Global Economic Prospects

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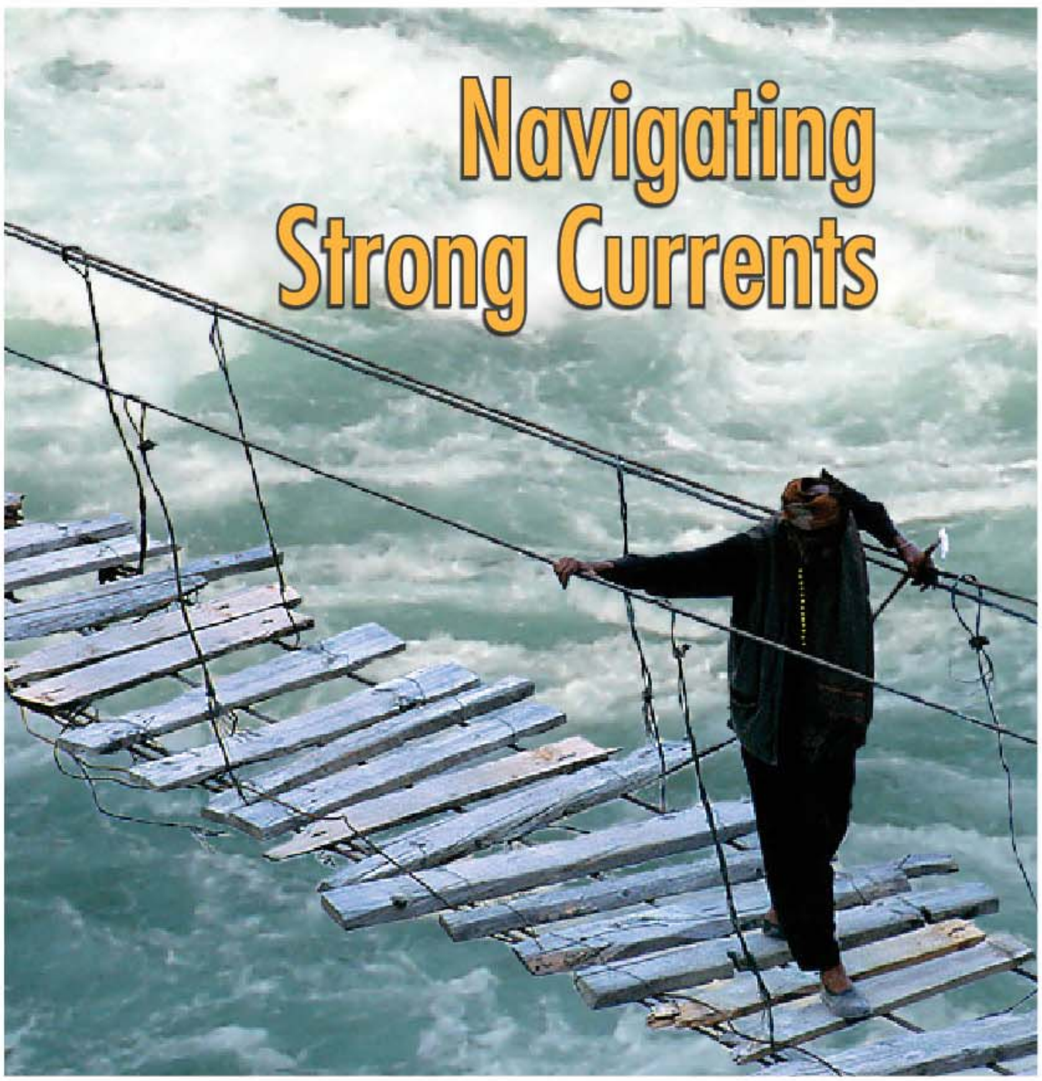

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Global Economic Prospects January 2011: *Navigating strong currents*

Overview & main messages

Economic activity in most developing countries has, or is close to having, recovered. Supported by a resurgence in international and domestic financial flows and higher commodity prices, most of the spare capacity in developing countries that was created by the crisis has been reabsorbed, and developing countries have regained trend growth rates close to those observed in the pre-crisis period.

In contrast, the recovery in many high-income countries (and several economies in developing Europe and Central Asia) has not been strong enough to make major inroads into high unemployment and spare capacity. Prospects in these economies, many of which were at the center of the financial boom and bust, continue to be weighed down by banking-sector restructuring, high consumer debt and a right-sizing of economic sectors that grew unsustainably large during the boom period.

The robust recovery in developing countries is all the more remarkable because it mainly reflects an expansion of their internal markets. Developing countries are not just leading the recovery. Increasingly they are an important source of stability, with many of the risks to global growth centered in high-income countries and reflecting as yet unresolved imbalances generated by the boom period.

Very low policy-induced interest rates in high -income countries plus better growth prospects in developing countries prompted a strong recovery in capital flows, mainly to middle-income countries. Overall net private capital flows to developing countries expanded 44 percent in 2010, but remain well below record 2007 levels. For most countries, the increase in flows was beneficial, helping to finance growth enhancing investment.

Capital inflows into some middle-income countries have placed undue and potentially damaging upward pressure on currencies. Many of these flows are short-lived, volatile and sometimes speculative in nature. Left unchecked, such flows can lead to abrupt real appreciations and depreciations that are out of line with underlying fundamentals, and can do lasting damage to economies. The biggest increases were in short-term debt flows, equities and bonds, notably corporate bonds. Long-term bank lending also posted large percentage increases, but from a very low base. Foreign direct investment (FDI) rose a relatively modest 16 percent given earlier large declines.

Low-income countries experienced modest declines in capital flows in 2009 and modest increases in 2010, partly reflecting their reliance on relatively stable FDI. However, many low-income countries did benefit from stronger remittance inflows, a recovery in tourism and higher commodity prices. South-South flows are increasingly important for low-income countries.

Global growth is expected to weaken somewhat in 2011, before picking up in 2012 (Table 1). Real GDP is estimated to have expanded by 3.9 percent in 2010, once again led by strong domestic demand in developing countries. Restructuring and right-sizing in the banking and construction sectors, combined with necessary fiscal and household consolidation, will continue to drag on growth in many high-income economies and developing Europe and Central Asian countries. At the same time, growth is projected to slow in other developing countries due to emerging capacity constraints. Overall global GDP is expected to grow 3.3 percent in 2011, before picking up to 3.6 percent in 2012 as the drag on activity from restructuring in high-income countries eases somewhat.

Strong growth of domestic demand in developing-country will continue to lead the world economy. Developing countries domestic demand is playing a major role in the recovery, representing 46 percent of global growth in 2010. GDP in low- and middle-income countries expanded 7 percent during 2010 (5.2 percent excluding India and China) and is projected to increase 6.0 and 6.1 percent in 2011 and 2012. As such it will continue to outstrip growth in the high-income countries (2.8, 2.4 and 2.7 percent in 2010, 2011 and 2012).

Serious tensions and pitfalls persist in the global economy, which in the short-run could de-rail the recovery to differing degrees. These include the possibility that:

- market concerns over debt sustainability in Europe escalate;
- continued very low interest rates in high-income countries once again prompt large and volatile flows of capital toward developing countries that contribute to destabilizing movements in exchange rates, commodity prices, and asset-prices.
- although real food prices in most developing countries have not increased as much as those measured in U.S. dollars, they have risen sharply in some poor countries; and if international prices continue to rise, affordability issues and poverty impacts could intensify.

Longer-term risks center around the possibility that policy in the economies most directly hit by the crisis fail to shift focus from short-term crisis management toward measures that address the underlying (and difficult to resolve) structural issues that contributed to the crisis in the first place. These include:

- putting in place credible plans for restoring fiscal sustainability;
- placing more emphasis on fiscal measures that facilitate the re-employment of displaced workers; and, in many countries, programs to improve longer-term competitiveness.
- completing the re-regulation of the financial sector;
- pursuing policies that permit exchange rates to gradually adjust in-line with relative fundamentals; and,
- reducing the volatility of major reserve currencies in order to sustain confidence in them as stores of value and facilitators of trade.

The remainder of this report is organized as follows. The next section discusses recent developments in global production, trade, and financial markets, and presents updates of the World Bank's forecast for the global economy and developing countries. It is followed by a discussion of the serious short- and longer-term challenges facing the global economy. This is followed by a short section of concluding remarks.

Recent economic developments and outlook

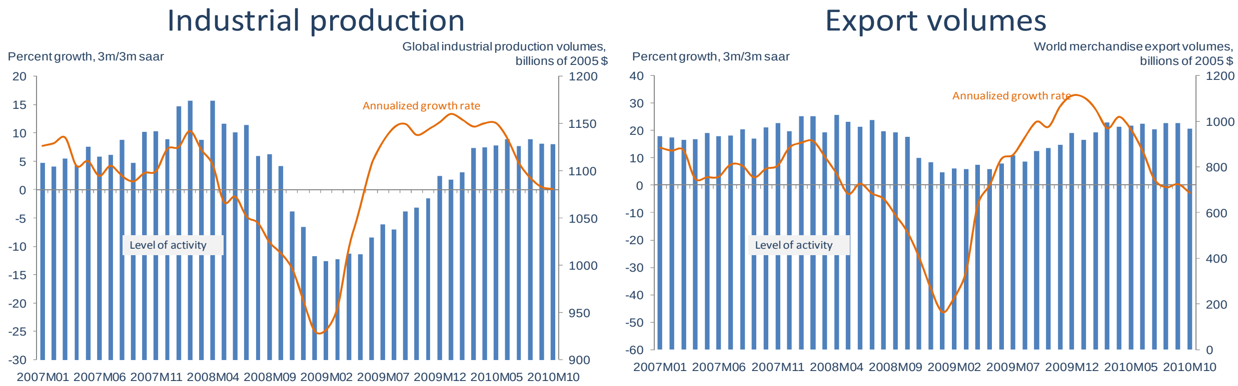
The global economy is transitioning from a rapid, bounce-back phase of recovery, toward a slower, more sustainably paced phase. Going forward, the recovery will be characterized by close to potential growth rates among those countries that were least directly involved in the excesses of the pre-crisis boom period.

Among those that were more closely implicated, including many high-income economies and developing Europe and Central Asia countries, aggregate activity will continue to be burdened by the restructuring required to undo the excesses of the boom period. As a result, unemployment is expected to decline only slowly.

The rebound in industrial activity

The rebound phase of the recovery came to an end toward the middle of 2010, when global industrial production and trade regained their pre -crisis levels of activity (dated here as August 2008 the month prior to the collapse of Lehman's and the onset of the acute phase of the crisis[1]). Almost at the same time, the pace of the expansion slowed abruptly, with 3-month industrial production and global exports

Figure 1 Industrial production and world trade volumes have regained pre-crisis levels



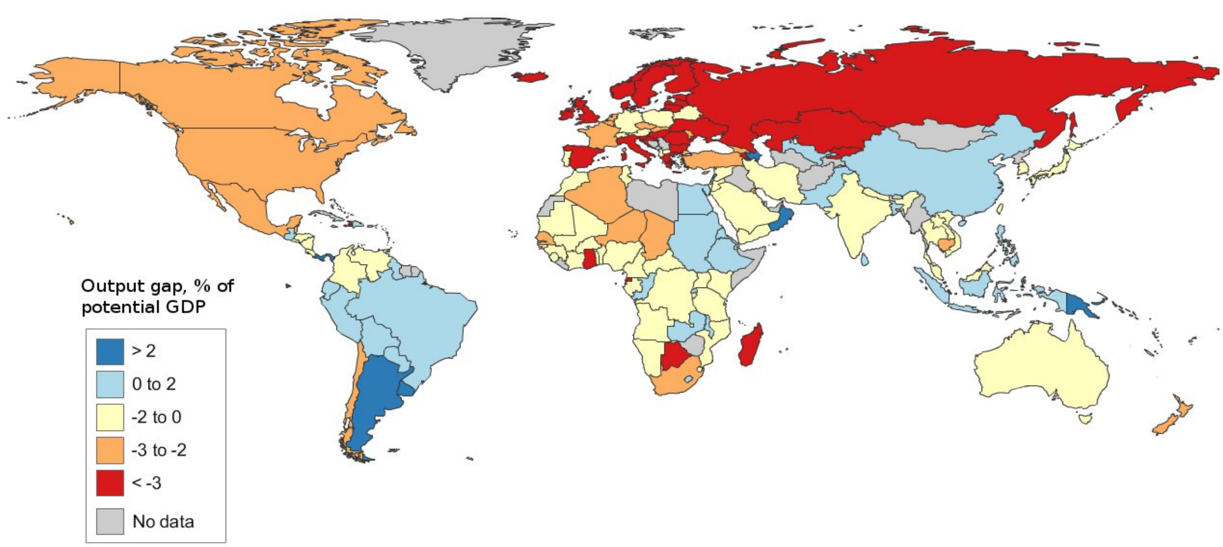
Source: World Bank.

annualized growth rates slowing from more than 10 and 20 percent respectively in early 2010 to near zero by September and only began to strengthen again in October (Figure 1).

Each developing region experienced the crisis differently. Industrial production in East and South Asia hardly declined at all, but growth rates did slow well below the pre-crisis trend of 10.5 percent in East Asia and 8.6 percent in South Asia. Production in the Middle-East and North Africa as well as in Sub-Saharan Africa declined only modestly, while it was harder hit in Latin America and the Caribbean. Developing Europe and Central Asia, where many economies overheated during the boom period, was hardest hit by the crisis, with output having fallen 20 percent at the trough.

The bounce-back phase of recovery was also

Figure 2 Output in most developing countries has rejoined with underlying potential, while gaps remain large in some high-income and developing Europe and Central Asia Economies
(% difference between actual and potential GDP in 2010)



Source: World Bank.

Table 1 The Global Outlook in summary

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

	2008	2009	2010e	2011f	2012f
Global Conditions					
World Trade Volume (GNFS)	2.7	-11.0	15.7	8.3	9.6
Consumer Prices					
G-7 Countries [1,2]	3.1	-0.2	1.3	1.1	1.6
United States	3.8	-0.4	1.9	1.5	2.0
Commodity Prices (USD terms)					
Non-oil commodities	21.0	-21.6	26.6	-0.1	-4.3
Oil Price (US$ per barrel) [3]	97.0	61.8	79.0	85.0	80.4
Oil price (percent change)	36.4	-36.3	28.0	7.6	-5.4
Manufactures unit export value [4]	6.7	-4.2	0.7	-2.9	-3.0
Interest Rates					
$, 6-month (percent)	3.2	1.2	0.5	0.5	0.9
€, 6-month (percent)	4.8	1.5	1.0	0.8	1.1
International capital flows to developing countries (% of GDP)					
Developing countries					
Net private and official inflows	4.5	3.7	4.4		
Net private inflows (equity + debt)	4.4	3.2	4.0	4.0	3.8
East Asia and Pacific	3.3	3.0	4.0	3.8	3.3
Europe and Central Asia	7.5	2.2	3.6	4.3	4.4
Latin America and Caribbean	4.1	3.8	4.5	4.4	4.1
Middle East and N. Africa	2.4	2.7	2.4	2.8	2.6
South Asia	3.6	4.3	4.0	3.6	3.9
Sub-Saharan Africa	3.5	3.9	4.6	4.9	5.2
Real GDP growth [5]					
World	**1.5**	**-2.2**	**3.9**	**3.3**	**3.6**
Memo item: World (PPP weights) [6]	2.6	-0.8	4.8	4.1	4.4
High income	**0.2**	**-3.4**	**2.8**	**2.4**	**2.7**
OECD Countries	0.1	-3.5	2.7	2.3	2.6
Euro Area	0.3	-4.1	1.7	1.4	2.0
Japan	-1.2	-6.3	4.4	1.8	2.0
United States	0.0	-2.6	2.8	2.8	2.9
Non-OECD countries	2.5	-1.8	6.7	4.4	4.8
Developing countries	**5.7**	**2.0**	**7.0**	**6.0**	**6.1**
East Asia and Pacific	8.5	7.4	9.3	8.0	7.8
China	9.6	9.1	10.0	8.7	8.4
Indonesia	6.0	4.5	5.9	6.2	6.5
Thailand	2.5	-2.3	7.5	3.2	4.2
Europe and Central Asia	3.9	-6.6	4.7	4.0	4.2
Russia	5.2	-7.9	3.8	4.2	4.0
Turkey	0.7	-4.7	8.1	4.1	4.3
Romania	7.1	-7.1	-1.9	1.5	4.4
Latin America and Caribbean	4.0	-2.2	5.7	4.0	4.0
Brazil	5.1	-0.2	7.6	4.4	4.3
Mexico	1.5	-6.5	5.2	3.6	3.8
Argentina	6.8	0.9	8.0	4.7	4.5
Middle East and N. Africa	4.2	3.1	3.3	4.3	4.4
Egypt [7]	7.2	4.7	5.1	5.5	6.0
Iran [7]	2.3	1.4	1.5	3.0	3.0
Algeria	2.4	2.4	2.4	4.1	4.1
South Asia	4.8	7.0	8.7	7.7	8.1
India [7, 8]	5.1	7.7	9.5	8.4	8.7
Pakistan [7]	1.6	3.6	4.4	2.6	3.8
Bangladesh [7]	6.2	5.7	5.8	6.1	6.3
Sub-Saharan Africa	5.2	1.7	4.7	5.3	5.5
South Africa	3.7	-1.8	2.7	3.5	4.1
Nigeria	6.0	5.6	7.6	7.1	6.2
Kenya	1.6	2.6	5.0	5.2	5.5
Memorandum items					
Developing countries					
excluding transition countries	5.8	3.2	7.5	6.3	6.3
excluding China and India	4.2	-1.8	5.2	4.3	4.5

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 can vary significantly from market price GDP. Starting with FY2009-10, factor cost GDP is: 7.7, 8.7,9, 8.5 percent – see Table B5.2 in the regional annex.

	2009e	2010f	2011f	2012f
Egypt	5.9	4.9	5.3	5.7
Iran	2.1	1.7	2.3	3.0
India	5.7	9.2	8.5	8.7
Pakistan	2.6	2.8	3.5	3.2
Bangladesh	6.0	5.8	5.9	6.2

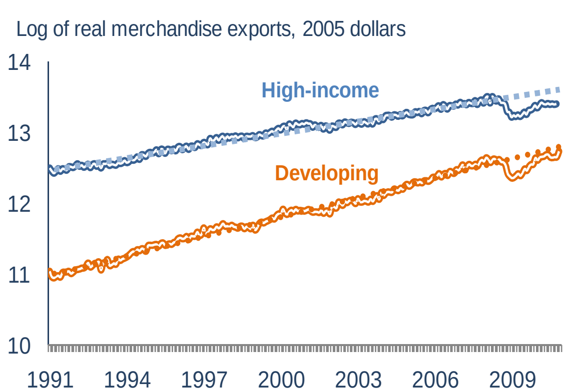
uneven, with countries and regions that were the least caught-up in the excesses of the boom period having recovered their pre-crisis growth paths most rapidly. Thus, as of October 2010, industrial production in many developing countries had surpassed pre-crisis (August 2008) activity levels by 10 percent or more (for example, China, India, Nigeria, Sri Lanka), while many others had drawn even with their pre-crisis activity levels. However, industrial activity in other countries—including many high-income countries and developing economies in Europe and Central Asia— remains some 5 percent or more below August 2008 levels.

Simple estimates of whole-economy potential output suggest that, based on pre-boom period performance (see Box 1 and annex for more details), most developing countries have regained or are close to regaining full capacity, while several high-income and developing Europe and Central Asia economies remain plagued by ample spare capacity (Figure 2).

Trade too has bounced back

The rebound in industrial activity was mirrored in the volume of goods traded, which also regained pre-crisis levels by mid 2010, with almost 50 percent of the global increase in import demand emanating from the faster growing developing countries. Although overall activity in high-income countries remains relatively depressed, by October 2010 their export volumes had regained 98 percent of their

Figure 3 Trade has yet to recover pre-crisis trend



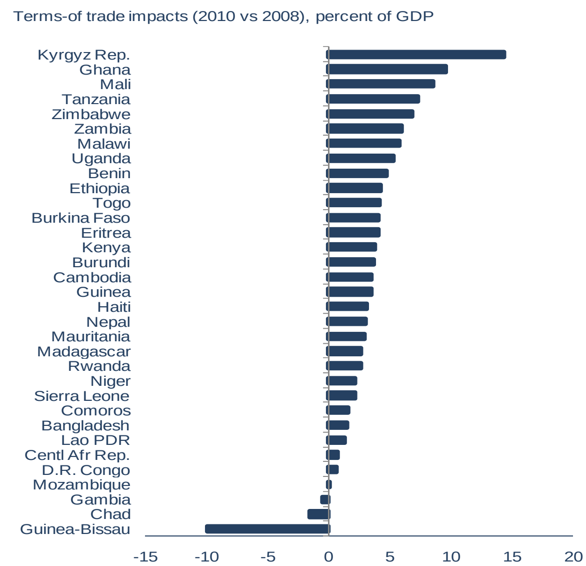
Source: World Bank.

August 2008 levels (up from 8.3 percent below that level at the beginning of the year). Developing country exports were some 16 percent higher than pre-crisis levels as of November.

While the recovery from pre-crisis levels is encouraging, trade volumes remain well below their pre-crisis peaks and the level that might have been expected to prevail had trade continued to grow at pre-crisis rates. Indeed, high-income countries export volumes are at the same level as in the beginning of 2007 (implying almost 3 years with no growth) and still some 10 percent below their pre-crisis peak of April 2008. Compared with their pre-boom trend, high-income exports are 19 percent below that which might have been expected, and developing country exports are 7 percent lower (Figure 3). In contrast, high-income imports are 14 percent below their long-term trend, whereas developing countries imports are some 7 percent higher than their long-term trend.

Despite the recovery in export volumes, much lower commodity prices (oil prices are 33 percent lower than they were in August 2008) meant that the U.S. dollar export earnings of developing countries remained between a quarter

Figure 4 Lower-energy prices translate into improved terms of trade gains for most low-income countries



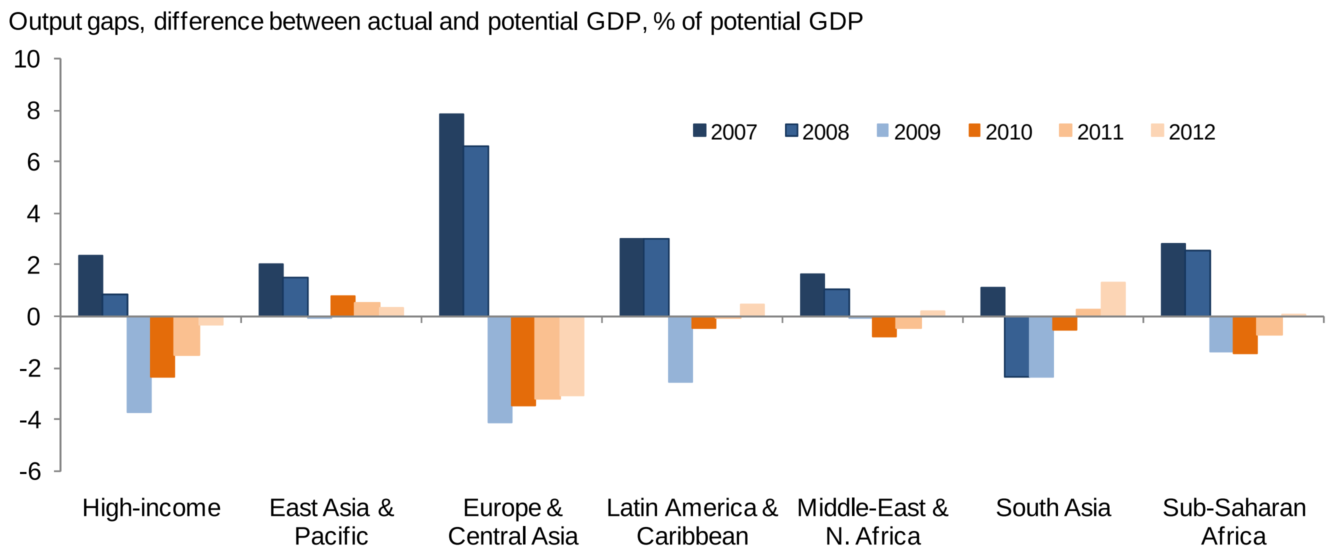
Source: World Bank.

Box 1 Estimating the level of economic slack

Though regaining pre-crisis activity and trade levels are important milestones, the extent of slack in an economy depends on both how far output declined, and its underlying trend growth rate. In fast-growing economies such as China, with an average annual industrial production growth rate of 14 percent during the first 5 years of the 2000s, merely regaining the August 2008 level of activity would imply an almost 20 percent shortfall in activity compared with what might have been expected in the absence of the crisis.

Estimates of potential output attempt to take into account the growth forgone during a crisis, and are based on activity in the whole economy — not just industry (see Annex for more detail). Such estimates confirm that the difference between actual demand levels and the productive potential of most economies largely disappeared or is about to disappear (Figure B1.1). Thus, while estimates of this output gap for high-income countries are more than 2 percent of GDP, they are less than 1 percent of GDP in every developing region except Europe and Central Asia. Even within that region, spare capacity is concentrated in 6 countries (Bulgaria, Kazakhstan, Lithuania, Romania, Russian Federation, and Ukraine). Elsewhere in the region, output gaps are close to zero. Similarly, relatively large output gaps in high-income countries are concentrated among countries that were most caught up in the excesses of the boom period, including transition economies such as Hungary and the Czech Republic. Unemployment rates in Estonia, Greece, Ireland, Lithuania, Ukraine, and the United States were in excess of 8 percent in late 2010, more than three times pre-crisis levels in some cases.

Figure B1.1 Spare Capacity is concentrated in high-income and developing Europe and Central Asian economies



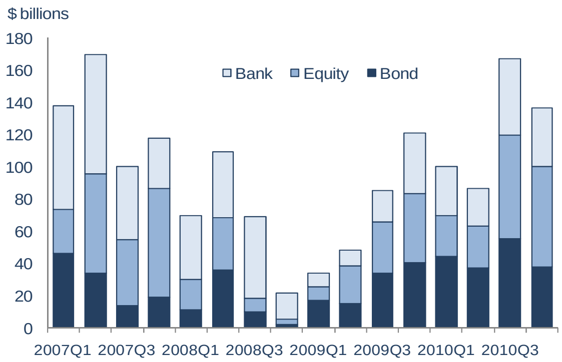
Source: World Bank.

and a third lower than pre-crisis levels. Overall, 29 percent of developing countries have seen their export earnings fall by 20 percent or more, substantially reducing incomes. By and large this has been offset by lower import costs. As a result, terms-of trade developments since 2008 have been generally positive for most non-oil-exporting developing countries—particularly low-income ones (Figure 4).

A surge in international capital flows

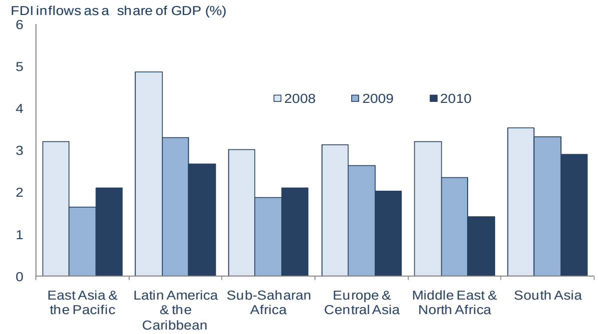
The rebound in real-side activity was supported by a global recovery in capital markets, partly reflecting loose monetary policy in high-income countries and resulting very low interest rates that have made equity and high-yielding bonds more attractive worldwide. As a result, despite still weak banking-sectors and little improvement in overall lending (net lending has increased sharply in percentage terms but remains quite low), equity markets in both high-income and developing countries have regained much of the value lost during the acute phase of the crisis, though they remain between 25.2-and 16.3 percent below previous peaks. The sharpest increase was in short-term debt flows (debt with an original maturity

Figure 5 Non-bank gross capital flows to developing countries surged in 2010



Source: World Bank using Dealogic.
Note: Data refer to gross flows of new bond and equity issues and syndicated bank loan commitments.

Figure 6 While up globally, FDI fell further as a percent of GDP in three of six developing regions.



Source: World Bank.

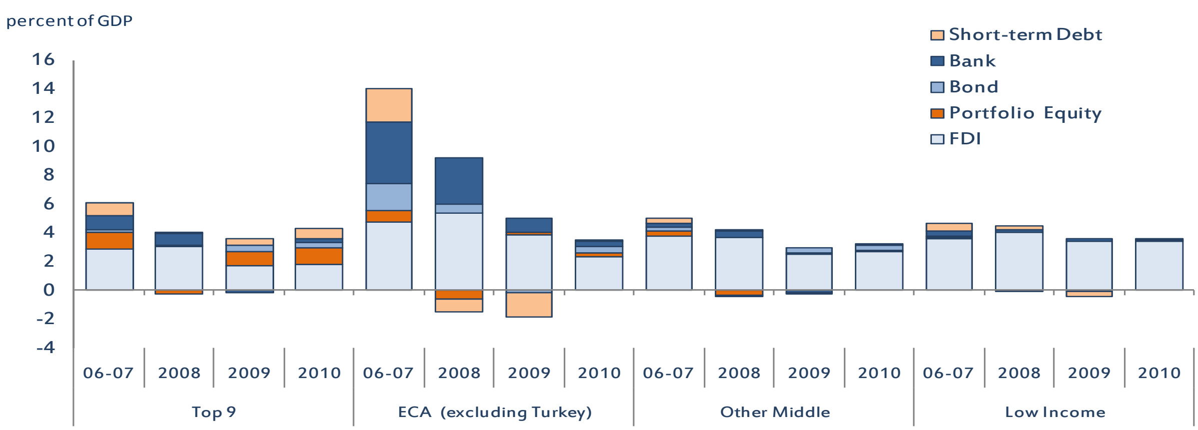
of one year or less). These flows tend to be mostly trade related in developing countries, and jumped to an estimated $86 billion in 2010 from $6.4 billion in 2009.

Gross equity flows to, and bond issuance by, developing countries increased by more than 60 percent between 2009 and 2010, reaching almost three-times the level recorded in 2008 (Figure 5). Private corporations were particularly active, taking advantage of investor's search for yield to compensate for weak bank flows (down 36 percent from 2009). Such firms issued 50 percent of all developing-country bonds –well in excess of their average 40 percent share during 2008-2009.

The recovery in FDI was more muted, with net flows to developing countries rising by an estimated 16 percent to $410 billion after falling 40 percent in 2009. Among developing regions, Europe and Central Asia recorded the largest cumulative shortfall in FDI inflows as a share of regional GDP (Figure 6).

An important factor in the rebound of FDI has been increases in South-South FDI, particularly from Asia. FDI outflows from developing nations rose to an estimated $210 billion (1.1 percent of their GDP) in 2010, surpassing the previous record of $207 billion of 2008. More than 60 percent of these flows originated in Brazil, Russia, India and China, with the bulk (60 percent) going to other developing nations — mostly in the form of greenfield investment. In contrast, South-North FDI mainly took the

Figure 7 Capital flows to low-income countries are dominated by FDI and therefore more stable than in middle-income countries.



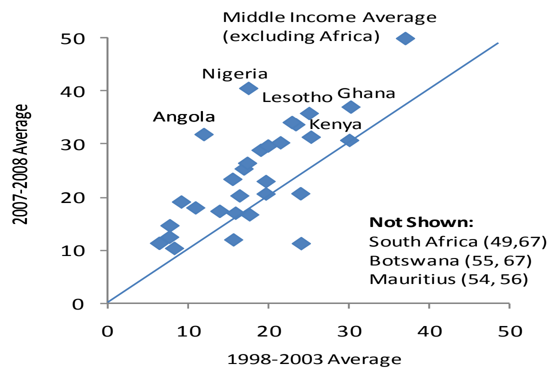
Source: World Bank.

Box 2 Sub-Saharan Africa's increasing attractiveness as a destination for international capital flows

Outside of South Africa, foreign private capital flows into Sub-Saharan Africa come almost exclusively in the form of foreign direct investment (FDI). And while such flows represent as much as [20] percent of total gross capital formation in the region, for years FDI inflows have been almost exclusively focused on the extractive sector. Indeed, the high commodity prices of recent years have supported large capital inflows to many resource-rich African countries and helped to sustain these flows even during the crisis.

However, several Sub-Saharan African countries appear to be better positioned to receive more international capital flows in the current cycle. The investment climate in most countries is improving (Figure B2.1); and many have improved their macroeconomic policies and debt sustainability (Radelet 2010). As a result, market makers are increasingly talking of several African countries' being on the verge of an economic takeoff (McKinsey 2010; Young 2009; and Pinkovsiy and Xala-i-Martin 2009). In fact, for global investors, several countries in the region represent relatively untapped large and rapidly growing markets (regional GDP is projected to grow by more than 5 percent annually between 2010 and 2012).

Figure B2.1 Improved investment climate in African countries



Source: Institutional investor country ratings.

As a result, multinationals are increasingly recognizing Africa's potential and getting interested in entering the local market to take advantage of the opportunity to service the local economy. The region has been attracting FDI into new sectors in services (telecom, banking). For example, Walmart has made an offer of 13 times the pre-tax earnings of the South African MassMart (290 stores in 13 African countries), in order to secure itself a foothold on the continent. Africa is also becoming an attractive destination for portfolio investment flows. Countries like Ethiopia, Ghana, Nigeria, and Rwanda are identified by several fund managers as possible destinations for Africa-centric investment funds.

Increased investment and trade ties with other developing countries have been playing an important role. While some of the South-South flows are intra-regional (coming from Tanzania, South Africa and Kenya), inter-regional South-South investment from China, Brazil, India and Malaysia has surged in recent years. The recent acquisition of telecom company Zain Africa by Indian Bharti for $10.7 billion was the largest South-South acquisition ever.

The potential and promise of Africa's future is clear. But continued success is not guaranteed. Concerns about the quality of growth and political stability remain. The realization of Africa's promise will depend on the continuation of policy reforms and institutional development that have underpinned the recent improvement in economic performance, building on the foundation that has been laid. And, even if the potential is realized, the absorption capacity of these countries will be a crucial determining the extent to which they benefits from better access to international capital flows. With limited experience of dealing with large capital flows, some countries may have difficulty managing the volatility that can accompany them.

form of mergers and acquisitions.

Because most of the surge in international capital flows was in short-term debt, equity and bonds (notably corporate bonds), the increase in inflows was mainly directed toward middle-income countries. As a percent of recipient GDP, capital flows increased significantly in the nine largest developing economies (Figure 7). But even for these countries, capital flows as a percent of GDP

Table 2 International capital flows to developing countries rebounds, surpassing 2008 levels
$ billions

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	126.6	185.0	322.8	448.9	476.7	434.6	279.6	298.2	272.5	265.9
as % of GDP	1.9	2.3	3.4	4.0	3.4	2.6	1.7	1.6	1.3	1.1
Financial flows:										
Net private and official inflows	262.3	342.2	464.9	610.3	1110.4	743.8	597.9	825.9		
Net private inflows (equity+debt)	274.3	366.3	528.9	679.9	1110.4	716.0	521.5	753.2	838.6	874.5
Net equity inflows	178.8	243.6	341.1	451.0	643.2	533.9	462.2	563.0	631.1	724.2
..Net FDI inflows	152.5	206.7	273.6	343.3	508.1	587.1	354.1	409.6	486.0	589.9
..Net portfolio equity inflows	26.3	36.9	67.5	107.7	135.1	-53.2	108.2	153.4	145.1	134.3
Net debt flows	83.6	98.6	123.8	159.3	467.2	209.9	135.6	262.9		
..Official creditors	-11.9	-24.1	-64.0	-69.6	0.0	27.8	76.4	72.4		
....World Bank	-2.5	2.4	2.7	-0.2	5.2	7.3	17.7	19.3		
....IMF	2.4	-14.7	-40.2	-26.7	-5.1	10.0	26.5	16.3		
....Other official	-11.8	-11.8	-26.6	-42.6	0.0	10.6	32.2	36.8		
..Private creditors	95.5	122.7	187.8	228.9	467.2	182.1	59.2	190.5	207.5	150.3
....Net M-L term debt flows	38.3	69.8	113.3	145.0	283.0	196.1	52.8	104.1		
......Bonds	23.1	34.3	48.3	31.7	88.2	24.1	51.1	66.5		
......Banks	19.5	39.7	70.3	117.9	198.5	176.8	3.2	37.6		
......Other private	-4.4	-4.1	-5.3	-4.7	-3.7	-4.8	-1.6			
....Net short-term debt flows/a	57.2	52.9	74.5	83.9	184.2	-14.0	6.4	86.4		
Balancing item /b	-103.5	-127.3	-372.9	-411.3	-495.5	-700.2	-250.2	-649.0		
Change in reserves (- = increase)	-285.5	-399.9	-414.8	-647.9	-1091.7	-478.2	-627.3	-475.1		
Memorandum items										
Net FDI outflows	23.6	46.1	61.6	130.5	148.7	207.5	153.9	210.0	250.0	275.0
Workers' remittances	137.4	159.3	192.1	226.7	278.0	325.0	307.1	325.0	346.0	374.0
As a percent of GDP										
	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Net private and official inflows	3.88	4.26	4.88	5.42	8.03	4.52	3.72	4.40		
Net private inflows (equity+debt)	4.05	4.56	5.56	6.04	8.03	4.35	3.24	4.01	4.00	3.77
Net equity inflows	2.64	3.03	3.58	4.01	4.65	3.24	2.73	3.00	3.01	3.12
..Net FDI inflows	2.25	2.57	2.87	3.05	3.67	3.57	2.09	2.18	2.32	2.54
..Net portfolio equity inflows	0.39	0.46	0.71	0.96	0.98	-0.32	0.64	0.82	0.69	0.58
..Private creditors	1.41	1.53	1.97	2.03	3.38	1.11	0.35	1.01	0.99	0.65

Source: World Bank.

were lower than the pre-crisis period (2006-07).

