competitiveness, and could lead to imposition of capital controls that may have longer term negative consequences for the financial systems.

Outside of this major risk, the remaining risks for the region are largely balanced, with the most important downside risk relating to the strength of the global recovery, and in particular the turnaround in high-income (notably the U.S.) countries. For tourism dependent economies the main downside risk is that of a sluggish recovery in labor markets and incomes in high-income countries which will delay the recovery in tourism revenues.

Among upside risks, the lagged effects of very accommodative macroeconomic policies and delays in withdrawing these stimuli could lead to even stronger growth, and in some cases overheating of economies. For commodity exporting countries, a stronger-than-expected global cyclical bounce back would translate into even larger terms of trade gains and much stronger external demand adding to the tenor of the recovery. In such a scenario the risks to inflation are on the upside, complicating macroeconomic management.

Strong capital inflows could also pose additional policy challenges for selected countries in the region, that could lead to further currency appreciation and reintroduction of capital controls.

Table B3.3 Latin America and the Caribbean country forecasts

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	2007	2008	2009	2010	2011	2012
Argentina							
Real GDP at market prices	2.3	8.7	7.0	-1.2	4.8	3.4	4.4
Current account bal/GDP (%)	-0.2	2.8	2.4	2.6	2.4	1.9	1.4
Belize							
Real GDP at market prices	5.6	1.2	3.8	-1.0	1.7	2.3	3.9
Current account bal/GDP (%)	-12.1	-4.1	-11.2	-7.2	-8.5	-8.1	-7.4
Bolivia							
Real GDP at market prices	3.8	0.0	6.1	3.3	4.2	4.1	4.2
Current account bal/GDP (%)	-3.0	12.1	11.6	3.4	3.3	3.3	3.4
Brazil							
Real GDP at market prices	2.4	5.7	5.1	-0.2	6.4	4.5	4.1
Current account bal/GDP (%)	-2.0	0.1	-1.7	-1.6	-2.9	-2.9	-3.0
Chile							
Real GDP at market prices	4.2	4.6	3.7	-1.5	4.2	5.6	5.4
Current account bal/GDP (%)	-1.5	4.4	-1.5	2.6	-1.1	-1.5	-2.4
Colombia							
Real GDP at market prices	2.4	7.5	2.4	0.4	2.8	3.7	4.2
Current account bal/GDP (%)	-2.2	-2.8	-2.8	-1.8	-2.6	-2.1	-2.5
Costa Rica							
Real GDP at market prices	4.5	7.9	2.8	-1.1	3.8	4.2	4.4
Current account bal/GDP (%)	-4.0	-6.3	-9.2	-2.1	-3.9	-3.8	-3.3
Dominica							
Real GDP at market prices	1.4	5.4	3.2	1.1	1.9	3.0	3.3
Current account bal/GDP (%)	-19.4	-25.0	-32.3	-32.4	-28.8	-27.2	-25.7
Dominican Republic							
Real GDP at market prices	5.2	8.5	5.3	3.5	4.0	5.3	6.7
Current account bal/GDP (%)	-0.8	-5.3	-9.7	-4.9	-6.0	-5.2	-4.7
Ecuador							
Real GDP at market prices	3.2	2.5	7.2	0.4	2.2	2.3	2.6
Current account bal/GDP (%)	-1.4	3.6	2.3	-1.1	-0.4	-1.2	-2.1
El Salvador							
Real GDP at market prices	2.7	4.7	2.5	-3.5	1.2	2.5	3.3
Current account bal/GDP (%)	-2.5	-6.0	-7.6	-1.6	-2.7	-2.8	-3.4
Guatemala							
Real GDP at market prices	3.5	6.3	3.3	0.6	2.0	2.8	3.5
Current account bal/GDP (%)	-4.9	-5.2	-4.5	-0.6	-3.1	-3.8	-4.1
Guyana							
Real GDP at market prices	1.7	7.0	2.0	3.1	3.5	3.8	4.2
Current account bal/GDP (%)	-9.4	-11.1	-13.2	-8.4	-10.9	-9.9	-8.0
Honduras							
Real GDP at market prices	3.8	6.3	4.0	-1.9	2.1	2.8	4.0
Current account bal/GDP (%)	-6.7	-10.4	-13.2	-3.2	-5.8	-5.9	-6.1
Haiti							
Real GDP at market prices	0.9	3.4	1.3	2.9	-8.5	9.6	9.1
Current account bal/GDP (%)	-3.7	-5.6	-10.2	-4.8	-9.5	-6.6	-6.4
Jamaica							
Real GDP at market prices	0.8	1.4	-0.9	-2.7	0.3	2.2	3.0
Current account bal/GDP (%)	-5.5	-15.6	-20.0	-7.8	-9.3	-7.8	-7.2

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Mexico							
Real GDP at market prices	3.6	3.2	1.8	-6.5	4.3	4.0	4.2
Current account bal/GDP (%)	-1.9	-0.8	-1.5	-0.6	-0.9	-1.2	-1.4
Nicaragua							
Real GDP at market prices	4.1	3.1	2.8	-1.5	1.7	2.3	3.6
Current account bal/GDP (%)	-20.2	-17.7	-23.8	-13.0	-18.1	-16.9	-17.3
Panama							
Real GDP at market prices	4.5	11.5	9.2	2.2	4.5	6.1	6.5
Current account bal/GDP (%)	-5.3	-7.2	-11.5	-0.5	-8.4	-8.6	-7.2
Peru							
Real GDP at market prices	3.3	8.9	9.8	0.9	6.1	5.6	6.2
Current account bal/GDP (%)	-3.3	1.4	-3.7	0.2	-0.8	-1.0	-1.9
Paraguay							
Real GDP at market prices	1.2	6.8	5.8	-3.8	5.1	4.4	4.7
Current account bal/GDP (%)	-1.5	1.4	-2.9	-1.3	-2.3	-1.2	-0.6
St. Lucia							
Real GDP at market prices	2.9	1.5	0.7	-5.2	1.1	2.7	3.7
Current account bal/GDP (%)	-13.6	-31.4	-31.0	-19.9	-18.1	-17.5	-17.7
St. Vincent and the Grenadines							
Real GDP at market prices	4.2	7.7	0.9	-1.1	2.1	3.9	4.2
Current account bal/GDP (%)	-18.3	-34.2	-33.8	-29.0	-30.9	-29.3	-26.8
Uruguay							
Real GDP at market prices	1.5	7.5	8.5	2.9	4.6	4.1	4.0
Current account bal/GDP (%)	-0.9	-0.9	-4.8	0.8	-1.5	-1.4	-1.2
Venezuela, RB							
Real GDP at market prices	1.6	8.4	4.8	-3.3	-2.9	1.4	2.7
Current account bal/GDP (%)	7.5	7.9	11.8	2.3	7.0	5.8	4.9

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

2. Barbados, Cuba, Grenada, Suriname are not forecast owing to data limitations.

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Middle East and North Africa[6]

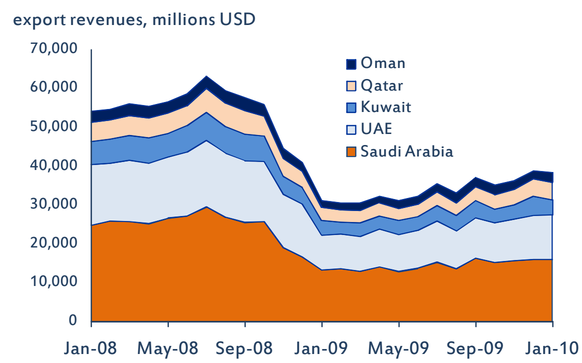
Recent Developments

The Middle East and North Africa shows tentative signs of recovery in 2010. Developments in the external environment for the region have been generally favorable over the second half of 2009 and into the first months of 2010, as the financial crisis and global recession have given way to hopes of stronger recovery, led by the developing countries. But changes in international financial markets and economic growth developments have also shifted to favor- or have placed at some disadvantage- the region's diverse set of countries grouped into high-income and developing oil exporting countries, and the more diversified economies. From 2008 through 2010, regional government policies shaped the outlines of domestic absorption growth—depending on the availability of fiscal space and inflation headroom—and the manner in which these measures will be modified or withdrawn over the course of 2010 through 2012 will play a key part in the outlook.

Just as during the decline of regional growth into the global recession of 2009 differed substantially by country, so recovery from the crisis will differ. This will depend on the set of initial conditions, and the intensity of effects flowing though the transmission channels—the price of oil and the balance of payments, reflecting impacts on trade, remittances and FDI flows. But serious headwinds for both oil- and diversified exporters have cropped up in the early months of 2010.

Hydrocarbon revenues increase. As the intensity of global recession began to ease in latter 2009, upward pressure on oil prices emerged, emanating from (i) market expectations of eventual return of strong fuels demand among developing countries, and (ii) substantial cutbacks in OPEC crude oil production to restrict growth of global supply and set a floor under prices. Together these developments yielded a gradual increase in oil and gas revenues for the high-income- as well as low-and -middle income oil exporters of the region, beginning in late 2009 and continuing into the first months of 2010 (Figure B4.1). The aggregate increase amounted to 25 percent, carrying total revenues to an annualized rate of $605 billion as of January 2010. This contrasts favorably with total 2009 earnings of $530 billion, offering some scope for optimism looking forward.

Figure B4.1 High-income oil revenues recover only slowly



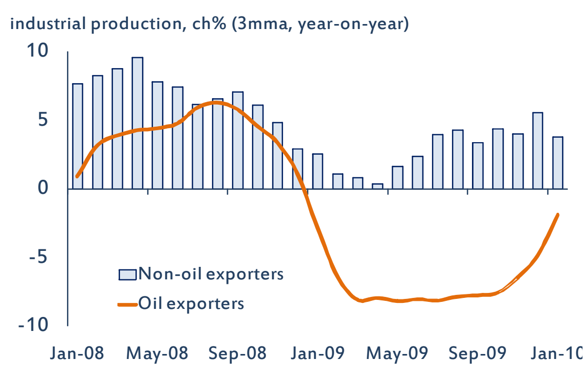
Source: World Bank data

Crude oil production cutbacks over 2009 and into 2010, initiated in an effort to reduce massive global stocks, were substantial and economically damaging for the high-income oil exporters, pushing oil-sector GDP well into decline. Generous expenditure of reserves was used as offsets to support the non-oil economy from fallout. Crude oil output declines for the group ranged from 8 to 9 percent from year-earlier levels by mid-2009, registering a 7.8 percent cut for the year (Figure B4.2). From mid-2009, production declines eased, and crude oil output recouped to stand 2 percent below January 2009 levels by January 2010. Having achieved this modicum of production management (given traditional OPEC-quota non-compliance), and with stronger GDP gains in developing countries, oil prices continued to move well above $70/bbl in early 2010 from $50/bbl as of spring 2009.

Indeed, after five consecutive quarters of decline, world oil demand moved into positive territory during the final quarter of 2009, led by strong demand in China—up 1.3mb/d or 17 percent (year-on-year). But global crude oil supplies are ample. OPEC's spare capacity has increased to 6.5mb/d following the recent cutbacks, roughly the level as of 2002 when oil prices registered $25/bbl.

For the diversified economies, there are signs of incipient revival in goods exports, being echoed to a lesser degree in a return of industrial production to stronger growth (Figure B4.2). Inflation has eased to more moderate rates in these economies, helping to support monetary measures designed to shelter financial systems from distress in the context of crisis. And despite the global downturn, reductions in key remittance-, tourism and FDI flows to the developing region may be considered moderate with respect to how far such flows *could have fallen*, given the deterioration in economic conditions in source countries. But for oil-and diversified exporters alike, economic headwinds have cropped up during the late spring months of 2010.

Figure B4.2 Oil and non-oil production recovering

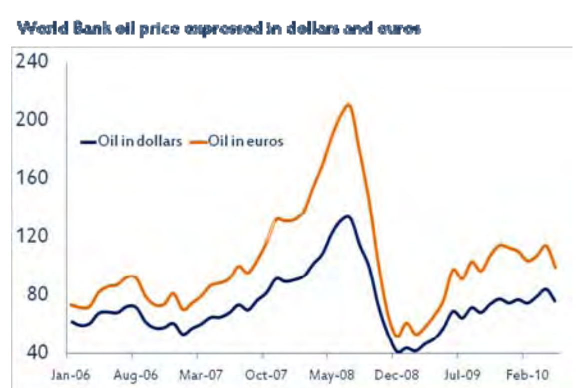


Source: World Bank

Headwinds near. Events in Europe over April-to -June 2010, grounded in the sovereign debt difficulties of Greece, Spain and Portugal, and the consequent EU/IMF Stabilization Package for the Euro Area, have dampened several of the emerging trends of importance for the Middle East and North Africa. Oil prices plummeted from $85/bbl in the first week of May 2010 to $70/bbl during the third week of the month, on concerns of potentially reduced global oil demand. And the economic outlook for Europe has also dimmed, as austerity measures are in place among the highly-indebted countries of the Southern Euro Zone, as well as in Germany, France, Italy, the United Kingdom and others. These adjustments will work to slow near-term economic activity. Business and consumer sentiment have fallen quickly, while the euro has depreciated sharply against the dollar, with negative implications for European demand and exports from the Middle East and North Africa's in 2010 and 2011. At this writing, the potential for financial contagion remains high within Europe, and between Europe and its neighboring developing regions, notably Europe and Central Asia, the Middle East and North Africa and Sub-Saharan Africa.

The euro's decline is a mixed development for the Middle East and North Africa. For oil exporters, where receipts are denominated in dollars, but where the bulk of procurement of capital and consumer goods is transacted with Europe in euros, exporters enjoy a boost to the purchasing power of exports. For the diversified group, the euro's decline carries less dramatic effects, as both foreign receipts and outlays tend to be euro-based (Figure B4.3).

Figure B4.3 Oil has held its value in Euro terms

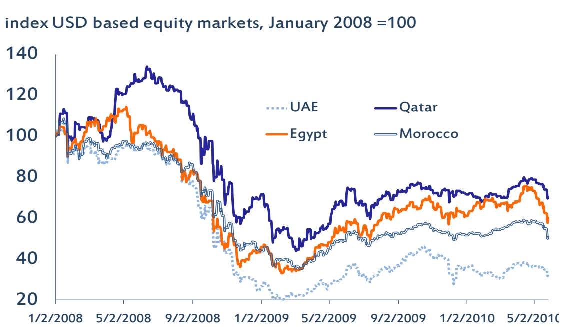


Source: World Bank

Middle East and North Africa suffered less disruption than most developing regions in the crisis. As background to recent developments, it should be noted that—contrasted with other developing regions which may carry tighter integration with global financial markets; and for those with trade linkages that may be more extensive—the adverse effects of the global crisis and recession on the Middle East and North Africa have been moderate. A loss of 1 point of growth during 2009 (from GDP gains of 4.2 percent for the developing region in 2008 to 3.2 percent in 2009), contrasts favorably with the 9.5 point decline in growth for Europe and Central Asia; a 6.4 point falloff for Latin America and the Caribbean, and 4 point drop for developing countries in aggregate.

Within the broader region, the high-income Gulf Cooperation Council economies were hardest hit by crisis, due to the huge terms of trade shock associated with the plunge in oil prices, and a financial shock which destabilized overextended domestic banks, in part leading to a bursting of real estate bubbles. The debt problems of Dubai, United Arab Emirates, first brought the possibility of 'sovereign default' in the region onto the global radar screen. Equity markets across the oil exporters plunged at the outset of crisis, and recovery has been exceptionally sluggish, underscoring continuing market uncertainties regarding the financial underpinnings of these economies (Figure B4.4).

Figure B4.4 Equity markets still down



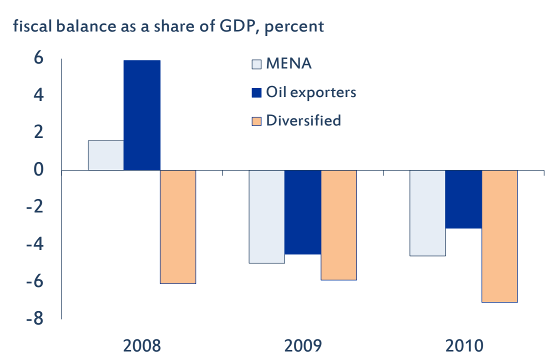
Source: Morgan-Stanley

A decline in the group's GDP growth in 2009 to 0.2 percent from 5.3 percent in the preceding year, tied to loss of oil revenues and scale-back in oil production, carried confidence across the broader region lower, and set the tenor for weaker growth. The high-income oil exporter's current account surplus plummeted to 10 percent of GDP from 30 percent in 2008, while the fiscal surplus narrowed by 20 percentage points. Remittances-, and especially flows of foreign direct investment (FDI) from the group to the developing region—which had become an import source of financing and for investment—slowed, removing an important factor for growth in the developing region.

Table B4.1 (below) highlights a number of dramatic developments for the region during 2009 and 2010. Growth of per-capita income for the developing region declined by almost a percentage point in 2009, increasing just 1.5 percent, following two consecutive years of stronger gains. Household spending grew at a slower pace in 2009 and is likely to remain subdued through 2010 (in historic comparison), suppressed by potential job losses, reduced government support, lower confidence levels and a decline in worker remittances. Trade performance has reflected the decline in hydrocarbons and goods exports, with some recovery expected in 2010.

Against this background, the current account surplus for the developing countries of the region shifted to deficit of 1.4 percent of GDP in 2009, a sharp correction from peaks nearer 10 percent in 2007. But the regional surplus is anticipated to improve moderately in 2010 to 0.4 percent of GDP on higher oil revenues. Public consumption in support of domestic demand picked-up to nearly 11 percent growth in 2009, in turn, pushing the fiscal balance from surplus of 1.6 percent of GDP in 2008 to deficit of 5 percent. And fiscal shortfalls are anticipated to continue through 2012 (Figure B4.5).

Figure B4.5 Government deficits up



Source: World Bank

Table B4.1 Middle East and North Africa forecast summary

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 USD) [2]	4.4	5.3	4.2	3.2	4.0	4.3	4.5
GDP per capita (units in USD)	2.7	3.5	2.4	1.5	2.3	2.6	2.8
PPP GDP [3]	4.5	5.6	4.1	3.1	4.0	4.3	4.4
Private consumption	4.2	6.1	5.4	3.6	4.1	4.7	5.2
Public consumption	3.3	4.3	7.8	10.7	8.5	6.5	5.7
Fixed investment	6.5	14.3	15.3	4.5	4.6	4.4	4.5
Exports, GNFS [4]	4.9	4.9	0.6	-12.3	2.0	4.3	5.1
Imports, GNFS [4]	5.7	12.2	13.8	-7.3	4.4	5.7	6.5
Net exports, contribution to growth	-0.2	-2.1	-4.6	-1.7	-0.9	-0.7	-0.7
Current account bal/GDP (%)	2.9	10.5	7.5	-1.4	0.4	-0.3	-1.1
GDP deflator (median, LCU)	5.2	7.3	17.5	6.7	6.6	3.4	4.3
Fiscal balance/GDP (%)	-1.5	0.0	1.6	-5.0	-4.6	-4.1	-3.1
Memo items: GDP							
MENA Geographic Region [5]	4.0	4.7	4.7	1.9	3.9	4.3	4.4
Selected GCC Countries [6]	3.6	3.9	5.3	0.2	3.7	4.2	4.4
Egypt	4.4	7.1	7.2	4.7	5.0	5.5	5.7
Iran	4.8	6.2	2.3	1.8	3.0	3.2	3.2
Algeria	4.0	3.0	2.4	2.1	4.6	4.1	4.3

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars. 3. GDP measured at PPP exchange rates.
4. Exports and imports of goods and non-factor services.
5. Geographic region includes high-income countries: Bahrain, Kuwait, Oman and Saudi Arabia.
6. Selected GCC Countries: Bahrain, Kuwait, Oman and Saudi Arabia.
Source: World Bank

Low-and-middle-income oil exporters' revenues halved. Algeria, Iran, Syria and Yemen collectively suffered a halving of hydrocarbon revenues in 2009, as exports declined 40 percent from $212 billion in 2008 to $125 billion in 2009. On this massive drop in revenue, the current account surplus of the group fell from 18 percent to 3 percent of GDP. For countries highly reliant on oil revenues to (i) finance longer term infrastructure and housing projects (Algeria); (ii) subsidize current consumer outlays (Iran), or (iii) build and maintain the capacity for exporting larger quantities of LNG (Yemen), the virtual collapse of incomes carried a toll on economic growth. But much stronger activity in non-oil sectors (Algeria) helped to soften the overall impact of the downturn. Though public spending in these countries is typically pro-cyclical, in the current crisis, both Algeria and Iran used monetary easing and fiscal stimulus to encourage economic growth. As is the case for the high-income exporters, oil revenues for the group have been on the rise of late, as oil prices firmed to near $80/bbl in early 2010 and hydrocarbons production in Algeria breached to positive growth as of February 2010 (3.1 percent, y/y), and that in Iran to 1.6 percent in the same period.

Economic developments in *Iraq* have been fast moving in the last months. The country's fiscal position deteriorated substantially in 2009 to 22 percent of GDP, a result of the sharp falloff in oil prices affecting revenues, from modest surplus positions during 2007-08. At the same time, GDP growth fell from a 9.5 percent jump in 2008 to 4.6 percent for 2009 tied once more to the oil price slump. A new two-year Stand-By Arrangement with the IMF, as well as a Fiscal Sustainability Development Policy Loan from the World Bank were approved in February 2010.

The diversified economies hit hard by the recession in Europe. The more diversified economies of the region, including Egypt, Jordan, Lebanon, Morocco and Tunisia, were directly affected by the recession in key export markets in the European Union, and to a lesser degree, the United States, carrying exports to sizeable decline over the course of 2009. Signs of some recovery are now apparent in the early months of 2010. Industrial production has largely followed the decline in exports. Though these (largely) oil-importing economies enjoyed reprieve on import bills, with a substantial improvement in terms of trade, they are also suffering severe indirect consequences of the financial crisis and recession. These include reduced remittance inflows from Europe and the high-income oil exporters, a cutback in FDI flows from the latter group, and tourist arrivals diminished by the crisis.

Fiscal policy for the diversified economies is expected to continue to be expansionary, as countries use various measures to stimulate demand. But these will carry adverse consequences for fiscal balances—for some economies, including Lebanon, Jordan and Egypt, for which fiscal space is limited—and the fiscal position could become a longer-term growth constraint.

Among the more prominent exporters of the group, Egypt's merchandise exports peaked at more-than 100 percent growth (y/y) during summer 2008 (the effects of oil exports coming on stream), before slipping to decline of 30 percent a year hence (Figure B4.6). In broader fashion, the sharp falloff of import demand in Europe yielded a growth path for the aggregate of diversified exporters which peaked near 70 percent in summer 2008- fell to nil by year-end- before recovery set in. Production in the diversified economies was directly affected by the downturn in exports, as well as by softening domestic demand, in turn adversely affected by several important indirect channels of the crisis.

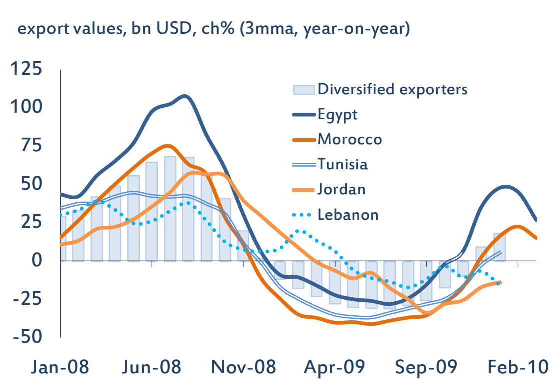
Industrial production for the group moved from gains of 10 percent in early 2008 (y/y) to trough at nil in spring 2009, though with much diversity across countries (Figure B4.7).

There are early signs of recovery, which have carried the group's merchandise exports to growth of 18 percent by January 2010 (y/y), with advances for Egypt and Morocco bettering these figures at 45 percent and 23 percent respectively during February. Production has not yet responded to the new impetus, as business may be using existing inventories to meet demand, a sign of caution under current global circumstances.

Table B4.2 highlights recent developments and estimates for important ancillary income and financial flows to the region, including worker remittance receipts, tourism revenues and net FDI inflows. For the diversified group, these are especially important, as additions to household incomes (remittances), employment, income and infrastructure growth (tourism), and investment as well as external financing (FDI).

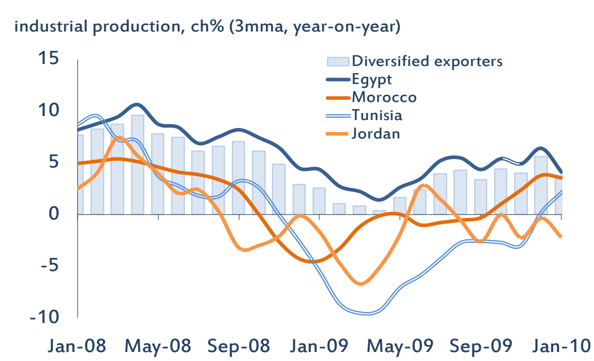
For the developing MENA region, *worker remittance inflows* reached an all time high in 2008 at $33.8 billion representing 4 percent of regional GDP. Egypt was the largest recipient of remittances at $8.4 billion, with the importance of such flows highest for Lebanon at close to 20 percent of GDP. Given deterioration of employment conditions in the European Union, and notably among the high-income oil exporters, remittance flows declined 6 percent in

Figure B4.6 Rebound in exports is slowing



Source: World Bank

Figure B4.7 Modest industrial production growth among diversified exporters



Source: World Bank

Table B4.2: Remittances, Tourism revenues and Foreign Direct Investment, selected MENA countries

	Remittances			Tourism revenues			Net FDI inflows		
Country / region	2007	2008	2009e	2007	2008	2009e	2007	2008	2009e
MENA region									
in dollars (bn)	29.6	33.8	31.8	29.2	35.1	32.2	23.4	28.4	19.2
as percent of GDP (%)	4.2	4.0	3.8	4.2	4.2	3.9	3.3	3.4	2.3
Egypt									
in dollars (bn)	6.3	8.4	7.6	8.2	10.8	10.5	11.1	13.2	8.1
as percent of GDP (%)	4.8	4.7	3.9	6.3	6.1	5.4	8.5	7.5	4.2
Jordan									
in dollars (bn)	3.4	3.8	3.6	2.3	2.9	2.5	1.9	2.0	1.5
as percent of GDP (%)	20.8	18.5	15.4	14.0	14.4	10.7	11.5	9.5	6.4
Morocco									
in dollars (bn)	6.7	6.8	6.3	7.2	7.2	6.6	2.2	2.0	1.3
as percent of GDP (%)	8.9	7.7	6.9	9.5	8.1	7.3	2.9	2.3	1.4
Tunisia									
in dollars (bn)	1.7	2.0	2.0	2.6	2.9	2.4	1.6	2.7	2.0
as percent of GDP (%)	4.9	4.9	5.0	7.4	7.3	6.1	2.1	3.2	2.2
Memo item:									
Diversified									
in dollars (bn)	23.9	28.2	26.5	29.2	35.1	32.2	18.6	22.5	14.1
as percent of GDP (%)	9.3	8.8	7.5	11.4	10.9	9.2	7.2	7.0	4.0

Source: World Bank, U.N. World Tourism Organization, U.N. Transnational Center (UNCTAD), Central Bank of Egypt.