Low-income countries were subjected to relatively small declines in overall capital flows during the crisis, and relatively small gains in the recovery, because they receive very little in the form of bonds or equity. Indeed, equity flows were close to zero in half of the 128 developing countries for which data exist, and more than 2/3 have *never* accessed the international bond market.

Given these patterns, the increase in capital flows expressed as a share of GDP was uneven across regions. Aggregate flows increased in all regions except South Asia, and the Middle East and North Africa (see Box 2 on FDI prospects for Sub-Saharan Africa).

Looking at 2010 as a whole and at capital flows in net terms (new flows less repayments), private capital flows to developing countries rebounded an estimated 44 percent, reaching about $753 billion, or 4 percent of recipient GDP (Table 2).

Recovery in remittances, tourism and commodity prices were positives for low-income countries

Although low-income countries did not benefit from the recovery in capital flows to the same degree as middle-income countries, their recoveries in 2010 were supported by a modest pickup in remittances, tourism and commodity prices.

Remittances are a very important source of income for a number of poorer developing economies, representing more than 20 percent of GDP in several (Figure 8). Overall, the dollar value of remittances to individuals living in developing countries rose an estimated 6 percent in 2010, after falling 5.4 percent in 2009 (World Bank, 2010b). However, the depreciation of the U.S. dollar against many developing country currencies reduced the extent to which the incomes of the poor were increased. At the aggregate level, the real-local currency value of remittances is estimated to have declined 3.9 percent in 2010, with losses in economies that appreciated against the dollar offsetting gains in those that were pegged to or depreciated with respect to the dollar.

Tourism is also an important source of income for some developing countries, representing 10 percent or more of GDP in 13 countries. For these economies, an estimated 7.6 percent increase in tourism arrivals in 2010 more than compensated for the 1.4 percent decline recorded in 2009 (World Tourism Organization, 2010). The Middle-East, East Asia, and South Asia saw the biggest estimated increases in volumes, up 13, 7.6, and 14 percent respectively, with intra-regional tourism in the Middle-East and North Africa playing a big role.

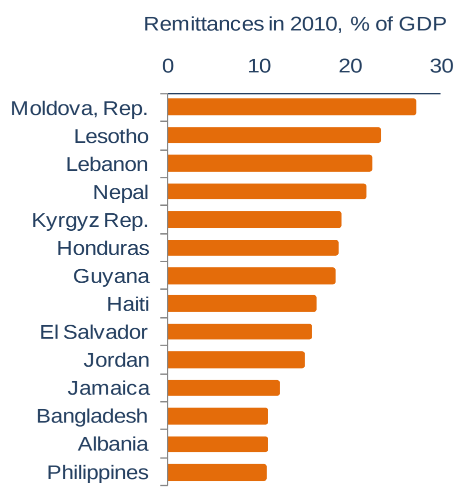
The strong rebound in metals and minerals prices, and to a lesser extent energy prices, boosted incomes in resource-rich developing countries, and helped economies to meet fiscal challenges.

A mid-year pause in the recovery

Growing supply-side bottlenecks in countries where the recovery was most advanced, and ongoing restructuring in those most directly affected by the financial crisis, contributed to a mid-year pause in growth. In the final quarter of 2010, this began giving way to what is expected to be slower growth more in line with longer-term trends.

The slowdown partly reflected the coming to an end of the easy ramping up of previously idled capacity, and of the investment cycle (a standard

Figure 8 Increased tourism and remittances boosted incomes in many low-income countries



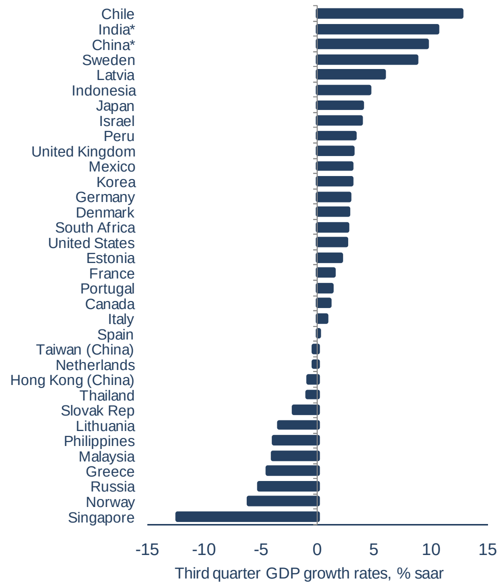
Source: World Bank.

Source: World Bank, UN International Tourism Organization.

mechanism underpinning recovery) in most developing countries. As activity rebounded, investment also picked up, partly driven by the need to replace depreciating equipment and by improving growth prospects. By the third quarter of 2010 aggregate investment rates in developing and high-income countries had regained near-normal levels. In aggregate, investment remains depressed in high-income countries, partly because of ongoing restructuring in some sectors. In the United States for example, outside of the residential sector, investment rates are almost back to normal levels (Box 3).

Indeed, the sharp mid-year slowdown in industrial production and global trade appears to have reflected an overshooting of activity rather than a decline in demand. Demand growth in the third quarter of the year (the same quarter over which the production figures appear to have stalled) was actually very strong both in high-income countries, and in most developing countries reporting quarterly GDP data (Figure 9). Negative growth was concentrated among countries enduring sharp fiscal consolidations or that are particularly specialized in industrial production.

Figure 9 Generally strong in 2010 Q3 growth



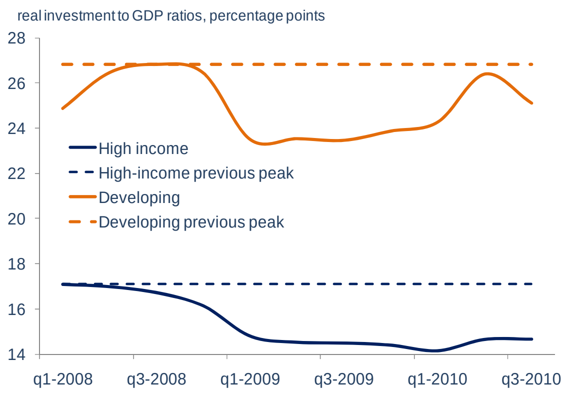
Source: Datastream.

Most concurrent and forward-looking indicators for the fourth quarter of 2010 point to a strengthening of economic activity. For example,

Box 3 The investment recovery

The crisis saw investment rates in both developing and high-income countries fall dramatically (down 3 percent of GDP in high-income and 3.4 percent of GDP in developing countries). With the recovery, investment has rebounded significantly. Real investment rates in developing countries, for which quarterly Q3 2010 GDP data are available, were less than 1/2 of percentage point lower than their pre-crisis peak in 2010 Q2, before falling back to 1.7 percentage point gap in the third quarter (Figure B2.1). In East Asia investment rates have recovered previous peaks, while in developing Europe and Central Asia and Latin America investment remains relatively depressed, down 5 and 2.5 percentage points from pre-crisis peaks.

Figure B3.1 Fixed investment is recovering in developing countries



Source: World Bank.

As of the third quarter of 2010, the investment to GDP ratio in high-income countries remained 2.5 percentage points below its pre-crisis peak. This partly reflects the nature of the pre-crisis investment boom. For example, in the United States, although aggregate investment remained 2.7 percentage points below its pre-crisis peak, this mainly reflected continued weakness in the housing sector. Business-sector investment was only 0.1 percentage points below its pre-crisis highs (the nominal ratio is 1.5 percentage points below its long-term average). Aggregate investment rates could take years to fully recover, as the boom-period overinvestment in housing only slowly works its way out of the system.

the pace of industrial production growth in China, which came close to zero during the two months ending June 2010, had returned to 15.1 percent by November 2010. And other BRIC countries are also showing signs of accelerating activity. Similarly, strengthening retail sales data and purchasing manager's indexes for the globe's largest economies point to a continued expansion of output (Figure 10). Although recent export order surveys look less bullish than earlier in the year, they remain in positive territory and new orders are accelerating.

Nevertheless, momentum growth rates in the United States and Europe remain weak, and some smaller economies continue to suffer from intense post-crisis restructuring. In addition, the renewed turmoil in European sovereign debt markets may dampen investment spending, while plans to tighten budget positions are likely to exert drag on growth — unless deficit reduction strategies improve consumer and business confidence and spending, by enough to offset the direct negative effects of reduced government spending.[2]

Outlook is for steady but slower growth in 2011 and 2012

After the sharp growth deceleration of 2008 and the contraction in 2009, global GDP is estimated to have increased 3.9 percent in 2010. The pickup in growth among high-income countries (a 6.2 percentage point improvement in growth rates) was more marked than in developing countries (5 percentage point increase in growth rates); but at 7 percent, growth in developing countries was more than twice as strong as in high-income countries. As a result, low and middle-income countries contributed almost half of global growth (46 percent) in 2010. Moreover, all of developing country growth was due to increased domestic demand.

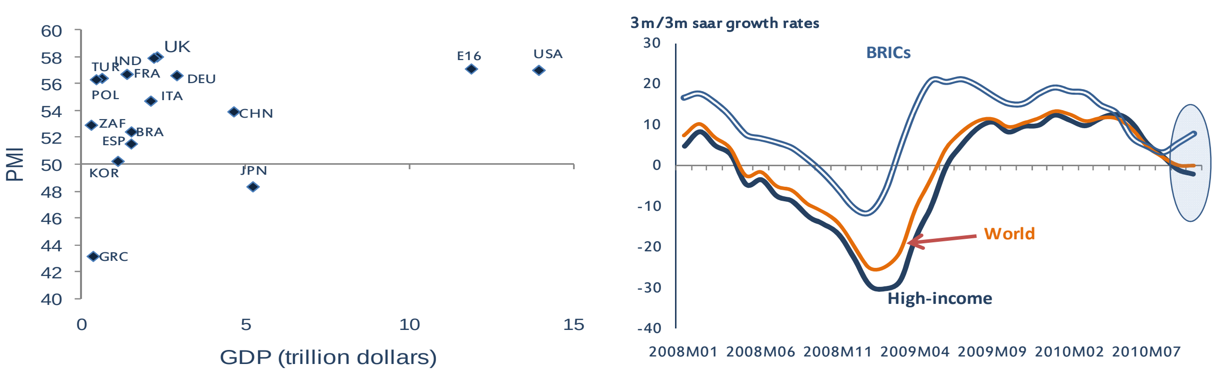
Growth in both high-income and developing countries is expected to slow somewhat in 2011, mainly reflecting the easing already observed in the second half of 2010, before picking up again toward mid 2011, settling at rates close to their longer-run potential. Global GDP is projected to increase by 3.3-and 3.6 percent during 2011 and 2012, with developing economies expanding by 6-or more percent in each year, more-than twice the 2.4 and 2.7 percent growth expected for high -income countries. Unfortunately these growth rates are unlikely to be fast enough to eliminate unemployment and slack in the hardest-hit economies and economic sectors.

The continued recovery should be supported by further strengthening of capital flows to developing countries in 2011 and 2012. However, carry-trade flows are expected to decline, as monetary policy tightens in high-income countries and interest rates rise. Partly as a result, total inflows to developing countries will rise less quickly — at just over 10 percent in 2011 and under 5 percent in 2012 (Figure 11). Because nominal GDP is expected to rise faster

Figure 10 Some indicators point to strengthening fourth quarter growth

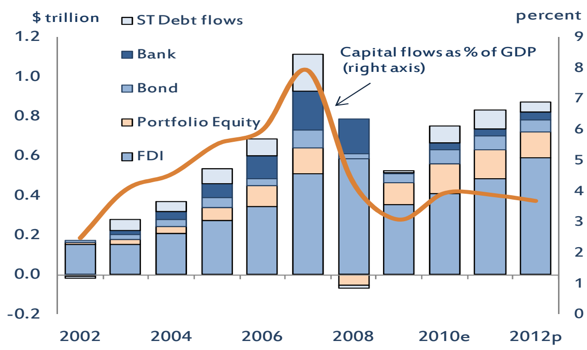
Purchasing manager indexes point to strengthening

Industrial production may be picking up again



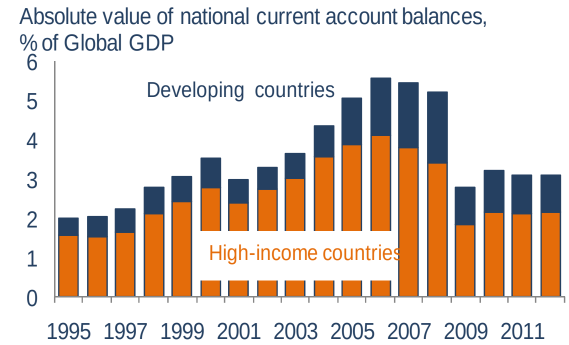
Source: World Bank.

Figure 11 Net private capital flows to developing countries



Source: World Bank.

Figure 12 Global imbalances have declined substantially and are expected to continue falling



Source: World Bank.

(10 and 12 percent), despite rising in dollar terms flow are projected to decline as a share of GDP, to around 3.7 percent in 2012.

A combination of lower commodity prices (compared with 2008) and a rebalancing of trade volumes in favor of high-income countries, has served to reduce global imbalances; and this trend is not expected to be reversed over the forecast period. The absolute value of the current account balances of the world's economies has declined from a peak of 5.6-to about 3.3 percent of global GDP in 2010 (Figure 12). Most of the decline reflects smaller imbalances in high-income countries (the current account deficit in the United States narrowed from 6-to 2.7 percent of GDP between 2005 in 2009, before bouncing back to 3.5 percent of GDP in the third quarter of 2010). Imbalances in developing countries have also declined from 1.5 percent of global GDP in 2006 to about 1.1 percent in 2010.

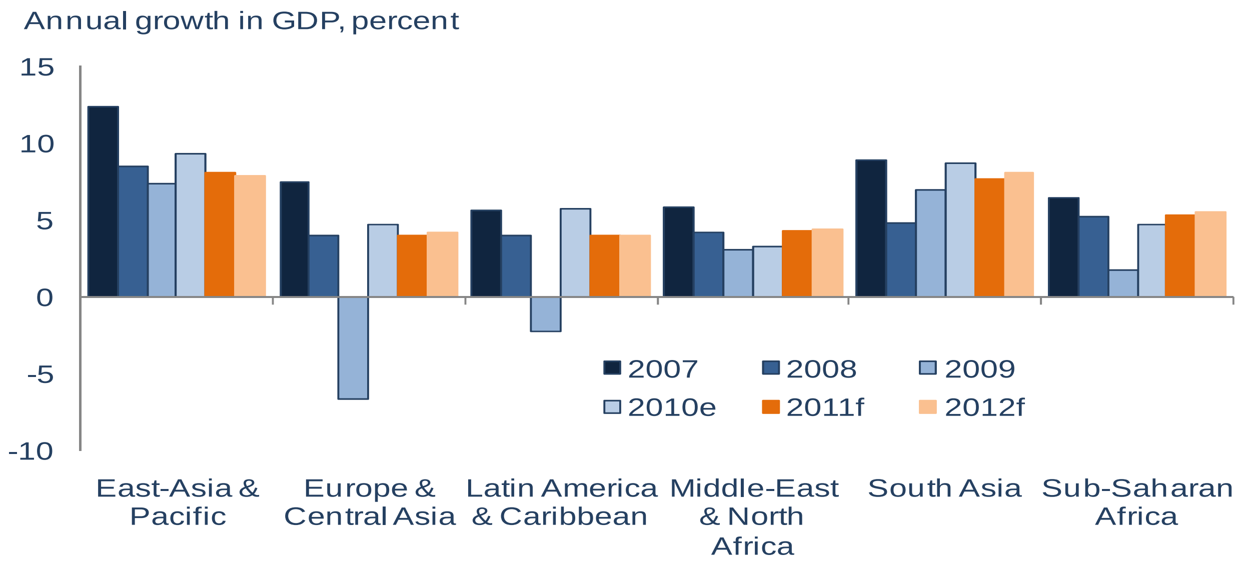
Looking forward, global imbalances are expected to decline marginally in 2011 and 2012, as whole economy savings in high-income countries continues to rise. Any tendency for private savings rates in high-income countries to decline due to cyclical improvements in the economy are expected to be countered[3] by higher public-sector savings as fiscal deficits decline and by an offsetting tendency for private savings to rise as interest rates increase with the withdrawal of monetary stimulus.

High-income countries

Activity in the *United States* is expected to continue to be characterized by strong domestic demand growth, but relatively disappointing GDP growth, as the economy continues to deal with high-unemployment and the shrinking of an overgrown housing sector. Notwithstanding the 9 percent real-effective depreciation of the dollar since January 2009, and stronger exports, leakages, both in the form of imports and capital outflows, continue to stymie efforts to grow the economy through demand stimulus. Boosted by the additional stimulus measures passed late in 2010, GDP is projected to expand 2.8 percent in 2011 and 2.9 percent in 2012.

In *high-income Europe*, the recovery will continue to face headwinds from the uncertainty surrounding sovereign debt in several countries as well as planned fiscal tightening on a wider scale. Nevertheless, growth in the larger economies is expected to remain close to- or slightly above past trends, helping to slowly re-absorb unemployment and spare capacity. Among those high-income European countries most deeply affected by the crisis, growth is not expected to be strong enough to reduce unemployment very rapidly, partly because of the intense restructuring that some of these economies are undergoing. Overall, Euro Area GDP, after expanding 1.7 percent in 2010, is projected to slow to 1.4 percent in 2011 and pickup to 2 percent in 2012, reflecting both a gradual tightening of fiscal policy and the

Figure 13 Developing country growth rates to stabilize at historically elevated rates



Source: World Bank.

region's reliance on bank lending, as opposed to equity and bond flows, to finance private-sector investment.

After a solid third quarter, *Japanese* growth is expected to contract in the fourth quarter of 2010, but an anticipated rebound in exports should see the economy renew growth in the first quarter of 2011. Overall, growth for 2010 is estimated at 4.4 percent, but is expected to moderate to 1.8 percent in 2011 and advance by 2 percent in 2012.

Developing countries

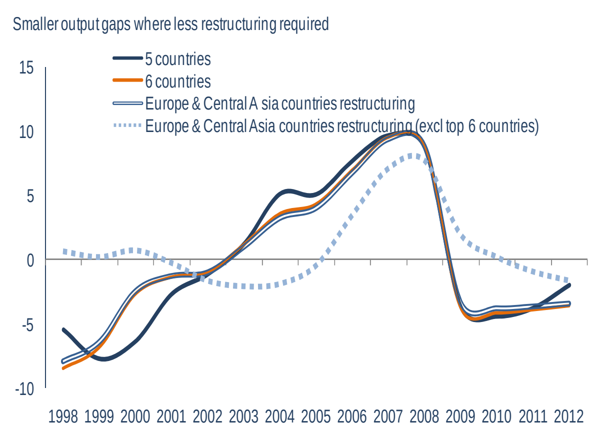
In-depth discussion of prospects in the different developing regions, including country-specific forecasts, are available in the regional annexes to this volume and online at: http::\www.worldbank.org\globaloutlook.

With the exception of the Europe and Central Asia region, most developing regions are projected to enjoy strong recovery (Figure 13), with growth close to underlying potential and output gaps close to or approaching zero (Figure 14). This apparent homogeneity masks important differences within regions, reflecting among other factors, countries' exposure to international capital flows, and their reliance on remittances, tourism and commodities. The following paragraphs examine the prospects of developing countries from this perspective.

Middle-income countries undergoing restructuring

On average, middle-income countries underwent a much more pronounced cycle than low-income countries, with GDP for middle-incomes growing only 1.9 percent in 2009, before rebounding 5.9 percent in 2010. Among those economies whose underlying structure was most

Figure 14 Output gaps in restructuring Europe and Central Asian economies remain large



Source: World Bank.

Table 3 Developing country GDP developments by economic category

	Real GDP growth							Economy-wide output gap 2010
	2000 - 2004	2005-2008	2008	2009	2010	2011	2012	
Fragile states	3.0	4.1	3.8	3.0	5.0	5.2	5.1	-0.7
Countries undergoing restructuring in Europe and Central Asia	6.9	7.3	5.3	-7.3	3.2	4.0	4.1	-3.9
5 most affected countries	7.2	7.0	4.4	-8.2	1.7	3.1	4.3	-4.4
6 most affected countries	6.9	7.1	5.0	-8.0	3.1	3.9	4.1	-4.2
Europe and Central Asia (excl the 6 most affected countries)	6.7	10.9	9.1	1.6	4.7	4.7	4.8	0.2
Top-9 capital inflow countries	5.6	7.8	6.0	3.7	8.4	6.8	6.8	-0.1
o/w those with pre-crisis current account surpluses	8.2	10.3	8.7	7.7	9.4	8.1	7.9	0.6
o/w those with pre-crisis current account deficits	3.8	5.5	3.5	-0.3	7.3	5.3	5.6	-0.8
LIC tourism and remittance dependence countries	4.8	6.1	5.6	4.3	5.3	6.4	6.3	-0.7
Remittance dependent	4.8	6.0	5.4	5.2	5.5	5.8	6.2	0.0
Tourism dependent	5.1	8.9	8.8	4.4	6.5	9.0	7.9	-1.6
LIC: Resource dependent economies	6.6	7.2	5.8	4.7	6.4	6.6	6.6	-0.5
MIC: Resource dependent economies	4.1	6.3	5.1	1.4	3.9	4.5	4.6	-0.8
Other: LIC	4.6	7.7	8.6	5.7	6.0	6.7	7.0	-0.3
Other: MIC	2.5	6.5	4.4	1.9	5.9	4.3	4.3	1.1

Source: World Bank.
Note: Top 5 (6) countries include: Bulgaria, Kazakhstan, Lithuania, Romania, (Russian Federation), and Ukraine.

distorted during the boom period and whose households and banking sectors are most burdened by bad debt,[4] output gaps are more-than 4 percent of GDP and unemployment remains endemic. To a large extent this reflects developments in 6 middle-income countries that experienced very pronounced booms during the period 2003-2007 and whose economies are currently undergoing severe restructuring.[5]

All of these countries are located in the Europe and Central Asia region. Partly as a result, the region's aggregate growth has been slow, with GDP increasing only 4.7 percent in 2010 after declining 6.6 percent in 2009 (see earlier Table 1). High levels of household indebtedness and widespread unemployment have held back consumer demand, while banking-sector consolidation and large quantities of bad-loans are limiting new lending. In addition, tepid growth and financial restructuring in high-income Europe has meant a weak recovery in foreign capital inflows, export revenues and remittances for developing Europe and Central Asia. In the five countries undergoing the most intense restructuring, output fell 8.2 percent in 2009, and rebounded by just 1.7 percent in 2010 (Table 3). Including Russia in the tally, output collapsed by 8 percent in 2009, but the growth rebound was stronger (3.1 percent) as Russia benefitted from the recovery in oil prices and state revenues.

Excluding the six most affected economies, the growth impact was less severe for Europe and Central Asia, with positive growth (1.6 percent) in 2009, and expectations for increases in a high 4-percent range through the projection period. Output gaps for these countries are slightly positive in contrast to the much larger gaps for the restructuring economies (Figure 14). Indeed, even by 2012, output gaps in the restructuring economies are expected to remain high, with growth coming in at less than half its pre-crisis rates.

Very strong capital inflows boosted growth in some countries

While most countries experienced a bounce back in capital flows during 2010, GDP in the 9 countries[6] that attracted the bulk of these flows surged 8.4 percent in 2010, after rising 3.7 percent in 2009.[7] The bounce-back in growth was strongest among current-account deficit countries within the group (7.6 percentage points) as renewed capital inflows eased domestic demand growth constraints (particularly investment and private consumption related).

Both groups have seen output gaps close rapidly, though gaps in current account deficit countries remain moderately negative. Growth in both groups of countries is expected to remain strong, albeit easing from the very fast rates posted in 2010. In the baseline projections continued strong capital inflows are projected to push GDP in each group to within 1/2 of a percentage point of potential by 2012 (Figure 15). However, if capital inflows accelerate further and growth escalates to above baseline projections, already existing inflationary pressures and asset price bubbles could build further — especially among those countries that continue to resist upward pressure on their currencies. For others, continued appreciation will cut into domestic competitiveness, reducing net exports and help to mitigate inflationary pressures.

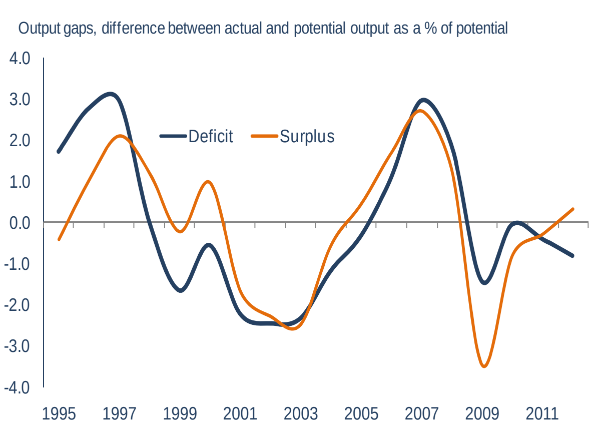
High commodity prices should continue to support robust growth among resource-dependent economies

The crisis affected both low– and middle-income resource-dependent countries less dramatically than other countries. For low-income exporters (many of which in Sub-Saharan Africa), GDP growth eased by about a percentage point into 2009, rebounded to 5.3 percent in 2010 and is anticipated to sustain rates of about 6.5 percent throughout the forecast period, as strong commodity prices continue to support incomes and government finances. The crisis slowed activity in resource-dependent middle-income countries more than like low-income countries mainly as these economies were more financially integrated with the world economy, and were characterized by larger manufacturing sectors. Moreover, many low-income resource-rich countries are still expanding production at a rapid rate, a process that continued despite the crisis. Middle-income resource-dependent economies are expected to grow 4.5-and 4.6 percent in 2011 and 2012, moderately above their average growth of 4.1 percent during the pre-boom period 2000-2004.

Further recovery in remittance and tourism revenues underpins expectations of gradual acceleration

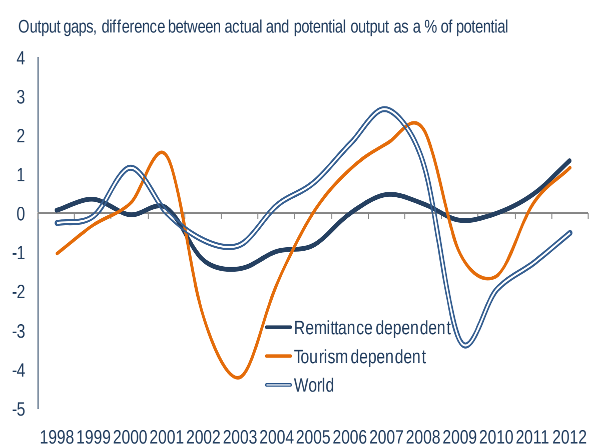
The impact of the crisis on low-income remittance and tourism dependent countries was limited, with growth declining from 5.6-to 4.3 percent between 2008 and 2009. Partly as a result, economy wide capacity utilization is already back to long-term trend levels (Figure 16). Tourism dependent economies were harder hit by the crisis, as declining incomes and uncertainties in tourism-originating countries yielded lower tourist volumes and/or reduced

Figure 15 Strong capital flows contributed to rapid closure of output gaps in some countries



Source: World Bank.

Figure 16 Output in remittance dependent developing countries was broadly stable



Source: World Bank.

spending.

The rebound in remittances-dependent economies is expected to be modest over the next two years, as employment conditions in high-income countries improve only slowly. Tourism is also not expected to bounce back very forcefully in most countries, as prospects in originating countries strengthen only slowly.

Assuming no further turmoil, growth in fragile states is expected to continue accelerating

The impact of the great recession on fragile countries[8] was relatively small, with growth falling off from 3.8 percent in 2008 to 3 percent in 2009. Assuming that domestic conditions continue to improve, growth is anticipated to average 5 percent per year or more over 2010-2012, well above the 3 percent average growth recorded during the pre-boom period. Of course, should political conditions in one or more countries deteriorate, growth could suffer markedly.

Remaining countries are projected to outperform pre-boom growth rates

Growth slowed in aggregate for the remaining low-income countries by almost 3 percentage points between 2008 and 2009; but growth is viewed to pick up to 7 percent by 2012. This strong performance, which is mirrored in other categories of low-income countries, reflects in part these countries' relatively weak links to international financial markets, which means they avoided the worst parts of the "boom-bust" cycle. However, improved macroeconomic management and earlier debt relief also increased their ability to react and adapt to volatile external conditions.

The remaining middle-income countries (excluding countries that are undergoing restructuring, receiving hot money inflows or that are resource rich) have also benefitted from the rebound in international financial conditions. FDI flows, which increased by about 20 percent to this group, contributed to strong growth of 5.9 percent in 2010. On average, output in these economies remains high relative to potential. Partly as a result, and reflecting a near term slowing of growth elsewhere in the world, the pace of expansion in these economies is viewed to establish a 4 percent pace over the projection period.

Challenges facing the global economy

The global recovery has gained strength, matured and broadened to include more countries and more components of demand. This dynamic appears to be well established, particularly among developing countries. As a result, concerns of a double-dip recession have eased. However, the recovery remains exposed to significant short and long-term risks that could derail it. The remainder of this section discusses these, beginning with short-term risks and concluding with longer-term ones.

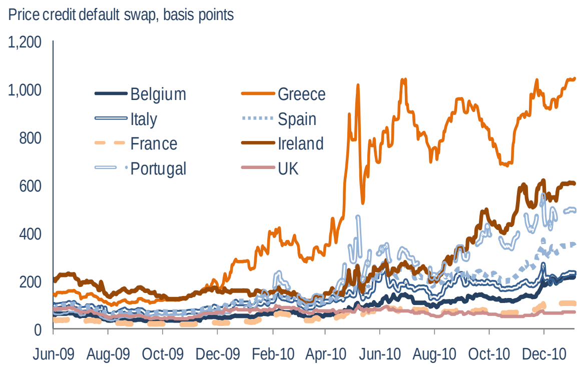
Short-term risks to the global recovery

As discussed earlier, the main short-term risks to the global economy include: the possibility of further disturbance and contagion in Euro area sovereign debt markets; the possibility that very low interest rates in high-income countries induces a second "boom-bust" cycle among one or more developing countries; and the possibility that rising commodity prices threaten recovery and/or poverty reduction in developing countries.

Financial turmoil in high-income Europe

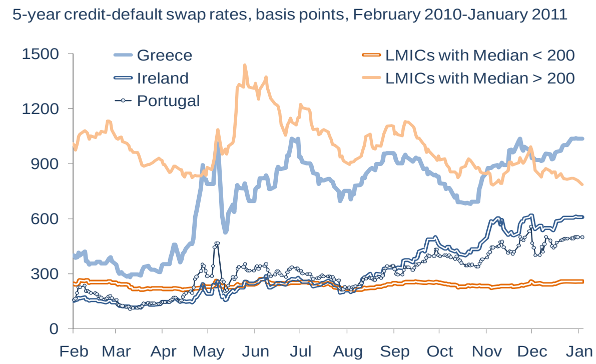
Market concerns about fiscal sustainability and the crisis resolution system in the Euro area intensified once again in final quarter of 2010, as Ireland became the second Euro-area state to receive external financial support from the European Union and the IMF. The package amounts to some 54 percent of Irish GDP, of which an amount equivalent to some 11 percent of GDP will be provided from Ireland's own resources. It's objective is to provide support to the banking sector. To date, however, calm has not been restored to the markets.

Figure 17 Renewed market anxieties concerning European sovereign debt have rebounded



Source: World Bank, Datastream

Figure 18 High-income sovereign debt woes have limited effect on developing countries credit costs



Source: World Bank, Datastream.

Concerns that banking sectors in other markets might require further support, and lingering uncertainty about the capacity of currently existing frameworks to address the potential financing needs of the economies involved placed upward pressure on the price of credit default swaps for Belgium, Greece, Ireland, Italy, Portugal and Spain during the fall of 2010 (Figure 17). Uncertainties also contributed to a decline in equity market valuations of between 1.2-and 8.9 percent. Equity markets recovered somewhat in early December, after the European Central Bank began to actively purchase outstanding bonds, but CDS spreads after an initial decline continued to rise or remained high through to the end of the year.

So far, the skittishness of investors concerning high-income European debt has not been passed onto the price of swaps of the majority of developing countries, although the price of CDS swaps of countries that initially had spreads in excess of 600 basis points also tended to move upwards (Figure 18). However, the uncertainty in November did contribute to an easing in capital flows to developing countries. Flows also remained low in December, a seasonally slow month for capital flows.

The implications of this renewed bout of investor nervousness are unclear. The most likely scenario, and the one retained in the baseline projections, assumes that although market nervousness continues, it will have limited impacts on the real economy — as was the case in May 2010 when the first bout of market nervousness regarding Euro-Area sovereign debt arose (see World Bank, 2010 for more).

However, if market volatility persists, investors may hold back on investment projects and/or consumers may delay durable goods purchases. Such behavior could slow growth and possibly lead to a double dip recession in some countries. Moreover, market nervousness may prompt countries to intensify fiscal consolidation strategies, further slowing the pace of the recovery in 2011. The simulations in Table 4 assume an 1 percent of GDP additional fiscal consolidation being introduced in the second quarter of 2011, and a 2.5 percentage point

Table 4 Estimated impact of increased fiscal consolidation and investor nervousness
(Percent deviation in the level of GDP from baseline)

	2010	2011	2012
World	**0.0**	**-0.6**	**-0.9**
High-income	0.0	-0.7	-1.1
Developing countries	**0.0**	**-0.1**	**-0.2**
Middle-income	0.0	-0.1	-0.2
Low-income	0.0	-0.1	-0.2
East Asia and Pacific	0.0	-0.2	-0.3
Europe and Central Asia	0.0	-0.1	-0.1
Latin America and Caribbean	0.0	-0.1	-0.1
Middle East and N. Africa	0.0	-0.1	0.0
South Asia	0.0	-0.2	-0.4
Sub-Saharan Africa	0.0	-0.1	-0.1

Source: World Bank.

reduction in investment compared with the baseline. This results in a slowing in growth of as much as 0.6 percentage points in 2011 and 0.3 percentage points in 2012. Most of the slowdown would be borne by high-income countries (a cumulative 1.1 percentage points). The more constrained environment would affect growth in developing countries to a lesser extent – in part because developing countries are not assumed to implement additional fiscal consolidation measures.

Although market nervousness about sovereign debt in the Euro Area has had limited impacts on the real economy so far, the consequences of a disorderly resolution to European fiscal tensions, unlikely as it may be, is still an important source of uncertainty for both high-income and developing countries—particularly those with close trading and financial ties with concerned economies.

As a consequence of the growing financial integration in the Euro area and the high-income world in general, there are extensive cross-exposures among high-income country banks. As of the second quarter of 2010, the Bank for International settlements estimates that European Banks held some $1.6 trillion in assets from Greece, Ireland, Portugal and Spain, or more than 8 percent of total claims of the European banking system — down substantially from the 10 percent of claims held in late 2009 (Figure 19).

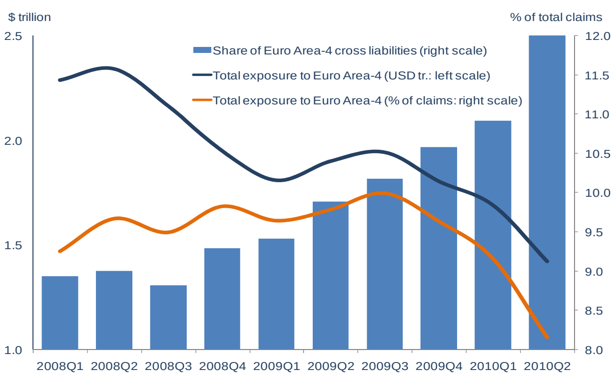
Another potential transmission channel could be through the financial sector. Banks in the countries under close financial market scrutiny hold international claims in emerging markets of around $0.7 trillion. Albania, Bulgaria, Romania, and Serbia are economies that have benefitted in the past from heavy capital inflows from Greek financial institutions. Similarly, banks in Portugal and Spain are an important source of finance in Latin America (Figure 20).

Overall, the public and private sectors in Latin America have borrowed some $320 billion or 8 percent of GDP and those in emerging Europe owe some $400 billion or 13 percent of GDP. Spanish banks own over 25 percent of bank capital in Mexico, Chile, and Peru. Approximately 11 percent of deposits in Latin America and the Caribbean are deposited with Spanish banks, while loans from Spanish banks represent 9 percent of total banking assets in the region. Portuguese banks play an important role in Brazil and account for 30 percent or more of banking assets in African countries such as Angola and Mozambique.

Should banks in high-income Europe be forced to re-capitalize or retrench, they (and their client companies) may have to pull back their investments to cover their losses. If this were to happen capital flows to the developing regions noted could contract.