2009 to $31.8 billion, or to 3.8 percent of regional GDP. And estimates for 2010 look less-than promising due to continuing uncertainties in the European economy. The knock-on effects of such decline are especially important for consumer spending and private investment in the diversified economies of the Middle East and North Africa.

Tourism revenues also established all-time highs in the region during 2008 at $35.1 billion, or 4.2 percent of GDP. Highest in Egypt, at near $11 billion during 2008, and of greater importance for Jordan at 14.4 percent of GDP, tourism represents an important source of job growth, with many “multiplier” effects in local communities. Analysis from the United Nation’s World Tourism Organization and the World Travel and Tourism Council, indicate that tourism was exceptionally hard hit by the global slump after a strong showing in 2008. During the former year, global tourist arrivals grew 2 percent, but were sharply affected during the second half of the year by the financial crisis, declining 1.5 percent over the like period of 2007. The Middle East however, saw strongest gains in international arrivals, moving up to 55 million persons in 2008 or 18 percent growth. North Africa also saw tourist arrivals increase to

Table B4.3 Capital flows to MENA region
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**12.2**	**10.1**	**16.4**	**12.2**	**26.1**	**18.6**	**22.0**			
Net private inflows (equity+debt)	**14.3**	**13.6**	**19.4**	**23.1**	**24.8**	**20.1**	**19.3**	**30.1**	**36.2**	**36.1**
..Net private inflows (% GDP)	3.1	2.5	3.2	3.2	2.9	1.9	1.8	2.5	2.8	2.6
Net equity inflows	7.7	7.5	16.2	25.9	22.9	26.5	18.8			
..Net FDI inflows	7.5	6.8	13.8	24.9	25.0	26.1	18.7			
..Net portfolio equity inflows	0.2	0.7	2.4	1.0	-2.1	0.4	0.1			
Net debt flows	4.5	2.6	0.2	-13.7	3.2	-7.9	3.2			
..Official creditors	-2.1	-3.5	-3.0	-10.9	1.3	-1.5	2.7			
....World Bank	-0.3	-0.6	0.0	-0.8	1.0	-0.3	0.9			
....IMF	-0.6	-0.5	-0.7	-0.2	-0.1	-0.1	-0.1			
....Other official	-1.2	-2.4	-2.3	-9.9	0.4	-1.1	1.9			
..Private creditors	6.6	6.1	3.2	-2.8	1.9	-6.4	0.5			
....Net M-L term debt flows	0.9	2.7	2.9	-1.7	-0.8	-2.9	-3.9			
......Bonds	0.7	2.8	2.5	0.8	0.7	-0.8	-1.3			
......Banks	-0.4	-0.1	1.2	-1.4	-0.4	-0.8	-1.7			
......Other private	0.6	0.0	-0.8	-1.1	-1.1	-1.3	-0.9			
....Net short-term debt flows	5.7	3.4	0.3	-1.1	2.7	-3.5	4.4			
Balancing item	**-11.3**	**-33.4**	**-54.6**	**-42.8**	**-57.6**	**-63.9**	**-9.1**			
Change in reserves (- = increase)	**-23.1**	**-14.6**	**-21.7**	**-38.6**	**-43.6**	**-43.2**	**-14.5**			
Memorandum items										
Workers' remittances	20.4	23.0	25.0	26.0	32.0	35.0	32.0	**33.0**	**34.0**	

17.2 million in 2008, a gain of 5 percent.

Travel conditions in 2009 and early 2010 deteriorated sharply, and the World Tourism Organization estimates that global arrivals declined by a heady 4 percent in the year. Tourism revenue estimates for the Middle East and North Africa in 2009 suggest a downturn of about $3 billion, a decline of 8.5 percent, especially affecting Egypt, Jordan and Morocco. The falloff in tourist income from Europe and the OECD has been offset to a degree by increased arrivals from within the region, a trend in development over the last years. Still, receipts are likely to decline further in 2010 against a less -than hospitable global environment for growth, notably in Europe.

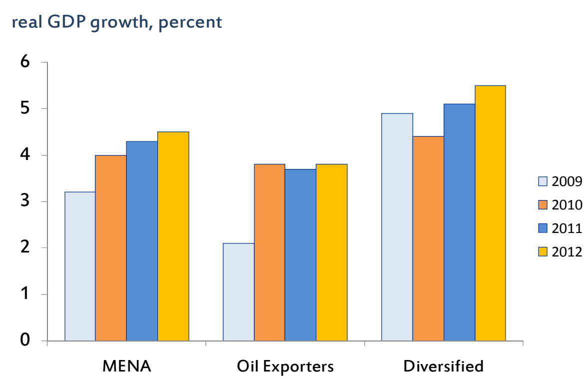
Given the adverse developments in economies that serve as the main source for *FDI flows* to the developing region, such flows are estimated to have declined sharply in 2009, by 32 percent to $19.2 billion in the year. Recent developments in Europe and the high-income oil exports suggest that FDI may continue its decline through 2010. The implications of the decline in FDI are important for the region, as the dynamism of private investment growth of the last years, largely spurred by FDI, is waning in 2009 and 2010. Moreover, as fiscal positions deteriorate into 2010, FDI as an external financing source will be more keenly missed.

Capital flows to the developing economies of the Middle East and North Africa, outside of foreign direct investment, are quite small both in dollar terms and as a proportion of GDP. Developments during 2009 reflect the downturn in FDI noted, with a $3.2 billion pickup in net debt flows, comprised of $2.7 billion from official sources and $0.5 billion from private creditors. Short term flows shifted to net inflow of $4.4 billion in the year from outflow of $3.5 billion in 2008 (Table B4.3).

Near-term Outlook

Despite gathering headwinds in the international environment, the Middle East and North African economy looks poised for recovery from the lows of the global financial crisis and recession. There are signs of recent increases in hydrocarbon revenues, merchandise exports, and the beginnings of spillover to crude oil- output and industrial production growth. But export markets remains constrained by the unwinding of sovereign debt in Europe; and oil exporters' shipments will face headwinds of large crude oil stocks among OECD countries, amounting to near record "days of consumption". Against this background, and following GDP gains of 3.2 percent in 2009, growth in the developing region is anticipated to pick-up to 4 percent in 2010, before a movement toward potential growth sets in more forcefully, with GDP registering 4.3 percent growth in 2011 and 4.5 percent by 2010 (Figure B4.8).[7]

Figure B4.8 Output to slowly pick up strength



Source: World Bank

GDP gains in 2010 should be supported by an improvement in the contribution of net exports from drag of 1.7 points of GDP in 2009 to subtraction of less-than a point, and a pickup in household spending contribution by three-tenths of a point to 2.2 points of growth. These elements should be sufficient to offset a falloff in government consumption and investment spending as it becomes clearer to authorities that fiscal deficits will need to be reined-in. Indeed, in 2010 fiscal balances for the region are likely to deteriorate from surplus of 1.6 percent of GDP in 2008 to deficit of 5 percent. The issue is more exigent for the diversified group, with deficits pegged nearer 9 percent of GDP over 2009-2010.

The high-income oil exporters seem better placed to lead recovery for the broader MENA region, as oil prices have traced an upward trend and financial conditions in the group are stabilizing. As noted earlier, world oil demand picked-up during the final quarter of 2009, fully concentrated in the developing countries, with U.S. demand improving in the early months of 2010, carrying global fuels demand growth to 2 percent (y/y). Against this background, selected economies may see GDP growth improve by a strong 3.4 points in 2010 to 3.7 percent, firming thereafter to 4.2-and 4.4 percent over 2011-2012 on stronger oil demand- increasing hydrocarbons output and resumed public spending on infrastructure and social development.

Within the developing region, the low-and middle-income oil exporters are likely to see GDP gains firm to 3.8 percent in 2010 from 2.1 percent in 2009, as oil production and export volumes pick-up gradually while domestic demand gains some momentum. In step with world oil demand, a further extension of growth near 3.8 percent over 2011 to 2012 appears likely. Some of the developing oil exporters will benefit from recovery in the high-income countries of the region, as exports to the group constitute a large proportion of total outbound shipments. And those which rely on remittances from the GCC, notably Yemen, will also gain from recovery.

Recovery for the diversified group of exporters will hinge largely on developments in Europe and the high-income exporters. Whether economic recovery in the EU will be dampened by the sovereign debt crisis or sufficiently ameliorated by the EU/IMF Stabilization Package remains an open question. Growth for the diversified group is anticipated to ease from 4.9 percent in 2009 to 4.4 percent in 2010 with growth in Morocco viewed to slow to 3 percent from 5.3 percent, as agricultural output normalizes this year following a 2009 bumper crop. Assuming a return to stronger growth in Europe and a revival in the region’s ancillary income and investment flows, the diversified

Table B4.4 Middle East and North Africa forecast summary

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Algeria							
Real GDP at market prices	4.0	3.0	2.4	2.1	4.6	4.1	4.3
Current account bal/GDP (%)	8.2	22.5	19.9	0.4	2.7	2.3	1.9
Egypt, Arab Rep.							
Real GDP at market prices	4.4	7.1	7.2	4.7	5.0	5.5	5.7
Current account bal/GDP (%)	0.4	4.3	0.5	-2.4	-1.7	-1.8	-1.9
Iran, Islamic Rep.							
Real GDP at market prices	4.8	6.2	2.3	1.8	3.0	3.2	3.2
Current account bal/GDP (%)	7.3	17.9	14.2	2.1	5.4	4.1	2.6
Jordan							
Real GDP at market prices	4.7	8.0	7.9	2.8	3.9	4.5	5.0
Current account bal/GDP (%)	0.0	-8.8	-5.3	-2.8	-6.1	-7.3	-8.4
Lebanon							
Real GDP at market prices	3.2	7.5	9.3	8.0	6.0	6.0	6.0
Current account bal/GDP (%)	-20.0	-11.3	-21.0	-18.5	-18.3	-17.9	-17.5
Morocco							
Real GDP at market prices	4.4	2.7	5.6	5.3	3.0	4.4	5.0
Current account bal/GDP (%)	0.7	-0.1	-5.8	-4.9	-6.0	-6.5	-6.5
Syrian Arab Republic							
Real GDP at market prices	3.2	4.2	5.2	3.0	4.0	5.5	5.5
Current account bal/GDP (%)	2.9	1.1	1.2	-2.9	-2.1	-3.7	-5.3
Tunisia							
Real GDP at market prices	5.0	6.3	4.5	3.1	4.0	5.0	5.5
Current account bal/GDP (%)	-3.0	-2.6	-4.3	-2.9	-2.5	-2.6	-2.6
Yemen, Rep.							
Real GDP at market prices	4.9	3.0	3.6	3.8	7.9	4.4	4.2
Current account bal/GDP (%)	3.1	-6.8	-5.6	-8.2	-1.6	-1.0	-1.6

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

2. Djibouti, Iraq, Libya, West Bank and Gaza are not forecast owing to data limitations.

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries’ prospects do not significantly differ at any given moment in time.

economies' growth should firm to 5.1 percent in 2011, and further to 5.5 percent by 2012.

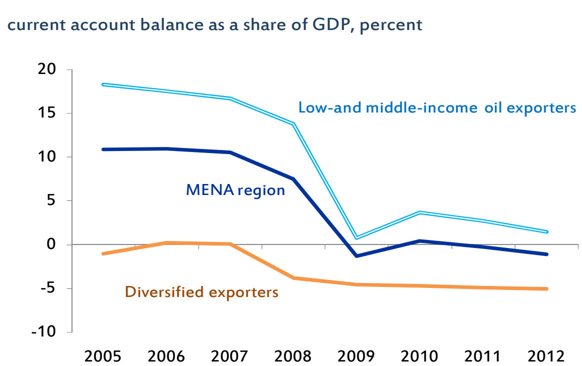
Current account positions are seen to improve in 2010 for the low-and middle-income oil exporters, on firming oil prices and increasing output; widening to 3.7 percent of GDP from 0.7 percent in 2009, before easing (on fairly steady oil prices) to 1.4 percent of GDP by 2012. Deficits are viewed to persist for the diversified group, but to inch down from minus 3.8 percent of GDP in 2008 to minus 5.1 percent by 2012 (Figure B4.9).

Risks

Risks for the region are clustered into three groups, and lie in large measure to the downside.

Uncertainty regarding the financial environment in Europe, and whether contagion across countries, and a shift from financial-difficulties to impacts on real-side activity occur, remains the principal risk for the broader region—carrying substantial effects on the breadth and tenor of export markets. Particularly for the high -income oil exporters (GCC) the problems of banking systems, within a still fragile environment of weak balance sheets and of note, the inability to generate new loans is a continuing concern. Aligned with the risk of slower European (and global) growth is that of a weaker-than anticipated profile for global oil prices over 2010-2012, coming to affect the region's oil exporters external surpluses, fiscal positions and GDP growth. Finally, developments on the domestic front in the region, including whether the series of reforms begun in countries such as Egypt, Tunisia and Morocco are stymied by the global crisis, or move ahead despite more adverse external conditions should be considered.

Figure B4.9 Current account balances to deteriorate



Source: World Bank

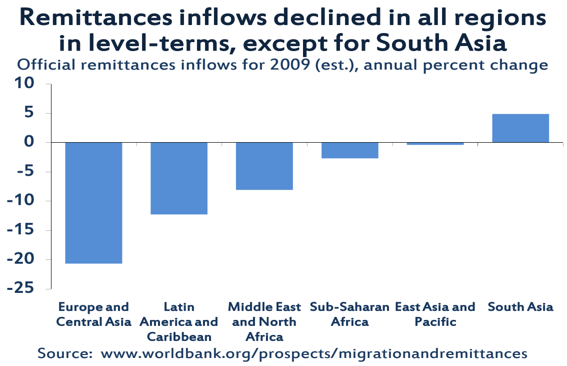
South Asia

Recent developments

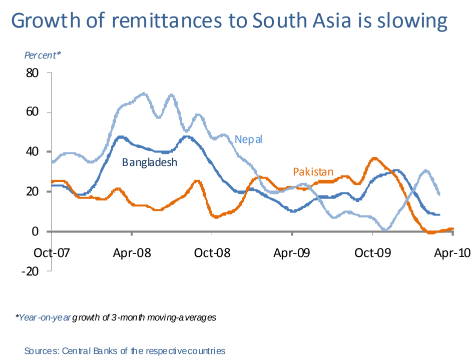
South Asia's GDP on a calendar year basis[8] began to recover in the second quarter of 2009, and GDP is projected to expand 7.6 percent in volume terms in 2010—posting the second fastest pace of growth among developing regions after East Asia and the Pacific (Table B5.1, line 2). This compares with a relatively modest 0.7 percentage point deceleration from 2008 to 2009, when GDP expanded 5.4 percent (down from 6.1 and 9.2 percent in 2008 and 2007, respectively). In contrast, GDP in the rest of the developing world slower by 4.6 percentage points in 2009, and indeed contracted by 6.2 percentage points, when China is excluded. (See the South Asia Economic Update at http://go.worldbank.org/6BU9N0AZM0 for more detail).

Although the global financial crisis has had important consequences for economic activity in South Asia, that impact was much less pronounced than in all other developing regions East Asia. Regional economic activity benefitted from limited exposures to the sub-prime markets and global banking systems—as the region's financial markets are less integrated than elsewhere—and relatively resilient capital inflows, which increased as a share of GDP—from 3.6 percent in 2008 to 3.9 percent in 2009. Fiscal and monetary stimulus (especially in India and, to a lesser extent, in Bangladesh and Sri Lanka), supported activity as well, along with the region's relative "niche" of trade in services, and in agricultural products—which were less impacted by the crisis than at the global level. Remittances also proved to be a key source of strength for the region during the global downturn. Reflecting the diversity of its migrant destinations and a rapid and large build-up in the stock of its migrants abroad in recent years, remittances inflows to the region expanded 4.9 percent in 2009—even as they declined by an estimated 9 percent in the rest of the developing world (Figure B5.1). And, while they are growing less quickly, remittances to the region have remained positive over the first four

Figure B5.1 Remittances have held up in South Asia



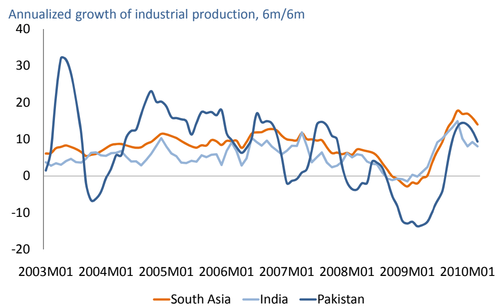
Growth in remittances to individual countries



months of 2010.

As elsewhere in the global economy, the fall-off in activity during 2008 and 2009 (relative to pre-crisis 2007) was concentrated in the financial and industrial sectors (Figure B5.2), with service and agricultural sectors less directly affected. Capital inflows to the region more than halved from $134 billion in 2007 to $68 billion in 2009 (Table B5.3), with net international bank and bond lending almost completely drying up. Among countries within the region, the macro-impacts of the crisis was more severe for those with weaker fundamentals and greater external vulnerabilities at the onset, including Pakistan, Maldives and Sri Lanka with significant internal and external imbalances. Ongoing conflict and post-conflict issues also hampered economic activity in Afghanistan, Pakistan, Sri Lanka and Nepal.

Figure B5.2 Industrial production growth is easing



Source: World Bank

The rebound in activity beginning in the second quarter of 2009 and into 2010 (Figure B5.2) initially reflected rebound factors, including a recovery in external demand and in consumer and investor confidence. This was followed by a rebound in capital inflows and trade activity. In addition, the end to a severe drought in Afghanistan and improving macroeconomic stabilization in the Maldives, Pakistan, and Sri Lanka—supported by IMF Stand-By Facilities reached in 2009 and late 2008—also contributed to the uptick in activity.

The revival of economic activity through the first half of 2010 can be observed in the fiscal year accounts of several countries. In India, growth accelerated from 5.1 percent in FY2008/09 (April 2008 to March 2009) to 7.7 percent FY2009/10, with a relatively strong contribution from consumer and government demand reflecting expansionary fiscal and monetary policies.[9] (Table B5.4 presents GDP at factor cost and market prices for India). Despite lower interest rates and rising business confidence, investment grew by half a percentage point less quickly than overall GDP. Net exports and stock building also supported growth. A poor monsoon—the worst in nearly forty years, with rainfall reaching only 78 percent of the long-term trend—translated into very weak 0.2 percent growth in agricultural output. The services sector continues to be an important engine of growth, but the 8.5 percent expansion in FY2009/10 was down slightly from the rate of FY2008/09. Growth in the manufacturing sector accelerated to 10.8 percent, thus fully accounting for the pick-up in factor cost output to 7.4 percent in FY2009/10 from 6.7 percent in FY2008/09.

Growth has been much less dynamic in Pakistan, partly reflecting the fiscal and balance of payment imbalances that the country carried into the downturn, which limited the scope for expansionary fiscal and monetary policies. This situation was compounded by security issues, which placed additional pressures on the fiscal deficit and hampered both domestic and foreign investor confidence. Economic activity has also been undermined by structural issues, notably persistent electricity shortages. As a consequence, real GDP is estimated to have eased to 3 percent in FY2010 (ending June 2010) from 3.7 percent growth in FY2009.

In Bangladesh, recovery has also been restrained by structural bottlenecks—notably energy supply—particularly in the manufacturing sector. Overall, FY2010 (ending June 2010) GDP growth is projected to have slowed to 5.5 percent from 5.7 percent in FY2009—a fourth consecutive year of slowing GDP growth. Supply-side constraints dampened private sector investment and undermined exports (export processing zones are not immune to electricity blackouts), which have more than neutralized an expansionary fiscal policy and relatively strong household consumption growth—the latter having been supported by continued growth of remittances, and an increase in non-rice agricultural output (and hence rural incomes). As a result, capacity utilization remains low and industrial production growth weak.

A potentially worrisome fiscal position has developed in South Asia, as government deficits in the region have more than doubled since 2007, and at 8.8 percent of GDP are higher than in any other developing region. While debt-to-GDP ratios in South Asia remain much lower than in high-income Europe, bringing fiscal policy back onto a sustainable path must be a priority for the authorities in the region. Recognizing this, the Government of India has announced a medium-term adjustment plan to

Table B5.1 South Asia forecast summary

(annual percent change unless indicated otherwise)	95-05 [1]	2007	2008	Est. 2009	Forecast 2010	2011	2012
GDP at market prices (2005 USD) [2,6]	6.0	8.5	4.9	7.1	7.5	8.0	7.7
GDP in Calendar year basis [3]	6.1	9.2	6.1	5.4	7.6	7.9	7.6
GDP per capita (units in USD)	4.1	6.8	3.4	5.6	6.1	6.6	6.4
PPP GDP [4]	6.0	8.5	4.8	7.1	7.4	8.0	7.7
Private consumption	4.7	6.0	5.7	4.4	5.9	6.9	6.6
Public consumption	5.0	3.8	18.2	7.8	8.5	6.3	5.4
Fixed investment	8.0	12.7	4.0	6.0	10.6	11.1	10.8
Exports, GNFS [5]	11.3	7.4	16.0	-4.5	18.3	12.2	12.4
Imports, GNFS [5]	10.6	7.0	19.0	-7.2	16.5	11.5	11.8
Net exports, contribution to growth	-0.2	-0.3	-1.5	1.0	-0.4	-0.4	-0.4
Current account bal/GDP (%)	-0.7	-1.4	-3.1	-2.3	-2.3	-2.2	-2.0
GDP deflator (median, LCU)	5.9	7.7	9.3	14.1	8.0	7.0	6.4
Fiscal balance/GDP (%)	-7.4	-4.4	-8.4	-8.8	-8.0	-7.0	-6.2
Memo items: GDP at market prices [6]							
South Asia excluding India	4.5	6.0	3.9	4.3	4.1	4.8	5.2
India	6.4	9.1	5.1	7.7	8.2	8.7	8.2
at factor cost [7]		9.2	6.7	7.4	8.5	9.0	8.5
Pakistan	4.1	5.7	2.0	3.7	3.0	4.0	4.5
Bangladesh	5.3	6.4	6.2	5.7	5.5	5.8	6.1

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars.
3. GDP figures are presented in calendar years (CY) based on quarterly history for India. For Bangladesh, Nepal and Pakistan, CY data is calculated taking the average growth over the two fiscal year periods to provide an approximation of CY activity.
4. GDP measured at PPP exchange rates.
5. Exports and imports of goods and non-factor services.
6. National income and product account data refer to fiscal years (FY) for the South Asian countries with the exception of Sri Lanka, which reports in calendar year (CY). The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India. Due to reporting practices, Bangladesh, Nepal and Pakistan report FY2007/08 data in CY2008, while India reports FY2007/08 in CY2007.
7. GDP at factor cost is customarily reported in India and tends to be higher than GDP at market prices. GDP at factor cost excludes indirect taxes and includes subsidies (while GDP at market prices includes indirect taxes and Table B5.4 and excludes subsidies). See the South Asia Economic Update (http://go.worldbank.org/6BU9N0AZM0) for more detail.
Source: World Bank

bring the debt-to-GDP ratio down to 68 percent of GDP at most by FY2014/15 from 77 percent in FY2009/10. Part of the recent fiscal deterioration reflects the costs of subsidies put in place in the wake of the food and fuel crisis, but not yet removed. In Pakistan the share jumped from 3.7 percent in FY2001/02 to 18.1 percent of GDP in FY2008/09, and in Bangladesh it rose from 1.3 percent to 9.6 percent over the same period. The increase was less pronounced elsewhere in the region, as in India, subsidies increased from 11.3 percent of government expenditures in FY2002/03 to 14.4 percent in FY2008/09 and in the Maldives, subsidies (including transfers) rose from 1.6 percent to 5.2 percent, respectively, in 2002 and 2008 (calendar years).[10]

Table B5.2 General government fiscal balance as percent share of GDP

	2006	2007	2008	2009	2010
South Asia	-5.1	-4.2	-8.4	-8.8	-8.0
India	-5.5	-4.2	-8.8	-9.5	-8.5
Pakistan	-3.7	-4.0	-7.1	-5.1	-5.1
Bangladesh	-3.3	-3.1	-6.1	-4.0	-5.5
Nepal	-1.5	-1.3	-4.6	-5.4	-6.5
Sril Lanka	-7.0	-6.9	-7.5	-9.8	-7.5
Other developing regions					
East Asia & Pacific	-0.6	0.4	-0.7	-2.9	-2.6
Europe & Central Asia	3.0	2.1	0.3	-6.3	-4.0
Latin America & Caribbean	1.4	1.2	0.3	-3.8	-2.3
Miidle-East & North Africa	-0.8	-0.2	1.7	-3.3	-4.1
Sub-Saharan Africa	1.5	-0.8	0.5	-5.8	-4.8

Source: World Bank.