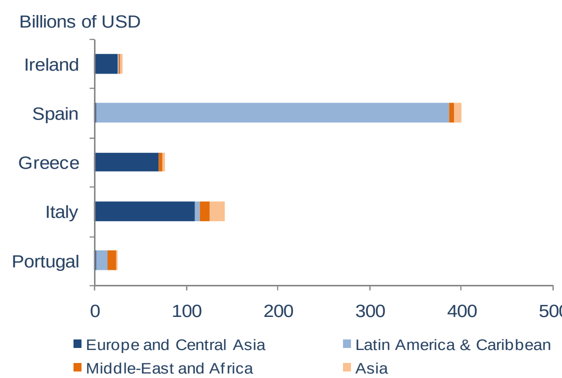
That said, capital shortages are unlikely to materialize in the case of Latin America and its

Figure 19 European banking-sector claims on assets of Greece, Ireland, Portugal and Spain



Source: Bank of International Settlements.

Figure 20 Distribution among developing regions of out-standing claims of banks in stressed-euro-zone countries



Source: Bank for International Settlements.

linkages to the Spanish Banking system, in part because most of these banks operate as subsidiaries and are subject to independent capital and regulatory requirements in the host country. Indeed, the main Spanish banks are increasingly reliant on earnings from their Latin American operations, and several have expanded their developing world holdings in 2010. For example, Santander bought the rest of its Mexican division from Bank of America Corp for $2.5 billion, while the Spanish bank BBVA took joint control of Turkish peer Garanti Bank in a $5.8 billion deal.

Beyond these financial linkages, FDI flows may also be affected, in particular to Latin America. Approximately 13 percent of FDI flows into the region in 2009 came from Spain, and that ratio is as high as 25 percent in Argentina and Mexico. Moreover, these high-income European economies are important trading partners for many developing countries (Figure 21). The Middle-East and North Africa, Europe and Central Asia and Sub-Saharan Africa regions have the closest trade ties Greece, Ireland, Italy, Portugal and Spain. At the country level, these countries account for 20 percent or more of the exports of Albania, Azerbaijan, Cameroon, Cape Verde, Morocco, Tunisia, and Namibia. How hard these countries are hit, will depend on the extent of the fiscal contraction initiated, and how successful they are in shifting sales to other markets.

Simulations conducted in the context of June's edition of Global Economic Prospects, suggest that a major default could have cumulative impacts as high as -4.1 percent of global GDP in the event of a serious loss of confidence (World Bank, 2010).

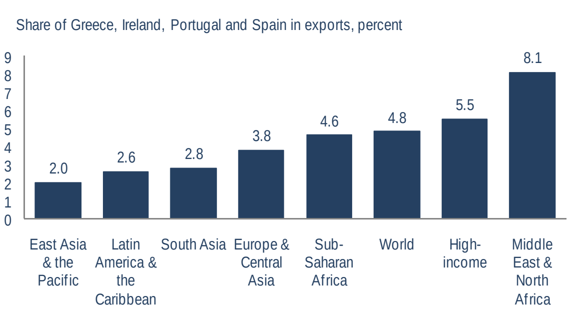
Implications of low interest rates for developing countries

The very different stances of macroeconomic policy being pursued in developing and high-income countries is another source of short-term risk. As discussed above, most developing countries have closed or are near-to-closing output gaps, while many high-income and developing European and Central Asian economies are still plagued by high unemployment and GDP levels well below pre-crisis growth trends.

As a result, in contrast to the immediate post-crisis period when macroeconomic policy throughout the globe was strongly expansionary, many developing countries are now tightening policy, even as high-income countries maintain an overall loose stance.

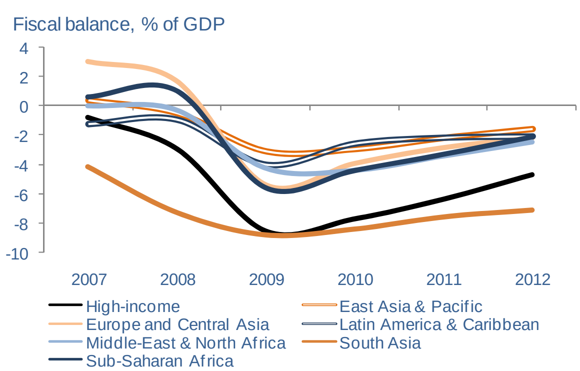
Thus, fiscal deficits are estimated to be less than 4.5 percent of GDP in every developing region except South Asia, where the ratio is estimated to top 8 percent in 2010 (Figure 22). Moreover, though fiscal policy is tightening in some high-income countries, it remains very loose (more than 10 percent of GDP in the United States,

Figure 21 Trade linkages with stressed economies



Source: World Bank, Comtrade.

Figure 22 Fiscal policy is much more relaxed in high-income countries



Source: World Bank.

Box 4 Alternative policy reactions to increased capital inflows

Policy makers can pursue a variety of strategies, none of which are mutually exclusive, when faced with strong capital inflows.

Perhaps, the simplest reaction is to allow the currency to appreciate. Such a policy has the advantage of preventing capital from adding to inflationary pressures (under perfect flexibility, foreign financial inflows have no impact on the money supply), but does so at the risk of causing long-term damage to their export and import-competing sectors.

Alternatively, countries can try to manage the upward pressure on the currency by accumulating reserves. This has an initial effect of increasing domestic money supply, which can be countered through monetary policy tightening. In some cases, this sterilization strategy may amplify inflows by magnifying the interest-rate differential between the country at the receiving end of the carry trade and the interest rates paid by investors abroad. In such instances, monetary tightening can be pursued through administrative rules, like increasing bank's reserve requirements.

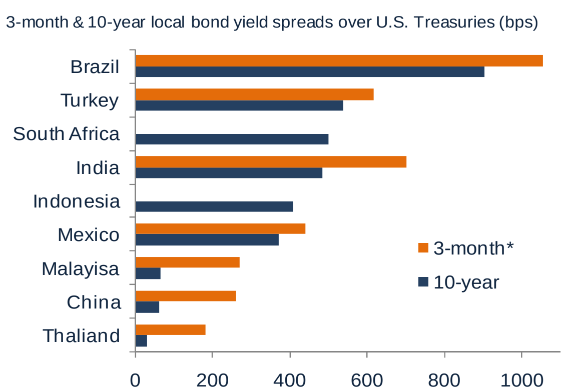
A third option is to try to dampen the capital inflows or encourage outflows with some form of capital controls or other regulatory strategies. These can involve the relaxation of pre-existing restrictions on outflows, the introduction of taxes on short-term foreign holdings or even stricter prohibitions on certain kinds of capital inflow.

To the extent that sterilization efforts are stymied in this manner, the capital inflows can expand domestic credit, generate inflation and spur asset bubbles.

more than 7.5 percent in Japan, and just under 6.5 percent in the Euro area).

Monetary policy is also at odds. Several developing countries (Brazil, China, India, Malaysia, Peru, Indonesia and Thailand to name few) have taken steps to tighten monetary policy toward a more neutral stance to preempt, or counter, rising (or already high) inflation. In

Figure 23 Large interest rate differentials between high-income and developing economies.



Source: World Bank, Bloomberg.
Note: 3-month yield data for Indonesia and South Africa are

contrast, monetary policy in high-income countries remains extremely loose, with nominal short-term policy interest rates close to zero, and real rates in negative territory.

Large-scale asset purchases and quantitative easing have also pushed down long-term interest rates.[10] As a result, even after the recent surge in yields that followed increased market concerns about fiscal sustainability in Europe, 10-year U.S. treasuries are still yielding a very low 3.3 percent, while similar German bonds are yielding 2.9 percent. As a result the gap between high-income and developing country short and long-term interest rates are high (Figure 23), contributing to a carry-trade where investors borrow in low interest rate high-income countries and invest in higher interest-rate developing countries.

Dealing with surging capital inflows

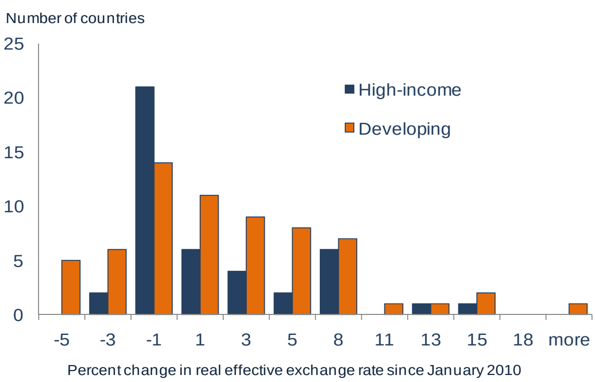
As discussed above, the recovery in capital flows to developing countries in 2010 reflects both these countries strong fundamentals and the very low opportunity cost of money implied by these low borrowing rates. Most developing countries

Table 5 Selected measures recently implemented to contain exchange rate pressures

Country		Measures taken
Brazil	·	Oct 18: Increased IOF tax on bond inflows to 6% from previously 4% (Oct 5) and 2% (Oct 22, 2009);
	·	IOF tax rate on nonresidents' margin deposits for derivative contracts was hiked from 0.38% to 6%
Chile	·	Administrative measures to reduce exporters' transaction costs
Colombia	·	Intermittent $20m daily purchases in spot market for 4 months, started in March 2010
	·	In November 2010, reduced tarrifs
	·	Proposed elimination of tax exemption for foreign borrowing;
Mexico	·	Policy of reserve accumulation, central bank selling dollar put options of $600m per month
China	·	Eased restrictions on foreign banks' investments in yuan-denominated Chinese bonds held offshore
Indonesia	·	July 7: Implemented a 1-month minimum holding period for central bank money market certificates
Korea	·	Implemented caps on size of banks' FX derivatives books as "macro-prudential measures".
Thailand	·	Imposed a 15% tax on interest income and capital gains earned by foreign investors.
Russia	·	The central bank abolished the ruble's R26-41 fluctuation band against the 0.55$/0.45€ currency basket in place since January 2009
Turkey	·	Increased daily foreign exchange purchase auction limits to $140m; increased bank reserve requirements, reduced short-term interest rates.
South Africa	·	Intervention in foreign exchange market to build reserves. Residual exchange controls on residents will be relaxed further.

absorbed the increased flows relatively easily, and these flows have played an important supporting role in their recoveries. However, for some others they have created serious policy challenges.

Figure 24 Histogram of real-effective appreciations since January 2010



Source: World Bank, JP Morgan, IMF

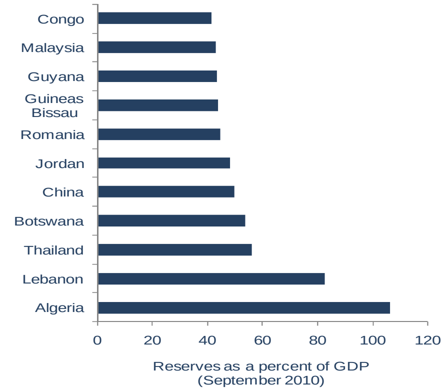
Policy makers can deal with capital flows through a variety of strategies including currency appreciation, sterilized intervention, and different kinds of capital control (Box 4). In the event, most countries have pursued a mix of these strategies. And for most developing countries the upward pressure on their currencies was manageable. Indeed, during the first 10 months of 2010, 60 percent of developing countries appreciated in real-effective terms, either through nominal appreciation or increased inflation, with many appreciating by substantial margins (Figure 24). In contrast, most high-income countries depreciated only marginally.

However, several countries (mainly middle-income countries with well developed debt and equity markets) were subject to very large capital inflows that either have caused their currencies to appreciate by more than warranted by their fundamentals, or have forced them to take extraordinary measures to prevent a disruptive appreciation, including accelerating the pace at which they accumulate foreign reserves, enacting administrative measures aimed at either slowing the rate of capital inflows (or increasing the pace of outflows), including policies to boost outward foreign direct investment (Table 5).

Although the benefits of preventing a too rapid appreciation are real, there are costs associated with resisting appreciation. Among countries that were more successful in resisting the upward pressure on their currencies, several have observed a rapid expansion in the money supply, and signs of mounting inflation pressures in both consumer goods and asset markets (Box 5).

For example, taken together the money supply in Brazil, Russia, China and India grew at a 27 percent annualized pace in 2010, 38 percent in the case of Russia. At the same time, real-estate prices have increased an average of 17 percent per annum since 2007 among the eight East Asian countries reporting data. And, inflation is high or on the rise in many developing countries, notably China, India, Indonesia and Sri Lanka. In Europe and Central Asia rising headline inflation mainly reflects drought-related increases in food prices.

Figure 25 Many countries have reserves in excess of what is required for prudential reasons



Source: World Bank, IMF IFS.

In addition, there are real fiscal and developmental costs associated with reserve accumulation. Several developing countries now have reserves that exceed 40 percent of their GDP (Figure 25). The costs of holding such large reserves can be high (especially considering the exchange rate risk when they are concentrated in one currency). For example, the

Box 5 International capital flows and macroeconomic volatility

International capital flows can play an important role supplementing domestic savings and overcoming deficiencies in domestic intermediation systems. However, they can be disruptive if they are volatile or exceed a country's capacity to sustainably absorb them.

The situation can be particularly dangerous when the influence of capital inflows on a country's currency becomes a factor inducing further flows. Although initially inflows may have been attracted by fundamentals, investors may redouble efforts because of the quick returns that can be made by investing in an appreciating currency. Such a strategy is inherently unstable. The initially self-reinforcing cycle of expected-appreciation-induced capital flows will inevitably and abruptly reverse itself when the ultimately unsustainable tensions produced by the speculative bubble (lost competitiveness, large current account deficits, increased indebtedness) eventually cause a sudden reversal in expectations. In the interim, for individuals and firms that invest in relatively liquid and or short-term assets, and who assume that they will be able to exit the market before the currency depreciates, the potential rewards of betting on further appreciations are large.

Faced with large inflows countries can allow their currency to appreciate, which will reduce the competitiveness of domestic industry, increase imports, reduce exports and lower domestic activity. Assuming that the increase in inflows is permanent and not so large as to exceed the economy's ability to adjust and appreciation may be the best strategy for a country to follow.

Alternatively, if the capital inflows are too large or viewed to be the result of temporary or speculative factors and therefore likely to reverse themselves in the future, a country may choose to resist the upward pressure on its currency. Indeed, as the crisis of 2008 in Europe and Central Asia bears testament, excessive capital inflows can distort the structure of demand and prove very burdensome and costly to unwind.

cost of holding foreign reserves equal to 50 percent of GDP could be as much as 1 1/2 percent of GDP per year (assuming the sovereign borrowing rate is 300 basis points higher than the reserves themselves earn). If a country is financing the deficit by issuing long term paper, and its reserves are mainly invested in short-term USD securities — which are currently yielding less than 1 percent, the financing costs could be closer to 3 percent of GDP.

Not only is maintaining large scale reserves expensive it denies resources to other growth-enhancing activities, such as infrastructure investment, education and health spending. For countries like China that have been resisting upward pressure on their currency for years, the recent decision to allow the currency to float more freely is likely to bring important advantages to the economy, including increased incomes and consumption opportunities for the poor, while at the same time helping to control domestic inflationary pressure as the cost of imported goods decline. Indeed, even more real appreciation in line with underlying productivity growth differentials may be warranted.

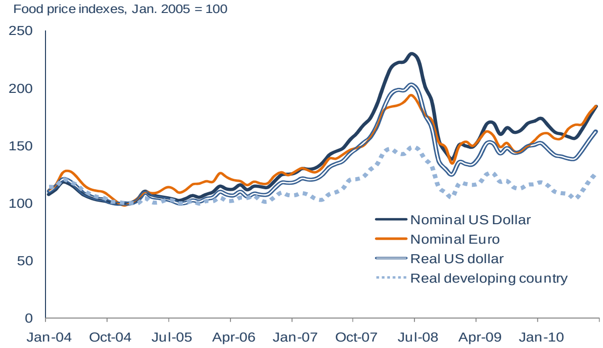
Nor can the success of such strategies be guaranteed. Despite efforts to control inflows and resist appreciation, Brazil, Colombia, Thailand and South Africa were among those countries whose currencies appreciated more than 7 percent in real-effective terms since January 2010, and by between 20 and 30 percent since January 2009.[11]

Among countries where inflows are of a more temporary nature and where overheating is becoming an increasing issue, a significant further tightening of fiscal policy may be required to tighten demand conditions in the domestic economy.

The search for yield may also be affecting international commodity prices

The gap between high-income and developing country macroeconomic policy has also affected commodity markets, both because of exchange rate movements and because of the search-for-yield that low interest rates have induced.

Figure 26 In real-terms food prices remain well below 2008 peaks



Source: World Bank.

The dollar prices of virtually every commodity grouping rose during the second half of 2010 (see the appendix on commodities for more information on recent commodity market developments), suggesting that common factors may have been at play. Part of the explanation lay in the depreciation of the U.S. dollar during the course of the year. While the dollar value of commodities was rising, expressed in Euros and until mid 2010, commodity prices were more stable (Figure 26).

Indeed, the depreciation of the dollar against most currencies, and the cumulative effect of the rise in price of other goods and services, means that during the past few years, the real at-the-border local currency price of internationally traded commodities in developing countries has increased much less than the U.S. dollar price normally quoted (Table 6). In economies where currencies have appreciated against the dollar, until most recently real prices have been broadly stable.

For example, despite the rise in the nominal dollar price of food, across developing countries considered as a whole, real local currency internationally-traded food prices in September 2010 were 25 percent higher than they were in January 2005 and almost 15 percent below their mid 2008 peaks. Since, then U.S. dollar prices have risen a further 17 percent, which has likely brought these real-at-the-border local currency

Box 6 The recent rise in international food prices, implications for poverty

The sharp rise in the dollar price of internationally traded grains in the second half of 2010 induced fears of a repeat of the 2008 food crisis, with potentially dire consequences for poverty. Although international food prices in dollar terms ended the year 7 percent below their June 2008 peak, in real local currency terms they remain 30 percent below that level, and indeed are broadly in line with levels observed in 2005. By implication, notwithstanding the recent acceleration in prices, the global poverty implications should — for the moment — be limited.

The real concern lies in the possibility that prices continue to rise, either because energy prices rise (as they did in 2008) or because further negative supply shocks result in a second year of bad crops. In such circumstances, prices could continue strengthening and become once again a major source of increased poverty. And while global developments ultimately are critical determinants of the long-term trend of local prices, in the shorter-run they are one of many influences.

Ultimately for the poor, what matters is how the prices of the foods that they consume evolve relative to their own income. Here the story becomes much more complicated. The vast majority of food consumed in the developing world is produced locally. Internationally traded maize, rice and wheat represent between 7 and 19 percent of global production of these grains, and a much smaller share of total food consumption in developing countries. The price of the food actually consumed by the poor depends more on local crop conditions, taxes, subsidies, transportation and distribution costs, than it does on movements in international dollar prices and exchange rate movements.

As a result, even as international wheat, maize and rice were rising in the summer of 2010 due to poor crops in several major grain exporting countries, prices at the local level were rising even more quickly in countries where local conditions were weak, and declining much more sharply in countries where local conditions had improved (including in many African countries) — see Table S4.3 in the Commodity Annex. Moreover, consumers have substitution opportunities among various food commodities.

While a rising trend in internationally-traded food prices would be of concern, the recent rises have not yet been reflected in local prices of maize, rice and wheat in many countries. And even where they have, they may overstate the increase in the cost of food actually consumed by the poor.

prices closer to their peak 2008 levels.

Of course, what matters for poverty is what happens to the prices paid by the poor for the food they consume, relative to their incomes (Box 6). And, while international prices play an important role in determining local price changes over the longer run, both the level of, and short-run changes in, local prices depend importantly on local production conditions, trade policies, infrastructure and distance from major production centers.

Table 6 Commodities domestic pricing

	September 2010 price relative to January 2005			
	Nominal USD	Nominal euros	Real USD	Real developing country
Energy	70	71	50	22
Metals and minerals	132	133	105	76
Agriculture	90	90	67	26
Food	84	84	62	25

	September 2010 price relative to June 2008			
	Nominal USD	Nominal euros	Real USD	Real developing country
Energy	-43	-32	-43	-43
Metals and minerals	7	27	6	-18
Agriculture	-11	6	-11	-8
Food	-20	-5	-20	-15

Source: World Bank.

Another common factor frequently debated has been increased investor interest in commodities as a new asset class, with relatively low correlation with other assets. According to this view, the emergence of actively traded commodity-based investment vehicles in recent years has allowed financial speculation in commodity markets to expand, thereby contributing to higher price volatility. Following this logic, low interest rates may be driving even more investors into taking such commodity positions. While intuitively reasonable, to-date empirical studies have produced mixed evidence on the effect of investment fund activity on

Box 7 The evidence for and against investment-based demand and the rise in commodity prices

For much of the 20th century regulations in the U.S. and elsewhere limited the extent to which financial investors could take positions in commodity markets. A reform of these rules in the U.S. in 2000 opened the door for investors to take indirect positions in commodities and commodity futures, mainly in the form of market index funds. These allow non-commercial actors (e.g., managers of sovereign wealth funds, pension funds, and other entities) hold commodities in their portfolios to hedge against future inflation (Hamilton 2010), diversification (Gordon and Rouwenhorst 2004), higher returns (Rogers 2004), or because of the belief that commodities (especially from extractive industries) have entered a long period of increasing prices, also known as the super-cycle hypothesis (see Heap (2005), Jerrett and Cuddington (2008), and Radetzki and others (2008)).

Investment in financial vehicles has grown rapidly during the past 5 years. As of mid-2010, $320 billion were invested in commodities (more than half in energy), about 1 percent of the assets held by global pension and sovereign wealth funds.

Despite the “smoking gun” of a substantial rise in the price of commodities along with the increase in financial investment in commodities, most industry and econometric studies (see Baffes and Haniotis, 2010 for a review) have failed to establish a strong link between these investments and the rise in commodity prices. However, more recent academic papers are increasingly leaning towards the view that investment has been responsible for at least part of the volatility in commodity prices during the post-2000 period.

commodity prices (see Box 7).

A final factor cited, and one that underpins some market expectations that commodity prices (especially metals and minerals) are destined to continue rising relative to other goods and services, is based in the strong growth of developing countries, their rising share in global commodity demand and their growing economic weight. According to this view, the world may be entering into a super-cycle during which commodity prices will continue to rise (or stay elevated) as supply seeks to meet demand.

Once again, the evidence is mixed. The growing size of developing countries and their progression up the income scales are all factors that are likely to increase their demand for commodities. The issue, however, is whether or not supplies can keep pace. Although supply growth over the past 15 years in a number of metals and energy products has been relatively slow, this reflects a period when prices were low and demand growth slower.

Prices are now higher, making economically viable exploration projects and known reserves that could not be profitably pursued when prices were lower. The question is whether supply will respond rapidly enough to meet that demand (and importantly how higher prices will affect demand). For most metals and energy sources, experts concur there are no impending supply constraints, and that today’s prices (or prices close to them) will induce sufficient new investment and supply so as to meet demand.

However, there are investment lags and long lead-times necessary to develop large, complex projects. Moreover, there are issues concerning access to resources, rising monopoly power (in the case of oil), higher costs, and diminishing returns. Technological change, substitution toward relatively abundant alternatives and the cost-structure of known but as yet unexploited reserves are among the factors likely to limit the increase in prices over the medium term.

Longer-term risks and policy challenges

How policy moves forward in the near term may have important long-term consequences as well. Currently, policy continues to be focused on dealing with the immediate (mostly demand oriented) repercussions of the global financial crisis. So far, this focus has paid dividends and spared the global economy from what could have been a much deeper and long-lasting recession. Increasingly, however, the remaining challenges are structural rather than cyclical in nature, implying a decreasing role for demand management going forward. Policy needs to begin shifting its attention to dealing with these more difficult problems if solid medium-term growth rates are to be re-established.

Restoring market confidence by implementing credible fiscal consolidation packages that support structural reform

The strong counter-cyclical fiscal policy response in the immediate wake of the crisis played an essential role in ensuring that a more worrisome and deeper downturn was avoided. However, the current stance of policy in many countries cannot be maintained without running into serious debt sustainability issues.

While fiscal consolidation measures can have negative impacts on growth in the short-run, they can make important positive contributions to future growth, especially when compared with a situation where debt dynamics are allowed to grow to the point they become or are expected to become destabilizing (see for example, European Commission 2010).

For maximum efficiency, the path back to a sustainable fiscal stance needs to be clearly articulated and credible (i.e., market participants need to believe that they are achievable and that governments are committed to carrying through with them). Simulations suggest that, if credible, the negative short-term effects of even a large-scale fiscal consolidation program can be quickly overcome by the positive effects it has on borrowing costs and the expectations of investor about future tax rates (see World Bank, 2010 for the case of fiscal consolidation among G-20 countries).

To maximize their effectiveness, consolidation measures need to re-establish the long run sustainability of public finances and contribute to resolving pre-existing structural problems in economies. For example, in many high-income European and developing Europe and Central Asian economies with aging populations, a well designed consolidation program might include reducing age-related contingent liabilities such as benefits in unfunded pay-as-you-go pension systems. In South Asia, plans might combine efforts to improve the efficiency of expenditure by reducing the extent of subsidization while at the same time increasing taxes so as to better mobilize domestic resources (tax revenues in several countries are less than 10 percent of GDP). In Latin America and the Caribbean the focus needs to be more on putting in place countercyclical fiscal tightening, both to reduce inflationary pressures, and to restore the fiscal buffers that served the region so well in responding to the acute phase of the financial crisis.

Conclude the financial-sector reform agenda

While financial markets have withdrawn from many of the activities that generated the worst excesses of the boom period, and which lay at the center of the crisis, the re-regulation agenda is not yet complete. As a result, the risk is that the same (or different) kinds of behaviors may redevelop, setting the stage for a new crisis. Indeed, the very low interest rates that characterize the current policy environment, while designed to prevent deflation in high-income countries, are promoting many of the same kind of risky behaviors that preceded the crisis, including capital inflows attracted by unsustainable expectations of currency appreciation, search-for-yield motivated investment in risky ventures, and bubbles in real-estate and financial markets.

The nature that these reforms should take, and the balance that they should strike between encouraging more responsible lending on the one hand and prudent risk-sharing on the other, goes beyond the scope of this report. But given the integrated nature of global financial markets, reforms will need to extend beyond individual national efforts. Strong global coordination may not be required. However, recent efforts within the context of the G-20 to agree a set of principles (including cooperation among national supervisory authorities) that take account of developing-country concerns and could be implemented at the national level are likely to be a critical element in the final reform.

Reforms might include greater global regulatory and supervisory coordination, the inclusion of explicit macro-prudential risk assessment

Box 8 How much demand slack is there?

Among the many challenges facing policymakers following a major financial crisis is determining how much of the resulting slack is structural and how much reflects insufficient demand. The January 2010 edition of *Global Economic Prospects* (World Bank, 2010a) explored the sensitivity of potential output to investment rates, while the fall edition of the IMF's *World Economic Outlook* (IMF, 2009b) examined the impact of past financial crisis on potential output of those countries most directly involved. The World Bank study indicated that even for countries not directly involved in the excesses of the boom period, scarcer capital and higher borrowing costs could reduce potential output growth rates by as much as 0.5 percentage points for several years resulting in a reduction in potential output of about 4 percent. The IMF work, which is explored in more detail in Abiad and others (2009), reports that on average for countries directly involved in a financial crisis, potential output was 7 percent lower than it would have been in the absence of the crisis even 7 years afterwards.

The very concentrated nature of unemployment in the United States, high-income Europe and developing Europe and Central Asia suggests that some significant portion of current joblessness may be structural in nature.[i] In the United States 46 percent of all the job losses between August 2008 and September 2010 were in the construction and manufacturing sectors, sectors that combined represented only 15 percent of employment at the outset of the crisis. Similarly, of the net job losses in the EU (over 4 million) between 2008 and 2009 occurred in these two sectors. In Russia, for instance, almost 2/3 of the two million jobs lost between 2008 and 2009 were in manufacturing and construction. Those job losses were concentrated in western Russia, Moscow and the Urals — the industrial heartland of both the Russian Federation and the whole CIS region.

Moreover, in Europe job-losses have been geographically concentrated, with Spain accounting for over a third of all EU job losses between 2008 and 2009. Indeed, unemployment in Germany is actually lower now than it was in August 2008 in stark contrast with Greece, Slovak Republic, Ireland and Spain where it increased by 4 percentage points or more.

[i] IMF (2010) estimates that between 1 and 1¾ percentage points of the 3.5 percent of the labor force increase in unemployment since August 2008 may be structural in nature. Similarly, Fujita (2010) finds that the extension of unemployment benefits has caused workers that would have otherwise left the labor force to remain, raising the reported unemployment by between 0.9 and 1.7 percent of the labor force.

mandates with a cross sectoral focus that addresses those weaknesses. Also, the "perimeter" of the regulatory and supervisory frameworks should be widened, to include what is sometimes called the "shadow banking system" (hedge funds, OTC derivative markets, etc.), previously largely excluded from usual supervisory and prudential requirements. The creation of the Financial Stability Board to coordinate the development and implementation of effective regulatory, supervisory and other financial sector policies may help in this regard.

Similarly, G-20 commitments to reduce procyclicality in financial regulation are welcome steps, such as the promotion of over-the-cycle provisioning should be introduced, so that banks prepare for downturns in times of windfall profits. Increases in the capital requirements of banks may also be required so that they are better able to deal with losses (this discussion is incorporated in the so-called "Basel III" rules). Additionally, the role of credit rating agencies in sanctioning certain types of risk provisioning and "herd-like" investment behavior by banks and other economic agents (like investment and pension funds) should be addressed.

As fiscal policy is scaled back, greater emphasis should be placed on targeting measures that support structural and labor market adjustment

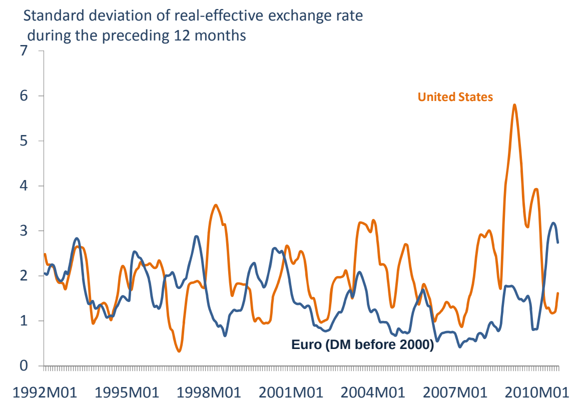
As the recovery progresses and the extent of demand slack in the economy shrinks (Box 8), an increasing share of it will be concentrated in those sectors, such as construction, that grew unsustainably large during the boom period. To be effective, fiscal policy needs to become increasingly targeted on assisting unemployed workers in these sectors to move into new areas, both to avoid the potential scarring effect of an extended period of unemployment, but also to support growth in new healthy sectors of the economy. In this regard, studies suggest that the growth impact of targeted fiscal measures can be larger than those of untargeted actions (European Commission, 2010a). For example, investment support measures can have effects 4 times as large, and credit to liquidity constrained households up to 2 times as large as blanket support measures. In regions such as Europe and Central Asia where significant barriers to labor mobility remain, targeted reforms can deliver between 50 and 80 percent of their long-run growth gains in as little as two years after implementation.[12]

Policy may also need to focus on improving competitiveness, both through productivity enhancing micro-economic reforms (including governance, investment climate, infrastructure, education, and energy efficiency), and better macroeconomic management. Research suggests that increasing competition in wholesale sectors and the reduction of the administrative burden (area-wide weaknesses) and some labor-market reforms (reduction of benefit replacement rates and wage mark ups) are relatively fast-acting (European Commission, 2010b).

Finally countries may wish to accelerate moves towards more flexible exchange rate regimes

Among the lessons to be learned from the crisis and the ensuing recovery, which is consistent with lessons from the great depression (Eichenberg and Wilson, 2010) is that economies with floating exchange rate regimes, suffered less economic distortions during the upswing of the cycle and therefore less disruption during the crisis. For example, countries in Europe and Central Asia that followed less tightly managed exchange rate regimes were better able to absorb the shocks of

Figure 27 Increased volatility of major reserve currencies may be of long-term concern



Source: World Bank, IMF IFS, JP Morgan.

the crisis. In contrast, those that went into the crisis with less flexible regimes, suffered the most in terms of inflationary pressures, asset–price bubbles and the accumulation of (unhedged) external liabilities. During the recovery phase, some of these countries have moved toward more flexible frameworks (Belarus, Russia and Ukraine), that have allowed for necessary adjustments to proceed in a smoother fashion.

Stresses in the United States and the euro zone may have longer-term implications for the international financial system

The very loose monetary policy and the depreciation of the dollar may be having impacts on global confidence in the dollar as the international reserve currency, which could have important and potentially unforeseen longer-term consequences. The situation is made all the more uncertain given that globe's second major currency, the euro, is also facing serious challenges arising from the sovereign debt crisis. Although unlikely, should conditions in sovereign debt markets and the economies concerned deteriorate much further, confidence in the euro as a reserve asset could be affected.

Indeed, over the past several years, both the value of the euro and the U.S. dollar have oscillated a great deal (Figure 27), potentially reducing their qualities as a stable store of value that partly explains their use as international currencies. Although the past offers little in the way of strong parallels, earlier episodes of sustained weakness in the international monetary system have been associated with significant economic upheavals. Both the abandonment of the gold standard during the great depression, and the collapse of the Bretton Woods system during the 1970s were associated with extended periods of slow growth.[13]

To date the dollar remains and is likely to remain for a long-time the dominant reserve currency in the global economy (as witnessed by financial markets return to dollar safe-haven assets during times of crisis). In the long-run a gradual move toward reliance on new or additional currencies is both likely and arguably desirable. In the medium-run, however, were the dollar and euro to cease anchoring the international monetary system as they have until now (as unlikely as such an event may be), this could give rise to a further bout of protectionism and disruptive exchange rate volatility, with damaging effects for global growth and poverty reduction.

Concluding remarks

The global economy is transitioning from the bounce-back phase of the recovery toward a period of slower but more sustainable growth. Growth in most developing countries is increasingly running into capacity constraints, while in high-income and developing Europe and Central Asia growth is hampered by the concentrated nature of slack and ongoing restructuring. In this environment, policy needs to be moving away from short-term demand stimulus toward measures that generate additional employment by enhancing the supply potential of economies.

The global policy environment has become highly charged and uncertain, and presents multiple risks to prospects for developing countries. As emphasized at the recent G-20 meetings in Seoul (G-20 2010), both developing and high-income countries will need to take care to minimize the negative external consequences of their domestic policy actions. Concretely, this means that while countries must remain mindful of domestic conditions, when opportunities present themselves to pursue domestic policy objectives in a manner that support adjustment elsewhere in the global economy these should be taken up.

In general, for developing countries, macroeconomic policy needs to tighten. For many countries this implies reducing fiscal deficits and replenishing some of the fiscal space that was expended in the immediate wake of the crisis. It also means tightening monetary conditions. This can be achieved both through higher interest rates and regulatory changes, but also through controlled currency appreciation in line with underlying differentials in productivity growth— something that the recent easing in capital inflows may make easier.

Notes

1. Alternatively pre-crisis production levels could be dated mid 2007, the point when industrial production in high-income countries began to decline. The August 2008 date has the advantage of being more directly related to the financial crisis, and preceding the point in time when activity collapsed. Indeed, arguably the process of until-then orderly unwinding of domestic and global imbalances was unfinished in August 2008 and both trade and industrial production were above their equilibrium levels.

2. Although in the classical Keynesian framework a tightening of fiscal policy would result in slower growth, under Ricardian equivalence this effect may be offset if firms and consumers recognize that the increased frugality now means less taxes and stronger income growth in the future (as compared with the no action alternative) and therefore spend more now.

3. At this stage, the cyclical recovery is broadly complete among developing countries so no further increase in savings rates is anticipated.

4. The countries in the Europe and Central Asia that are undergoing significant restructuring include: Albania, Armenia, Azerbaijan, Bulgaria, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Lithuania Moldova, Macedonia, FYR, Romania, Russian Federation, Ukraine and Uzbekistan

5. The 6 developing countries undergoing the most serious restructuring include: Bulgaria, Kazakhstan, Lithuania, Romania, Russian Federation, and Ukraine.

6. Nine countries (Brazil, China, India, Indonesia, Malaysia, Mexico, South Africa, Thailand, and Turkey) received [95%] of portfolio equity and [74%] of short-term debt flows and almost half of bond flows in 2010.

7. Maldives, Lesotho, Costa Rica, Venezuela and Kiribati also appreciated sharply for diverse reasons — including being pegged to an appreciating middle-income currency and high inflation.

8. A fragile state is defined as an IDA-eligible (International Development Association), low-income country or territory (including those countries which may currently be in arrears) with a Country Policy and Institutional Assessment (CPIA) score of 3.2 or below or those countries without a CPIA score. CPIA rankings are revised annually and are available at http://www.worldbank.org/ida/idalloc.htm.

9. The EU/ IMF funded Irish package came in at €85 billion versus market expectations of €100-120 billion, with €17.5 billion of it is actually to come from Ireland's own pension fund.

10. Initially the primary motivation for these non-traditional interventions was to stabilize these markets (including those for long-term government bonds, secondary mortgages, and corporate bonds). Increasingly, they seek to stimulate demand by reducing long-term real interest rates both by lowering nominal rates and raising inflation expectations.

11. Of course, higher inflation and an appreciating real exchange rate are part and parcel of the process of economic development, and therefore all emerging economies shall experience that. Here we distinguish between this long term, unavoidable and ultimately beneficial trend and the short run overshooting caused by unsustainable capital flows.

12. In particular, the reduction of mark-ups in wholesale sectors and the reduction of the administrative burden (region-wide weaknesses) deliver between 50 and 80% of all their long-run growth gains in as little as two years after implementation (European Commission 2010).