While Central Banks in the region responded to the crisis by relaxing monetary policy, the period of monetary easing appears to be coming to an end, with central banks having either started to raise rates or signaling their intentions to do so in the near-term. In India, the rebound in international commodity prices (food and fuel) and the poor monsoon have contributed to higher inflationary pressures into early-2010. However, capital inflows increased in the first half of 2010 as well, putting upward pressure on the currency and leading the Reserve Bank of India to seek a balance between raising interest rates to limit inflation, and keeping them low to limit capital inflows and currency appreciation.

In Bangladesh, Pakistan and Sri Lanka, inflation is on the rise, partly reflecting one-off effects from higher food and fuel prices. In Bangladesh and Pakistan, the acceleration in inflation comes despite sluggish growth, and Central Banks in both countries face the unwelcome prospect of boosting interest rates even as growth disappoints. Indeed, Bangladesh Bank increased the Cash Reserve Requirement from 5.0 percent to 5.5 percent in May and revised the FY2008/2009 GDP growth estimate down to 5.7 percent from 5.9 percent. Elevated international commodity prices—notably fuel, and in particular food prices—have also contributed to higher inflationary pressures in some of the smaller economies (including Bhutan and the Maldives). Even in Afghanistan, a period of falling prices appears to be coming to an end. In Nepal, broad money growth has also been very rapid, due in large part to strong growth in remittances. Correspondingly, inflation has been in the double digits for the last two years—again reflecting to a considerable degree increases in food prices. Monetary policy has been very accommodating, witnessed negative real interest rates.

In contrast, prices continue to fall in Afghanistan, but the pace of deflation eased in late-2009, buoyed by firming of housing and food prices. The monetary targets agreed with the IMF for money circulation growth were overshot—but given continued deflation, no corresponding policy action is anticipated.

Capital inflows into the region have picked up sharply from recent lows. Approximately $60 billion in capital (including portfolio and FDI) flowed into India in (April 2009 to March 2010), up from $7 billion in FY08. On a calendar year basis, net inflows in 2009 rose less markedly, with much of the uptick expected in 2010, when net private capital flows are projected to reach $66.5 billion for the region compared with $61.9 billion posted in 2009 (Table B5.3).

Table B5.3 Net capital flows to South Asia
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**14.3**	**21.0**	**28.2**	**61.4**	**134.2**	**62.7**	**73.8**			
Net private inflows (equity+debt)	**18.5**	**21.4**	**25.3**	**57.9**	**129.5**	**53.2**	**61.9**	**66.5**	**74.2**	**87.2**
..Net private inflows (% GDP)	2.4	2.4	2.5	5.0	9.0	3.6	3.9	3.4	3.2	3.4
Net equity inflows	13.4	16.6	23.3	36.4	68.4	32.9	66.0			
..Net FDI inflows	5.4	7.6	10.9	26.0	32.3	48.7	41.4			
..Net portfolio equity inflows	8.0	9.0	12.4	10.4	36.1	-15.8	24.6			
Net debt flows	0.9	4.4	4.9	25.0	65.8	29.8	7.8			
..Official creditors	-4.2	-0.4	2.9	3.5	4.7	9.5	11.9			
....World Bank	-2.3	2.3	2.3	2.0	2.0	1.4	2.4			
....IMF	-0.1	-0.3	0.0	-0.1	-0.1	3.2	3.7			
....Other official	-1.8	-2.4	0.6	1.6	2.8	4.9	5.8			
..Private creditors	5.1	4.8	2.0	21.5	61.1	20.3	-4.1			
....Net M-L term debt flows	3.1	4.1	-0.3	19.8	31.0	12.7	-3.6			
......Bonds	-3.7	3.9	-2.8	6.4	10.4	1.7	0.4			
......Banks	6.8	0.5	2.6	13.4	20.4	10.9	-4.1			
......Other private	0.0	-0.3	-0.1	0.0	0.2	0.1	0.1			
....Net short-term debt flows	2.0	0.7	2.3	1.7	30.1	7.6	-0.5			
Balancing item	**10.1**	**7.6**	**-6.6**	**-3.1**	**-12.8**	**-41.7**	**-15.0**			
Change in reserves (- = increase)	**-36.9**	**-27.6**	**-6.8**	**-41.8**	**-101.1**	**26.4**	**-20.8**			
Memorandum items										
Workers' remittances	30.4	28.7	33.9	43.0	54.0	72.0	75.0	**79.0**	**83.0**	

Outlook

Regional GDP growth is projected to rebound to 7.6 percent in 2010 (calendar year basis), up from 5.4 percent in CY 2009. GDP in India (about 80 percent of the region's output) is expected to increase by 8.3 percent in CY 2010, up from 5.7 percent in CY 2009 and average 8.4 percent in CY 2011 through CY 2012 (Table B5.4). Regional growth excluding India, is projected to expand by 4.1 percent in 2010 (slightly less quickly than in the rest of the developing world excluding India and China), and close to 5 percent for the remainder of the forecast period.

The pick-up in South Asia's output in 2010 reflects a projected rise in the contribution to growth of private consumption and investment, buoyed by improving consumer and business sentiment and easing credit conditions. The government sector is expected to add to overall demand only marginally, as the stimulus measures begin to unwind, while the contribution from net exports should be slightly positive, as rapid consumer and business demand cause imports to grow nearly as quickly as exports.

The recovery in capital inflows already visible in monthly data is projected to continue, with total inflows to the region reaching close to $74.2 billion in 2010 and $87.2 billion in 2011 and 2012, respectively—although as a share of GDP they are projected to diminish slightly to 3.2 percent in 2011 before firming back to a share of 3.4 percent in 2012. While more than 33 percent higher than in 2009, flows will remain one-third below their peak 2007 level. Robust growth in FDI inflows (attracted by relatively strong growth prospects) are projected to more than offset a projected fall-off in portfolio inflows (2009 inflows were inflated by the return of stakes that fled the region during the massive outflows of late-2008). Remittances to the region are also expected to strengthen as economic activity in donor countries improves. Increased foreign currency flows from remittances and international capital sources, together with the region's reduced current account balance, suggest that the region should not face any serious financing challenges

Regional growth is projected to accelerate further in CY 2011 to 7.9 percent before moderating somewhat to 7.6 percent in CY 2012. This firming partly reflects a strengthening of the recovery in Pakistan, Sri Lanka and Maldives, where gains have been made in reducing significant macroeconomic imbalances. Regional growth will also be supported by stronger external demand from high-income countries—which should bolster regional exports and capital inflows. With relatively strong growth prospects, South Asia is expected to draw significant FDI inflows (a rising share of those to developing countries), which will bolster investment and trade activity. An enhanced pace of fiscal consolidation and withdrawal of monetary stimulus measures are expected to be the major drivers of the projected moderation of growth rates in 2012.

With ongoing fiscal consolidation efforts, government deficits are nevertheless projected to remain high at 6.2 percent of regional GDP in 2012. Especially with markets' current focus on fiscal sustainability issues, these high deficits and associated repayments will be of growing concern (interest payments currently represent 22 percent of government expenditures in the region).[11]

The moderation of economic growth in 2011 and 2012, a tightening of credit conditions, stable oil price, along with expectations of a good Monsoon in 2010 (the India Meteorological Department recently projected that the upcoming monsoon will be normal), suggest that inflationary pressures should diminish over the coming year.

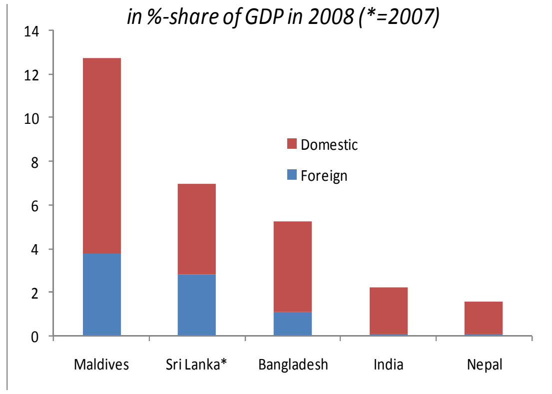
Risks

The main risk facing the global economy at this stage, comes from the possibility that the debt sustainability issues in high-income Europe cause countries in the region to default or impose a major restructuring of debt. Steps so far to guarantee the short-term solvency of these countries have calmed markets, but issues concerning the political (and economic) feasibility of taking the steps necessary to bring this debt under control remain unresolved. Moreover, many banks in the high-income world carry large exposures to debt in these highly-indebted countries. A major default or restructuring could inflict serious damage on their balance sheets, with potentially large repercussions on the global financial system—and such an event would also likely cause a significant increase in risk aversion resulting in higher international interest rates, and uncertainty about fiscal policy could cause risk premia to rise.

Further, a prolonged period of heightened uncertainty could translate into weaker-than-projected external demand. Under such a scenario, the estimated total impact in South Asia is for as much as a 2.5 percent cumulative reduction in GDP growth between 2010 and 2012 relative to the forecast presented. (See main text, alternative scenarios). Notably, trade impacts in South Asia would likely be smaller than in other developing regions—given that about 5.7 percent of total exports are with the at-risk high-income European countries (compared with 10 percent and 19.3 percent in Europe and Central Asia and Middle East and North Arica, respectively).

Failure to bring regional fiscal policy back onto a sustainable path would likely exacerbate these effects further. Here, policy should focus on broadening the revenue base, reining in subsidies, and gaining greater efficiency in outlays, in part by focusing expenditure on projects that alleviate longstanding bottlenecks. Even in the absence of a high-income crisis, countries in South Asia will face increased competition for global capital and rising borrowing costs. In this regard, the recourse that countries in the region have had to domestic borrowing is welcome, because it reduces foreign currency risk associated with international borrowing (Figure B5.3). However, increased sovereign borrowing on domestic markets also has its costs; in particular, it may hamper growth by crowding out private-sector borrowers.

Figure B5.3 Net incurrence of government liabilities



Source: World Bank, GDF Finance database April 2010

Outcomes in South Asia will also be sensitive to other external conditions, notably remittance flows and international commodity prices. Should the recovery in high-income countries—notably Europe—stall, sustained high unemployment rates in migrant-destination countries could lead to a reduction in the stock of migrants abroad and a decline in remittance flows that are a critical source of income for countries in South Asia. Similarly, a spike in fuel or food prices could undermine real incomes, stymieing progress in reducing poverty.

On the upside, South Asia might benefit from a larger than projected influx of foreign capital inflows. While inflows provide significant benefits that are supportive of growth, countries such as India—which are attracting substantial and rising shares of total capital inflows to developing countries due to their relatively strong growth performance and prospects—face some associated risks. Large and sudden inflows can stoke inflationary pressures and contribute to asset-price bubbles while creating challenges for monetary policy management.

Table B5.4 South Asia country forecasts

(annual percent change unless indicated otherwise)	95-05 [2]	2007	2008	Est. 2009	Forecast 2010	2011	2012
Calendar year basis [3]							
Bangladesh							
Real GDP at market prices	5.4	6.3	5.9	5.6	5.7	6.0	6.1
Current account bal/GDP (%)	-0.6	1.2	1.2	2.9	1.7	1.5	1.5
India							
Real GDP at market prices	6.5	9.9	6.4	5.7	8.3	8.6	8.2
Memo: Real GDP at factor cost [5]	-	9.5	7.4	6.7	8.6	8.9	8.5
Current account bal/GDP (%)	-0.5	-0.9	-2.3	-2.3	-2.3	-2.2	-2.1
Nepal							
Real GDP at market prices	4.0	4.4	5.0	3.8	3.5	4.1	4.2
Current account bal/GDP (%)	-3.5	-1.1	3.0	4.0	-1.9	0.0	-0.1
Pakistan							
Real GDP at market prices	4.2	3.8	2.9	3.3	3.5	4.2	4.5
Current account bal/GDP (%)	-1.1	-5.5	-10.1	-5.4	-3.6	-3.8	-3.9
Sri Lanka							
Real GDP at market prices	4.5	6.8	6.0	3.5	5.8	5.7	5.9
Current account bal/GDP (%)	-3.2	-4.6	-9.5	-0.5	-2.8	-3.3	-3.5
Fiscal year basis [4]							
Bangladesh							
Real GDP at market prices	5.3	6.4	6.2	5.7	5.5	5.8	6.1
Current account bal/GDP (%)	-0.7	1.4	0.9	2.9	1.9	1.6	1.5
India							
Real GDP at market prices	6.4	9.1	5.1	7.7	8.2	8.7	8.2
Memo: Real GDP at factor cost [5]	-	9.2	6.7	7.4	8.5	9.0	8.5
Current account bal/GDP (%)	-0.4	-1.4	-2.4	-2.4	-2.4	-2.3	-2.1
Nepal							
Real GDP at market prices	4.1	3.3	5.3	4.7	3.0	4.0	4.2
Current account bal/GDP (%)	-0.9	-0.1	2.9	4.1	-2.0	0.0	-0.1
Pakistan							
Real GDP at market prices	4.1	5.7	2.0	3.7	3.0	4.0	4.5
Current account bal/GDP (%)	-0.7	-5.8	-9.7	-5.6	-3.8	-4.0	-3.9

Notes: 1. Afghanistan, Bhutan, Maldives are not forecast owing to data limitations.

2. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

3. GDP figures are presented in calendar years (CY) based on quarterly history for India. For Bangladesh, Nepal and Pakistan, CY data is calculated taking the average growth over the two fiscal year periods to provide an approximation of CY activity.

4. National income and product account data refer to fiscal years (FY) for the South Asian countries with the exception of Sri Lanka, which reports in calendar year (CY). The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and April 1 through March 31 in India. Due to reporting practices, Bangladesh, Nepal and Pakistan report FY2007/08 data in CY2008, while India reports FY2007/08 in CY2007.

5. GDP at factor cost excludes indirect taxes and includes subsidies, (while GDP at market prices includes indirect taxes and excludes subsidies).

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Sub-Saharan Africa

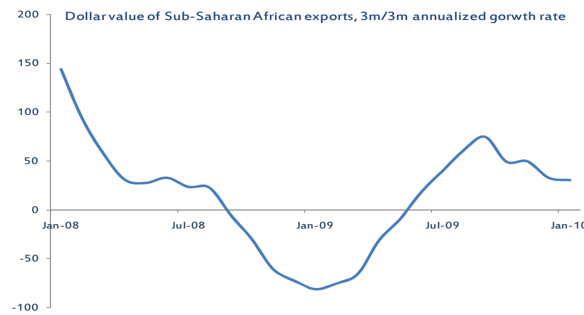
Recent developments

Countries in Sub-Saharan Africa have weathered the global crisis better than expected, and better than in previous, milder global economic slowdowns. In part, this good performance reflects the nature of the global downturn, which was concentrated in consumer durables and investment goods, relatively small sectors in most African economies. The limited extent of financial integration of the region also diminished the size of the initial shock. Perhaps as important, improved macroeconomic fundamentals meant that fiscal policy could react counter-cyclically in many cases in contrast with the past when it often reacted pro-cyclically.

Overall, GDP growth in the region decelerated to 1.6 percent in 2009, from 5 percent in 2008. Excluding South Africa, activity was even more resilient, with GDP growth easing to 3.7 percent from 5.8 percent. Resilience in low-income and fragile states was also bolstered by a step-up in official financial assistance, particularly among countries emerging from conflict. On average, GDP in low-income countries grew by 3.9 percent in 2009, about 1.5 percentage points slower than the rate of growth recorded in the boom period. The more globally integrated middle-income economies were among the worst affected by the recession, with growth falling from 4.9 percent to 1 percent. Excluding South Africa, the deceleration was more moderate, from 6 percent to 3.6 percent. And, large oil exporting countries have proven a lot more resilient than initially thought, with growth boosted mainly by non-oil sectors. Many countries in the region benefitted from disinflationary pressures, on account of lower food and fuel prices, and weaker demand, with the median inflation for the region down to low single digits in the first months of 2010.

Although high-frequency data for Sub-Saharan Africa are sparse, the region appears to be staging a robust recovery, in large part because of the strong cyclical rebound in external demand and stronger commodity prices. And, the value of exports, which fell 45 percent between August 2008 and May 2009 has been recovering rapidly, posting extremely high annualized monthly growth rates (Figure B6.1). While export volumes have recovered to within 5 percent of their August 2008 levels, lower commodity prices mean that, the value of exports remains only 68 percent of its August value.

Figure B6.1 Export growth has boomed

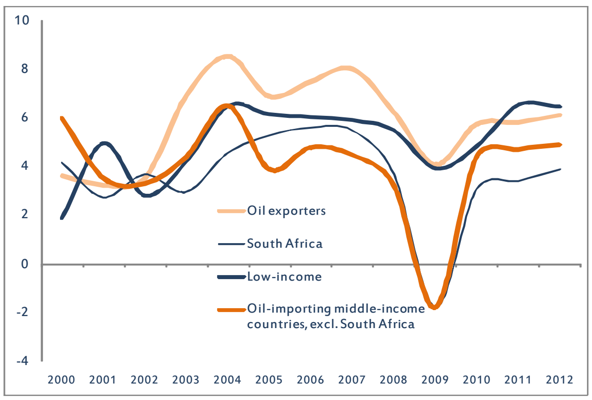


Source: World Bank.

In South Africa, the region's largest and most integrated economy growth strengthened significantly, starting with the final quarter of 2009, when output expanded an annualized 3.2 percent, with growth accelerating further in the first quarter of 2010 to 4.6 percent (saar). The turnaround was strongly correlated with the recovery in external demand, resurgence in capital inflows and a more generalized revival in investors' interest in emerging markets. Strong trade and financial linkages with the global economy helped boost the recovery, just as they were responsible for the contraction in the first half of the year. So far the recovery in domestic expenditure in South Africa has been modest; in particular household consumption increased only 1.4 percent (saar) in the fourth quarter, after five consecutive quarters of contraction. Going forward, as employment rises and the lagged impact of lower interest rates comes through we expect domestic expenditure growth should recover more strongly.

Other South African Customs Union (SACU) member countries are experiencing lagged effects of the global economic downturn. Their revenues from SACU have fallen as imports into the common external tariff area shrank in 2009. Overpayments by SACU in 2009 (based on over -optimistic projections for trade growth) have triggered automatic repayments into the SACU revenue pool, thus hampering their ability to use fiscal stimulus to bolster growth. Overall, South Africa projects that the transfers under the SACU revenue sharing agreement will drop from 27.9 billion rand in 2009/2010 to only 12.9 billion rand in 2010/2011. In the case of the two countries most dependent on SACU revenues, Swaziland and Lesotho, the reduction in SACU transfers is equivalent to a revenue loss of 13.3 percent of GDP and 20.4 percent of GDP respectively in 2010/11, diminishing growth by an estimated 1 and 3 percent respectively in 2010.

Figure B6.2 The shape of the recovery varies among different groups

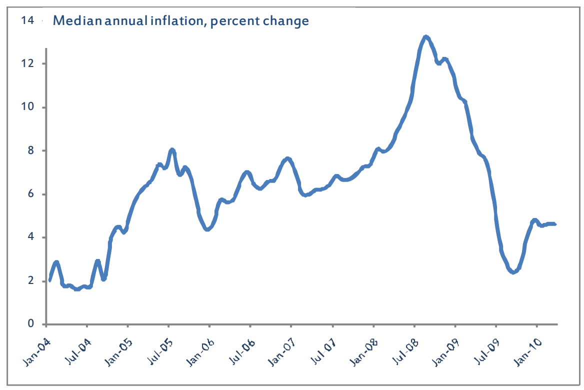


Source: World Bank.

Growth in major oil exporters in the region has surprised to the upside. Nigeria recorded a modest acceleration in growth to 5.6 percent in 2009, and continued to expand at a robust pace into the first quarter of 2010, supported by strong growth in agriculture, wholesale, retail trade, and services. Angola managed to expand by close to 2 percent last year, buoyed by strong performance in the non-oil sectors, after a double digit expansion the previous year. Growth was undermined, however, by a decline in oil production, cutbacks in government investment and weak private consumption, as well as large government payment arrears to domestic suppliers.

Inflationary pressures in the region have been subsiding in most economies, as food price inflation is retreating, and as currencies have appreciated (limiting the increase in prices of imported goods). Despite the fillip that this provides to real incomes, domestic demand remains relatively weak in most economies. As of April 2010 the median monthly inflation rate in the region had declined to 4.7 percent, down from 8 percent in April 2009 (Figure B6.3). Nevertheless these lower inflation rates follow a period of double-digit inflation in many countries, that has significantly reduced real incomes in the previous years and led to increased poverty incidence. Over the last few years the prices of staples in several domestic markets have increased significantly and have become much more volatile, posing a significant threat to both food security and nutrition in the region.

Figure B6.3 Median inflation in Sub-Saharan Africa has moderated



Source: World Bank.

The global crisis has eroded the fiscal space for many economies in the region, with the fiscal balance turning from surplus of close to 1 percent of GDP in 2008 to a deficit of more than 5.5 percent of GDP, with the bulk of the deterioration occurring in oil exporting and middle income countries, notably South Africa. The deterioration in fiscal balance in low-income countries was muted, with the budget gap inching up to 4.3 percent of GDP, its highest level since 2000. In oil–importing middle-income countries outside of South Africa the government balances deteriorated by nearly 4.3

percentage points to 6 percent of GDP in 2009 relative to the previous year.

Current account balances deteriorated markedly in Sub-Saharan Africa in 2009, turning from a 0.4 percent surplus in 2008, to a deficit of 2.5 percent of GDP. The deterioration was more marked in countries with stronger trade ties to the global economy, and oil exporters in particular, where current account balances deteriorated by 8 percentage points of GDP as oil prices declined and demand for oil was affected by the global recession. Current account balances also deteriorated in oil –importing middle-income countries outside of South Africa, by more-than 5 percentage points of GDP to a deficit of 6.2 percent of GDP. In the case of oil importers, their current account deficits registered an improvement of 2 percent of GDP, while low-income countries also saw mild improvements in their current account of 1.2 percentage points to a deficit of 9.2 percent of GDP.

Remittances (flat for Africa in 2009), and official aid flows (ODA to developing countries declined a relatively small 2.2 percent) were less affected than expected by the recessions in high-income countries so far. However, ODA is already lagging donor commitments, including commitments to double aid to Africa in 2005-10. Furthermore ODA is declining as a share of recipient GDP, and based on past behavior (Dang and others, 2009) ODA flows could fall sharply in the years to come as high-income countries cut back on their own government spending, affecting most heavily low income countries and fragile economies. Remittances are also expected to see a subdued recovery due to continued unemployment and spare capacity in high-income source countries.

Capital flows to Sub-Saharan Africa are less ample than to other developing regions, and they recovered in 2009 mostly on a return of portfolio inflows to South Africa (Table B6.1). The decline in FDI was somewhat less sharp than expected, in part because reduced FDI from high -income countries was met by stronger South-South FDI. Excluding South Africa, FDI inflows declined only 3.6 percent in 2009, much less than the decline in developing countries of more than 40 percent, supported by FDI flows into resource sectors. In particular energy-oriented

Table B6.1 Net capital flows to Sub-Saharan Africa
$ billions

	2003	2004	2005	2006	2007	2008	2009e	2010f	2011f	2012f
Financial flows:										
Net private and official inflows	**14.2**	**22.9**	**33.4**	**42.3**	**52.7**	**34.4**	**45.0**			
Net private inflows (equity+debt)	**12.7**	**20.6**	**34.5**	**44.8**	**50.3**	**29.4**	**36.0**	**37.1**	**45.2**	**55.8**
..Net private inflows (% GDP)	2.9	3.8	5.4	6.0	5.9	3.0	4.0	3.6	3.8	4.2
Net equity inflows	13.5	16.6	26.7	37.5	38.1	23.8	37.7			
..Net FDI inflows	12.8	10.0	18.5	20.7	27.9	33.1	28.3			
..Net portfolio equity inflows	0.7	6.7	8.1	16.8	10.1	-9.3	9.4			
Net debt flows	0.7	6.3	6.7	4.8	14.6	10.6	7.3			
..Official creditors	1.5	2.3	-1.1	-2.5	2.4	5.0	9.0			
....World Bank	2.2	2.5	2.4	2.0	2.3	1.8	3.0			
....IMF	0.0	-0.1	-0.4	-0.1	0.1	0.7	2.3			
....Other official	-0.7	-0.1	-3.1	-4.4	0.0	2.5	3.7			
..Private creditors	-0.8	4.0	7.8	7.3	12.2	5.6	-1.7			
....Net M-L term debt flows	0.9	2.7	4.8	-2.1	8.1	0.9	-0.2			
......Bonds	0.4	0.6	1.3	0.3	6.7	-0.7	1.7			
......Banks	1.2	2.4	3.8	-1.7	2.1	1.7	-1.5			
......Other private	-0.7	-0.3	-0.3	-0.7	-0.7	-0.1	-0.4			
....Net short-term debt flows	-1.7	1.3	3.0	9.4	4.1	4.7	-1.5			
Balancing item	**-6.8**	**-11.7**	**-44.0**	**-46.9**	**-47.7**	**-51.2**	**-44.6**			
Change in reserves (- = increase)	**-3.5**	**-21.7**	**-20.0**	**-32.4**	**-28.8**	**-8.6**	**9.1**			
Memorandum items										
Workers' remittances	6.0	8.0	9.4	13.0	19.0	21.0	21.0	**22.0**	**23.0**	

FDI was less affected, as many companies with expertise in energy exploration still have strong cash positions, while falling prices of developing -country energy assets raised investment attractiveness

Encouragingly, foreign investors' interest in the region has returned swiftly after the crisis, attested by the decline in sovereign spreads to pre-crisis levels, the successful issuance of the first international bond by Senegal in December 2009, a successful debt exchange by Seychelles in early 2010, and a return to equity markets in the region, although the recovery in equity prices has been more subdued than in other regions.