13. As today, the causality is likely two way. Real-side weakness contributed to a dilution of international confidence in the international monetary system, which exacerbated the real-side crisis. (see Eichengreen and Irwin 2010 for an interesting discussion in the context of Great Depression and the end of the gold standard).

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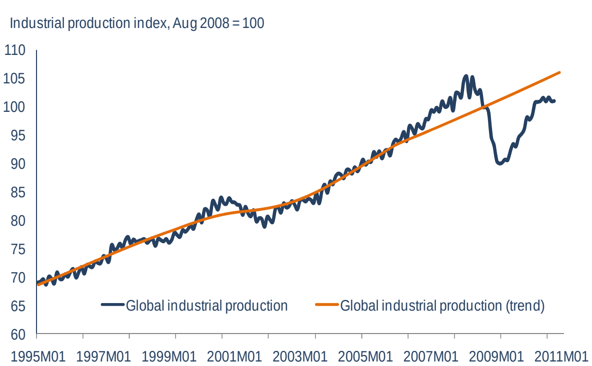
Topical Annex

Estimating the degree of economic slack: capacity utilization and potential output

After plunging at annualized rates of nearly 25 percent in early 2009, global industrial production growth peaked at 15.6 percent in February 2010, then declined moderately in the first and second quarters, slowing abruptly during the third quarter, with growth effectively stalling by October 2010 (Figure S1.1). Notwithstanding the sharp rebound in activity during the first half of 2010, by October 2010 global industrial production was 1 per cent above its pre-crisis levels (August 2008). However, industrial production was 4.6 percent away from where it would have been if "normal" trend growth had been maintained, where during the boom period 2005-2010 trend growth is assumed to be equal to the median growth rate observed over 2000-2005 of Hodrick-Prescott-smoothed industrial production (Figure S1.2).[1, 2]

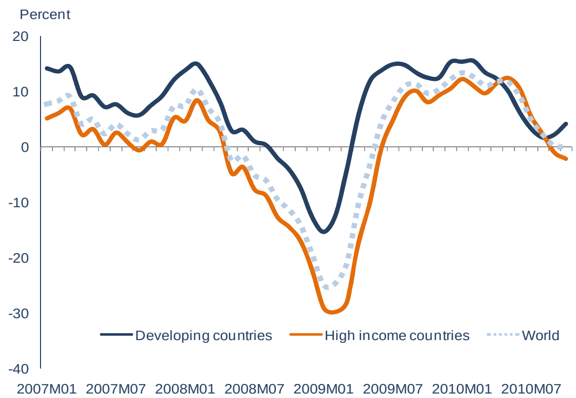
The industrial production growth cycle has been highly synchronized across developing and high-income economies (Figure S1.1). However, this masks large differences in the depth of post crisis troughs across regions, and the extent to which the subsequent recovery has managed to bring industrial production back to pre-crisis levels and how much spare capacity remains.

Figure S1.1 Global industrial production yet to fully recover from crisis



Source: World Bank.

Figure S1.2 Global industrial production growth slowing

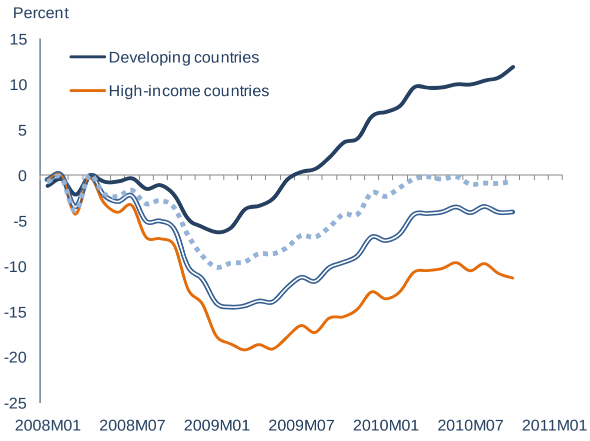


Source: World Bank.

When October 2010 industrial production levels are compared to their respective 2008-peaks (defined as maximum monthly industrial production level attained during calendar 2008), then developing countries (largely on the back of China and India), have surpassed earlier peaks by 11.99 percent, while high-income country and world production is still 11.3 and 0.7 percent respectively below pre-crisis peaks (Figure S1.3). However, if current levels of production are compared to where it would have been in the absence of a boom and bust cycle between 2005 and 2009, developing countries production is almost back to its underlying trend levels, which we define here as full capacity utilization (Figure S1.4).[3] Based on this notion, developing countries considered as a whole have regained full capacity utilization, although industrial activity in the Europe and Central Asia region remains some 17.0 percent below capacity, while in China and India it is about 0.5 and 6.1 percent above. For the remaining developing countries, as of October 2010 there remains about 5.7 percent spare capacity.

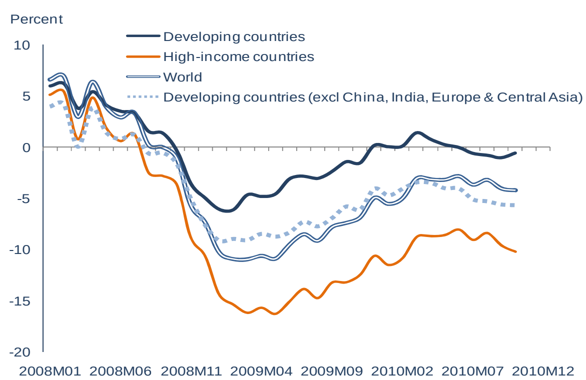
This sharp divergence between the amount of spare capacity available in developing and high-income countries is not only related to the extent

Figure S1.3 industrial production recovery when compared to 2008 peak



Source: World Bank.

Figure S1.4 industrial production recovery compared to "trend"



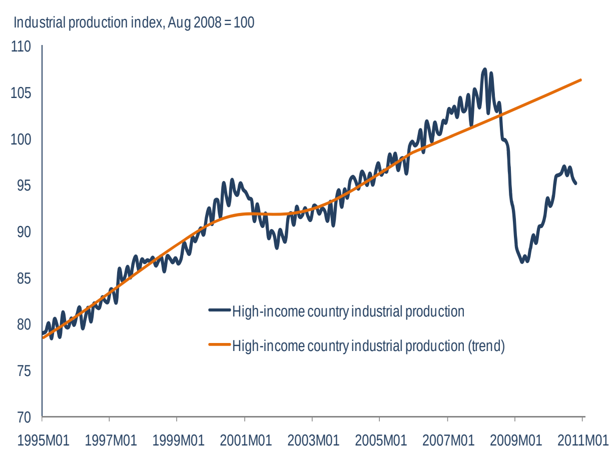
Source: World Bank

of production decline during the crisis, but also to where the respective economies were in the cycle, when the crisis started. Due to the pre-crisis boom, plants in developing countries were operating at levels significantly above "trend". Although developing country industrial production was already decelerating (and moving back to trend), it was still some 1.5 percent above full capacity in August 2008—just before the onset of the crisis. At that point, industrial production in high-income countries was already operating at some 2.6 percent below "trend", while overall global production (reflecting the weighted share of developing and high-income country industrial production) was marginally below "trend". This implies that even if production were to fall by similar percentages across all regions, high income country troughs would have been much deeper, due to the already below "trend" industrial production levels when the crisis started.

However, because the financial crisis having directly originated in high-income countries and because of very strong North-North trade linkages, industrial production in these economies plunged sharply and more steeply than in developing countries. Moreover, as markets stabilized and recovery set in, the rebound was not as strong as in some developing countries. The peak annualized growth rate of high-income country industrial production during the rebound period was 12.6 percent in May 2010 versus 15.8 percent for developing countries, despite the fact that the troughs was deeper in high-income countries. As a result of this steep decline, deep trough and more "moderate" recovery, by October 2010 high-income country industrial production was still some 11.3 below pre-crisis peaks, while spare capacity was estimated to be in the order of 9.6 percent (Figure S1.5). For example, as of October 2010, there remains 8.3 and 9.8 percent of spare capacity in the United States and the Euro Area.

With developing countries less directly affected by the financial crisis, industrial production was not only less affected, but the recovery started

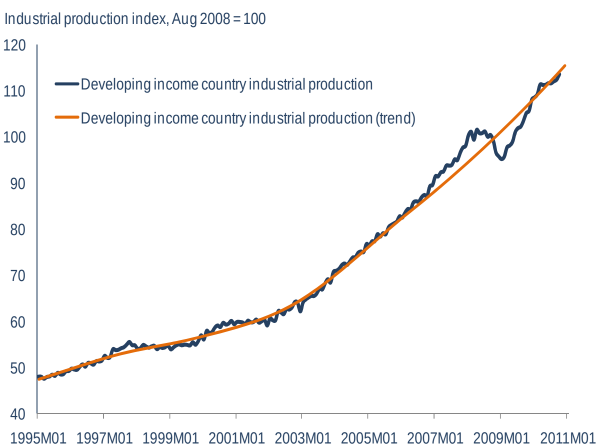
Figure S1.5 High income country industrial production remains well below trend & spare capacity high



Source: World Bank.

earlier and the rebound was stronger (albeit from a higher base). For instance, at its trough, industrial production was only 6.2 percent below pre-crisis peaks, at that point translating into just more than 5.7 percent spare capacity. Moreover, the pace at which output contracted in developing countries -15 percent (saar) was about half the 30 percent pace recorded in high-income countries (Figure S1.6), while the rebound was stronger - (15.8 percent versus 12.6 percent in high-income countries.

Figure S1.6 Developing country industrial production levels fully recovered from crisis & nearly back on trend



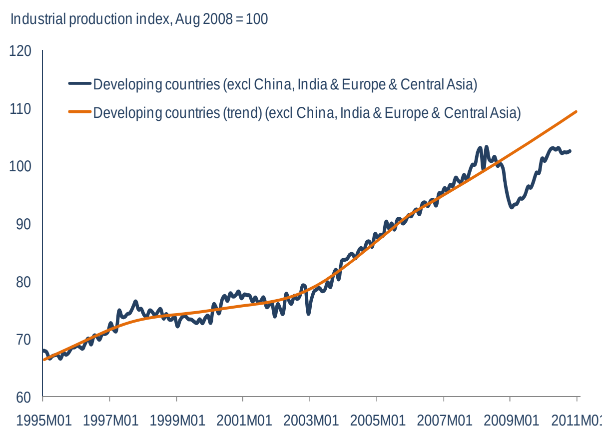
Source: World Bank

But even among developing countries there are significant divergences between the size of post-crisis troughs, the extent of the recovery and the remaining spare capacity. The global recovery was to a large extent driven by the turnaround in China, where output growth reached 27.2 percent in May 2009. Despite slowing thereafter to more sustainable rates, by November 2010, Chinese industrial production was 32.8 percent higher than its August 2008 level and exceeded its pre-crisis trend levels by 0.5 percent. Output in India followed a similar pattern, with output exceeding pre-crisis level by 21.1 percent in October 2010.

In contrast, output in the developing Europe and Central Asia region was hard hit by the crisis, and as a result, as with high-income countries, there remains significant spare capacity. Current industrial output levels are still around 17 percent below pre-crisis trend levels, output is about some 6.7 percent below pre-crisis peaks.

Excluding China, India and developing Europe and Central Asia, industrial production in the remainder of developing countries was 0.8 percent below pre-crisis peaks in October 2010 and there was about 5.4 percent of spare capacity (Figure S1.7). With the exception of Europe & Central Asia, Middle East & North Africa and Sub Saharan Africa (and in the latter case, almost entirely driven by Nigeria and South Africa which makes up 75% of monthly available industrial production data for the region), spare capacity in most countries and developing regions have either surpassed or are very close to trend production, with virtually no spare capacity remaining (Figure S1.8).

Figure S1.7 Industrial production recovery in developing countries (excl China, India and ECA)



Source: World Bank

The extent of spare industrial spare capacity is only a partial and limited measure of slack in an economy, where in many countries the majority of employment and GDP is in the services and agricultural sectors. The notion of potential output is the whole economy analog of manufacturing capacity. The World Bank's econometric model comprises estimates of potential output for some 156 countries, based on a somewhat more sophisticated approach than the one outlined above for industrial production.

Box S1.1 Estimating potential output in developing countries

The notion of potential output used here was introduced in the 2010 edition of Global Economic Prospects: Finance, Crisis and Growth, and is based on a hybrid production-function model of potential output similar to that used by the Congressional Budget Office (CBO) in the United States, the OECD, the European Commission and the Federal Reserve Board (CBO, 2001, OECD 2008; Cournède, forthcoming; and Denis and others 2006). In this model the supply side of GDP is described by a simple Cobb-Douglas function of the form

$$GDP = AK^{\alpha}L^{1-\alpha}$$

where GDP is gross domestic product, K is the capital stock, and L is labor employed. Potential output is the level of output attained when the entirety of the capital stock and effective labor supply is employed. Replacing L with the working-age population (P1565), the labor force participation rate (Pr), and the unemployment rate (UNR) gives

$$GDP = AK^{\alpha}(P_{1565} * Pr * (1 - UNR))^{1-\alpha}$$

And stating everything in growth terms gives

$$\dot{y} = \dot{TFP} + \alpha\ \dot{K} + (1-\alpha) * (\dot{P}_{1565} + \dot{Pr} + (1 - \dot{UNR}))$$

Assuming that all of the capital stock and all of the labor force are fully employed (UNR and Pr equal their equilibrium values), that all of the services of the available capital stock are used, and that total factor productivity (TFP) is growing at its trend rate gives an expression for the rate of growth of potential. For most developing countries, we do not have reliable economy-wide data for Pr and UNR, so for the purposes of calculating the rate of growth of potential, it suffices to assume that the equilibrium unemployment and participation rates are constant, which leaves us with

$$\dot{y} = \dot{TFP} + \alpha\ \dot{K} + (1-\alpha) * (\dot{P}_{1565})$$

as an expression for the rate of growth of potential output.

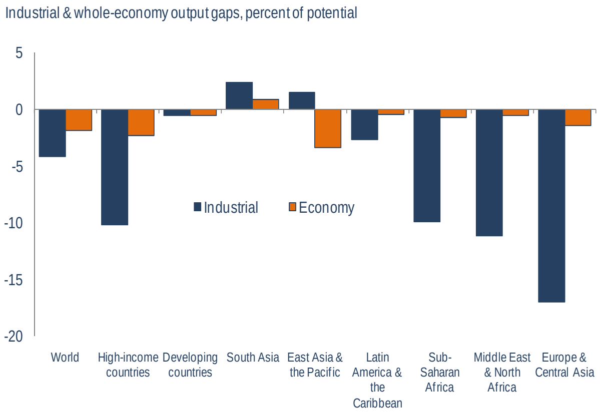
The capital stock in the World Bank model is estimated using the perpetual inventory method from investment data (running from 1960 in the case of most countries) and assuming a depreciation rate of 7 percent (IMF 2005).

TFP is calculated as the Solow-residual, i.e. it is equal to the change in value added (GDP) not explained by the sum of the weighted changes in labor- and capital inputs. This TFP calculation includes the 2010-2012 period, where GDP, labor and capital stock values are based on a first-run model forecast. The TFP series is then smoothed using a Hodrick-Prescott filter. However, to address Hodrick-Prescott filter end-point problems, the calculated TFP series is extended to 2020 on the assumption that TFP growth over 2013-2020 is equal to the median TFP growth rate observed between 1995 and 2005 (i.e. excluding the excesses associated with the boom period). The calculated TFP values over the entire period (i.e. 1960 - 2020) is then smoothed using a Hodrick-Prescott filter. The model is now solved for a second time, this time using the smoothed Hodrick-Prescott filtered TFP growth rates, to calculate potential output and output gaps.

In that approach potential output is based on a constant returns-to-scale Cobb-Douglas production function with fixed factor share parameters[4] and Hicks-neutral technology. Potential output is thus the level of output attained when the entirety of the capital stock[5] and effective labor supply[6] is employed, while total factor productivity (TFP) is growing at its trend rate.[7] The output gap (or economy wide capacity utilization) in turn refers to the gap between actual and potential GDP. For example, a positive output gap (or positive economy-wide capacity utilization figure) would imply that actual GDP is larger than potential output and vice versa. And a negative output gap of 5 percent is analogous to a positive 5 percent level of spare capacity, except that the first measure refers to the whole economy and the second only to the industrial sector.

Because the industrial sector of the economy was among those hardest hit by the crisis, economy-wide gaps in 2010 are in most instances significantly smaller than industrial spare capacity—depicted in the figure as a negative (Figure S1.8).

Figure S1.8 Industrial spare capacity and economy wide capacity utilization across regions



Source: World Bank

Notes:

1. Trend output was estimated using a Hodrick-Prescott filter (Lambda 14400), fitted through monthly data spanning the period 1995 – 2005. The chosen period thus excludes the excesses associated with the pre -crisis "boom" years in the sustainable (industrial capacity) trend calculation. Post 2005, trend growth was set at the median HP filter trend growth rate observed between 2000 and 2005.

2. Hodrick-Prescott filters have well-known shortcomings, including ignoring the underlying productive structure and end-point bias. In some studies Kalman filters has been used to address these shortcomings (See for instance D'Auria, F. et all, "The Production Function Methodology for Calculating Potential Growth Rates and Output Gaps", European Commission, Economic Papers. 420. July 2010. Brussels.)

3. Industrial capacity refers to the HP filter values of industrial production (see previous footnote) – and may/may not relate to actual observed physical capacity. Capacity utilization is defined as actual industrial production divided by industrial capacity and expressed as a percentage, while the deviation from full (i.e. 100 per cent) capacity utilization gives our notion of spare capacity.

4. The share of capital (labor) in total output was assumed to be a uniform 30 (70) percent in all developing countries.

5. Capital stock was estimated using the perpetual inventory method from investment data (running from 1960 in the case of most countries) and assuming a depreciation rate of 7 percent (IMF 2005).

6. Effective labor supply here refers to a labor force which is fully employed, i.e. the natural rate of unemployment is in equilibrium.

7. TFP is the smoothed Hodrick-Prescott filter values of the Solow-residual. For more information, see Box A2.1.

Prospects for financial markets

- The on-going recovery in international capital flows reflects both push factors and pull factors. Push factors include low short-term interest rates in advanced economies and their sluggish growth prospects and heightened risk. Among pull factors are the strong growth prospects of developing countries, their higher interest rates, and their generally strong fundamentals, which has contributed to improving credit quality and ratings, particularly as compared with high-income countries.

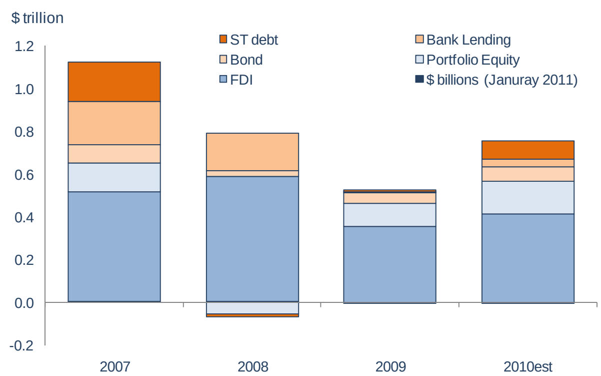
- The recovery has been sharp in short-term lending (mostly in form trade credit), considerable in portfolio equity and bond flows; modest in FDI (supported also by increasing South-South FDI). While net medium and long-term bank lending also improved significantly relative to 2009 levels, it remains well below its historical average. The nature of the recovery generated challenges for several middle income countries to preserve competitiveness during a sluggish economic recovery.

- The share of developing countries in global financial flows increased considerably in 2010, continuing a trend that began in the early 2000s, reflecting improved fiscal deficits and debts, more effective monetary policy regimes, and improved credit ratings.

- While economic rationale is in favor of developing countries with higher growth and improved risk profile, policies in developed (monetary tightening/protectionism in the face of high unemployment) and developing countries (capital controls) will shape the level and the composition of the capital flows in coming years.

International capital flows to developing countries recovered strongly in 2010. Net private capital flows to developing countries rebounded by 44 percent in 2010 reaching an estimated $753 billion (4 percent of GDP). The rebound came after two years of sharp declines: 36 percent in 2008 and 27 percent in 2009 that brought net flows from $1.1 trillion (8.1 percent) in 2007 to $522 billion (3.2 percent) in 2009 (Figure S2.1). All types of flows have improved. Portfolio equity and bond flows increased by a 40 and 30 percent, respectively; while FDI inflows rose a relatively modest 16 percent. In percentage terms, short-term loans (less than one year's maturity) rose the most 1250 percent, and net medium and long-term bank lending the second most (1000 percent), but both came from close to zero levels in 2009. While short-term debt flows reached more than 75 percent of their average 2005-2007 level, longer-term bank lending remained only one-third of past levels.

Figure S2.1 International capital flows, 2007-2010e



Source: World Bank.

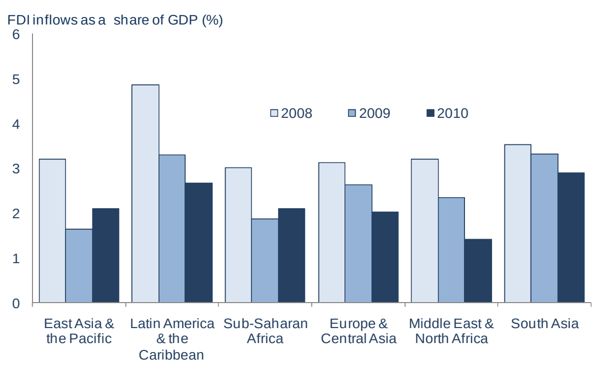
Short-term debt flows (debt with an original maturity of one year or less) to developing countries jumped to an estimated $86 billion in 2010 from $6.4 billion in 2009.[1] These flows were highly concentrated in few middle income countries, and considerable portion of it is trade–related. The largest jump was in China, where the stock of short-term debt reached a record $440 billion in the second quarter of 2010, almost half of all short-term debt owed by developing countries.

Bond and equity flows both increased by more than 30 percent reaching $153 and $67 billion, respectively. Sixty-seven percent of the increase in bond financing was due to increased issuance by private sector borrowers, who took advantage of high-income investor's search for yield to issue bonds, partly compensating for still weak bank-lending. Several developing country sovereign also successfully floated bonds at attractive yields. Developing country corporates also raised capital through initial public offerings (IPO) and equity issuance in international markets with two record breaking deals in 2010, including a world record $22.1 billion IPO (both domestic and international) by first Agricultural Bank of China, and another world record equity sale of $70 billion by the Brazilian oil company Petrobras in September. Because the Brazilian government took a large stake in the deal, only $26.5 billion was recorded as foreign capital inflows.

The 16 percent recovery in FDI inflows in 2010 was more modest than that of other flows, especially considering the sharp 40 percent decline that was observed in 2009. FDI inflows to developing countries totaled an estimated $410 billion in 2010 and remain the largest component of the international capital flows to developing countries. The recovery was not even across regions, however. As a percentage of GDP, FDI flows expanded significantly in East Asia and Pacific and Latin American regions and slightly in Sub-Saharan Africa. Elsewhere, FDI continued to declines as a percent of GDP (Figure S2.2). Outward FDI flows originating in developing countries rebounded almost twice as quickly (up 35 percent), with South-South flows—particularly from Asia—among the fastest growing categories of FDI (Box S2.1).

Disbursements of medium and long-term bank

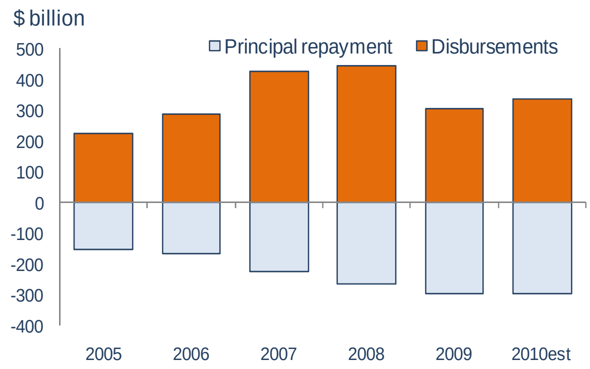
Figure S2.2 Uneven rebound in FDI inflows across regions



Source: World Bank.

loans to developing countries increased by $34 billion in 2010, while repayments fell by $4 billion (Figure S2.3). As a result net flows $3.2 billion to $38 billion. The fall in repayments was the first during the decade and reflects the sharp decline in new loans in 2009. Gross syndicated bank loans also increased in 2010 totaling $100 billion up from $76 billion in 2009.

Figure S2.3 Disbursements on bank loans increased, while repayments decline slightly



Source: World Bank.

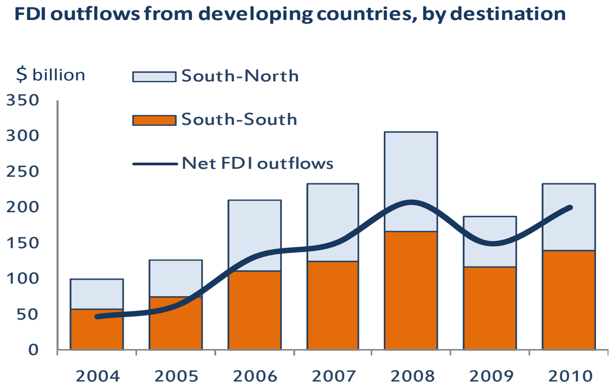
The share of developing countries in global financial flows increased considerably in 2010, continuing a trend that began in the early 2000s. Due to progress in capital account liberalization, improved macroeconomic conditions, and stronger investment climates, financial markets increasingly view developing countries as being less risky. As a result, the premium charged to developing country borrowers have been declining, a process that the events of the past two years have accelerated. In particular, the Euro area turmoil in May and November of this year saw risk premiums on the debt of several high-income countries rise, even as those of developing countries did not (see Figure 17 in the main text). As a consequence, there has been a sharp decline in international financial flows such as FDI, bank lending and equity flows to these high-income countries. Meanwhile, the resilience of developing countries during the crisis plus their better growth prospects has increased their attractiveness as a destination for external financial (and real) investment.

Box S2.1. Outward FDI flows from developing countries are increasing, notably South-South FDI flows.

After a short-lived setback in 2009, investment flows from developing countries are back on their upward trend and reached an estimated $210 billion (1.1% of GDP) in 2010. The economic crisis had dampened developing countries' outward investment in 2009, when FDI declined by 28 percent to $149 billion following $207 billion in 2008. Despite its severity, that decline was significantly below the 45% drop in FDI flows from developed countries. Normally FDI is relatively resilient, but these sharp declines reflected parent companies reliance on international debt markets to finance their overseas expansions and the drying up of this kind of financing. FDI outflows from developed countries did not expand as rapidly as FDI from developing countries and as a result the share of developing country in global FDI outflows reached 18 percent, almost double the 10 percent average of previous three years.

FDI outflows from the BRIC (Brazil, the Russian Federation, India and China) continue to lead, accounting for more than 60 percent of outward FDI (OFDI) flows from developing countries. In terms of destination, detailed cross-border M&A and Greenfield data shows that sixty percent of the OFDI flows from developing countries went into other developing countries, mostly in the form of greenfield investments. Developing country FDI into high-income country mainly takes the form of mergers and acquisitions (M&A). The difference between the sum of the M&A and greenfield data and OFDI may be the result of underreporting of OFDI flows from developing countries as well as the fact that actual cross-border flows from an M&A transaction might be less than its face value.

Box Figure S2.1 FDI flows from developing countries recovered in 2010

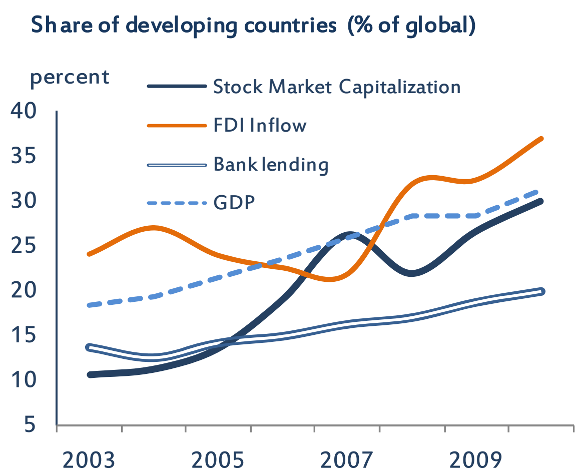


Source: World Bank Global Development Horizons (2011), forthcoming.

With the sharp decline of OFDI flows from developed countries since the crisis, the importance of investment from other developing countries (South-South FDI) increased and accounted for an estimated 34 percent in 2010 compared to 25 percent in 2007. With the acquisition of telecom company Zain Africa by Indian Bharti for $10.7 billion earlier this year—the largest South-South M&A deal and other large mergers in the sector, services sector contested the dominance of extractive sector in South-South flows in 2010.

As a result, the trend rise in the share of developing countries in global asset allocation has intensified, even though in some cases because of lower global flows this amounts to a larger share of a smaller pie. For example, the share of developing countries in global FDI inflows increased to 37 percent in 2010 from an average 30 percent in previous three years (Figure S2.4). Similarly, increased equity flows have boosted market valuations in developing countries such that their share in global market capitalization has risen from about 14 percent in 2005 to roughly 30 percent in 2010—more or less in line with their share in global GDP. International banks also appear to be shifting funds towards fast growing emerging markets. Provisional data through September 2010 show that while total claims (both international and local currency) by BIS reporting banks on high

Figure S2.4 Investors are shifting their asset allocations towards developing countries



Source: BIS, Global Stock Market Factbook, and World Bank .

income countries continued to decline. In contrast BIS claims on developing countries increased, raising their share in BIS banks total claims to 19 from 15 percent in 2007.

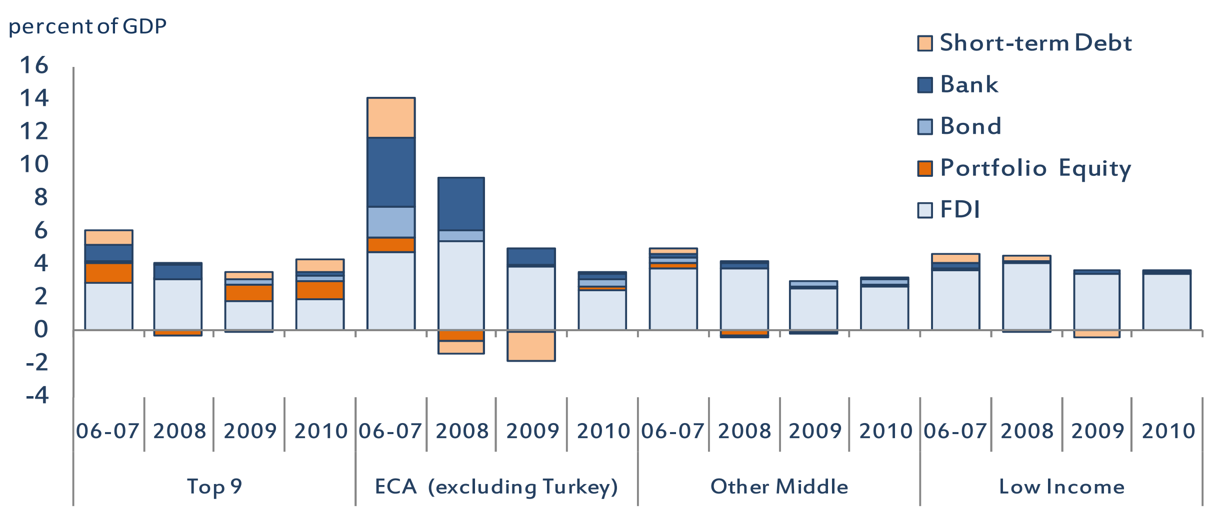
The nature of the recovery in capital flows has concentrated the benefits in a few middle income countries. Much of the recovery in capital flows has been in portfolio equity, bond financing and short-term debt, all of which are highly concentrated among middle-income countries, in contrast with FDI inflows and bank lending, which tend to be more evenly distributed among middle- and low-income countries. Ninety five percent of portfolio equity flows, 78 percent of short-term debt and almost half of bond flows go to the top 9 countries (China, Brazil, India, Turkey, South Africa, Mexico, Indonesia, Thailand and Malaysia) that account for 63 percent of developing country GDP. In fact, half of the 128 developing countries received no portfolio equity flows in 2010 and almost 70 percent of them have never accessed international bond markets.

International capital flows to the top-nine countries increased from 3.4 percent of their GDP in 2009 to an estimated 4.3 percent in 2010. Nevertheless, it remained well below the 6.1 percent during the 2006-2007 pre-crisis period (Figure S2.5). As a percentage of GDP, all types of capital flows except bond flows increased and contributed to the recovery in 2010.

The recovery was more subdued for other countries and mostly supported by the reversal of short-term debt flows from negative to positive territory (i.e. short-term debt stock in 2010 was higher than its 2009 level). For Europe and Central Asian countries, improved access to international bond markets also helped to compensate for the continuing sharp declines in FDI and bank lending. These countries entered the crisis with excessive reliance on external debt flows and were most affected by it. Currently, although capital flows to the region are well off their boom-period highs, expressed as a share of GDP they are now much closer to the levels observed in other developing countries.

Other middle income countries (excluding the top 9 and those in developing Europe and Central Asia) and low income economies benefited from stable FDI flows as a percent of the GDP in addition to the rebound in short-term debt. In particular, FDI remains the most important capital flow for low income counties and helped these economies to weather the crisis relatively better than the middle income countries in terms of capital flows.

Figure S2.5 The recovery was more evident in few middle income countries and relatively modest in other countries

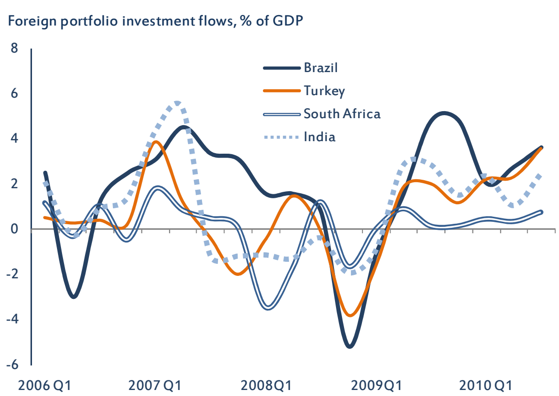


Source: World Bank.

The surge in capital flows generated challenges for the top recipient countries. Over the past two years, record low interest rates in the U.S., Japan, and the European Union have prompted investors to borrow cheaply and invest in high-yielding markets. Investors are attracted to developing countries both because of their stronger growth potential, and because as these countries move to tighten monetary policy their interest rates are rising even as they remain low in high-income countries. Resulting capital flows have accentuated the attraction putting upward pressure on the currencies of several countries. Inflows into fixed-income and equity funds focusing on emerging markets, for example, have received record volume of $150 billion in 2010 compared to $110 billion in 2009 and $82 billion in 2007. Emerging market exchange-traded funds have also attracted robust inflows as well, with an estimated $35 billion, compared with $14.4 billion in 2009. These factors continue to fuel large cross-border inflows to equity and debt security markets in Brazil, Turkey, South Africa and few Asian economies (Figure S2.6).

By the end of October 2010, the portfolio investment flows (portfolio equity and local debt securities) had surged in Turkey (reaching 17.8 billion) and South Africa ($13.4 billion). October flows were particularly strong for both Brazil and India, as they were $14.5 billion and $28.7 billion, totaling $62.7 billion and $50 billion in the first ten months, respectively.

Figure S2.6 Large inflows to their stock markets and local debt securities

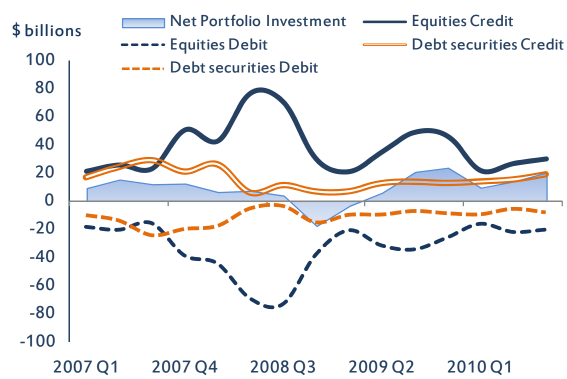


Source: Central Banks and World Bank.

While these net flows are high, they do not fully reflect the capital inflows countries are receiving, partly because stronger gross inflows have been offset to varying degrees by large outflows (Figure S2.7).

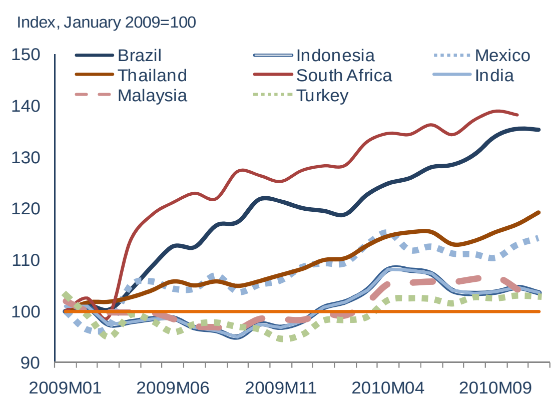
While some countries have resisted the upward pressure on their currencies through sterilized interventions (see main text for a description of the some of the measures undertaken), others have either allowed their currencies to appreciate or been unable to prevent them from doing so. In countries like Brazil, South Africa for example, the local currency has appreciated by more than 30 percent in real-effective terms since January 2009, significantly reducing the competitiveness

Figure S2.7 Gross foreign portfolio investment flows to Brazil have been much higher than the net flows



Source: Central Bank of Brazil.