Medium-term outlook

Growth in the Sub-Saharan Africa region is projected to rebound to 4.5 percent this year and strengthen further to 5.1 and 5.4 percent in 2011 and 2012 (see Table B6.2). Initially, the recovery is expected to be driven by a cyclical rebound in external demand and fixed investment, while the shift in the inventory cycle will also make marked contributions to growth in some countries. Over time, domestic demand will increasingly hold sway. Due to limited and rapidly deteriorating fiscal space, Sub-Saharan African countries will have to withdraw fiscal stimuli more rapidly than warranted by the speed and strength of the recovery. Idiosyncratic factors such as weather patterns, inadequate infrastructure, socio-political tensions will continue to influence growth developments in the region. Despite the expected further strengthening of growth, spare capacity and unemployment will continue to characterize the economies of the region in 2012.

The recovery is expected to be broad-based, but strength will vary markedly across countries. Middle-income countries that are more integrated with the world economy and oil exporting countries are projected to enjoy a stronger recovery. Growth in oil-importing middle-income countries outside South Africa should arebound (see Figure B6.2) from a 1.8 percent contraction in 2009 to 4.4 percent growth in 2010. Investment will be buoyed to some extent by donor-funded infrastructure spending in the low-income countries, where growth is expected to accelerate by nearly 1 percentage point to 4.8 percent. Strong demand for minerals from Asia will ensure continued investment in copper, iron, manganese and uranium mines in mineral rich countries. But, persistently high unemployment in high-income countries will have a negative impact on workers' remittances and tourism limiting the strength of the recovery in countries dependent on these two sources of income. Growth will remain largely below potential over the forecast horizon, leaving relatively large output gaps across the region. Job creation will remain anemic and insufficient to absorb a large number of new entrants into the labor market, while excess capacity and higher capital costs will keep investment below its pre-crisis level.

South Africa's economy is projected to expand 3.1 percent this year. The recovery in private consumption is relatively subdued, weakened by persistently high unemployment, high levels of indebtedness, and strict credit rules applied by banks, notwithstanding a recovery in wealth as equity prices have recouped most of their losses. The lagged benefits from the countercyclical fiscal policy already enacted will be countered by the cutbacks in expenditure as the government seeks to bring the fiscal deficit down from 6.7 percent of GDP in the fiscal year 2009/2010 close to the 3 percent of GDP target. The economy will benefit from increased tourism activity from the month-long Football World Cup hosted by South Africa as expenditure related to the Soccer World Cup is projected to boost South African GDP by around 0.5 percent during 2010. But preparations for the FIFA matches will also carry longer term benefits for the country—from the new and improved international airports; expanded and refurbished highways and modern public transportation systems—reducing many infrastructural bottlenecks. However, job creation will remain disappointing, but there should be some cyclical recovery as output recovers (albeit with a lag). Growth will remain below potential over the forecasting horizon, which suggests significant spare capacity in the economy in the medium term.

GDP in large oil exporting countries is expected to accelerate in 2010 to 5.7 percent, fueled by stronger oil prices and increased external demand for oil, as well as renewed investor interest in mineral rich countries. Nigeria's growth is forecast to remain robust, as performance in the oil sector improves, benefiting from the relative calm in the Delta region. Performance in the non-oil sectors is also expected to remain strong, especially in agriculture, wholesale, retail trade, and services, as the benefits of improved macroeconomic policies have increased the growth potential in the non-oil economy. Lower oil revenues, a less expansionary fiscal policy, and to some extent political uncertainty surrounding the 2011 elections are likely to cause growth to decelerate slightly in that year. Inadequate infrastructure will continue to act as a deterrent to faster economic growth over the medium term. Angola's growth is projected to pick-up sharply to close to 7 percent in 2010, on improved performance in both the oil and non-oil sectors, and as the government is expected to resume arrears payments to domestic suppliers. Stronger oil prices and higher export volumes will ensure a large improvement in the current account balances of oil exporting countries in 2010, with current account surpluses averaging 4.7 percent over the forecast horizon.

Donor-funded investments in infrastructure should alleviate somewhat the electricity shortages in East Africa. Growth performance remains dependent on weather patterns which affect both agricultural output and the manufacturing sector via hydroelectricity supply. Electricity shortages will continue to plague economic growth over the forecasting horizon. Improved road infrastructure will increase market access and give a welcome boost to the agricultural and manufacturing sectors. Kenya is projected to grow more rapidly this year, as the political and economic situation normalizes further. Tourism is also expected to fare better, notwithstanding still weak labor markets in high-income countries, as it is coming off a low base. Normalization in rainfall will further support

Table B6.2 Summary of projections

Sub-Saharan Africa forecast summary							
(annual percent change unless indicated otherwise)				**Est.**	**Forecast**		
	95-05 [1]	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
GDP at market prices (2005 USD) [2]	4.0	6.5	5.0	1.6	4.5	5.1	5.4
GDP per capita (units in USD)	1.4	4.0	3.0	-0.3	2.5	3.0	3.7
PPP GDP [3]	-1.6	-4.4	-10.1	3.6	4.2	3.0	3.9
Private consumption	2.0	7.6	3.3	1.1	3.7	4.5	4.7
Public consumption	5.1	5.7	7.4	5.3	5.2	5.0	4.8
Fixed investment	6.7	16.7	12.0	5.0	6.8	7.6	8.2
Exports, GNFS [4]	4.8	3.7	4.7	-6.9	9.3	6.5	6.7
Imports, GNFS [4]	6.2	11.1	6.5	-4.2	9.8	7.4	7.4
Net exports, contribution to growth	-0.1	-2.6	-0.8	-0.8	-0.6	-0.6	-0.6
Current account bal/GDP (%)	-2.9	-0.4	0.4	-2.5	-1.5	-1.9	-2.2
GDP deflator (median, LCU)	7.3	7.0	9.2	7.7	4.9	5.1	5.2
Fiscal balance/GDP (%)	-2.1	0.5	0.7	-5.6	-4.8	-3.3	-2.3
Memo items: GDP							
SSA excluding South Africa	4.5	7.1	5.8	3.7	5.3	6.0	6.1
Oil exporters [5]	4.6	8.0	6.2	4.1	5.7	5.8	6.1
CFA countries [6]	4.4	4.4	4.1	2.6	3.7	4.1	4.6
South Africa	3.3	5.5	3.7	-1.8	3.1	3.4	3.9
Nigeria	4.6	6.4	5.3	5.6	6.1	5.7	6.4
Kenya	2.9	7.0	1.7	2.6	4.0	4.9	5.4

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
2. GDP measured in constant 2005 U.S. dollars. 3. GDP measured at PPP exchange rates.
4. Exports and imports of goods and non-factor services.
5. Oil Exporters: Angola, Cote d Ivoire, Cameroon, Congo, Rep., Gabon, Nigeria, Sudan, Chad, Congo, Dem. Rep.
6. CFA Countries: Benin, Burkina Faso, Central African Republic, Cote d Ivoire, Cameroon, Congo, Rep., Gabon, Equatorial Guinea, Mali, Niger, Senegal, Chad, Togo

Source: World Bank

economic activity in the agricultural sector, helping to bring down food prices and allowing an increase in hydroelectricity generation.

Diamond producing countries are likely to see a strong bounce-back in activity in 2010, after poor performance in 2009, as demand for diamonds has recovered sharply. Botswana and Namibia are projected to grow 5.8 percent and 4.4 percent this year, while other mineral rich economies will also benefit from robust external demand, particularly from Asia.

After a relatively modest recovery in 2010, notwithstanding substantial monetary easing, Ghana's economic growth should receive a strong boost in 2011 when oil production is expected to commence boosting both exports and industrial output.

In the CFA countries, growth performance will vary dramatically. Growth in Côte d'Ivoire will weaken, with GDP gains easing to 3 percent in 2010, largely on account of energy shortages coupled with political uncertainty. These will affect investment, and possibly donor support, and delay the normalization of the economic situation in the country. Growth in Gabon and Cameroon will also remain subdued this year, as oil production is expected to decline in Cameroon and rise only modestly in Gabon. Burkina Faso, the Republic of Congo, Niger, and Senegal, will see growth accelerate in 2010, and Niger will enjoy a surge in growth in 2011 on increased mineral output. Growth will inch up marginally in Benin, the Central Africa Republic, Mali, and Togo. For CFA franc zone countries a weaker currency, in line with a weaker euro, will help improve external competitiveness and increase producer prices for agricultural commodity exports (notably cotton), but also lead to higher costs of imported goods.

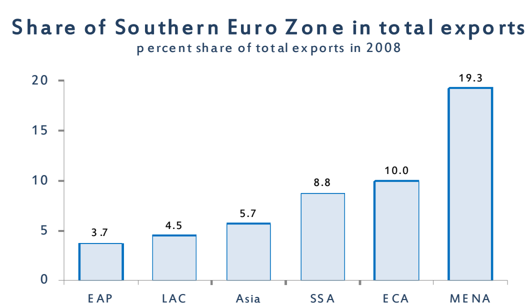
Risks

The possibility of a major disruption emanating from concerns over sovereign debt sustainability in Europe is real. Many African countries have close trade ties with economies at risk. Twenty or more percent of the exports of Cape Verde and Cameroon go to the EU-5 countries. Overall, Sub-Saharan exporters are the third most exposed in the developing world (Figure B6.4). Furthermore there is an increased risk of a buildup in inflationary pressures in CFA franc zone countries as their currencies depreciate in line with the euro, making imported goods, and in particular oil more expensive. Conversely the depreciation of the CFA franc will help bolster external competitiveness of member countries that maintain a peg to the euro.

The risk of contagion to the African countries' banking sectors of a banking crisis in the Euro Area is not negligible given that European banks, and French banks in particular, are still predominant in CFA franc zone countries. These banks have so far not shown signs of stress, as they are locally incorporated, and rely on local deposits. Furthermore, they play a limited financial intermediation role in the local economies, investing most of their funds in government debt. Faced with losses from their exposure to Greece and other EU countries with high debt levels, European banks could repatriate capital from their subsidiaries in CFA franc zone countries.

The direct impact of the sovereign debt crisis in Europe on South African banks is unlikely to be significant, as their exposure is very limited, estimated at 0.2 percent of their total assets. There are risks of second round effects through trade flows and heightened risk aversion among investors, as about 30 percent of South Africa's exports are destined for European markets and as

Figure B6.4 Countries with large trade links to EU-5



Source: COMTRADE; World Bank.

the cost of credit could rise significantly for the private sector.

Outside of an aggravation of the crisis in Europe, risks for the region are largely balanced, with the most important downside risk relating to the strength and sustainability of the global recovery, and in particular that of high-income countries. The untimely withdrawal of fiscal and monetary stimuli could weaken the recovery in the short-term, although as discussed in the main text a slow withdrawal of fiscal and monetary stimulus in high-income countries would if delayed too much, lead to macroeconomic imbalances. Volatility in the global economy has increased in the last years—in terms of commodity prices, exchange rates, and financial market developments, and this heightened volatility is taxing economic growth globally. Strong capital inflows also pose additional policy challenges for selected countries in the region, as currency appreciation will reduce external competitiveness.

Among the upside risks for commodity exporting countries is the possibility of a stronger-than-expected global cyclical bounce back, which could translate in larger terms-of-trade gains and much stronger external demand adding to the tenor of the recovery.

In the wake of the global crisis many financially-constrained countries in the region have a much more limited fiscal space, and their ability to deal with future external shocks, such as might arise from the current situation in high-income Europe is much reduced. The potential for significant declines in aid flows in the years ahead as high-income donors tighten the strings of the fiscal purse, will further squeeze already limited fiscal space. A real challenge will be to maintain existing investment levels in this environment. Failure to do so could impose costs on future growth. Even a small reduction in average growth rates could have large impacts on poverty in the longer term. For example, a 0.5 percent reduction in regional growth rates over a ten year period can be expected to increase poverty in the region by 6.7 million.

Another challenge facing policy makers in the region is that of stimulating creation of productive employment at an adequate rate given that 7-10 million young Africans enter the labor force each year. The prospects of a jobless recovery in high-income countries increases this pressure as less migrants find jobs in migration destination countries with the possibility even that some migrants return to their country of origin, pushing unemployment higher and potentially fueling social tensions.