Figure S2.8 Real effective exchange rate appreciation in selected economies



Source: International Monetary Fund.

of domestic exporting and import-competing firms (Figure S2.8). In other countries, efforts to resist exchange rate appreciation have resulted in rapidly rising credit and localized asset bubbles (for example real-estate prices have been rising at a 17 percent annualized pace in several Asian economies).

Other signs of bubble include the tendency for emerging markets equities to continue rising in price, even though they are no longer cheap relative to developed countries. Developing country equities are currently trading at a premium over mature markets with the relatively higher average price/earnings (P/E) ratio. This said some of high P/E ratios can still be justified by high-returns on equity, low real interest rates and robust growth prospect in developing countries. Furthermore, the benchmark index for developing-country stocks has not yet reached the peak levels of 2007, suggesting that there is still room for further outperformance.

After the U.S. Federal Reserve announcement of $600 billion of long-term government bonds purchase in November 2010 (so-called quantitative easing or QE2), pressures on currencies were expected to be maintained or

Box S2.2. Change in policies toward capital flows: more of this, less of that

Efforts to contain the surge in hot money flows have been widespread among developing countries. Brazil, for example, raised its financial operations (IOF) tax on foreign investments in fixed income securities twice so far: first, from 2 to 4 percent on October 5th, and then to 6 percent on October 18th. The impact of these hikes was short-lived and limited, and was therefore followed by further increases in the IOF tax and reintroduction of 15 percent withholding tax on federal securities are being contemplated. Indonesia imposed a 1-month minimum holding period on central bank money market certificates on July 7th and introduced new regulations on the net foreign exchange positions of banks. Meanwhile, Thailand implemented a 15 percent tax on interest income and capital gains by foreign investors.

On the contrary, China, South Africa, India, and Turkey, which receive high levels of cross-border flows, have not introduced any new measure so far. Rather than new measures, China announced that it will intensify the checks based on existing measures. Also to ease some of the tension, China and South Africa have started to promote capital outflows. China has boosted its support to outward FDI by its state-owned enterprises, state banks and SWFs by a new round of administrative reforms and lowered the quota for its institutional investors to get a license to invest abroad. Similarly, South Africa will relax any exchange control on residents and is planning to change the prudential framework so that pension funds can invest abroad.

The effectiveness of the capital controls in reducing the short-term capital flows is still in question. Empirical evidence suggests that effectiveness of capital controls is of limited duration, and best used when the capital surge is temporary (IMF 2010). In fact, the impacts of the two hikes in IOF tax in Brazil and imposition of 1-month minimum holding period in Indonesia were both short-lived. Also, these types of restrictions on a certain type of flow tend to change the composition of capital inflows rather than their levels, hence may do very little in easing the exchange rate pressures. In some cases, shifting the composition (from short-term to long-term) might be the intended result, as countries would like to receive less short-term capital inflows and more FDI inflows—since FDI flows tend to be more stable and have a stronger impact on economic growth.

The differences in policies across different asset groups may have unintended consequences. For example, when Chile restricted short-term hot money inflows (investment with a horizon of less than one year) in the 1990s, some foreign investors created firms in Chile—technically FDI, whose only purpose and investments were short-term fixed-income instruments. Chile later further tightened its capital controls to prevent such avoidance of inflow controls (Roubini 2010). This type of capital control avoidance might be something to watch as most countries, including those that try to curb hot money flows, have also further liberalized their policies to promote FDI inflows since 2009. India, Indonesia and Malaysia raised the cap on foreign–ownership in certain sectors. China lifted the threshold level of investment that requires state approval. Several regulations were relaxed in most developing countries. Recently, in order to limit similar issues, China announced the intensification of audits of fund repatriation by Chinese companies listed abroad and investments by existing foreign-invested Chinese companies.

Source: IMF Global Financial Stability Report April 2010; Roubini, Nouriel. “How should emerging markets manage capital inflows and currency appreciation?” Roubini Global Economics, November 14, 2010.

even intensify. And despite the uptick in market nervousness in November due to the sovereign debt crisis in Europe, flows toward developing countries eased only temporarily.

However, portfolio investment and short-term debt flows can be volatile and react quickly to changing market conditions (such as a shift in investors' sentiment or monetary tightening in developed economies). Several developing countries have experienced net disinvestment more than once over the years. They were first to fall and plummeted sharply in the last quarter of 2008, for example, as investors retreated from risky assets all around the world including emerging markets but they were also first to recover.

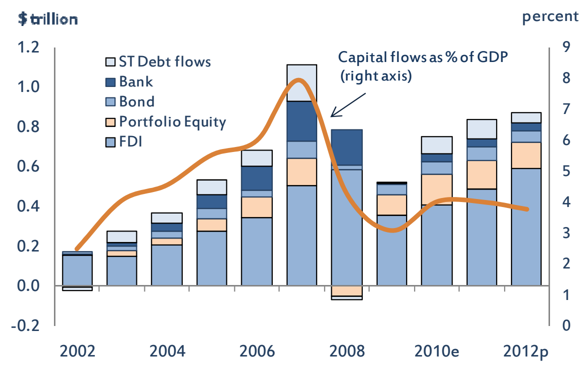
Several emerging economies have voiced concerns about the impact of hot money flows in their economies and signaled further actions to curb them. So far, policy responses to mitigate the short-term impact of these flows have varied from introduction of capital controls (such as Brazil's IOF tax) with limited impact, improvement in screening and implementing existing restrictions on cross-border inflows (such as China) and promoting further capital outflows such China and South Africa (Box S2.2). Some governments have also taken steps to improve their regulations to restrain asset-bubbles. China and Vietnam, for example, have tightened mortgage lending standards or raised the provisioning for the real-estate sector, where such bubbles are believed to have been building.

Prospects: More even recovery ahead

Developing countries with higher growth rates, improved risk profile, and higher interest rates than in high-income countries will continue to be attractive destinations for international capital flows for some time.

Cross-border flows to developing countries are projected to increase further in nominal terms in the medium-term, but with a slower pace than their nominal GDP growth reaching $875 billion (3.8 percent of GDP) by 2012 (Figure S2.9, Table S2.1). Much of the increase is expected to

Figure S2.9 Prospects for capital flows



Source: The World Bank.

be in FDI inflows. While FDI is driven by growth prospects like other flows, the modest recovery in FDI flows vis-a-vis others in 2010 was mainly because of the remaining uncertainties in global economy. According to a recent survey of large multinational companies, extensive downside risks for growth at the beginning of the year, tight credit conditions, and high commodity and food prices that generated fears about cost of production and transportation in the medium term caused many to postpone investment until 2011. These types of uncertainties hinder FDI more than other flows because FDI investment has a longer time horizon (decision to actualization) and exit costs are much higher. As uncertainty surrounding the economic recovery has eased—especially among developing countries, the momentum of M&A in developing countries and greenfield investments accelerated in the second half of 2010, suggesting further gains in 2011 and onwards. As a result, FDI inflows to developing countries are projected to reach $590 billion (2.5 percent of GDP) by 2012. Net bank lending is also expected to rise further up to $42 billion as the health of global banking system improves. Nevertheless, bank-lending levels will be much lower than the recent historical average both because of endogenous deleveraging by global banks, and because of the implementation of new regulations in 2011 that will effectively increase capital requirements and thereby restrict lending.

Toward the middle of 2011, the authorities are expected to begin unwinding the extraordinary monetary measures that have lowered short- and medium- to long-term interest rates. As interest rates in high-income countries return to more normal levels, search-for-yield induced capital flows to developing countries are expected to ease. This will make the international bond markets less favorable for developing country issuers, particularly their non-investment grade corporate borrowers. In addition, many sovereign borrowers have taken advantage of low yields to pre-finance future borrowing requirements and are less likely to issue in 2011 in the face of higher interest rates. Both of these factors will contribute to a modest reduction in bond issuance over the projection period. Similarly, portfolio equity flows are expected to decline slightly next year as the rise in asset prices will gradually limit the return on emerging market assets. Also, there will be a slight contraction in short-term debt flows by 2012 with trade-related flows remaining solid and its speculative portion falling.

With stronger FDI inflows and rising bank lending, both of which are more evenly distributed across countries than other capital flows, low-income countries are expected to benefit more from the increase in flows in 2011 and 2012.

Table S2.1 Capital flows forecast table

Net capital flows to developing countries
$ billions (January 2011)

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	126.6	185.0	322.8	448.9	476.7	434.6	279.6	298.2	272.5	265.9
as % of GDP	1.9	2.3	3.4	4.0	3.4	2.6	1.7	1.6	1.3	1.1
Financial flows:										
Net private and official inflows	262.3	342.2	464.9	610.3	1110.4	743.8	597.9	825.9		
Net private inflows (equity+debt)	274.3	366.3	528.9	679.9	1110.4	716.0	521.5	753.2	838.6	874.5
Net equity inflows	178.8	243.6	341.1	451.0	643.2	533.9	462.2	563.0	631.1	724.2
..Net FDI inflows	152.5	206.7	273.6	343.3	508.1	587.1	354.1	409.6	486.0	589.9
..Net portfolio equity inflows	26.3	36.9	67.5	107.7	135.1	-53.2	108.2	153.4	145.1	134.3
Net debt flows	83.6	98.6	123.8	159.3	467.2	209.9	135.6	262.9		
..Official creditors	-11.9	-24.1	-64.0	-69.6	0.0	27.8	76.4	72.4		
....World Bank	-2.5	2.4	2.7	-0.2	5.2	7.3	17.7	19.3		
....IMF	2.4	-14.7	-40.2	-26.7	-5.1	10.0	26.5	16.3		
....Other official	-11.8	-11.8	-26.6	-42.6	0.0	10.6	32.2	36.8		
..Private creditors	95.5	122.7	187.8	228.9	467.2	182.1	59.2	190.5	207.5	150.3
....Net M-L term debt flows	38.3	69.8	113.3	145.0	283.0	196.1	52.8	104.1		
......Bonds	23.1	34.3	48.3	31.7	88.2	24.1	51.1	66.5		
......Banks	19.5	39.7	70.3	117.9	198.5	176.8	3.2	37.6		
......Other private	-4.4	-4.1	-5.3	-4.7	-3.7	-4.8	-1.6			
....Net short-term debt flows/a	57.2	52.9	74.5	83.9	184.2	-14.0	6.4	86.4		
Balancing item /b	-103.5	-127.3	-372.9	-411.3	-495.5	-700.2	-250.2	-649.0		
Change in reserves (- = increase)	-285.5	-399.9	-414.8	-647.9	-1091.7	-478.2	-627.3	-475.1		
Memorandum items										
Net FDI outflows	23.6	46.1	61.6	130.5	148.7	207.5	153.9	210.0	250.0	275.0
Workers' remittances	137.4	159.3	192.1	226.7	278.0	325.0	307.1	325.0	346.0	374.0
As a percent of GDP										
	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Net private and official inflows	3.88	4.26	4.88	5.42	8.03	4.52	3.72	4.40		
Net private inflows (equity+debt)	4.05	4.56	5.56	6.04	8.03	4.35	3.24	4.01	4.00	3.77
Net equity inflows	2.64	3.03	3.58	4.01	4.65	3.24	2.73	3.00	3.01	3.12
..Net FDI inflows	2.25	2.57	2.87	3.05	3.67	3.57	2.09	2.18	2.32	2.54
..Net portfolio equity inflows	0.39	0.46	0.71	0.96	0.98	-0.32	0.64	0.82	0.69	0.58
..Private creditors	1.41	1.53	1.97	2.03	3.38	1.11	0.35	1.01	0.99	0.65

Source: World Bank.

The outlook for capital flows is still subject to several downside risks, however. First and most immediate is the European debt crisis. While its impact was limited and temporary in 2010, an unexpected disorderly resolution of the debt problem in 2011 might prompt a broad-based risk-aversion in global financial markets driving capital flows toward safe assets—such as US Treasury bonds. This could lead to a sharp reversal in capital flows to developing countries, with a potentially disproportionate impact on countries in developing Europe and Central Asia, whose economies are more closely tied to those in high-income Europe.[2] Second, international capital flows will remain sensitive to differences in the stance of policy between developing and high-income countries. If high-income countries shift toward a tighter policy

Table S2.2 Regional summary table

Net private inflows (equity+debt)
$ billions

	2002	2003	2004	2005	2006	2007	2008	2009	2010e
Developing Countries	147.7	274.3	366.3	528.9	679.9	1110.4	716.0	521.5	753.1
East Asia & Pacific	57.3	83.6	132.2	174.2	201.7	286.1	184.3	186.9	283.3
Europe & Central Asia	32.7	85.8	107.2	156.2	248.9	413.5	251.0	57.6	111.0
Latin America & Caribbean	28.0	57.5	67.3	116.6	86.1	218.5	170.7	147.5	203.4
Middle East & North Africa	12.4	15.6	16.4	22.4	25.7	28.4	22.9	25.5	25.8
South Asia	9.8	18.6	21.5	25.6	73.1	113.3	52.8	68.2	80.7
Sub-Saharan Africa	11.8	13.2	21.7	33.9	44.4	50.7	34.3	35.8	49.3

FDI ($ billion)

	2002	2003	2004	2005	2006	2007	2008	2009	2010e
Developing Countries	154.3	152.5	206.7	273.6	343.3	508.1	587.1	354.1	409.6
East Asia & Pacific	59.4	56.8	70.4	104.3	105.7	177.1	186.6	102.5	150.2
Europe & Central Asia	14.0	23.8	41.9	51.1	92.3	133.2	160.1	85.1	79.0
Latin America & Caribbean	55.2	43.3	65.9	72.2	72.0	109.4	127.9	73.6	99.3
Middle East & North Africa	8.1	10.0	9.7	16.8	27.2	27.6	29.3	24.4	20.8
South Asia	6.8	5.4	7.8	11.2	26.0	32.3	48.7	38.3	28.3
Sub-Saharan Africa	15.2	13.3	11.0	18.0	20.2	28.5	34.5	30.3	32.0

Portfolio Equity ($ billion)

	2002	2003	2004	2005	2006	2007	2008	2009	2010e
Developing Countries	8.3	26.3	36.9	67.5	107.7	135.1	-53.2	108.2	153.0
East Asia & Pacific	3.8	12.5	19.3	25.7	56.2	35.1	-7.3	29.9	37.0
Europe & Central Asia	2.7	1.5	1.8	6.7	12.3	27.0	-15.1	5.0	7.0
Latin America & Caribbean	1.4	3.3	-0.6	12.2	11.0	28.8	-9.7	41.6	54.0
Middle East & North Africa	-0.5	0.2	0.7	2.4	1.0	-2.1	0.4	1.2	1.4
South Asia	1.1	8.0	9.0	12.4	10.4	36.1	-15.8	20.5	43.0
Sub-Saharan Africa	-0.4	0.7	6.7	8.1	16.8	10.1	-5.6	10.0	11.0

Net Private Debt flows ($ billion)

	2002	2003	2004	2005	2006	2007	2008	2009	2010e
Developing Countries	-14.8	95.5	122.7	187.8	228.9	467.2	182.1	59.2	190.5
East Asia & Pacific	-5.9	14.3	42.5	44.2	39.9	73.9	5.0	54.5	96.1
Europe & Central Asia	16.0	60.5	63.5	98.4	144.3	253.3	106.0	-32.5	25.0
Latin America & Caribbean	-28.6	10.9	2.0	32.2	3.1	80.3	52.5	32.3	50.1
Middle East & North Africa	4.8	5.4	5.9	3.2	-2.5	2.8	-6.8	-0.1	3.6
South Asia	2.0	5.1	4.7	2.0	36.7	44.9	19.9	9.3	9.4
Sub-Saharan Africa	-3.0	-0.8	4.0	7.9	7.4	12.1	5.5	-4.4	6.3

Source: World Bank.

stance more quickly, or if markets become increasingly concerned by the buildup of debt and central bank liabilities, longer-term interest rates may begin to rise—raising the cost of capital for developing countries and likely weakening flows. On the other hand, if policy remains loose and pressures on the currencies of developing countries intensify they may take further steps to restrict flows finance, with potentially negative impacts on investment and growth and in a worst case scenario could result in an escalation of protectionist trade measures.

Notes

1. Short-term debt flows are calculated as the change in short-term debt stocks at the end of the year. Hence, flows do not reflect the short-term debt that is issued and repaid during the year.

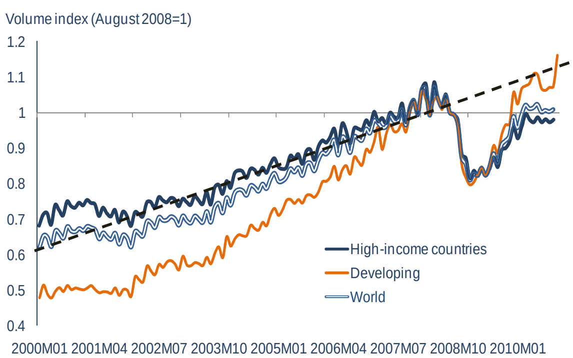
2. Of course a less severe scenario could see the relative position of developing countries improve and capital flows shift from high-income countries to developing countries.

Developments in trade

Just as the unprecedented 17 percent decline in trade during 2009 was one of the major channels for the diffusion of the crisis, it has been a major factor underpinning the recovery in 2010. Global trade began recovering in the second quarter of 2009, and continued growing rapidly for four consecutive quarters, expanding at a 11.9 percent annualized pace during the first ten months of 2010.

World export volumes have regained pre-crisis levels (August 2008). As of October 2010, world export volumes regained all of the losses sustained during the acute phase of the crisis and stood some 0.8 percent higher than their August 2008 levels (Figure S3.1). Although pre-crisis levels have been surpassed they remain below their pre-crisis peaks and about 13.6 percent lower than what might have been expected had the crisis not occurred. Despite the recovery in trade volumes, because of lower commodity prices, the value of merchandise trade remains 8.0 percent lower than its pre-crisis levels.

Figure S3.1 World trade reaches pre-crisis levels



Source: World Bank.

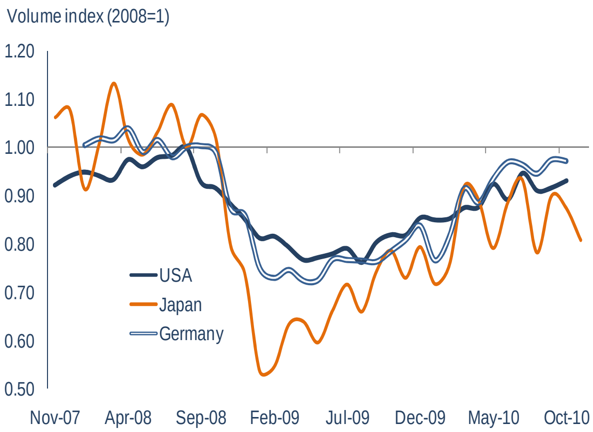
The recovery in trade is more advanced among developing countries than in high-income countries. During the first ten months of 2010, high-income country export volumes grew at a 10.4 percent annualized pace versus 15.5 percent among developing countries. By September 2010, high-income countries export volumes were still some 2 percent below their pre-crisis levels, whereas developing countries were 16 percent above their pre-crisis level by November 2010. All developing regions, have attained their pre-crisis output levels with the so-called BRIC countries charging ahead with export volumes some 21 percent above August 2008 levels in November 2010, whereas Europe and Central Asia lagged behind at 9.2 percent.

Developing countries imports drove the rebound. Much of the increase in world trade was on account of rapidly growing demand from developing countries. Three quarters of the increase in high-income country exports during the first half of 2010 was sold to developing country importers, and overall developing country imports accounted for 58 percent of the increase in global exports during that period.

Much of that import demand was in the form of capital goods, a sector of global activity still dominated by high-income countries. The downturn in global trade was concentrated in investment and durable goods, expenditures upon which can be delayed during periods of uncertainty. Indeed, whereas exports of consumer non-durables fell 20 percent during the crisis, durables and machinery, transportation as well as minerals fell 30 percent. As a result, much of the recovery in trade was in these same categories

With the commencement of the recovery and a firming up of demand, businesses begun replacing their depleted inventories and consumers, aided-on by various government incentives programs, stopped holding back on some big-ticket expenditures such as automobiles. These factors together helped in the rebound in capital goods and consumer durables which account for the bulk of global trade (Figure S3.2).

Figure S3.2 Capital goods exports lead trade recovery in high-income countries (2008=1)



Source: World Bank.

In the euro area, capital goods exports to the rest of the world expanded at a 12 percent annualized pace in the first 7 months of 2010, versus 9 percent for consumer goods. In Japan the boom was more intense, with capital equipment exports rising 40 percent during the 8 months ending August 2010 as compared with the same period the year before. Trade in consumer goods rose less than half as quickly. Similarly, in the US exports of capital goods (excluding automobiles) expanded at 14.0 and 11.5 in the first and second quarters versus 11.0 and minus 4.6 percent for consumer goods.

This surge in capital goods exports has been an important contributor to the recovery in growth. In the US for instance equipment and software spending contributed 1.24 percent, 1.52 percent and 1.02 percent to GDP in Q1, Q2 and Q3 respectively.

…and low-income countries benefitted from the rebound in commodity prices. The increase in the demand for capital goods and durable consumer goods has also led to the recovery in demand for inputs that feed these markets including industrial metals. Partly as a result, industrial metal dependent economies experienced a surge in export revenues. For instance, export revenues in Zambia rose by some 45 percent in 2010 on account of high copper prices. Further, increased remittances to developing countries (up by 6 percent in 2010, compared with a decline of 5.5 percent in 2009) provided support to their current accounts (Box S3.2).

Global trade in services, which proved more resilient to the crisis than merchandise trade, is also on the recovery path. In 2009, services trade fell by 15.5 percent, with the largest decline occurring in the financial, transportation, construction and personal and recreational services. Insurance services fell the least 6 percent. The United States remains the world's leading exporter of services, accounting for 14.8 percent of services trade in 2009. After services exports declined by 6 percent in 2009, it increased by 8.4 percent in the first ten months of 2010, with passenger fares and other travel services leading the way.

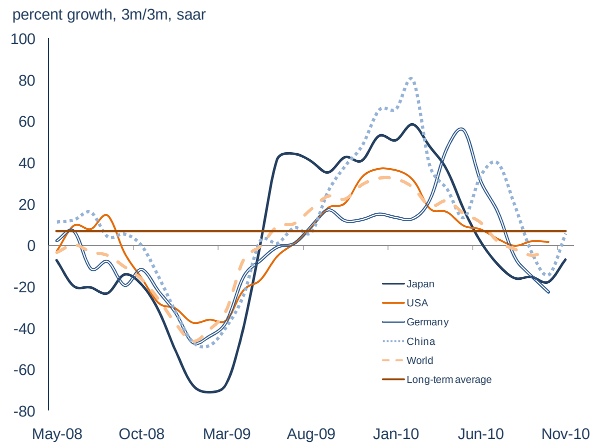
Tourism services, which remains critical for many developing countries also rebounded in 2010. International tourist arrivals fell by 4.2 percent in 2009 (World Tourism Organization), but advanced 7 percent during the first six months of 2010, mainly driven by rising activity in developing economies. Arrivals rebounded in all regions with Asia and the Pacific, the second most visited region globally recording a 14 percent increase in international arrivals. Supported by hosting the FIFA World Cup, sub-Saharan Africa, the only region to have experienced an increase in tourist arrivals in 2009, sustained its growth trajectory with a 16 percent increase during the first half of 2010. Arrivals were 20 percent in the Middle East, 7 percent in the America's and 2 percent in Europe. Nonetheless, the growth in international tourism receipts are expected to lag those of tourist arrivals, because much of the volume increase in tourism reflects more intra-regional travel over shorter periods of time. Further, significant discounting of prices has also taken place to attract tourists. The World Tourism Organization estimates tourist arrivals to have grown by 4 percent in 2010.

Global imbalances have declined substantially and are expected to continue falling. The onset of the global crisis accelerated the narrowing of global imbalances that had already begun in 2006. The increase in public sector and consumer spending in China as well as the increase in household savings rate in the U.S. in 2010 supported this reduction in global imbalances (Box S3.1). Looking forward, the extent to which imbalances narrow further will depend importantly on oil prices; the extent to which fiscal stimulus in the United States is withdrawn as the recovery unfolds, and to which interest rates rise (prompting increased savings behavior). For China, the issue will be the authorities' capacity to maintain the recent shift toward increased domestic spending.

The bounce-back phase of the trade recovery has ended. Many of the factors that helped drive the trade rebound were temporary in nature (e.g. inventory re-stocking, restarting of trade-finance, declines in crisis-induced precautionary savings, and the growth impact of government stimuli packages). As these factors faded, global trade decelerated. Thus after growing at a 21.1 percent annualized rate in the first half, global exports decelerated sharply, declining at an annualized pace of 1.65% in the 3rd quarter (Figure S3.3).

All regions participated in the deceleration. In Japan for instance momentum growth rates peaked at 58.5 percent, but trade was actually declining at 14.4 percent annualized pace during the three months ending October 2010. The deceleration in China was equally brutal, with exports declining at 14.8 percent annualized pace

Figure S3.3 After rebounding world trade volumes have decelerated sharply



Source: World Bank.

in October, after expanding at a peak rate of 79.7 percent pace in February 2010.

Global trade growth still remains below its pre-crisis trend. The long-term average annual growth in global trade volumes during the pre-crisis period (1991-2008) was 7.0 percent. Thus the sharp downward adjustment in global trade growth that occurred in the third quarter points to the fact that global trade growth, post-the bounce back phase, is well below the long-term trend and had not yet stabilized at a new equilibrium by September.

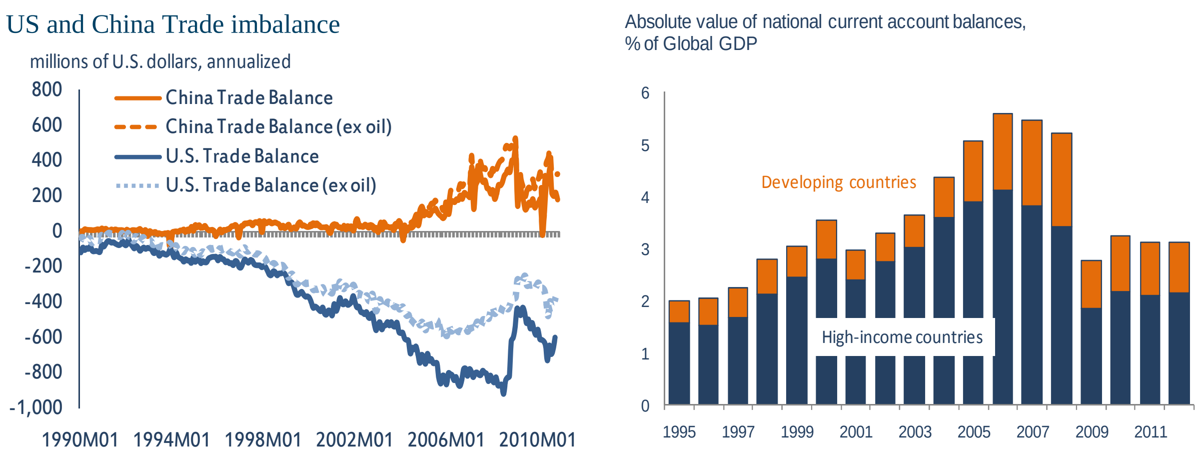
Several factors suggest the pace of recovery will pick-up… While worrisome, the deceleration appears to reflect a temporary pause in trade growth following some overshooting during the bounce-back phase. The most recent trade data for instance points to a slowdown in the pace of deceleration. In October, the pace of deceleration in global trade volumes had moderated to -2.8 percent from the -4.8 percent that occurred in September. Indeed, industrial production after registering a similarly sharp deceleration is now accelerating once again in the fourth quarter.

Box S3.1: Global Imbalances continued decline in 2010.

The onset of the global crisis accelerated the narrowing of global imbalances that had already begun in 2006. Global imbalances (measured here as the absolute value of national current account balances divided by global GDP) peaked at 5.6 percent of global GDP in 2005, and had fallen to 3.9 percent in 2009 and an estimated 3.3 in 2010.

China's current account surplus, which stood at 10.6 percent of GDP in 2007 declined to 5.6 percent of GDP in 2010, reflecting increased imports associated with government efforts to stimulate domestic demand, and higher commodity prices (consumer spending as a share of GDP rose from 8.7 percent in 2009 to 9.3 percent in 2010). Further China's export growth has been constrained by the anemic levels of consumer spending from several high-income OECD countries.

Box figure S3.1 Global trade imbalances have eased substantially



Source: World Bank.

In the United States, large negative wealth effects associated with falling higher prices prompted a large increase in consumer savings, which contributed to a sharp decline in the current account from a high of 6.4 percent in 2006Q3 to an estimated 3.2 percent in 2010. Looking forward, whatever tendencies there might be for consumer savings to decline along with lower unemployment rates and more certain prospects, will be offset by increased public-sector saving and higher interest rates as fiscal and monetary policy is gradually shifted to a more neutral stance. As a result, the U.S. current account deficit is not projected to deteriorate much further, although it will remain sensitive to energy prices and interest rates.

Moreover, demand-side indicators show continued positive growth, and in high-income countries there is reason to believe that the recovery is becoming more broadly based—involving more countries and more segments of aggregate expenditure. In particular, consumer demand, which has lagged business demand throughout the recovery, is showing early signs of adding vigor to the recovery. Retail sales in the U.S grew at 10.1 per cent and 14.1 percent (3m/m, saar) in October and November, after declines in July and August. In Europe, retail sales growth has remained mostly positive throughout 2010. And for large developing countries such as China and India, November retail sales growth was 18.0 percent (3m/m, saar) and 16.1 percent (3m/m, saar) respectively.

Recent Purchases Managers Index (PMI) surveys confirm the slowdown nut no reversal in export orders. Overall, they point to a continued expansion but at lower rate. In December for instance the J.P Morgan Global Manufacturing PMI rose to 55, above the critical 50 mark which indicates that production will be expanding in the coming months. The new export orders sub-component of the index also rose in October, marking a sixteen consecutive monthly increase. More significantly, however, was the pick-up in the rate of growth of new export orders, which accelerated to its fastest pace since July. Similarly, the Baltic Exchange Dry Index, a high -frequency (daily) index of shipping costs for primary commodities has picked up in the fourth quarter – suggesting a revival in the demand for industrial inputs.

In contrast to high-income countries, orders data for Asian economies generally is declining or indicating only modest growth, suggesting that the soft-patch on production in that region may be longer-lived – partly in response to policy tightening and currency appreciation.

Outlook

Against the backdrop of these recent developments, and reflecting strengthening global consumer and industrial demand the expansion is expected to return in coming months and through the forecast horizon. Overall, global merchandise trade is expected to grow by 8.2 percent in 2011 and by 9.5 percent in 2012, with goods and services trade expanding by 8.2 and 9.0 percent in the two years. The contribution of the imports of developing countries to global trade is projected to decline from its 35 percent share in 2010 to around 29 percent in 2012 as the recovery in high-income countries picks up.

As a consequence of the increasing importance of developing countries in global trade, significant changes to trading partners could occur over the forecast horizon. In 2004 the United States and the E.U. accounted for some 40 percent of Japan's exports. By 2008 their share had fallen to 31.7 percent and with the crisis hitting both the U.S and the E.U harder they accounted for 28.6 percent in 2009. This trend has however persisted during the recovery phase. For the first ten months of 2010, a further 2.1 percent drop in export shares to these two economies occurred.

At the same time, China became an increasingly important destination for Japanese exports, accounting for 19.2 per cent of Japanese exports during the first ten months of 2010, compared with 13.1 percent in 2004. If these trends continue, over the forecast period China could become equally important or possibly a more important export destination than the E.U. and U.S. combined. Similarly, China is on route to become the largest destination for U.S. exports, having already overtaken Mexico and closing in on Canada's lead. In December 2004, U.S's share of total trade with Canada was 19.5 per cent whereas China accounted for 10.1 per cent. By September 2010 Canada's share of US's total trade had fallen to 16.4 per cent and China's share had risen to 15.4 per cent.

South-South trade is also growing. Just as developing countries are becoming increasingly important markets for high-income exporters, so to are other developing countries becoming more important destinations for the exports of developing countries. China, in particular has become an increasingly important export market for all developing regions. In Sub-Saharan Africa, China's voracious appetite for commodities has led to a significant increase in trade with the region. However, China's trade with sub-Saharan Africa is not only in merchandise trade, indeed an increasing proportion of bilateral flows is also occurring as services trade. The Forum on China Africa Cooperation (FOCAC) reports that as of August 2010, Chinese projects in Africa had reached $205.2bn since 2000. Most of these projects were infrastructure related such as the construction of roads (60,000km in total) and building of power plants (3.5 million kw of total generating capacity).

The growing importance of developing countries in global trade has implications for the structure of global trade. Because demand patterns in developing countries are different than in high-income countries, their growing share in global imports is shaping the product structure of global trade. Rapidly industrializing developing countries demand proportionately more industrial raw materials, energy and food products, as opposed to manufactured consumer goods and non-tradeable services. Hence with the growing importance of developing countries as an engine of growth, this is likely to sustain the high increases in commodity prices that occurred in 2010 over the forecast horizon (see commodities annex).

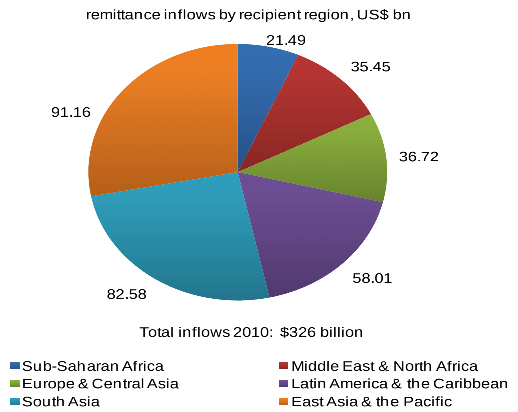
Although progress has been limited, concluding the Doha process remains critical to maximizing the potential benefit to developing countries from trade openness. With global growth set to slow in 2011(see main text), efforts to spur trade such as through the conclusion of the beleaguered Doha Development Agenda should be encouraged. The continued proliferation of bilateral and regional trade agreements only partly compensates for the lack of multilateral progress and has eroded the preferential margins of many low-income countries. A multilateral deal that takes into account the supply-side constraints in low-income economies, and therefore allows for greater transition periods and better market access opportunities for agricultural goods as well as processed commodities would be more development friendly than the current system. Nevertheless, some of the largest barriers to trading developing country goods and services are imposed by other developing countries. Removal of these barriers could reap significant benefits, spurring an even faster expansion of South-South trade.

Box S3.2 Prospects for remittances

The global recession of 2009 took a toll on the flow of remittances to developing countries from expatriate workers overseas. Economic activity in the high-income countries softened or declined, unemployment increased, and in several host countries, anti-immigrant sentiment showed patent signs of buildup. Newly available data indicates that officially record remittance flows to developing countries fell to $307 billion in 2009, a 5.5

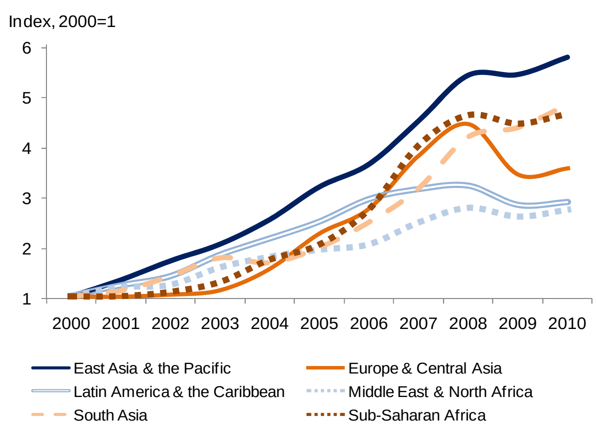
Box figure S3.2

East– and South Asia dominate remittance flows to developing regions in 2010



Source: World Bank.

The recession of 2009 exacted a toll on remittance receipts



Source: World Bank.

percent decline from the previous year. But contrasted with other forms of financial flow, the decline in remittances was quite modest (see Finance annex for more): foreign direct investment dropped 40 percent in the year, while portfolio debt and equity flows declined by a large 46 percent. Estimates for remittance inflows for 2010 are for a 6 percent increase to $325 billion.

In broad terms, the relative resilience of remittances during the global recession is tied to a number of factors. Importantly, despite the financial crisis and ensuing recession, the stock of migrants has continued to grow, lending persistence to streams of remitted incomes. Existing migrants remained in host countries to a large degree, rather many returning home, as was earlier anticipated by the World Bank and other analysts. And, South-South migration is actually larger than South-North migration, with an estimated 43 percent of migrants from developing countries in other developing countries. Given the relatively robust economic conditions among emerging markets in the last few years, remittance flows were supported to higher levels than would otherwise be the case.

The 5.5 percent decline in remittance incomes during 2009 for the aggregate of developing countries masks highly diverse outcomes across regions. During the year, remittances to South Asia continued to grow at a 4.5 percent pace, through well below the 20-30 percent annual rates of the years just preceding; East Asia edged 0.3 percent higher. But inflows dropped by a substantial 23 percent to Europe and Central Asia; by 12 percent in Latin America, and 6- and 4 percent in MENA and Sub-Saharan Africa, respectively (Box figure S3.2).

The World Bank's Migration and Remittances Unit estimates that the USD value of remittances increased 6 percent in 2010. The benefits of the increase in remittances in 2010 to the poor in developing countries has been reduced by exchange rate developments, with the dollar depreciating against many developing country currencies. As a result, the real local currency value of remittances is estimated to have declined a further 6.3 percent in 2010.