Figure B6.3 Sub-Saharan Africa country forecasts

(annual percent change unless indicated otherwise)				Est.	Forecast		
	95-05 [1]	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Angola							
Real GDP at market prices	8.3	20.3	13.2	1.7	6.9	7.7	7.0
Current account bal/GDP (%)	-2.2	17.2	7.6	-3.7	4.6	4.4	4.4
Benin							
Real GDP at market prices	4.6	4.6	5.1	3.1	3.3	4.8	5.1
Current account bal/GDP (%)	-7.2	-12.0	-6.5	-6.9	-7.8	-7.6	-6.0
Botswana							
Real GDP at market prices	6.8	4.2	3.1	-6.0	5.8	5.5	5.2
Current account bal/GDP (%)	8.2	11.0	3.8	-5.5	-6.4	-6.9	-5.5
Burkina Faso							
Real GDP at market prices	6.4	3.6	5.2	3.2	4.6	5.2	5.9
Current account bal/GDP (%)	-10.1	-8.7	-11.5	-6.8	-7.7	-8.3	-7.6
Burundi							
Real GDP at market prices	0.4	3.6	4.5	3.5	3.7	4.1	4.3
Current account bal/GDP (%)	-13.7	-15.7	-12.2	-12.2	-10.6	-9.7	-10.2
Cape Verde							
Real GDP at market prices	5.2	6.9	5.9	4.0	4.7	5.4	5.8
Current account bal/GDP (%)	-10.1	-13.7	-12.8	-19.3	-25.8	-24.4	-22.8
Cameroon							
Real GDP at market prices	4.2	3.3	2.9	2.2	2.8	3.4	4.6
Current account bal/GDP (%)	-3.2	1.4	-1.8	-2.7	-4.1	-4.7	-5.2
Central African Republic							
Real GDP at market prices	0.7	4.2	2.8	1.7	3.0	3.3	3.6
Current account bal/GDP (%)	-4.4	-6.7	-9.5	-7.8	-8.9	-9.4	-8.5
Chad							
Real GDP at market prices	8.6	0.2	-0.4	-1.4	3.7	4.0	4.3
Current account bal/GDP (%)	-36.5	-8.6	-10.2	-28.3	-26.6	-26.6	-23.9
Comoros							
Real GDP at market prices	2.1	0.5	1.0	1.1	1.7	2.3	2.4
Current account bal/GDP (%)	-6.3	-6.8	-11.5	-6.1	-9.1	-8.7	-9.0
Congo, Dem. Rep.							
Real GDP at market prices	0.1	6.3	6.2	2.9	5.2	6.9	7.2
Current account bal/GDP (%)	-2.9	-2.7	-15.1	-12.5	-15.7	-16.9	-17.6
Congo, Rep.							
Real GDP at market prices	3.4	-1.6	5.6	7.5	11.0	4.9	2.9
Current account bal/GDP (%)	-2.2	-8.4	-1.1	-12.6	0.1	3.1	0.1
Cote d Ivoire							
Real GDP at market prices	1.6	1.6	2.3	3.8	3.0	4.1	4.5
Current account bal/GDP (%)	-0.2	-0.7	2.4	7.3	4.3	3.1	1.1
Eritrea							
Real GDP at market prices	1.7	1.3	-8.4	4.2	2.7	4.1	4.9
Current account bal/GDP (%)	-15.3	-6.4	-5.9	-5.7	-2.2	-2.4	-2.7
Ethiopia							
Real GDP at market prices	5.5	11.1	11.3	8.8	7.0	7.5	8.5
Current account bal/GDP (%)	-3.3	-4.3	-7.2	-5.1	-7.8	-8.0	-8.3
Gabon							
Real GDP at market prices	1.0	5.6	2.7	-1.3	3.8	4.3	4.4
Current account bal/GDP (%)	10.6	12.2	21.3	11.5	4.5	2.9	2.9
Gambia, The							
Real GDP at market prices	4.4	6.3	6.1	4.6	4.8	5.0	5.1
Current account bal/GDP (%)	-5.3	-12.2	-15.9	-14.4	-14.2	-14.1	-13.3
Ghana							
Real GDP at market prices	4.7	6.1	7.3	3.8	4.6	17.5	7.5
Current account bal/GDP (%)	-5.4	-14.4	-20.0	-5.7	-10.9	-6.3	-7.1
Guinea							
Real GDP at market prices	3.7	1.5	4.5	-0.6	2.6	3.6	4.1
Current account bal/GDP (%)	-5.1	-8.7	-11.6	-9.7	-9.2	-8.8	-8.3

(annual percent change unless indicated otherwise)	95-05 [1]	2007	2008	Est. 2009	Forecast 2010	2011	2012
Guinea-Bissau							
Real GDP at market prices	-1.4	0.6	3.5	3.0	3.4	3.9	3.4
Current account bal/GDP (%)	-13.5	4.9	2.1	2.2	-1.7	0.0	-1.5
Kenya							
Real GDP at market prices	2.9	7.0	1.7	2.6	4.0	4.9	5.4
Current account bal/GDP (%)	-7.5	-3.8	-6.6	-6.9	-6.6	-6.0	-5.1
Lesotho							
Real GDP at market prices	2.8	5.1	4.5	1.1	2.7	2.8	4.3
Current account bal/GDP (%)	-22.0	13.1	9.5	-1.5	-18.2	-17.2	-15.9
Madagascar							
Real GDP at market prices	3.1	6.2	7.1	-4.1	0.7	4.1	5.0
Current account bal/GDP (%)	-8.6	-14.4	-20.9	-16.1	-14.6	-12.8	-11.8
Malawi							
Real GDP at market prices	2.4	8.6	9.8	7.7	5.6	6.0	6.6
Current account bal/GDP (%)	-5.7	-1.7	-6.4	-8.4	-2.4	-2.3	-1.4
Mali							
Real GDP at market prices	5.8	2.8	5.0	4.2	5.0	5.5	6.3
Current account bal/GDP (%)	-8.7	-8.5	-8.4	-9.7	-10.5	-11.4	-10.4
Mauritania							
Real GDP at market prices	3.3	1.9	3.7	-1.0	4.9	5.4	6.0
Current account bal/GDP (%)	-3.2	-9.7	-15.6	-13.6	-10.9	-11.6	-13.5
Mauritius							
Real GDP at market prices	4.8	4.7	4.2	2.2	3.9	4.4	5.0
Current account bal/GDP (%)	0.1	-5.6	-10.4	-8.3	-8.4	-8.7	-8.4
Mozambique							
Real GDP at market prices	8.0	7.3	6.7	6.3	5.9	6.7	7.2
Current account bal/GDP (%)	-15.1	-9.8	-11.9	-11.8	-13.4	-13.8	-14.2
Namibia							
Real GDP at market prices	4.2	4.1	2.7	-0.8	4.4	4.8	4.8
Current account bal/GDP (%)	3.0	9.2	2.8	-2.3	-5.8	-5.2	-4.0
Niger							
Real GDP at market prices	3.5	3.3	8.7	-1.2	3.5	4.3	11.7
Current account bal/GDP (%)	-7.1	-8.3	-13.4	-19.9	-21.6	-22.1	-17.4
Nigeria							
Real GDP at market prices	4.6	6.4	5.3	5.6	6.1	5.7	6.4
Current account bal/GDP (%)	6.5	18.6	20.2	11.2	13.0	11.8	10.6
Rwanda							
Real GDP at market prices	8.3	7.9	11.2	4.5	5.5	5.8	6.8
Current account bal/GDP (%)	-4.7	-4.3	-5.0	-6.8	-7.1	-6.5	-6.9
Senegal							
Real GDP at market prices	4.4	4.8	2.5	1.2	3.2	4.4	4.9
Current account bal/GDP (%)	-5.7	-11.6	-10.4	-9.6	-10.1	-10.2	-9.4
Seychelles							
Real GDP at market prices	2.8	7.3	-0.9	-7.6	3.5	4.2	5.0
Current account bal/GDP (%)	-13.4	-20.5	-44.1	-23.5	-30.4	-29.4	-27.0
Sierra Leone							
Real GDP at market prices	4.6	6.8	5.5	4.0	4.7	6.1	6.5
Current account bal/GDP (%)	-12.4	-12.1	-11.1	-8.4	-9.1	-8.7	-8.3
South Africa							
Real GDP at market prices	3.3	5.5	3.7	-1.8	3.1	3.4	3.9
Current account bal/GDP (%)	-4.3	-9.2	-7.1	-4.0	-4.5	-5.8	-6.4
Sudan							
Real GDP at market prices	6.2	10.2	6.8	4.5	5.5	6.2	6.2
Current account bal/GDP (%)	-6.3	-12.5	-9.0	-12.8	-8.2	-6.4	-5.8
Swaziland							
Real GDP at market prices	3.5	3.5	2.5	0.2	1.1	2.7	3.4
Current account bal/GDP (%)	-0.8	-2.3	-4.9	-6.3	-10.4	-12.3	-12.4
Tanzania							
Real GDP at market prices	5.4	7.1	7.4	6.0	6.3	6.8	7.0
Current account bal/GDP (%)	-6.3	-9.4	-10.5	-9.7	-10.1	-9.2	-9.2
Togo							
Real GDP at market prices	3.2	1.9	2.2	3.1	3.3	3.5	3.7
Current account bal/GDP (%)	-9.6	-8.6	-9.9	-6.9	-7.5	-6.4	-5.9
Uganda							
Real GDP at market prices	6.4	8.6	8.7	6.6	5.7	5.9	6.6
Current account bal/GDP (%)	-6.9	-4.5	-5.0	-5.9	-6.3	-5.1	-6.3
Zambia							
Real GDP at market prices	3.8	6.2	5.7	6.2	5.4	5.9	6.4
Current account bal/GDP (%)	-11.8	-6.5	-7.1	-3.6	-2.9	-3.0	-2.5
Zimbabwe							
Real GDP at market prices	-2.4	-6.9	-14.1	4.0	4.1	2.3	3.3
Current account bal/GDP (%)	-11.5	-8.1	-23.7	-28.2	-22.8	-17.6	-15.5

Notes: 1. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.

2. Liberia, Somalia, Sao Tome and Principe, are not forecast owing to data limitations.

Source: World Bank

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

Notes:

1. Armenia, Bosnia and Herzegovina, Georgia, Latvia, Romania, and Ukraine entered Stand-by-Arrangements; Moldova and Tajikistan entered Extended Credit Facilities; Moldova also entered an Extended Arrangement, and the Kyrgyz Republic entered an Exogenous Shock Facility. Additionally, Poland opened a Flexible Credit Line of 13.7 billion SDRs, but it did not draw upon it before it expired in early-May 2010.

2. Central Bank of Russia (http://www.cbr.ru/eng/statistics/?Prtid=svs).

3. The countries covered in the Europe and Central Asia section of the regional appendix are those that fall into the World Bank's definition of low- and middle-income countries (with economies divided according to 2008 GNI per capita, calculated using the World Bank Atlas method, with income groups categorized as low income, with income of $975 or less; lower middle income with $976 - $3,855; upper middle income, with $3,856 - $11,905; and high income with $11,906 or more). The 24 countries are Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, Latvia, Lithuania, Former Yugoslav Republic of Macedonia, Montenegro, Poland, Romania and Serbia (in the Central European sub-region); Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, Tajikistan, Ukraine, and Uzbekistan (in the Commonwealth of Independent States sub-region); and Turkey. Transition countries include all 24 countries with the exception of Turkey. Among these developing countries, Bulgaria, Latvia, Lithuania, Poland and Romania are new European Union members. Owing to data limitations, forecasts are not available for Kosovo, Montenegro, and Turkmenistan. The EU-10 countries consist of: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

4. The output gap is defined as the difference between the actual level of industrial production in March 2010 (or latest date) and the level that would have been observed if output had continued to expand at the average rate between January 2003 and August 2008, expressed as a percent of that trend rate.

5. IMF Regional Economic Outlook: Western Hemisphere, May 2010.

6. The low-and-middle income countries of the Middle East and North Africa region as presented in this report include Algeria, the Arab Republic of Egypt, the Islamic Republic of Iran, Jordan, Lebanon, Morocco, the Syrian Arab Republic, Tunisia and the Republic of Yemen (low-income country). Several developing countries are not covered owing to data insufficiencies, including Djibouti, Iraq, Libya and the West Bank and Gaza. High-income economies of the broader geographic region, including Gulf Cooperation Council (GCC) members, Bahrain, Kuwait, Oman and Saudi Arabia are covered in this report under the group of "other high-income countries". But as the GCC has become more integrated with the developing economies of the region, a brief discussion of economic developments is a feature of this appendix. Among the GCC, insufficient data exists for inclusion of Qatar and the United Arab Emirates in the database and forecasting model underlying this note.

7. Average growth for the developing Middle East and North Africa region over the ten-year span from 1995-2005, registered 4.4 percent--a fair estimate for growth of potential output for the region's developing countries.

8. Many countries in the region commonly report GDP on a fiscal year (FY) basis in contrast with most developing (and high-income) countries, which report GDP on a calendar year (CY) basis. In this annex, this data is converted onto a calendar year basis in order to ensure comparability with data presented for other countries. The conversion is achieved by calculating CY equivalents for GDP in India using quarterly data, and by making an estimate using appropriately weighted averages of the FY data for Bangladesh, Nepal and Pakistan. Sri Lanka reports national income and product accounts on a calendar year basis. The fiscal year runs from July 1 through June 30 in Bangladesh and Pakistan, from July 16 through July 15 in Nepal, and from April 1 through March 31 in India. Because of reporting practices, Bangladesh, Nepal, and Pakistan report FY2008/09 data in CY2009, while India reports FY2008/09 in CY2008.

9. The text references GDP at market prices for all countries including India for consistency across developing countries (as GDP at market prices is the metric used by most economies). In some South Asian economies, GDP at factor cost is more widely referenced in the press. GDP at factor cost excludes indirect taxes and includes subsidies—whereas GDP at market prices includes indirect taxes and excludes subsidies. Table B5.4 presents GDP at both factor cost and market prices for India.

10. World Bank, World Development Indicators, and Government sources.

11. World Development Indicators (April 2010).

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