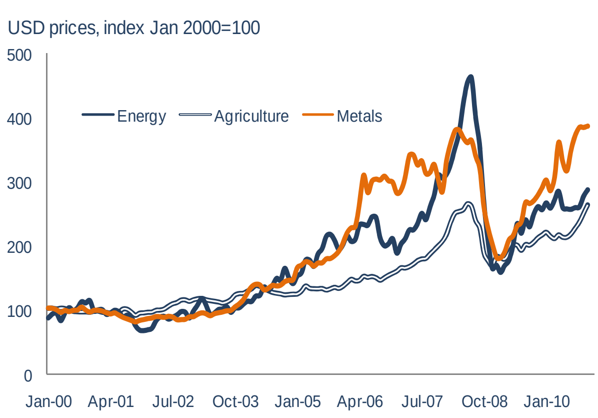
The outlook is for further increases in remittances of 6.3 percent and 8.1 percent in 2011 and 2012 respectively to reach $375 billion by the latter year. There are several risks to this view, including the possibility that the recovery in the high-income countries could falter, or follow a profile of below-trend growth for several years. Fiscal retrenchment underway in Europe and elsewhere also augers poorly for more vibrant labor market conditions and work opportunities in key migrant host countries. Finally, volatile currency and commodity prices, such as continued decline of the U.S. dollar against currencies of remittance sending and receiving countries could carry adverse effects on flows.

Prospects for global commodity markets

The $U.S. price of commodities continued to rebound in 2010 from the post-financial crisis lows, with price changes varying from a relatively small increase in energy to larger gains in metals and agriculture (Figure S4.1). Oil prices have been stable on opposing forces of supply cuts and strong demand versus surplus capacity and high stocks. Base metals prices have risen 43 percent since December 2009 supported by relatively strong demand, with continued strong (yet easing) demand in emerging markets that was partly buttressed by recovering demand in developed countries.

Although the downturn in industrial production during the second half of 2010 caused demand momentum to slow, dollar denominated commodity prices were given a boost in the fourth quarter by strengthening demand in China and expectations of tightening supplies in the medium term. Agriculture prices were up 17 percent in 2010, with some commodities rising much higher on extreme weather events. For example, severe drought in Russia and surrounding countries led to a sharp rise in wheat prices. Corn and soybeans prices followed, in part due to expected competition for acreage. Heavy rains in Asia affected several tropical commodities, as did drought concerns in South America. Interestingly, Africa faced the least weather-related problems during the past year.

Figure S4.1 Commodity prices rebound



Source: World Bank

Other key developments during 2010 include acceleration of food price inflation in several low and middle income countries where consumers often spend more than half of their income on food. Food prices in China (world's largest producer and consumer of many commodities) increased 7.5 percent between August 2009 and August 2010 (by contrast, non-food price inflation increased by a meager 0.5 percent). In response, the government lifted quantitative restrictions on several commodities and released publically-held reserves while it is accelerating efforts to increase domestic production by expanding the use of biotechnology in maize and rice with the expectation that it will significantly increase crop yields. Food price inflation has been a key concern in other countries as well. During the 12 -month period ending in August 2010 (just before world grain prices began spiking), food price inflation in India, Indonesia, and Bangladesh run at an annual rate of 10.4, 13.2, and 9.6 percent, respectively, as opposed to non-food price inflation of 3.7, -0.7, and 3.4 percent.

On exchange rates, the $U.S. appreciated almost 10 percent against the euro (from 1.46 $US/euro in December 2009 to 1.32 $US/euro in December 2010) amid considerable volatility. However, it appreciated much less against other major currencies and against the broader group of trading partners. Lastly, there have been concerns that the US$600 billion quantitative easing announced by the US in November may induce higher commodity price volatility as some of the "new money" may find its way to commodity futures exchanges through hedge and investment fund activity (it may also increase the physical demand for commodities). As of mid-2010, $320 billion were invested in commodities (more than half in energy), representing about 1 percent of the assets of global pension and sovereign wealth funds.

Moving forward, energy prices are expected to strengthen in 2011, despite slower demand growth and large surplus capacity as OPEC now prefers a wider price range of $70-90/bbl. Base metals prices, on the other hand, are expected to rise by 15 percent on continuing strong demand by China, falling stocks, and supply constraints. Agricultural commodities are expected to decline 8 percent (they increased 17 percent from 2009 to 2010), assuming a return to normal crops and rebuilding of stocks. Large declines are expected in beverages (11 percent) while grain prices will decline 5 percent.

There are long-term upside risks for some commodities, especially those in the extractive industries. Because of strong developing country growth, demand for some commodities may be entering into a phase during which commodity prices will continue to rise (or, at least, remain elevated) as supply growth struggles to meet demand. As discussed in World Bank (2008), China is clearly in an extremely metals-intensive phase of its development, and has become the world's largest consumer of most metals and minerals. Compared with other developing countries at similar income levels, the metals intensity of China's GDP is well above average. China's copper and aluminum intensity was 1.8 and 4.1 kgs per $1,000 of real GDP for 2007-09, compared with world averages of 0.4 and 0.7, respectively. If China continues to follow the pattern experienced during the past decade, it may put strong upward pressure on metals and mineral prices—particularly those in which China is a net importer, and/or ceases to be a net exporter. More importantly, such pressure may be intensified if other developing countries, say, India, follow suit.

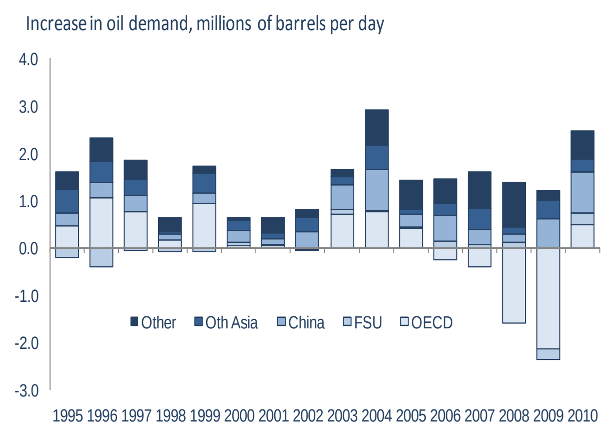
Such up-side risk has been described in the context of a super-cycle, i.e., a period during which commodity prices can stay elevated for a long time (perhaps as much as two decades) due to strong import demand as one or more economies go through a major industrial transformation phase. Super-cycles of this nature have taken place in the past rather infrequently (e.g., industrial revolution in the UK and early 1900s in the US). Several authors have argued that some metals (especially copper and iron ore) may be going through such a super-cycle period because Chinese demand. While Chinese demand has been very strong and metals prices are expected to remain firm, they are not expected to continue rising because they are already substantially above production costs. As a result, there are large incentives for producers to step up supply, while at the same time, high prices are leading to substitution with other materials, notably from copper to aluminum — a market currently in surplus.

Crude Oil

Despite an uptick toward the end of the year, world oil prices were relatively stable during 2010 compared with the extreme volatility of 2008-09. Prices, which averaged $U.S. 79.04/bbl in 2010 (up from $US 61.76/bbl in 2009), were supported by OPEC supply cutbacks and recovery in global demand which grew by an estimated 2.9 percent or 2.3 mb/d in 2010 following two years of declines (Figure S4.2).

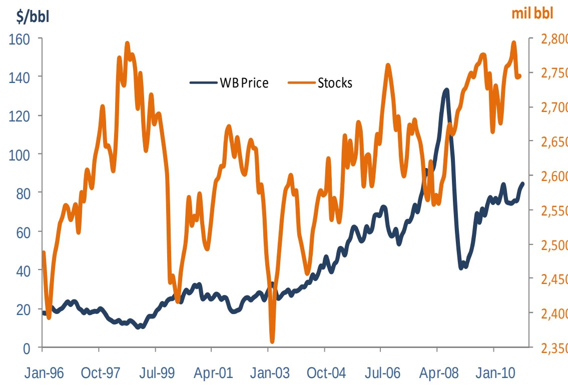
Developing Asia accounted for about half of the growth, similar to the gain in 2009, and China accounted for much of that, up 10.5 percent or 0.9 mb/d. However, quarterly growth rates fell during the course of the year. The growth increase during 2009 was exceptional because of one-off increases in naphtha demand due to the addition of new petrochemical capacity—naphtha is a key crude oil byproduct. OECD oil demand posted a 1.1 percent increase or 0.5 mb/d, after four years of decline, with much of the growth occurring in the U.S. By 2010:Q4, world oil demand had settled into near-trend growth of around 2.0 percent. In the medium term, world

Figure S4.2 Growth in world oil demand recovers, 1995-2010



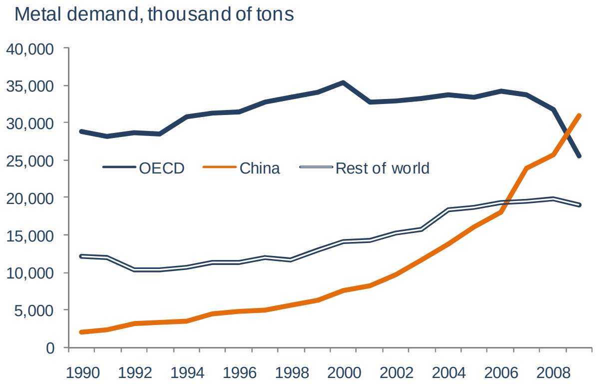
Source: International Energy Agency.

Figure S4.3 Stable oil prices and high OECD stocks



Source: World Bank and IEA.

Figure S4.4 China overtakes OECD in metal consumption



Source: World Bureau of Metal Statistics.

oil demand is expected to experience modest growth, owing to efficiency improvements in transport and ongoing efforts by governments and industry to reduce carbon emissions, particularly in high-income countries.

Despite the recovery of oil demand—albeit off of low levels from recession—the market remained mired in surplus production and refining capacity. OECD oil inventories reached record highs in both crude oil and products (Figure S4.3). There were also large volumes of crude oil and products in floating storage, though the crude portion of this was greatly reduced in the second half of the year. Furthermore, because OPEC continued to restrain output to keep oil prices within a $70-90/bbl range, its surplus capacity remains at 6 mb/d, with 5 mb/d in the Gulf, and two-thirds of total spare capacity in Saudi Arabia. Such levels of spare capacity are similar to those observed during the early 2000s when the price of crude oil was ranging between $20 and $30/bbl.

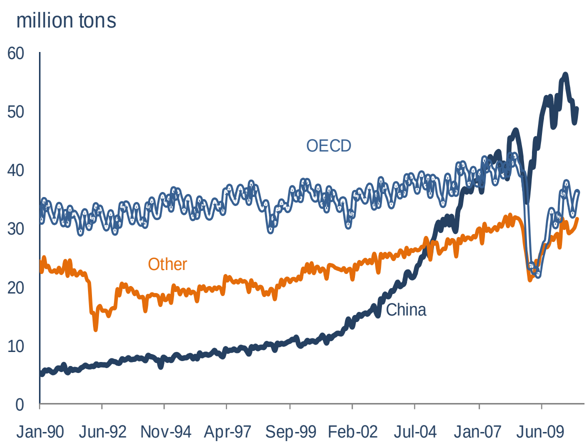
Non-OPEC supplies posted a second year of strong gains, up 0.9 and 1.1 mb/d in 2009 and 2010, respectively, with the largest gains coming in the U.S., Russia, Brazil, Kazakhstan, Colombia, China, Azerbaijan, Oman and Canada, and from biofuels. Finally, OPEC natural gas liquids production rose 0.5 mb/d in 2010, leaving little growth in the demand for OPEC crude oil.

Over the medium term, oil prices are expected to be more volatile than during the past year, but on average are expected to remain in the $70-80 range as OPEC continues to restrict supply. It is also expected that OPEC will prevent prices from going much above that range due to concerns that new technologies and policies may curb oil use. Growth in global oil demand is expected to remain moderate at 1.5 percent in the near term, with most of the growth in developing countries. Non-OPEC oil supplies are projected to continue rising modestly, with production increases from Brazil, Canada, Colombia, the FSU, and other areas. Globally there are no resource constraints, and the World Bank's long-term forecast of $80/bbl in real terms is commensurate with the higher end cost of developing additional oil capacity, notably from oil sands in Canada.

Metals

China has been the chief driver of metal demand over the past decade (Figure S4.4). Between 2000 and 2009 Chinese consumption of the main base metals (aluminum, copper, lead, nickel, tin and zinc) rose by 17 percent per annum — trends that continued during the recovery. Chinese apparent demand surged 20 percent in 2009 due to restocking, and rose a further 10 percent in the first 10 months of 2010. Currently, China accounts for 41 percent of global refined metal consumption, overtaking the OECD by a margin

Figure S4.5 China becomes the world's largest steel producer



Source: World Steel Association.

Figure S4.6 Copper prices reach pre-crisis level

Source: Datastream

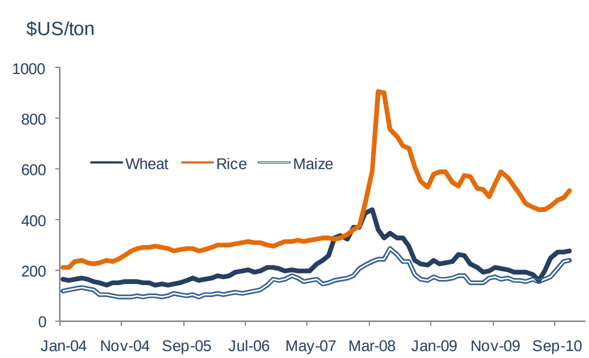
of 4 million tons. In contrast, OECD metals demand plunged 21 percent in 2009, with more than half of the volumes losses in Europe. OECD demand rebounded by 17 percent in the first 10 months of 2010 as it began restocking, with Europe accounting for nearly two thirds of the increase.

A similar pattern has occurred with steel production (Figure S4.5). China's steel output rose sharply in the second half of 2009 and first half of 2010, but fell in the third quarter due to slowing demand and reduced profitability because of oversupply. OECD steel output also rose sharply before falling in the third quarter, in line with the slowdown in industrial production.

Metal production has increased commensurately with demand, but supplies for a few metals have become tight, notably for copper and tin, and stocks have been declining in 2010 (Figure S4.6). Copper mine supply growth was flat in 2010 because of declining ore grades, and development of large projects on the horizon is limited. Tin prices reached record nominal highs in 2010 on strong demand, falling stocks, and lower production in Indonesia because of heavy rains. All other base metals remain in surplus and stocks are relatively high.

Over the next two years, prices are not expected to rise substantially, partly given the large price increases to date, but also due to substantial idle capacity in some sectors. Further large price increases would require idle capacity being reabsorbed over the longer-term, but with demand growth slowing towards 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. Such pressure on prices, however, may well intensify if metal demand by China grows at the rates that it has been expanding in the recent past (see earlier discussion on super-cycles).

Figure S4.7 Grain prices rebound



Source: World Bank.

Agriculture

Following a relatively stable first half, agricultural prices rose sharply during the second half of 2010 registering a 17 percent nominal increase over 2009, 2 percent above the 2008 average. However, contrary to the 2008 price spike which was accounted for by food commodities, the recent price increases were more broadly distributed and included most tropical commodities and raw materials which did not increase much during 2008. For example, between 2008 and 2010, beverages (led by arabica coffee) and raw materials (led by cotton) increased by 40 and 45 percent, respectively, while food prices declined 9 percent.

Most agricultural commodity price sub-indices registered large gains during the second half of 2010. The increases were more pronounced among grains, primarily led by wheat, following weather problems that surfaced earlier in the summer (Figure S4.7). Policy actions, including Russia's wheat embargo and later Ukraine's export quotas, and the USDA latest updates indicating a tighter global market for coarse grains due to yield declines further boosted food prices. As a result, maize and wheat prices increased by 94 and 63 percent from June to December 2010 while the overall grain index gained 53 percent compared to the 29 percent increase in the non-energy index.

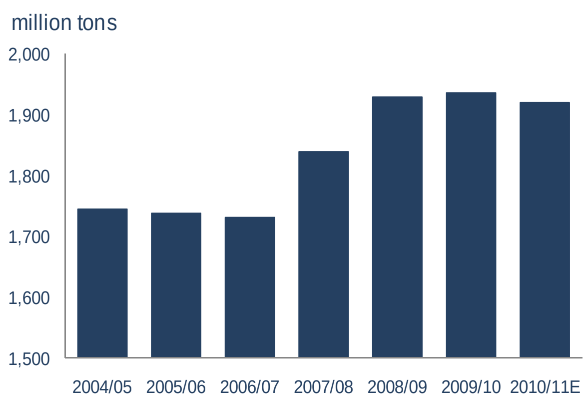
Not unexpectedly, the price increases triggered food security concerns and discussions of whether a 2007/08-type price spike is unfolding. However, the situation today is different from three years ago for a number of reasons. First, global supplies of the three key grains (wheat, maize, rice) are 18 percent higher now than in 2007/08 (Figure S4.8). Second, global production is expected to be 1.92 billion tons in 2010/11, 10 percent higher compared to the 2004/05-2006/07 average of 1.74 billion tons. Third, input prices, notably energy and fertilizer, have been stable during 2010 and no major increases are expected in the medium term. Fourth, policy measures in the wheat market have had less of an impact on prices than in 2008 (policy reactions were a key driver behind the earlier price spike). As compared with rice market, the main driver in 2008, wheat and maize markets are less concentrated in terms of production and trade, subject to fewer policy distortions, more broadly traded, and not as politically sensitive. Lastly, price increases in

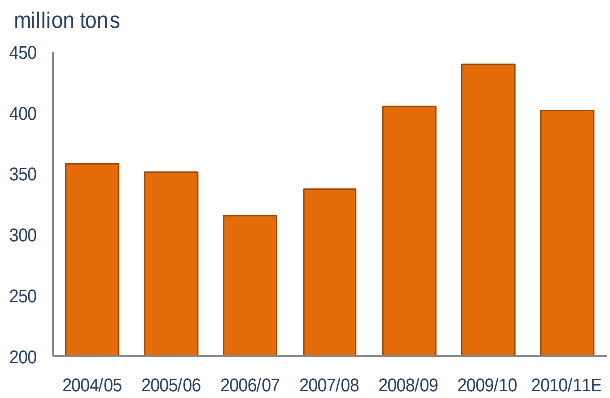
Table S4.1 Key nominal commodity price indices (actual and forecast, 2000=100), 2005-12

	Actual						Projection	
	2005	2006	2007	2008	2009	2010	2011	2012
Energy	188	221	245	342	215	271	293	277
Non-Energy	149	192	225	272	213	267	270	258
Agriculture	133	150	180	229	198	228	213	205
Food	134	147	185	247	205	221	208	204
Beverages	137	145	170	210	220	250	225	210
Raw Materials	131	160	175	196	169	232	219	206
Metals & Minerals	179	280	314	326	236	348	386	367
Fertilizers	163	169	240	567	293	278	255	249

Source: World Bank

Figure S4.8 Global grain production is expected to be healthy but stocks are set to decline





Source: US Department of Agriculture (December 10, 2010 update) domestic terms (after accounting for exchange rate fluctuations and inflation) increased much less than their $US counterparts (see next section).

Agricultural prices are expected to decline by 8 percent in 2011, followed by a further 3.7 percent decline in 2012 (Table S4.1). Over the longer term, trends in agricultural prices will be shaped by two key (and opposing) forces: Upward push by energy prices (agriculture is an energy intensive industry) and downward pressure due to gains in total factor productivity (TFP)—which for agriculture is much higher than manufacture. Thus, if the flatness of energy prices persists, TFP will be the dominant force.

Yet, there are several risks. First, weather-related problems can always induce price variability as they did during July-August 2010. Second, trade-related policy actions are always a concern, although the lessons from the rice price spike episode of 2008 could (and should) serve as a reminder on their adverse impact on world prices and trade. Third, if biofuel mandates change due to new blending requirements, grain and oilseed demand patterns will follow suit with proportional impact on most other crops; however, that scenario is less likely to materialize in the short term as it would require new technologies for car engines and infrastructure of delivering ethanol over long distances. Fourth, while energy prices—a key input to most agricultural commodities and closely correlated with fertilizer prices—have been relatively stable so far and are expected to stay relatively flat over the medium term, an energy price spike would likely spread quickly to agricultural markets for two reasons: the higher cost of energy and the fact that biofuels may set a floor for key agricultural commodities.

Price movements in domestic terms

International commodity prices in $U.S. do not always move in tandem with prices paid by consumers or received by producers for numerous reasons. First, exchange rate fluctuations imply that the country is likely to face a different price at the border compared to the price quoted in $U.S. Second, trade policies, including non-trade barriers and taxes or subsidies (very common in countries where key food commodities have been designated as “sensitive” or “strategic”) often introduce large gaps between border and domestic prices. Third, poor infrastructure (prevalent in Sub-Saharan Africa), large distances from ports (especially in landlocked countries), and various customs-related obstacles, may further amplify the gap between international and domestic prices. For these reasons, domestic commodity markets are often disconnected from world markets, or, at best, world price signals are transmitted to domestic markets with considerable lags. Finally, the relative price of food commodities will evolve differently in developing countries than in the United States because the prices of other goods and services in these countries involve at different rates. As a result, the real price of internationally-traded food commodities in developing countries will rise and fall at a different rate than the real US dollar price.

Table S4.2 breaks out the influence of each of these factors in explaining the difference between changes in nominal $U.S. prices of internationally traded commodities and their real local currency price movements between January 2005 (prior to the food rice boom and August 2010). It decomposes world price movements into the following components: inflation, exchange rate, and the domestic weight

Table S4.2 At-the-border price decomposition: January 2005 and August 2010

Median country from each income level:	Change in border price (real, domestic CPI)	-------- Contribution of --------		-------- Change in world price based on: --------		
		Inflation	Ex. rate	Domestic weights (nominal)	World weights (real, US CPI)	World weights (nominal)
	[A]	[B]	[C]	[D]	[E]	[F]
High	20%	-13%	-13%	45%	57%	67%
Middle	20%	-10%	-15%	45%	57%	67%
Developing	14%	-20%	4%	31%	57%	67%
Low	21%	-28%	12%	37%	57%	67%

Source: World Bank calculations based on various country data sources.

Note: Column A is the sum of columns B, C, and D. Column E denotes the change of world food price index in real terms (deflated by the US CPI) while column F denotes the change of world food price index in nominal terms.

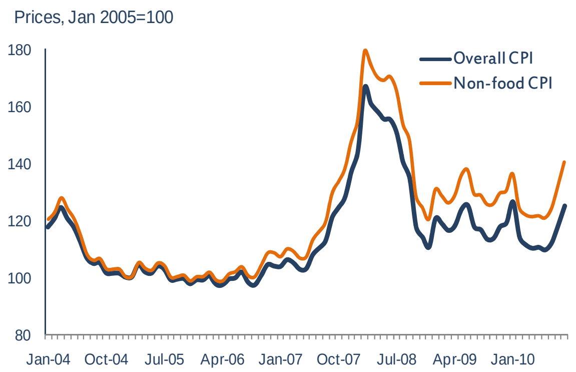
composition of food imports. During this period the World Bank's global food price index increased by 67 percent in nominal terms and 57 percent in real terms (when deflated by the U.S. CPI).

The increase of real food prices in domestic currency terms relative to non-food prices was much smaller. For example, during this period, the median low income country's food price index (Bangladesh in this case) increased by 37 percent. Considering that its exchange rate appreciated against the $U.S. by 12 percent while non-food price inflation stood at 28 percent, domestic food prices were only 21 percent higher in real terms. The corresponding at-the-border real food price increase for the median developing country was 14 percent, while that of middle and high income countries was 20 percent.

Table S4.2 uses non-food prices as a deflator and reports income-group data as the median increase. Alternatively, these calculations can be done using the price of all goods and services (including food) and aggregated using GDP weights (see discussion in the main text). This has the advantage of allowing more countries to be included in the calculation (120 countries with overall CPI, versus only 41 for which non-food CPI can be calculated). When calculated in this way, the increase in real-at-the border internationally traded food commodity prices was 6 percent between January 2005 and August 2010 (see main text). But, deflating food prices with the overall CPI where food has a large weight in the overall CPI (often ranging between 50 and 60 percent) may understate the extent to which food prices have risen relative to other goods and services.

Finally, for the 41 developing countries for which both overall and non-food CPI data exist , we report at-the-border food price index adjusted by both measures of inflation (Figure S4.9). When international food prices are adjusted by the overall CPI (same measure reported in in main text, applied to fewer countries), the developing-country real food price index increased by 14 percent between 2005 and 2010

Figure S4.9 Real at-the border prices deflated with overall and non-food CPI



Source: World Bank and ILO.

(year averages). However, when adjusted by the non-food CPI, the index increased by 25 percent, almost twice as much.

To further analyze the degree to which domestic commodity markets respond to world price changes, Table S4.3 compares world $U.S. price changes to changes in prices paid by consumers (expressed in local currencies) for three food commodities—wheat, maize, and rice—in selected developing countries. Specifically, three comparisons are made: (i) the second half of 2010 is compared to the first half (first column), an attempt to capture whether the recent price spike shows up in domestic markets; (ii) 2010 is compared to 2009 (second column), to examine whether the declines in maize and wheat prices had a discernable impact on domestic prices; and (iii) 2010 is compared to 2006, effectively capturing the entire food commodity boom cycle. The latter figures are reported in both nominal (third column) and real (domestic CPI-deflated) terms (fourth column).

The figures for the short and medium term give a very mixed picture. Between the first and second half of 2010, $U.S. wheat and maize prices increased by 32 and 22 percent, respectively while rice prices registered a 6 percent decline. However, domestic retail prices of maize and wheat declined in most cases while they increased in the case of rice. A mixed picture emerges when comparing 2010 with 2009 as well, essentially indicating that world price are may not be transmitted to domestic markets in the short run.

However, a pattern emerges when domestic and $U.S. prices are compared over a longer period. For example, from 2006 to 2010 prices for the three commodities increased, on average, by 40 percent in $U.S. nominal terms. During this period, the average nominal price increase for these three commodities in Sub-Saharan Africa (21 countries for a total of 35 cases, not all reported here) rose by 46 percent. This implies that while prices may follow independent paths in the short term, over the longer term there is some degree of convergence.

Yet, a less clear picture emerges when food prices are deflated by the domestic non-food CPI. Countries with high non-food price inflation did not experience large increases in real food prices (e.g., Ethiopia). On the contrary, in countries with small non-food inflationary pressures food prices increased considerably (e.g., Pakistan).

Table S4.3 World ($US) and domestic (local currency) price movements of key food commodities in selected countries

	Jan-Jun 2010 to Jul-Nov 2010 percent change, nominal	*2009 to 2010 percent change, nominal*	*2006 to 2010 percent change*	
			Nominal	**Real**
WHEAT				
World price (US$, HRW US Gulf Ports)	**32%**	**-6%**	**12%**	**4%**
Burundi (retail, Bujumbura)	0%	19%	144%	na
Pakistan (retail, Karachi)	-1%	1%	110%	43%
Cameroon (retail, Yaundé)	-7%	-3%	6%	3%
Ethiopia (retail, Addis Ababa)	-4%	-5%	89%	-12%
Afghanistan (retail, Kabul)	30%	-20%	32%	na
South Africa (wholesale, Randfontein)	23%	-3%	82%	20%
MAIZE				
World price (US$, fob US Gulf ports)	**22%**	**-13%**	**52%**	**46%**
Burundi (retail, Bujumbura)	-11%	9%	55%	na
Chad (retail, N'Djamena)	6%	-9%	-5%	-10%
Tanzania (wholesale, Dar es Salaam)	-32%	-18%	33%	na
Philippines (retail, national average)	-16%	-2%	36%	21%
Malawi (retail, Lilongwe)	-16%	-30%	na	na
Ethiopia (wholesale, Addis Ababa)	-10%	-22%	78%	-14%
RICE				
World price (US$, 5% Thai, Bangkok)	**-6%**	**5%**	**57%**	**41%**
Indonesia (retail, national average)	10%	16%	na	na
Burundi (retail, Bujumbura)	4%	-4%	58%	na
Tanzania (wholesale, Dar es Salaam)	-22%	-9%	38%	na
Bangladesh (retail, Dhaka)	18%	30%	na	na
Chad (retail, imported N'Djamena)	0%	-3%	16%	10%
Pakistan (retail, irri type, Karachi)	4%	6%	116%	47%

Source*:* World Bank (world prices); country sources (wholesale or retail prices); ILO (the non-food CPI).
Notes: Real world prices have been deflated by the MUV. Real domestic prices have been deflated by the domestic non-food CPI. na implies data is not available.

Recent exchange rate developments

The financial and real-side gyrations of the past few years have also been accompanied by large swings in exchange rates. Counter-intuitively the onset of a major financial crisis in the United States initially prompted a sharp appreciation of the U.S. dollar, which was only subsequently followed by a depreciation. As concerns about the sustainability of fiscal situations in Europe increased, the euro depreciated viz-a-viz the dollar only to regain value as markets calmed during the summer of 2010 and then lose value in the fall when concerns intensified once again.

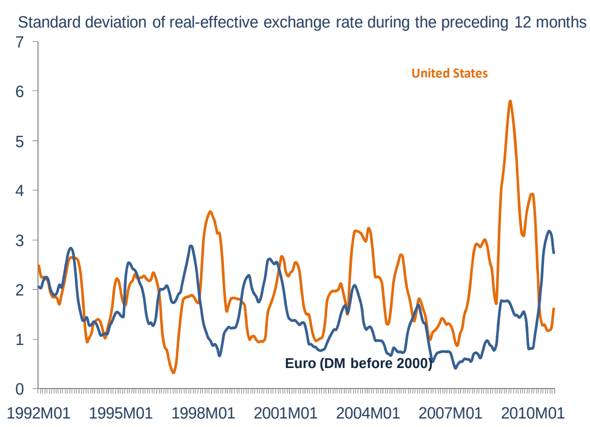
In part, these fluctuations reflected an increase in the volatility of the U.S. dollar against other currencies. Since 2007, the volatility of the dollar and the euro, as measured by the 12 – month standard deviation in their fluctuation of their real-effective exchange rate, has increased sharply to levels in the case of the United States not seen over the past 20 years (Figure S5.1).

Indeed, cross-rates between the euro and the Canadian dollar or the euro and the British pound (until recently) were much more stable than the U.S. dollar euro exchange rate (Figure S5.2). Similarly, while the dollar exchange rate of many developing countries rose and fell sharply in the recent period, in general cross-rates with other currencies were more stable.

Of course, very low interest rates in high-income countries, and ensuing capital inflows to developing countries also help explain both the weakness of the dollar and the euro and the strength of developing currencies. Overall, the dollar depreciated 3.5 percent in real-effective terms during 2010 and the euro fell about 3 percent on the same basis, with most developing countries appreciating with respect to these two reserve currencies. Overall, the currencies of close to 60 percent of developing countries appreciated in real-effective terms since January 2010 (Figure S5.3), and almost 20 percent of them by 5 or more percent. In contrast, most high-income countries depreciated in real-effective terms – albeit by relatively modest amounts.

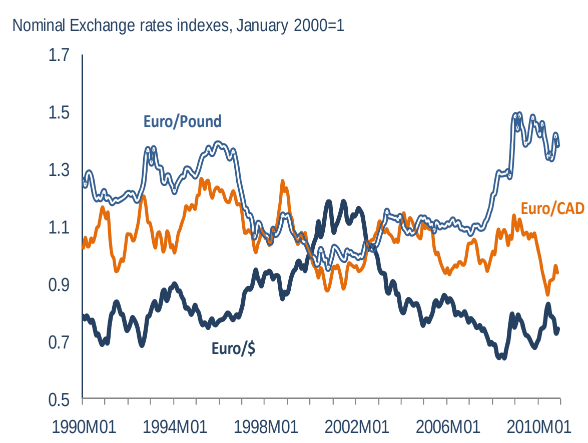
Generally, the appreciation of developing countries currencies is a normal and welcome reflection of strong productivity growth and good growth prospects — and for most countries this appears to have been the major factor in the appreciations observed during 2010. Other factors that contributed were: strong capital

Figure S5.1 Increased exchange rate volatility



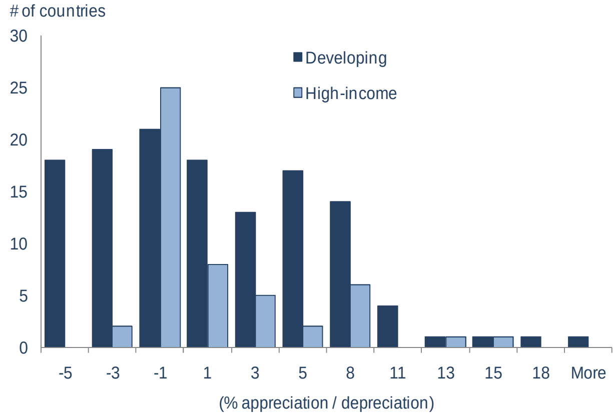
Source: World Bank, IMF IFS.

Figure S5.2 Cross exchange rates have been less volatile



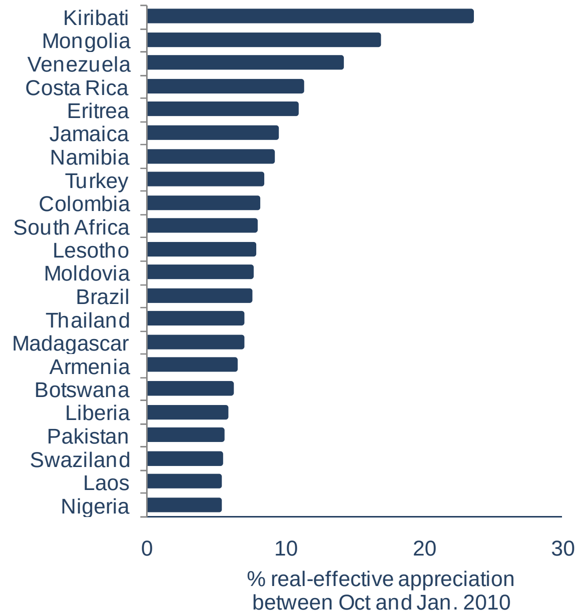
Source: World Bank, IMF IFS.

Figure S5.3 Most developing countries have appreciated



Source: World Bank, IMF IFS.

Figure S5.4 Countries having experienced a large appreciation



Source: World Bank. IMF IFS.

inflows, rising commodity prices, and relatively high inflation.

Among those having experienced the sharp est appreciations (Figure S5.4), capital flows played a major role in Turkey, Colombia, South Africa (and indirectly Lesotho and Swaziland), Brazil, and Thailand. The (partial) recovery in commodity prices were an important factor in many Latin American and African economies, while rapid inflation was at root in several others.

Global Economic Prospects January 2011:
Navigating strong currents
Regional Annex

East Asia and the Pacific

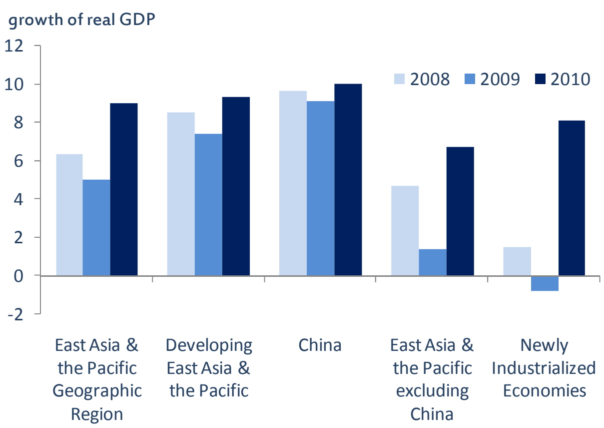
Recent developments

The East Asia and Pacific region led the global recovery from the deepest recession since the 1930s over 2009 and 2010. The recovery was led by robust 10 percent GDP gains in China, where fiscal and monetary support measures contributed almost a percentage point to growth (Figure R1.1 and Table R1.1).[1] For the ASEAN countries and smaller island economies, growth picked up sharply from 1.5 percent in 2009 to 6.8 percent in 2010, partly reflecting strong stimulus-related import demand from China. Overall, GDP of the developing East Asia and Pacific region increased 9.3 percent in 2010 up from a resilient 7.4 percent pace in 2009.[2]

Sources of growth. For China, domestic demand contributed some 7.8 percentage points to overall growth of 10 percent in 2010, with net trade contributing the remainder. With real imports expanding at a 35 percent pace, China's demand served as a powerful impetus for exports from the East Asia region and beyond. GDP growth in the rest of the developing region was underpinned largely by domestic demand, especially private consumption (accounting for 3.2 points of growth) and fixed investment (2.5 points), as stimulus measures continued to carry positive effects. Reflecting strong internal demand, imports for the group expanded at a 30 percent pace, and though exports advanced 25 percent, net trade offered a drag to GDP; 'gross' exports however, provided support for production, jobs and incomes. Robust regional import demand played a role in spurring recovery in the high-income countries, as well as helping to reduce overall global imbalances (see main text).

Setting the stage. Available GDP data and high-frequency indicators suggest that growth in the region hit a soft patch in the second half of 2010 (Figure R1.2). But outturns across countries vary substantially, reflecting different fiscal and monetary stances, varying exposures to external trade and financial markets, and greater or lesser trade linkage with China. In general, growth was strong through the first quarter, and began the adjustment toward more sustainable rates in

Figure R1.1 Developing East Asia grew robustly in 2010



Source: World Bank

Figure R1.2 GDP growth easing quickly in second-half 2010

Source: Haver Analytics

the second and third quarters.

Many countries in the region saw a surge in international capital inflows during the second half of 2010, evidenced in rising equity values and appreciating currencies, with the potential—as increased liquidity moved through local economies—to trigger higher inflation, or to sow the seeds of asset bubbles.

The industrial production cycle in East Asia was more pronounced than in other developing regions in the year, as the region was particularly hard hit by the global collapse in demand for capital-, IT- and consumer durables (e.g. autos). However when global recovery set in, the production of these goods also registered sharpest rebounds, and regional output quickly regained previous peaks (Figure R1.3).

The variation in the speed of post-crisis recovery within the region reflects underlying trend growth rates, and China's industrial output stood some 34 percent above pre-crisis peak levels - versus 3.5 percent-above for the rest of the region in October. Differences in remaining spare capacity are less stark. World Bank estimates suggest that China's spare manufacturing capacity is effectively at trend rates at present, as it is broadly for the remainder of the region. But the structure of economies in developing East Asia differs widely with respect to external accounts, with many focused on manufacturing-, others commodities, and still other economies upon remittances and service incomes, notably tourism receipts.

Developments across larger countries. China's growth moderated over the course of 2010 with domestic demand (particularly consumption and investment) cooling gradually as stimulus faded and the monetary stance tightened. With domestic demand easing, import growth slowed, while stronger export performance helped to maintain growth at high levels and contributed to an increase in the trade surplus. While growth

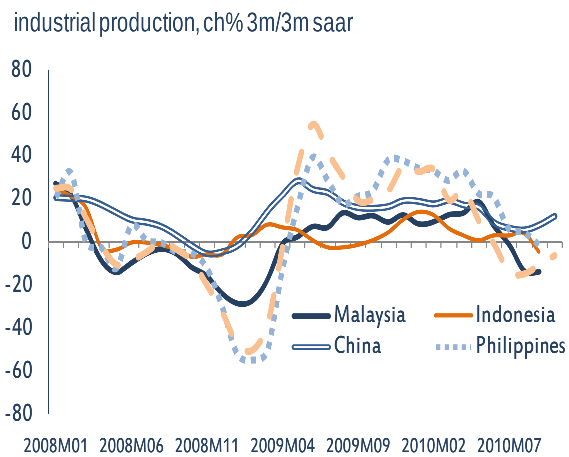
Table R1.1 East Asia and Pacific forecast summary
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 US$) [b]	7.4	12.3	8.5	7.4	9.3	8.0	7.8
GDP per capita (units in US$)	6.4	11.4	7.6	6.5	8.5	7.2	7.0
PPP GDP [c]	7.4	12.2	8.4	7.4	9.3	8.0	7.9
Private consumption	5.7	8.9	7.4	7.2	8.9	7.4	7.3
Public consumption	7.9	10.7	8.6	6.7	8.0	8.6	7.5
Fixed investment	0.7	12.4	9.1	19.1	10.1	9.9	8.2
Exports, GNFS [d]	12.9	15.4	7.1	-10.5	31.8	11.7	13.7
Imports, GNFS [d]	10.4	11.3	4.6	-2.1	33.4	11.2	12.1
Net exports, contribution to growth	0.7	2.8	1.6	-4.2	1.2	1.0	1.6
Current account bal/GDP (%)	2.2	9.1	8.1	5.8	5.2	4.8	5.2
GDP deflator (median, LCU)	5.4	5.0	7.8	3.5	4.9	4.2	4.6
Fiscal balance/GDP (%)	-2.1	0.4	-0.5	-3.1	-2.9	-2.2	-1.6
Memo items: GDP							
East Asia excluding China	3.5	6.3	4.7	1.5	6.8	5.2	5.8
China	9.2	14.2	9.6	9.1	10.0	8.7	8.4
Indonesia	2.7	6.3	6.0	4.5	5.9	6.2	6.5
Thailand	2.7	4.9	2.5	-2.3	7.5	3.2	4.2

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Estimate.
f. Forecast.

Source: World Bank

Figure R1.3 Production adjusting down post-recovery



Source: World Bank

prospects are bright, further normalization of the macro stance is likely required to guard against asset price increases, strained local government finances and a buildup of non-performing loans in the banking system. Authorities have started to raise interest rates and are making administrative changes designed to tighten liquidity. China experienced significant upward pressure on equity prices and the exchange rate in the fall months of 2010, the latter of which was mitigated through market intervention, leading to a further large build-up of reserves.

Among ASEAN economies,[3] *Indonesia* was least affected by the global financial crisis and recession, in part given earlier reforms to its financial system as well as an export mix (commodities) less affected than manufactures by the falloff in OECD demand. By the first half of 2010 growth patterns had largely normalized with GDP advancing a strong 6.2 percent in the second quarter (year-on-year), largely driven by household consumption, which benefited from low inflation and better consumer confidence; and by private investment associated with improved growth prospects. In *Thailand*, despite an escalation of political crisis and the onset of global recession, the manufacturing sector helped the economy consolidate recovery. However, following robust 15 percent growth in the first quarter (saar), GDP declined in both the second and third quarters, as the political turmoil of April and May adversely affected tourism arrivals and services exports. Nonetheless Thailand is likely to have registered 7.5 percent growth in 2010 on the strength of its initial rebound. And in *Malaysia* the recovery was smoother, with government- household- and investment spending driving the rebound, but with net trade continuing to disappoint. In response to rising demand pressures, the central bank raised policy interest rates 75 basis points between March and July.

External accounts. Goods export volumes for East Asia recovered strongly from the depths of the 2009 recession to double digit growth during the first months of 2010. China's export volumes peaked at 80 percent growth in February 2010 (3m/3m saar). For the region excluding China, peaks were closer to 50 percent (saar) in late 2009 with stronger performance in Indonesia and Malaysia (80 percent) than in the Philippines and Thailand (40 to 50 percent), driven in part by vibrant import demand in China. China's import share in the exports of the rest of developing East Asia advanced from 16.2 percent at the start of 2008 to 18 percent by fall 2010.[4]

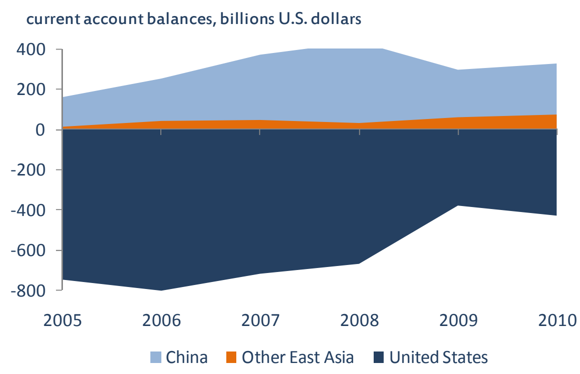
As global inventories of capital- and durable goods were replenished and business conditions began to "normalize"—based in part on expectations for only moderate growth in high-income country demand—the momentum of East Asian exports began to wane by spring 2010. Downward adjustment in export growth from exceptionally high peaks continued more rapidly into autumn of the year, such that by October, China's exports were *falling* at a 15.7 percent annualized pace (saar), with exports for the region excluding China declining by 11.2 percent.

Imports traced a different course over 2009-2010. After recovering in dramatic fashion beginning in mid-2009 (once more reflecting Chinese stimulus programs), East Asian merchandise import growth slowed to near zero by October, reflecting a global overshooting of industrial production (see main text). Indications are that the global industrial and trade cycle is picking up momentum in the fourth quarter of 2010, and East Asian import growth is expected to pick up momentum in-line with still robust demand growth in the region (Figure R1.4). Overall, net exports are likely to be modestly supportive or neutral for growth in 2010, and recent increases in trade balances in dollar terms should ease in coming quarters.

The surge in domestic demand underpinned by public sector stimulus served to reduce the region's current account surplus by 4 percent of regional GDP between 2007 and 2010, with that of China narrowing from 10.6 percent to 5.5 percent (Figure R1.5). While some of this adjustment is likely cyclical in nature, it also reflects potential longer-term changes, including higher savings rates in the United States, which have translated into lower import levels, and in East Asia, policy driven increases in the share of domestic demand in GDP.

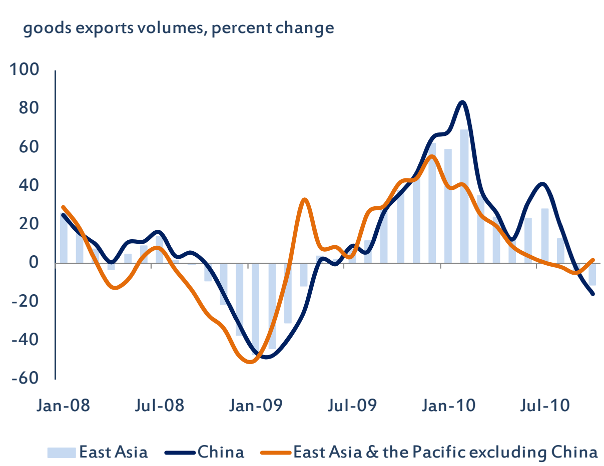
Capital flows and financial market developments. Net capital flows from private sources flowing into the developing East Asia region[5] surged by 52 percent during 2010, carrying the total of portfolio-equity and foreign direct investment to $187 billion—yet still more than 10 percent below the previous peak ($212 billion) of 2007. Improved international market conditions (despite European sovereign debt tensions) permitted strong bond issuance; IPO offerings from China continued on an impressive scale and foreign direct investment (FDI) increased by 47 percent in the year to $150 billion (Table R1.2, and Figure R1.6). The surge is being driven by improved East Asian growth prospects, strong investor sentiment and large differentials between East Asia and the high-income economies in both growth and interest rates. FDI flows have been dominated by China, accounting for $110 billion of the region's $150 billion inflow in the year (see Financial Markets appendix for more information).

Figure R1.5 Imbalances narrowed during 2009 recession



Source: U.S. Department of Commerce, World Bank

Figure R1.4 East Asia's export volumes decline as bounce-back factors fade; imports recovered earlier, but have flattened to no growth



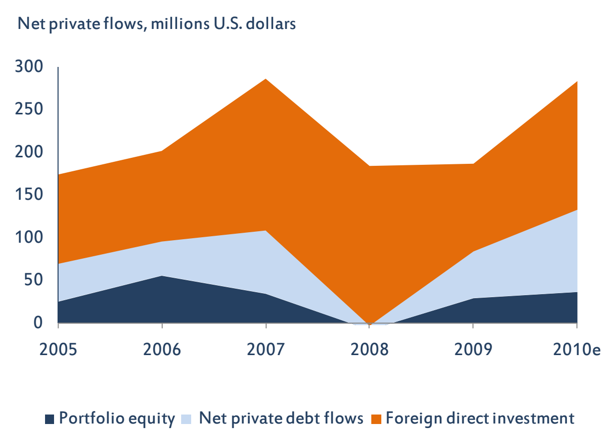
Source: World Bank

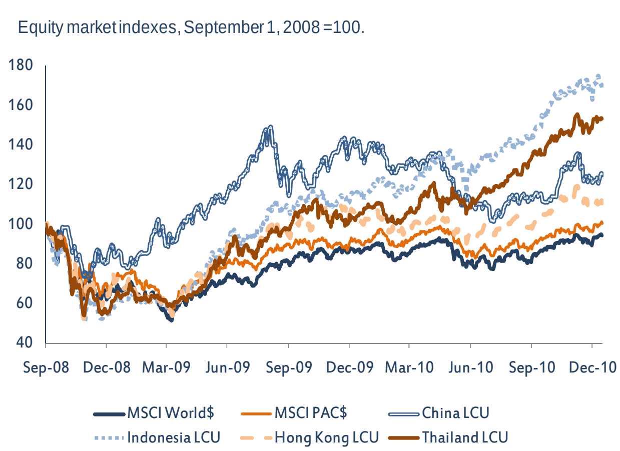
In the third quarter of 2010 there was a sharp acceleration of international capital flows, driven by the carry trade, in which investors borrow money in low-interest countries and invest in higher yielding economies. Investor's cash entered East Asian financial markets directly, into equity markets or local currency bonds, the issuance of which surged over the last 12 months, or indirectly through mutual funds and other vehicles. Inflows were particularly strong for Indonesia, Malaysia and Thailand (nevertheless, to the extent that overall foreign liquidity is what is relevant, the large current account surpluses in countries like China and the Philippines are equally relevant). Indonesia's local stock market index increased 3-fold from March 2009 to end-November 2010; Thailand's bourse was up 150 percent, which dwarfs the still-impressive 75 percent increase in the MSCI World equity index. In the fourth quarter inflows have eased somewhat, with the escalation of sovereign fiscal/debt problems in the Euro Area and a rebound in the dollar.

The inward flow of capital placed upward pressure on regional currencies. Since the start of 2010 through recent peaks in early November, the Thai baht jumped 13 percent against the greenback and 10 percent in real-effective terms; the Malaysian ringgit 10.8 percent (with a decline of 1.2 percent in real effective terms), and the Philippines peso 7 percent, with a sharp 5.5 percent falloff in its real effective exchange rate (Figure R1.7). In-step with equity markets through mid-December 2010, currencies lost about a percentage-point and a half of the appreciation witnessed up to November peaks, as international investors moved out of local markets selling local currencies for dollars. Some countries had intervened heavily to resist upward exchange rate pressures, accelerating the accumulation of international currency reserves. To the extent that these interventions were not fully sterilized, they could contribute to rising inflation, which like nominal appreciation has the effect of reducing external competitiveness and inducing real appreciation (see Main text).

A large role for service exports and remittances in East Asia. Tourism is a source of substantial foreign currency revenue for a number of countries in the region, amounting to $92 billion in 2009 (during recession) from peak receipts of $104 billion in 2008. In that year, tourism represented 1.4 percent of regional GDP. The United Nation's World Tourism Organization reports that in 2009, global international tourist arrivals dropped 4.2 percent (the worst year for the industry within memory).[6] But for the first six months of 2010 arrivals advanced 7 percent (year-on-year) driven by more robust performance in developing economies. The rebound in arrivals occurred across all world regions, but East Asia and the Pacific, the second

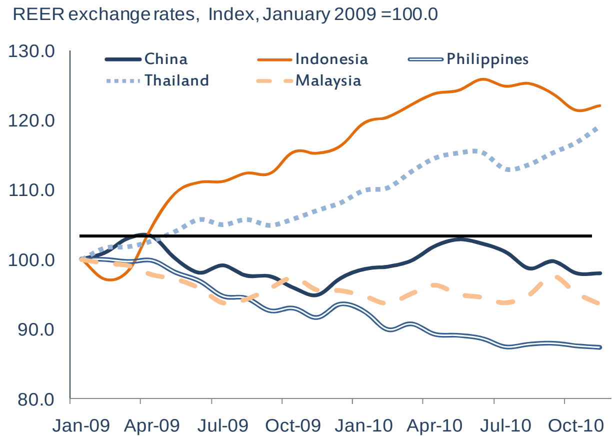
Figure R1.6 East Asian private inflows almost set fresh record in 2010 and strong capital inflows lofted local bourses across the region





Source: World Bank, Thomson-Datastream

Figure R1.7 Real effective appreciation extensive for Indonesia and Thailand



Source: JP Morgan-Chase through Thomson-Datastream

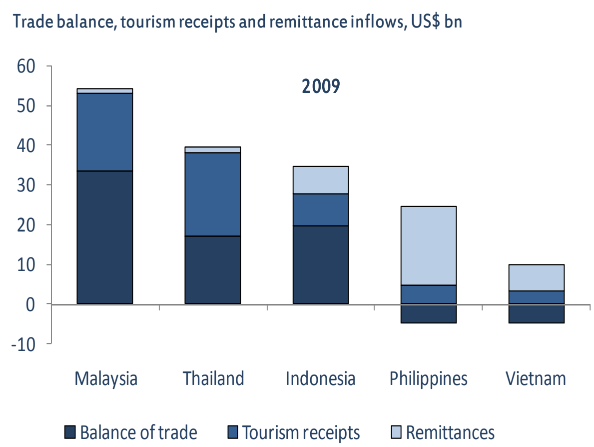
most visited region globally, led the upturn with a 14 percent jump in arrivals during the first half of the year.

Estimates for full year 2010 suggest that arrivals to East Asian destinations grew 7.6 percent to 114 million. This was driven by a pick-up in arrivals to China of near 5 percent, exceptionally robust gains in Indonesia (11 percent) reflecting in part local cross-border movements, a strong showing for Thailand (10 percent) and the Philippines (4 percent). Receipts for the region dropped by 11.4 percent in 2009, but are likely to have revived over the course of 2010. East Asia accounts for fully 50 percent of tourism revenues for the aggregate of developing countries (Table R1.3, bottom panel).

Since 2000, arrivals to East Asian tourism destinations have advanced within a range of 5- to 10 percent per year. Tourism expenditures in host countries have grown closer to 10 percent annually. Such revenues are critical for small Pacific islands, and for destinations such as Malaysia (8.5 percent of GDP) and Thailand (6.5 percent) where incremental receipts from tourism bolster current account positions while serving to support domestic employment and demand (Figure R1.8).[7] The UNWTO anticipates that tourism prospects are encouraging for East Asia, with arrivals advancing 6.5 percent per year through 2020 (see Trade Annex).

Worker remittances are also critical for a number of countries in East Asia (Table R1.3, top panel), where such income flows from the expatriate labor force can amount to substantial shares of GDP. Inflows continued during the worst of the recession in 2009, and are estimated to have increased 6.4 percent for developing East Asia in 2010. Although China leads the remittances table in the region, such flows account for only 0.9 percent of the country's GDP. In contrast, remittances amount to 11 percent of GDP in the

Figure R1.8 Remittances and tourism are key for a number of East Asian economies



Source: World Bank, United Nations World Tourism Organization

Philippines, 7 percent in Vietnam and 3.5 percent for Fiji. The World Bank's Migration and Remittances Unit sees a pickup from 6 percent gains for all developing countries in 2010 to 6.3- and 8.1 percent for 2011 and 2012 respectively to reach $375 billion by the latter year.[8]

Medium-term outlook

East Asia is well positioned to enjoy further years of strong- albeit more moderate- growth over the period to 2012. Increasingly, domestic demand will be the major driver for regional gains. Due to projected weaker activity among high-income countries, regional export volumes are expected to expand at a 12 percent pace in 2011-12 versus the 15 percent rate recorded

Table R1.2 Net capital flows to East Asia and the Pacific
$ billions

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	69.9	88.1	175.3	298.7	425.0	470.1	358.0	359.3	379.1	420.5
as % of GDP	3.1	3.4	5.8	8.3	9.4	8.5	5.8	5.1	4.7	4.7
Financial flows:										
Net private and official inflows	76.4	127.0	171.0	192.4	282.2	183.2	190.6	287.0		
Net private inflows (equity+debt)	83.6	132.2	174.2	201.7	286.1	184.3	186.9	283.3	300.9	294.2
..Net private inflows (% GDP)	3.7	5.0	5.8	5.6	6.3	3.3	3.0	4.0	3.8	3.3
Net equity inflows	69.3	89.7	130.0	161.9	212.2	179.3	132.3	187.2	199.4	234.2
..Net FDI inflows	56.8	70.4	104.3	105.7	177.1	186.6	102.5	150.2	164.4	202.2
..Net portfolio equity inflows	12.5	19.3	25.7	56.2	35.1	-7.3	29.9	37.0	35.0	32.0
Net debt flows	7.1	37.3	40.9	30.6	70.0	3.9	58.3	99.8		
..Official creditors	-7.2	-5.2	-3.2	-9.3	-3.8	-1.1	3.7	3.7		
....World Bank	-1.5	-1.9	-0.6	-0.4	-0.3	1.2	2.2	1.8		
....IMF	-0.5	-1.6	-1.6	-8.5	0.0	0.0	0.1	0.1		
....Other official	-5.2	-1.7	-1.0	-0.4	-3.5	-2.3	1.4	1.8		
..Private creditors	14.3	42.5	44.2	39.9	73.9	5.0	54.5	96.1	101.5	60.0
....Net M-L term debt flows	-9.8	9.1	9.3	14.8	18.5	16.2	-0.8	22.9		
......Bonds	1.8	9.6	10.1	3.9	0.7	0.2	8.4	16.4		
......Banks	-8.5	1.7	1.6	12.2	18.1	18.3	-8.7	6.5		
......Other private	-3.1	-2.1	-2.3	-1.3	-0.3	-2.3	-0.5	0.0		
....Net short-term debt flows/a	24.1	33.4	34.8	25.1	55.4	-11.2	55.4	73.2		
Balancing item /b	-6.5	22.0	-128.6	-196.0	-166.3	-220.9	-13.8	-306.8		
Change in reserves (- = increase)	-139.8	-237.1	-217.7	-295.1	-541.0	-432.4	-534.8	-339.5		
Memorandum items										
Workers' remittances	32.3	40.0	50.3	57.4	71.1	85.5	85.7	91.2	98.0	106.0

Source: World Bank.

during the boom. Nevertheless, trade will continue to grow faster than GDP, as intra-regional interconnectivity continues to expand.

Policies which foster increased productivity, growth of domestic incomes and a wider provision of services, can help to broaden the base for consumer spending in many countries, improving development prospects for the poor. Regional per-capita GDP growth is expected to step-up to 7 percent growth in 2011-12 from 6.3 percent during the 2000-2007 pre-crisis interval, with the investment share of GDP moving higher to 41.4 percent by 2012 from 35.5 percent over 2000-2007.

Growth in *China* is likely to ease from the 10 percent pace of 2010—due in part to the unwinding of fiscal stimulus, restrictions placed on over-heating sectors (e.g. housing) and a general tightening of monetary conditions in the face of rising inflation pressures. Nevertheless, industry-led, capital intensive growth is likely to keep GDP gains near 8.5 percent over the period, with net exports contributing smaller shares of growth than in the pre-crisis years, closer to 0.5 to 1 points of growth. China will remain the focal point of regional activity, with East Asian exports of materials and semi-finished manufactures to China for final processing and export to high-income destinations likely to intensify (Figure R1.9).

GDP gains for the aggregate of the *ASEAN countries* are anticipated to ease from 6.8 percent in 2010 to 5.2 percent in 2011, partly reflecting the slowdown in quarterly growth in the second half of 2010. GDP should then revive to a 5.8 percent pace in 2012—in-line with historic performance. Normalization of fiscal and monetary policy remains a key challenge for the group. In *Malaysia* for example, fiscal consolidation is expected to contribute to a slowing from 7.4 percent growth in 2010 to 4.8

percent in 2011, before expanding 5.7 percent by 2012. And in the *Philippines*, an end to election-year spending should see GDP growth slow into the second half of 2010, while activity settles into a medium term path of 5-to 5.5 percent, grounded in remittance-supported household spending and further government support for infrastructure development. Fiscal deficits for the region are expected to halve from 3.1 percent of GDP in 2009 to 1.6 percent by 2012.

Following the global financial and economic crisis, *Vietnam's* economy recovered rapidly, in part due to government's prompt decision to implement a large, effective stimulus package. Growth recovered to 6.7 percent in 2010 from 5.3 percent the previous year, on buoyant private investment and construction spending. However, the current account deficit remains high, and the currency—despite being devalued twice in the course of the year—remains under pressure. While the real economy has managed to restore pre-crisis growth momentum, investors remain concerned about the ability of Vietnam to achieve a soft landing. In the medium term, improved non-oil exports should complement domestic demand to maintain growth at 6.5 to 7 percent, close to Vietnam's historic record, but still below its long-term growth potential.

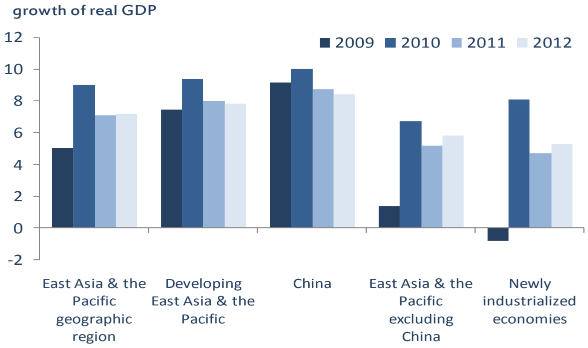
On balance, GDP gains for developing East Asia are expected to decelerate to 8 percent in 2011, from 9.3 percent in 2010 (see Table R1.1). In 2012, growth for the overall region moves down moderately to 7.8 percent, a stability that masks further moderation of growth in China, and a firming elsewhere in the region. From 2009 through 2012, the region's current account surplus position is anticipated to decline by about one-half percentage point of GDP. Still, the surplus will expand in dollar terms, coming to average $390 billion over 2011-12.

Table R1.3 East Asia and Pacific, remittances and tourism-related revenues, 2000-2010e

	2000	2005	2007	2008	2009	2010e
Remittances inflows ($mn)						
East Asia Region	**15,806**	**50,300**	**71,073**	**85,465**	**85,685**	**91,160**
growth per year (%)		**26.1**	**18.9**	**20.2**	**0.3**	**6.4**
share of GDP (%)	**0.92**	**1.65**	**1.56**	**1.49**	**1.35**	**1.26**
China	5,237	24,102	38,791	48,524	48,729	51,000
Philippines	6,961	13,556	16,302	18,642	19,766	21,311
Vietnam	…	4,000	5,500	7,200	6,626	7,215
Indonesia	1,190	5,420	6,174	6,794	6,793	7,139
Thailand	1,697	1,187	1,635	1,898	1,637	1,788
Malaysia	342	1,117	1,570	1,329	1,110	1,576
Cambodia	121	200	353	325	338	364
Other East Asia	258	718	748	753	686	767
Memo items: EAP ex China	10,569	26,198	32,282	36,941	36,956	40,160
growth per year (%)		19.9	11.0	14.4	0.0	8.7
EAP share of global remittances	19.5	26.2	25.5	26.3	27.9	28.0
Tourism arrivals and revenues						
East Asia Region						
Arrivals - Thousands	**61,443**	**88,840**	**107,048**	**107,486**	**105,947**	**114,018**
Tourism expenditure in the country - US$ Mn	**41,382**	**65,950**	**95,653**	**104,228**	**92,353**	…
growth of arrivals per year (%)		**7.7**	**9.8**	**0.4**	**-1.4**	**7.6**
growth of revenues per year (%)		**9.8**	**7.7**	**9.0**	**-11.4**	…
Tourism arrivals						
China	31,229	46,809	54,720	53,049	50,875	54,742
Malaysia	10,222	16,431	20,973	22,052	23,646	24,261
Thailand	9,579	11,567	14,464	14,584	14,145	15,560
Indonesia	5,064	5,002	5,506	6,234	6,324	7,020
Vietnam	2,140	3,468	4,244	4,236	3,747	4,496
Philippines	1,992	2,623	3,092	3,139	3,017	3,231
Cambodia	466	1,422	2,015	2,001	2,046	2,251
Other East Asia	751	1,518	2,034	2,191	2,147	2,457
Memo items: EAP ex China						
Arrivals - Thousands	30,214	42,031	52,328	54,437	55,072	59,276
Tourism expenditure in the country - US$ Mn	24,064	34,108	54,527	60,098	50,914	…
growth of arrivals per year (%)		6.8	11.6	4.0	1.2	7.6
growth of revenues per year (%)		7.2	26.4	10.2	-15.3	…

Source: Remittances: World Bank; Tourism: United Nations World Tourism Organization and World Bank estimates

Figure R1.9 Developing East Asia growth to moderate



Source: World Bank

Risks

East Asia's trade and financial linkages to the global economy are broad and intensifying; hence shocks emanating from financial markets, from OECD trade partners as well as oil and other commodity markets can carry adverse effects to the region quickly. At this juncture there are three primary risks to the baseline projections for the region.

- Continued reliance on export trade as a source of growth (though as noted, domestic demand is moving quickly to the fore) leaves

Table R1.4 East Asia and Pacific country forecasts
(annual percent change unless indicated otherwise)

	95-06 [a]	2007	2008	2009	Est. 2010	Forecast 2011	2012
Cambodia							
GDP at market prices (2005 US$) [b]	8.3	10.2	6.7	-2.0	4.9	6.0	6.5
Current account bal/GDP (%)	-4.4	-5.8	-10.2	-7.9	-8.6	-11.0	-11.2
China							
GDP at market prices (2005 US$) [b]	9.2	14.2	9.6	9.1	10.0	8.7	8.4
Current account bal/GDP (%)	2.6	10.6	9.7	6.0	5.5	5.3	5.7
Fiji							
GDP at market prices (2005 US$) [b]	2.3	-0.9	0.2	-3.0	0.1	0.9	1.0
Current account bal/GDP (%)	-3.3	-14.4	-12.8	-10.1	-4.7	-2.9	-1.4
Indonesia							
GDP at market prices (2005 US$) [b]	2.7	6.3	6.0	4.5	5.9	6.2	6.5
Current account bal/GDP (%)	1.5	2.4	0.0	2.0	2.6	-0.1	2.3
Lao PDR							
GDP at market prices (2005 US$) [b]	6.2	7.6	7.3	6.4	7.7	7.5	7.5
Current account bal/GDP (%)	-7.7	3.3	2.1	-0.3	-0.9	0.0	-0.1
Malaysia							
GDP at market prices (2005 US$) [b]	4.8	6.5	4.7	-1.7	7.4	4.8	5.7
Current account bal/GDP (%)	6.5	16.0	17.2	16.8	14.7	17.8	13.3
Mongolia							
GDP at market prices (2005 US$) [b]	5.2	10.2	8.9	-1.6	8.5	7.0	6.0
Current account bal/GDP (%)	-3.4	6.7	-14.0	-9.8	-13.9	-22.9	-18.0
Papua New Guinea							
GDP at market prices (2005 US$) [b]	0.7	7.2	6.7	5.5	7.5	5.5	5.0
Current account bal/GDP (%)	3.3	0.9	9.1	9.1	-16.1	-18.5	-16.1
Philippines							
GDP at market prices (2005 US$) [b]	4.2	7.0	3.5	1.1	6.8	5.0	5.4
Current account bal/GDP (%)	-1.4	4.9	2.2	5.5	5.3	4.5	3.5
Thailand							
GDP at market prices (2005 US$) [b]	2.7	4.9	2.5	-2.3	7.5	3.2	4.2
Current account bal/GDP (%)	1.9	6.3	0.8	8.3	6.0	4.3	4.9
Vanuatu							
GDP at market prices (2005 US$) [b]	2.3	6.7	6.3	3.6	4.5	5.5	5.5
Current account bal/GDP (%)	-8.9	-9.9	-8.2	-4.6	-3.9	-4.2	-3.6
Vietnam							
GDP at market prices (2005 US$) [b]	7.2	8.5	6.2	5.3	6.7	6.5	7.0
Current account bal/GDP (%)	-2.5	-20.1	-12.3	-8.7	-15.5	-12.5	-11.6

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.
American Samoa; Kiribati; Korea, Democratic People's Republic; Marshall Islands; Micronesia, Federate States; Mongolia: Myanmar; N. Mariana Islands; Palau; Solomon Islands; Timor-Leste; and Tonga are not forecast owing to data limitations.
a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. Estimate.
d. Forecast.

Source: World Bank

China and other manufactures exporters at risk, as key export markets adjust to a environment of more moderate growth. High -double-digit export volume performance is unlikely to characterize the coming two years.

- A challenge for all policymakers is to achieve a balance in stance required to (i) begin the fundamental shift of easing stimulus efforts while planning for further medium term budgetary consolidation; at the same time (ii) financial markets (and in some cases earlier domestic overheating) are generating contingencies for potential short term asset-price bubbles, emerging inflation pressures, exchange rate appreciation—and in the medium term a loss of export competitiveness.

- Food price increases underway have—as of December 2010—not exceeded their real values during the food/fuel crisis of 2008. Still, as international investors continue to explore new avenues for higher returns, commodities may become an attractive alternative to financial instruments and staple foods could be bid up further. Terms of trade would be adversely affected for a number of countries in the region (see Main text). The pickup of inflation in China is tied in large part to higher food prices; and for a number of countries import bills would escalate substantially.

Notes:

1. See "China Quarterly Update". November, 2010. Beijing Office. World Bank.

2. See "Robust Recovery, Rising Risks". East Asia and Pacific Economic Update, 2010, Volume 2. October, 2010. World Bank. East Asia and Pacific Region.

3. See East Asia and Pacific Economic Outlook, October 2010, for a complete coverage of all EAP country developments and prospects.

4. For the high-income NIEs (Hong Kong (SAR, China), Singapore, and Taiwan (China)) the shift was greater, rising from 22.5 percent to 25 percent.

5. Countries covered in the summary of aggregate East Asian capital flows include: Cambodia, China, Fiji, Indonesia, Lao PDR, Malaysia, Mongolia, Burma (Myanmar), Papua New Guinea, Philippines, Samoa, Thailand, Tonga, Vanuatu and Vietnam. Of course, part of these flows are intra-regional.

6. 'World Tourism Barometer', Update, August 2010. United Nations World Tourism Organization, Madrid. 2010.

7. Though Malaysia has attracted more tourists than has Thailand, structurally this is a very different story. Half of all arrivals in Malaysia are from Singapore alone (70% if adding Thailand and Indonesia). According to Malaysian authorities, many Singaporeans visit Malaysia on a daily basis to buy less expensive basic items. Though this boosts retail sales, the multiplier effects of tourism are smaller for Malaysia than might otherwise be the case.

8. Migrant remittances are defined as the sum of workers' remittances, compensation of employees, and migrants' transfers. Workers' remittances, as defined by the International Monetary Fund (IMF) in the Balance of Payments Manual, 6th edition (IMF 2010a), are current private transfers from migrant workers who are considered residents of the host country to recipients in the workers' country of origin.4 If the migrants live in the host country for one year or longer, they are considered residents, regardless of their immigration status. If the migrants have lived in the host country for less than one year, their entire income in the host country should be classified as compensation of employees.

Europe and Central Asia

GDP growth in developing Europe and Central Asia[1] rebounded to an estimated 4.7 percent in 2010, following the 6.6 percent decline in 2009. The recovery has been slow owing to continued large-scale restructuring, reflecting the severity of impact of the crisis through multiple channels of transmission to the region—including the collapse in capital inflows, sharp contraction in external demand, plunge in commodity prices and large fall-off in remittances inflows. Coming out of the crisis, high levels of household indebtedness and widespread unemployment held back consumer demand, while banking-sector consolidation and elevated bad-loans constrained new lending. Countries with fixed exchange-rate regimes faced more limited policy options, often implying fiscal spending cuts to bring about adjustment in domestic demand. In contrast, a revival in external demand and firming international commodity prices—especially for hydrocarbons and metals—underpinned the recovery in regional growth in 2010. While also recovering, net international capital flows to Europe and Central Asia were tepid in 2010 (see main text), and in particular bank-lending remains severely limited compared to pre-crisis flows, accentuating rather than offsetting contractionary forces emanating from the domestic banking sector. Looking forward, growth in the region is expected to accelerate only slowly. Persistent and increasingly structural unemployment, significant personal debt burdens, and financial-sector restructuring are expected to keep growth modest, with GDP projected to expand only 4.0 percent in 2011 and 4.2 percent in 2012. (Table R2.1).

Significant variation in the extent of recovery at the individual country level broadly reflects initial conditions at the onset of the crisis and main channels of transmission. Countries that had relied heavily on international inflows to finance large current account deficits in the pre-crisis boom years, typically reported weaker rebounds in 2010, given ongoing large private sector debt deleveraging, continued banking sector consolidation and severely crimped domestic demand. In Bulgaria, Lithuania and Romania, for instance—which had posted sharp contractions in 2009—GDP growth was lackluster, and indeed contracted in Romania, and significantly lagged the regional average rebound. Where credit booms had been relatively more subdued ahead of the crisis, and where the transmission of the crisis was driven more strongly by swings in trade growth and commodity prices (which rebounded quickly)—such as in Armenia, Azerbaijan, Belarus, Georgia, Russia, Turkey, Turkmenistan, Uzbekistan—growth outturns in 2010 were stronger and exceeded the regional average.

Recent developments

Much of the impetus for recovery in Europe and Central Asia in 2010 was external in nature: strengthening demand in export markets, higher metals and energy prices, a revival in remittances inflows, and in some cases large inflows of crisis-related official aid. Nearly all of the economies in the region posted positive growth in 2010. The regional aggregate is dominated by Russia and Turkey, which together comprise nearly 75 percent of regional GDP, and which posted strong outturns of 3.8 percent and 8.1 percent, respectively. Russia's real-side recovery was supported by fiscal stimulus equivalent to 5.3 percent of GDP and strong oil and metals prices, which generated strong spillovers for other countries in the region in the form of import demand (up an estimated 7 percent) and remittances, which after falling 18 percent in 2009 picked up 11 percent in dollar terms during 2010. Turkey's recovery was more vibrant—a reflection of strengthening domestic demand, supported by rising foreign capital inflows, and an accommodative monetary and fiscal policy. GDP outturns were strongest in Turkmenistan, Uzbekistan and Belarus with growth of 11.7 percent, 8 percent and 7.0 percent, respectively, due to the rebound in natural gas prices and minerals prices. In contrast, Kyrgyz Republic saw GDP decline, given political and civil dislocation. Sharp fiscal consolidation and household balance sheet restructuring was reflected in a second year of GDP decline in Romania, and near zero growth in Bulgaria and Lithuania. In part this reflected the constraints of fixed exchange-rate regimes, and policy-makers were limited to fiscal policy-levers to implement adjustment through domestic demand.

Regional domestic demand remains subdued, given significant debt-overhang from pre-crisis borrowing, stagnant or falling household incomes, and tepid job-growth—which also underlie weak private-sector credit demand by borrowers. Ongoing recapitalization and provisioning of high non-performing loan ratios along with more restrictive lending standards are constraining bank-lending by lenders. Non-performing loans account for a median of 11 percent of all loans in the region, the highest among developing regions , with the ratio reaching as high as 42 percent, 27 percent, and 20 percent in the cases of Ukraine, Kazakhstan and Lithuania, respectively, in early-2010 (Figure R2.1).[2] Consequently, credit growth remained stagnant in most economies across the region in 2010. Credit expansion is somewhat stronger in Russia, but below the pre-crisis pace,

Table R2.1 Europe and Central Asia forecast summary
(annual percent change unless indicated otherwise)

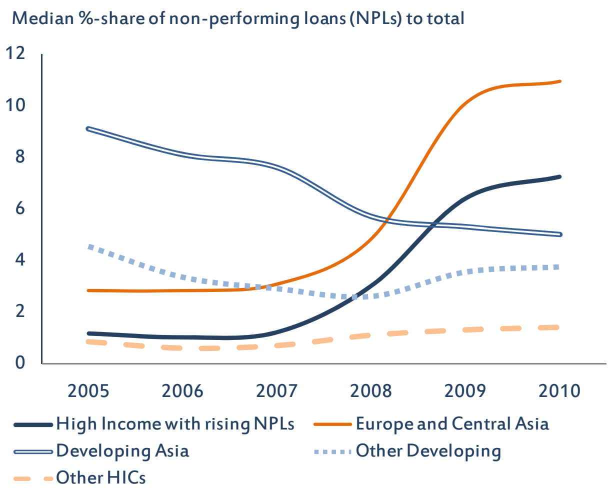
					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 US$) [b]	4.0	7.4	3.9	-6.6	4.7	4.0	4.2
GDP per capita (units in US$)	4.1	7.4	4.0	-6.5	4.7	4.0	4.2
PPP GDP [c]	4.0	7.7	4.3	-6.7	4.4	4.0	4.5
Private consumption	5.0	10.7	6.7	-6.3	4.4	4.4	4.6
Public consumption	1.8	4.4	3.2	2.5	1.7	2.3	2.7
Fixed investment	4.4	15.4	6.4	-18.5	6.9	6.4	7.9
Exports, GNFS [d]	7.5	7.3	3.0	-6.8	7.9	5.8	7.0
Imports, GNFS [d]	7.9	19.6	8.6	-24.0	12.3	8.4	8.0
Net exports, contribution to growth	0.3	-3.7	-2.0	6.5	-1.0	-0.7	-0.2
Current account bal/GDP (%)	2.0	-0.5	0.5	0.7	0.8	-0.3	-1.4
GDP deflator (median, LCU)	19.7	11.8	12.0	2.5	6.4	6.2	5.3
Fiscal balance/GDP (%)	-5.1	3.0	1.6	-5.5	-4.3	-3.1	-2.4
Memo items: GDP							
Transition countries [e]	3.9	5.2	2.1	-5.4	5.7	3.6	4.2
Central and Eastern Europe [f]	2.9	6.7	6.2	-7.3	-0.9	2.1	3.9
Commonwealth of Independent States [g]	4.0	8.8	5.1	-7.3	4.1	4.3	4.2
Russia	3.8	8.5	5.2	-7.9	3.8	4.2	4.0
Turkey	4.3	4.7	0.7	-4.7	8.1	4.1	4.3
Romania	2.2	6.0	7.1	-7.1	-1.9	1.5	4.4

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Transition countries: Albania, Bulgaria, Lithuania, Macedoneia, FYR, Romania, Turkey.
f. Central and Eastern Europe: Albania, Bulgaria, Lithuania, Macedonia, FYR, Romania.
g. Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldovia, Russian Federation, Ukraine, Uzbekistan.

Source: World Bank

in part reflecting continued capital outflows. Turkey too is an exception, where credit growth has been buoyed by the strong recovery and capital inflows.

Figure R2.1 Bank NPLs remain elevated in Europe and Central Asia



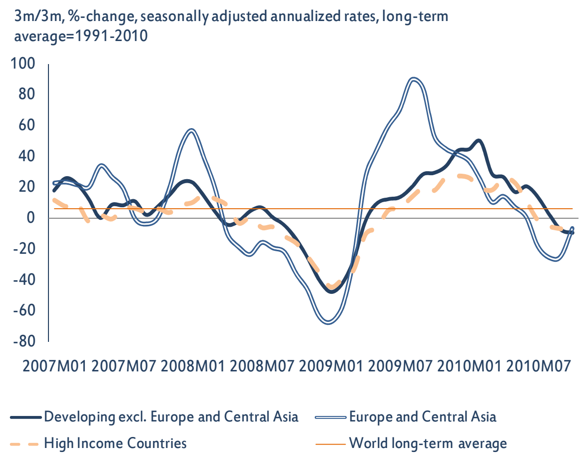
Source: Source: IMF Global Financial Stability Report and World Bank

Note: 2010*=most recent 2010-observation; 62 country sample

Unemployment rates in Europe and Central Asian remain significantly elevated, having risen for example, as of September 2010 from end-2009 in Bulgaria and Lithuania to 10 percent (from 8.6 percent) and to 18.4 percent (from 16 percent), respectively. While still elevated, unemployment rates appear to have peaked and are falling in Russia and Turkey.

The rebound in Europe and Central Asia was led by a surge in merchandise export volumes (notably of commodities) starting mid-2009, while import growth (reflecting lackluster domestic demand) remained weak. Export growth decelerated sharply starting in early-2010, ahead of the more generalized global slowdown that began mid-year, turning strongly negative in the third quarter before beginning to expand once again in the fourth quarter (Figure R2.2). Services trade has posted a much more modest recovery, albeit from a less severe contraction in 2009. Tourism remained a drag on services receipts, with arrivals estimated to have

Figure R2.2 Europe and Central Asia's merchandise goods exports remain in duldrums in late-2010



Source: Thomson Datastream and World Bank

continued contracting in 2010, albeit slightly by 0.3 percent after the sharp 8.2 percent downturn in 2009.

Remittances are also up a modest 3.7 percent in US dollar terms following the sharp 23 percent decline in 2009. Higher oil prices and strengthened activity in Russia were main factors supporting increased flows into neighboring Commonwealth of Independent States, for which Russia represents a key migrant destination country. Tajikistan continued to record the highest share among developing countries, with official inflows for 2010 estimated at 35 percent of GDP, followed within Europe and Central Asia region by Moldova (fourth among LMICs), where official flows are estimated to have reached 23 percent in 2010. Notably, corrected for inflation and shifts in exchange rates, remittances inflows actually contracted in Romania, Russia, Turkey and Ukraine. (Figure R2.3).

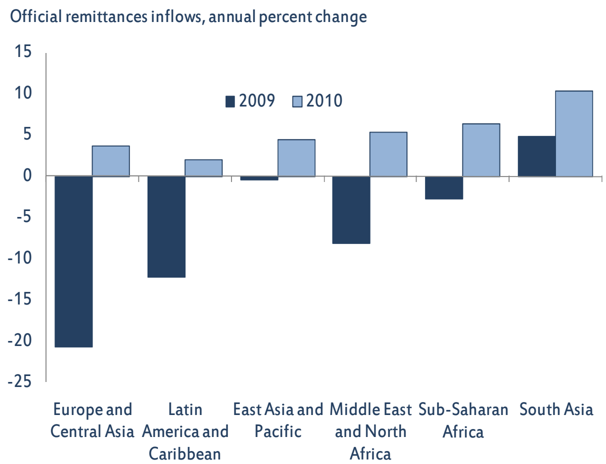
Despite the strong rebound in exports, subdued recovery in domestic demand and imports and resumption of the US-dollar value of remittances inflows, the regional current account surplus shrank as a share of GDP in 2010. This largely reflected a sharp increase in Turkish imports, which contributed to a near-tripling of its current account deficit from 2.3 to 5.9 percent of GDP.

Most other regional economies that posted deficits in 2009 recorded shrinking deficits in 2010 (Albania, Bosnia and Herzegovina, Bulgaria, Georgia, FYR Macedonia, and Montenegro) or increased surpluses (Azerbaijan, Russia and Uzbekistan).

The pickup in Turkish imports is a partial reflection of the sharp increase in foreign capital inflows, which helped boost credit growth and contributed to an appreciation of its currency. Overall, net private capital inflows to Europe and Central Asia nearly doubled in 2010–reaching $111 billion or about 3.6 percent of GDP, but remain only about a quarter of their peak level of $414 billion or 15.5 percent of GDP in 2007. (Figure R2.4) The uptick was led by a firming in international bond issuance, which was concentrated in Montenegro, Romania, Russia and Turkey. In contrast, foreign direct investment to the region declined, reflecting continued adjustment in both source and recipient economies. While net bank-lending to the region firmed slightly, it remained sharply compressed compared with pre-crisis levels—equivalent to less than one-tenth of the 2007 and 2008 levels—reflecting ongoing banking sector consolidation and loan provisioning in both source and recipient countries.

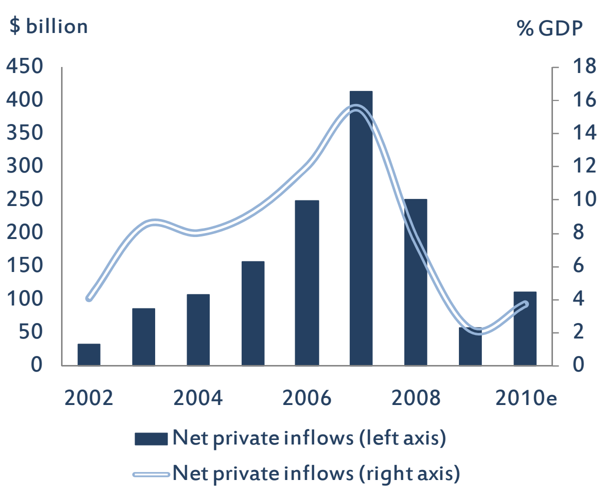
Extensive spare capacity throughout the region has kept core inflation in check, but the severe drought and extensive wild fires (notably in Russia and Kazakhstan) provoked a sharp rise in food prices and a temporary uptick in median inflation in the region, which rose from 2.3 percent in 2009 to 6.7 percent in 2010. Administrative price hikes in Romania and Ukraine have also played a role, while capacity constraint and capital inflows have contributed to an acceleration of Turkish prices. (Figure R2.5).

Figure R2.3 Remittances inflows declined most in Europe and Central Asia, tepid recovery tied to slow E.U. job-growth



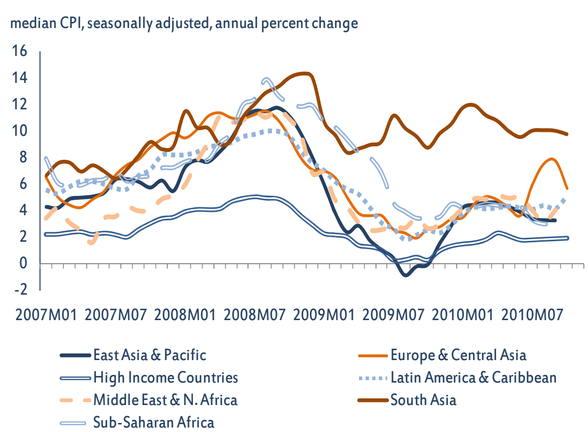
Source: Source: World Bank, Migration and Development Brief, no. 13, 2010

Figure R2.4 Net private capital inflows to Europe and Central Asia projected to have firmed in 2010



Source: World Bank

Figure R2.5 Inflation is quiescent in most regions; temporary upswing in ECA tied to drought



Source: Thomson Datastream and World Bank

Outlook

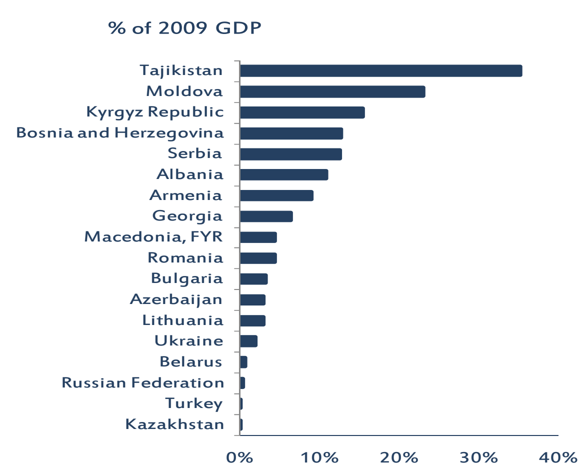
GDP growth in Europe and Central Asia is projected to slow to 4.0 percent in 2011 from 4.7 percent in 2010, before firming to 4.2 percent in 2012. Growth rates will remain well-below the boom-period average of 7.4 percent recorded during 2003-07, and will not be strong enough to make a significant impact on regional unemployment. Both investment and consumer demand will continue to be held back by high unemployment, and household and banking-sector restructuring, even as domestic demand growth plays an increasing role in the recovery. The deceleration in 2011 mainly reflects weaker exports due to slower growth in export markets (notably with high-income Europe), while expected improvement in domestic conditions underpin the modest acceleration in 2012. Reflecting strengthening domestic demand, imports are expected to grow more quickly than exports and the regional current account is projected to incrementally shift into deficit of 1.4 percent of GDP in 2012 from a slight surplus of 0.8 percent in 2010 and slight deficit of 0.3 percent in 2011.

Projected growth paths vary significantly at the sub-regional level. For example, Turkey is projected to post a deceleration in GDP growth to 4.1 percent in 2011 from an estimated 8.1 percent in 2010, due to falling export competitiveness and weaker base effects. Growth in the Central European economies at 2.1 percent and 3.9 percent in 2011 and 2012, respectively, will continue to be held back by restructuring. In contrast, the Commonwealth of Independent States are projected to post somewhat stronger real GDP growth of 4.3 percent and 4.2 percent in 2011 and 2012, respectively. (Table R2.2).

The more commodity-dependent Commonwealth of Independent States economies, such as Russia, Ukraine and Uzbekistan, should continue to benefit from elevated key export prices for hydrocarbons and metals. And, in the case of Turkmenistan, added export capacity will also be a factor. In contrast, in Azerbaijan growth is projected to slow to more sustainable rates, as the pace of capacity expansion slows. In Russia, growth is projected to firm to 4.2 percent in 2011 from 3.8 percent in 2010, reflecting strengthening domestic demand, higher oil prices and supportive base effects. However, in 2012 Russian GDP growth is projected to moderate to 4.0 percent and converge toward potential, as underlying structural factors are expected to increasingly constrain activity. In Kazakhstan the recovery is expected to slow over the forecast horizon, given ongoing banking sector problems that are expected to impinge on credit growth.

Economic activity within the Commonwealth of Independent States will also be supported by the recovery in Russia, a major export market and important migrant destination country within the sub-region. Armenia, Moldova and Tajikistan, in particular, are expected to benefit, among others. Just over 45 percent of Commonwealth of Independent States remittances inflows originate from Russia, and 50 percent from the EU-15. The recovery in remittances inflows to the region in aggregate is expected to progressively firm by 6.5 percent and 10.4 percent in 2011 and 2012, respectively (in US-dollar value-terms). While this would result in remittances inflows reaching a projected $43bn in 2012, the level would remain 6 percent below the record high posted in 2008 (Figure R2.6).[3]

Figure R2.6 Remittances inflows to Europe and Central Asia



Source: World Bank, Migration and Development Brief, no. 13, 2010

Better economic performance should see fiscal balances improve. Further fiscal consolidation in Central and Eastern Europe, partly under the aegis of IMF programs, should help set the stage for more balanced and sustainable growth in the future. However, given existing significant hurdles, only gradual progress in reducing large fiscal deficits is expected. Russia is expected to continue unwinding the large stimulus measures introduced during the crisis, but significant tightening is unlikely until after the presidential elections in the spring of 2012. In Armenia,

Table R2.2 Europe and Central Asia country forecasts
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Albania							
GDP at market prices (2005 US$) [b]	5.4	6.0	7.5	2.5	3.0	3.7	4.2
Current account bal/GDP (%)	-5.5	-10.6	-15.4	-15.6	-12.2	-10.9	-9.9
Armenia							
GDP at market prices (2005 US$) [b]	8.6	13.7	6.8	-14.4	4.0	4.6	4.9
Current account bal/GDP (%)	-11.7	-6.4	-11.6	-15.7	-12.7	-11.6	-10.5
Azerbaijan							
GDP at market prices (2005 US$) [b]	10.2	25.0	10.8	9.3	3.7	3.5	3.9
Current account bal/GDP (%)	-16.6	27.3	35.6	23.7	27.2	24.4	24.0
Belarus							
GDP at market prices (2005 US$) [b]	6.7	8.6	10.2	0.2	7.0	6.0	5.5
Current account bal/GDP (%)	-3.2	-6.8	-8.7	-13.0	-14.0	-14.2	-13.3
Bulgaria							
GDP at market prices (2005 US$) [b]	2.8	6.4	6.2	-4.9	0.0	2.5	2.7
Current account bal/GDP (%)	-3.4	-27.2	-21.9	-9.7	-2.4	-3.1	-3.4
Georgia							
GDP at market prices (2005 US$) [b]	6.6	12.3	2.3	-3.9	5.5	4.0	4.7
Current account bal/GDP (%)	-9.8	-20.9	-25.3	-12.3	-12.1	-12.0	-11.1
Kazakhstan							
GDP at market prices (2005 US$) [b]	6.4	8.9	3.3	1.2	5.5	4.5	5.1
Current account bal/GDP (%)	-2.3	-7.9	4.7	-3.7	3.8	4.4	4.0
Kosovo							
GDP at market prices (2005 US$) [b]		6.3	6.9	2.9	4.3	5.7	5.2
Current account bal/GDP (%)		-8.3	-15.2	-17.0	-19.7	-18.2	-17.0
Kyrgyz Republic							
GDP at market prices (2005 US$) [b]	4.7	8.5	8.4	2.3	-3.5	7.0	4.5
Current account bal/GDP (%)	-10.2	-6.9	-14.6	-6.6	-5.4	-9.4	-9.1
Lithuania							
GDP at market prices (2005 US$) [b]	6.1	9.8	2.8	-15.0	0.4	3.3	3.1
Current account bal/GDP (%)	-7.8	-14.5	-11.8	4.4	2.6	1.3	1.2
Moldova							
GDP at market prices (2005 US$) [b]	2.3	3.1	7.8	-6.5	2.6	3.0	3.6
Current account bal/GDP (%)	-7.9	-16.5	-17.3	-9.9	-10.0	-10.3	-10.6
Macedonia, FYR							
GDP at market prices (2005 US$) [b]	2.2	5.9	4.8	-0.7	1.2	3.0	4.5
Current account bal/GDP (%)	-6.0	-7.6	-12.8	-7.0	-4.4	-5.3	-5.1
Romania							
GDP at market prices (2005 US$) [b]	2.2	6.0	7.1	-7.1	-1.9	1.5	4.4
Current account bal/GDP (%)	-5.8	-13.6	-11.9	-4.5	-6.3	-6.4	-6.5
Russian Federation							
GDP at market prices (2005 US$) [b]	3.8	8.5	5.2	-7.9	3.8	4.2	4.0
Current account bal/GDP (%)	7.6	6.0	6.2	4.0	5.1	3.3	1.1
Tajikistan							
GDP at market prices (2005 US$) [b]	4.6	7.8	7.9	3.4	5.5	5.0	5.0
Current account bal/GDP (%)	-4.5	-8.6	-7.7	-4.9	-3.5	-5.4	-5.4
Turkey							
GDP at market prices (2005 US$) [b]	4.3	4.7	0.7	-4.7	8.1	4.1	4.3
Current account bal/GDP (%)	-1.5	-5.9	-5.7	-2.3	-5.9	-5.8	-5.6
Ukraine							
GDP at market prices (2005 US$) [b]	2.7	7.9	2.1	-15.1	4.3	4.0	4.5
Current account bal/GDP (%)	2.7	-3.7	-7.1	-1.5	-2.2	-3.1	-3.4
Uzbekistan							
GDP at market prices (2005 US$) [b]	4.6	9.5	9.0	8.1	8.0	7.3	8.3
Current account bal/GDP (%)	3.3	7.3	8.7	2.7	4.3	8.3	9.6

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.
Bosnia and Herzegovina, Turkmenistan, Serbia, Montenegro are not forecast owing to data limitations.
a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.

Source: World Bank.

Georgia, Kyrgyz Republic, Moldova, Tajikistan and Ukraine improved conditions are expected to see policy shift toward a more neutral stance beginning in 2010.

Financing external imbalances will be facilitated by continued improvement in international financial market conditions and rising international flows to the region, which will also support stronger investment growth. Although financial conditions are much tighter than during the pre-crisis boom, international borrowing costs have fallen sharply and consolidation efforts are beginning to bear fruit. Several countries in the region have seen their credit ratings upgraded (Azerbaijan, Georgia, Moldova, Montenegro, Turkey, and Ukraine -- although Montenegro also received one downgrade).

Reflecting these improving conditions, net private inflows into the region (excluding official inflows) are projected to expand by 30 percent and 16 percent in 2010. Similarly, FDI is projected to firm over the forecast horizon, partly because of an expected pick up in privatization, reaching 3.3 percent of regional GDP in 2012. (Table R2.3).

Risks

Banking system balance sheets remain impaired in a number of Europe and Central Asia countries, and significantly lower growth outturns could further undermine positions. In a number of countries, decisive actions—including improved provisioning and supervision standards—are required to help restore normal credit expansion.

Growth in energy exporters remains very reliant on hydrocarbon exports and volatile international oil prices. Significantly lower-than-projected commodity prices could lead to weaker growth outcomes for the mineral-export-led and

Table R2.3 Net capital flows to Europe and Central Asia
(annual percent change unless indicated otherwise)

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	20.3	36.7	48.5	37.6	-13.6	8.1	14.6	33.6	21.2	12.2
as % of GDP	2.0	2.7	2.9	1.8	-0.5	0.2	0.6	1.1	0.6	0.3
Financial flows:										
Net private and official inflows	81.0	99.9	127.8	218.2	410.4	262.1	89.8	134.7		
Net private inflows (equity+debt)	85.8	107.2	156.2	248.9	413.5	251.0	57.6	111.0	144.2	167.8
..Net private inflows (% GDP)	8.5	8.0	9.3	12.0	15.5	7.5	2.2	3.6	4.3	4.4
Net equity inflows	25.3	43.7	57.8	104.6	160.2	145.0	90.0	86.0	112.2	135.3
..Net FDI inflows	23.8	41.9	51.1	92.3	133.2	160.1	85.1	79.0	103.2	124.3
..Net portfolio equity inflows	1.5	1.8	6.7	12.3	27.0	-15.1	5.0	7.0	9.0	11.0
Net debt flows	55.8	56.2	70.0	113.6	250.2	117.1	-0.2	48.7		
..Official creditors	-4.7	-7.3	-28.4	-30.7	-3.0	11.1	32.2	23.7		
....World Bank	-0.2	1.0	-0.7	0.2	0.2	0.7	2.8	2.2		
....IMF	-2.0	-5.9	-9.8	-5.8	-5.0	6.2	20.2	10.5		
....Other official	-2.5	-2.5	-18.0	-25.1	1.8	4.2	9.3	11.0		
..Private creditors	60.5	63.5	98.4	144.3	253.3	106.0	-32.5	25.0	32.0	32.5
....Net M-L term debt flows	34.0	52.2	80.0	108.9	177.5	121.3	5.3	24.0		
......Bonds	7.3	14.4	16.6	32.3	55.9	16.2	-1.7	13.5		
......Banks	27.1	39.0	64.7	77.5	122.6	105.7	7.3	10.5		
......Other private	-0.4	-1.3	-1.3	-0.8	-1.0	-0.6	-0.4	0.0		
....Net short-term debt flows/a	26.5	11.3	18.4	35.4	75.7	-15.3	-37.7	1.0		
Balancing item /b	-52.3	-67.7	-89.3	-84.2	-170.7	-328.0	-78.4	-121.2		
Change in reserves (- = increase)	-49.1	-68.8	-87.0	-171.6	-226.1	57.8	-26.0	-47.2		
Memorandum items										
Workers' remittances	11.6	16.0	23.3	28.4	39.3	45.8	35.4	37.0	39.0	43.0

Source: World Bank
Note: Countries covered are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Kazakhstan, Kosovo, Kyrgyz Republic, Lithuania, Macedonia FYR, Moldova, Montenegro, Romania, Russian Federation, Seychelles, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan

interlinked CIS economies. And, while the build-up of oil revenue savings-funds prior to the onset of the crisis—albeit significantly drained in the interim (Azerbaijan, Russia, Kazakhstan)—have created some cushioning for downturns, diversification to other sources of growth would further underpin sustainable long-term growth. Continued improvement in the investment climate (for example in public administration and judicial reforms) would facilitate private sector development.

Given the extent to which the region, particularly the CEE economies, has become tightly integrated with high-income Europe (trade, finance and labor), a significantly lower-than-projected growth-outturn in the Euro Area represents a downside risk. Further, a number of the Europe and Central Asian economies (e.g., Bulgaria, Romania) have some exposure to the banking systems of high-income Euro Area countries with elevated sovereign debt (e.g., Greece), where recovery is particularly fragile. While spill-over of heightened risk-aversion from the Euro Area countries has been limited so far, Europe and Central Asia's bond markets remain vulnerable to downswings in investor sentiment. As sustainability of public debt and concerns about the health of banking systems will remain a key concern over the forecast horizon, countries with large external financing needs face the risk that international financial markets might require greater fiscal consolidation to maintain confidence.

Notes:

1. For the purposes of this report the developing Europe and Central Asia comprises only low- and middle-income countries

2. IMF Global Financial Stability Report, October 2010.

3. Ratha, Dilip et al, "Migration and Development Brief (number 13)", November 8, 2010, The World Bank.

Latin America and the Caribbean

Recent developments

The Latin America and Caribbean (LAC) region has emerged from the global crisis faster than expected. After contracting by 2.2 percent in 2009, GDP is estimated to have expanded by 5.7 percent in 2010, similar to the average growth recorded during the 2004 – 2007 boom years. Growth is forecast to slow to around 4.0 percent in the remainder of the forecast period, largely because of a weaker external environment as growth in advanced economies and China moderates. Nonetheless, the recovery compares well to the region's own past and the recovery in other emerging regions.

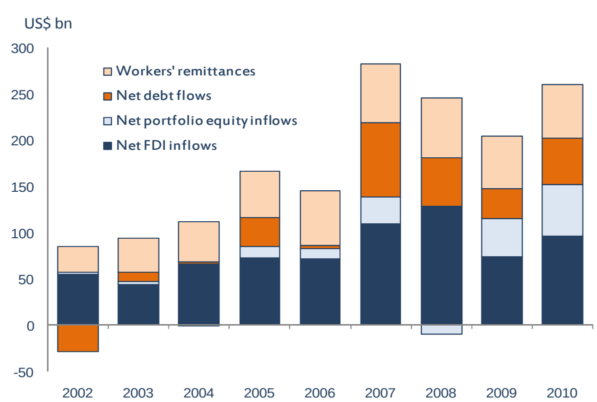
That strong aggregate performance masks significant differences within the region, reflecting differences in the terms-of-trade effects, capital flows and policies stances across countries and sub-region. *Central America* (particularly Mexico with its strong links to the US) was most affected by the crisis, with GDP declining by 5.9 percent in 2009. Although the rebound to an estimated 5 percent growth during 2010 in Central America was also the strongest, there is still considerable slack in the sub-region, with countries still having considerable catch-up to do before regaining pre-crisis trends. In the *Caribbean* countries, the impact of the crisis was smaller, while the rebound has been more muted, in part because remittances and tourism from high-income countries, an important source of foreign exchange and incomes are expected to remain weak. Overall, GDP for these countries is expected to grow by between 2½ and 4 percent over the forecast period, much less than the almost 7 percent rate recorded during the years 2005-2007.

The region's newfound resilience reflects the much healthier macroeconomic position from which it entered the crisis. Noticeable improvements have been made in terms of the quality and credibility of monetary policy, better fiscal and debt management, an improved balance sheet, and trade diversification towards Emerging Asia, and improved systems of financial regulation. All helped to bolster the region's resilience. The rebound was also supported by strong cyclical factors such as the rebound in external demand (particularly from China), renewed capital inflows, strong commodity prices, the turn in the inventory cycle and a significant boost to domestic demand from monetary and fiscal stimulus.

Financial conditions have also improved noticeably. After a brief pause during the global crisis, the LAC region experienced a strong recovery in capital inflows as the very loose monetary policy and the associated negative real interest rates that currently prevail in high-income countries have boosted yield-searching bond and equity capital inflows to the region. Based on the gains already made, net private inflows are expected to reach over $203 billion in 2010 – less than 7 percent shy of the 2007 peak, and almost 38 percent above 2009 (Figure R3.1 and Table R3.1).

The strong inflows have been a mixed blessing. On the positive side, it provided cheap financing, thereby boosting domestic demand. But increasingly, these flows are raising concerns

Figure R3.1 Financial flows to Latin America and Caribbean recovered sharply in 2010



Source: World Bank.

Table R3.1 Net capital flows to Latin America and the Caribbean
(annual percent change unless indicated otherwise)

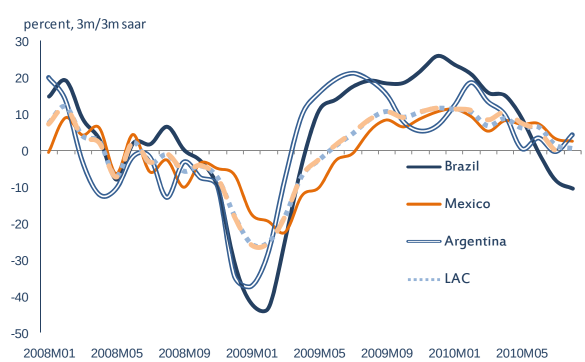
	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	8.8	21.2	33.9	44.3	10.5	-34.5	-20.4	-52.8	-68.2	-84.9
as % of GDP	0.5	1.0	1.3	1.4	0.3	-0.8	-0.5	-1.2	-1.4	-1.6
Financial flows:										
Net private and official inflows	62.2	57.2	85.2	66.2	217.5	177.2	166.7	223.8		
Net private inflows (equity+debt)	57.5	67.3	116.6	86.1	218.5	170.7	147.5	203.4	212.9	212.7
..Net private inflows (% GDP)	3.1	3.1	4.5	2.8	6.1	4.1	3.8	4.5	4.4	4.1
Net equity inflows	46.6	65.3	84.4	83.0	138.2	118.2	115.2	153.3	160.9	170.5
..Net FDI inflows	43.3	65.9	72.2	72.0	109.4	127.9	73.6	99.3	109.9	127.5
..Net portfolio equity inflows	3.3	-0.6	12.2	11.0	28.8	-9.7	41.6	54.0	51.0	43.0
Net debt flows	15.7	-8.1	0.8	-16.8	79.2	59.0	51.5	70.5		
..Official creditors	4.7	-10.2	-31.3	-19.9	-1.1	6.5	19.2	20.4		
....World Bank	-0.4	-1.0	-0.7	-3.4	-0.1	2.4	6.6	6.2		
....IMF	5.6	-6.3	-27.6	-12.1	0.0	0.0	0.4	0.2		
....Other official	-0.4	-2.9	-3.0	-4.4	-1.0	4.1	12.2	14.0		
..Private creditors	10.9	2.0	32.2	3.1	80.3	52.5	32.3	50.1	52.0	42.2
....Net M-L term debt flows	9.2	-0.9	16.4	5.2	47.6	48.4	34.1	40.9		
......Bonds	16.7	3.1	20.6	-11.9	13.4	7.5	40.3	33.5		
......Banks	-7.0	-3.8	-3.9	17.7	34.6	41.4	-5.6	7.4		
......Other private	-0.5	-0.1	-0.3	-0.6	-0.4	-0.5	-0.5	0.0		
....Net short-term debt flows/a	1.8	3.0	15.7	-2.1	32.7	4.1	-1.8	9.2		
Balancing item /b	-35.4	-53.0	-84.8	-55.1	-90.2	-92.5	-94.3	-108.3		
Change in reserves (- = increase)	-35.6	-25.4	-34.4	-55.5	-137.8	-50.1	-52.0	-62.7		
Memorandum items										
Workers' remittances	36.7	43.3	50.1	59.2	63.1	64.6	56.9	58.0	62.0	69.0

Source: World Bank.

about domestic overheating, external competitiveness and increased sterilization costs. Although the recovery in domestic financial conditions is not complete (domestic credit growth remains moderate), very large external capital inflows have induced booms in many equity- and bond markets, raising fears about possible asset price bubbles. Moreover, capital-inflow induced exchange-rate appreciations in the region are having growing impacts on competiveness and growth and are of increasing concern to regional policy makers.

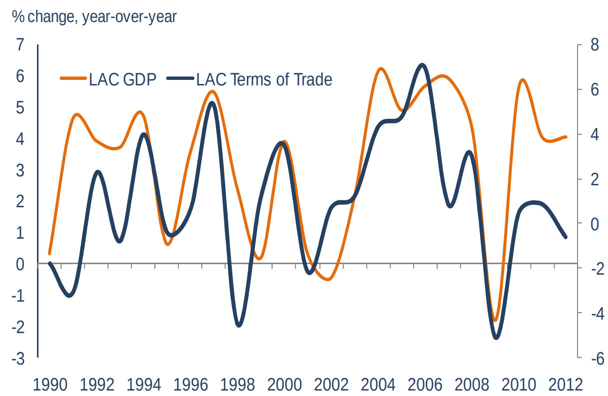
The strong recovery in GDP during 2010 reflects a rapid bounce back in industrial activity during the early part of the year, followed by a sharp slowing mid-year. This is a pattern repeated in virtually every region of the world (see discussion in main text). Regional industrial production reached peak growth rates in excess of 11 percent (annualized) during the final months of 2009, but was actually declining during the third quarter (Figure R3.2). Chile proved an exception to this trend, with industrial production activity there growing relatively quickly, reflecting a bounce back after the 28 percent decline (3m/3m saar) recorded following the earthquake earlier in the year. Although forward looking indicators in the region point to continued growth, growth rates are expected to be more modest than earlier this year, as capacity utilization stabilizes throughout the region and output gaps approach zero. With private

Figure R3.2 Sharp recovery in industrial production growth is slowing



Source: World Bank

Figure R3.4 GDP growth rebound also benefitting from strong recovery in the terms of trade



Source: World Bank

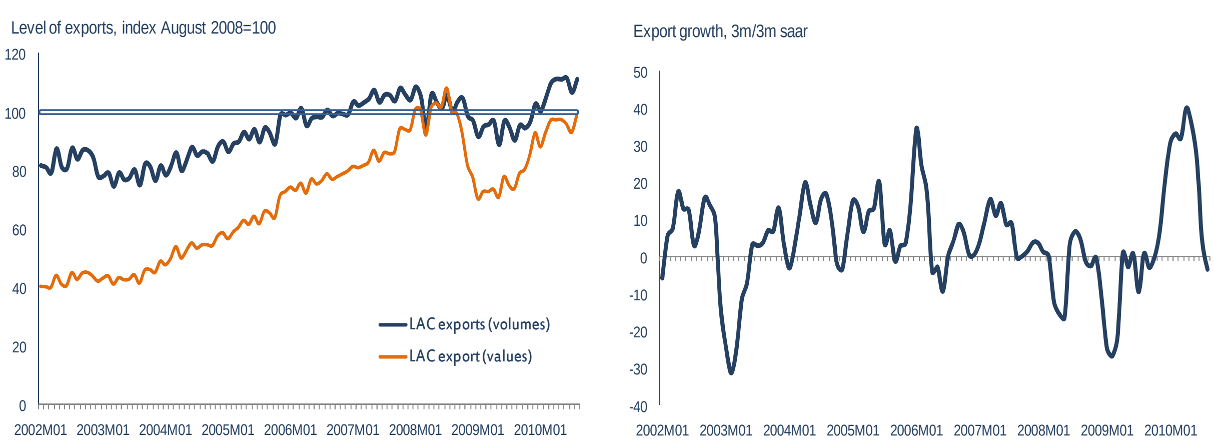
consumption, investment and export growth rates forecast to moderate substantially over the forecast, industrial production growth will also slow to more sustainable growth rates of around half those registered in the first half of 2010.

Deeper trade linkages to Emerging Asia, and China in particular, have contributed to the region's quick recovery through exports and rising commodity prices. Export volumes have fully recovered from the crisis, but as is the case with other high frequency indicators worldwide, export growth (temporary) slowed sharply mid year (Figure R3.3). Strong demand for commodities – especially from China – also benefited the region, boosting its terms of trade, raising incomes and contributing to stronger domestic demand (Figure R3.4).

Regional imports were boosted by the rebound in investment spending (investment goods in the LAC region tend to have a high import content) (Figure R3.5). This, plus the real-effective appreciation of many of the currencies in the region meant that merchandise import volumes grew by an estimated 21.4 percent in the 12 months ending October 2010, versus 8.3 percent for exports. Had it not been for stronger commodity prices (notably metals prices see annex on commodities), the region's current account deficit would have deteriorated much more. As it is, it went from -0.5 percent of GDP in 2009 to about -1.2 this year (with about half the swing accounted for by Brazil) – nevertheless a marked swing from the 1 percent of GDP average surpluses recorded during the 2004-07 commodity boom.

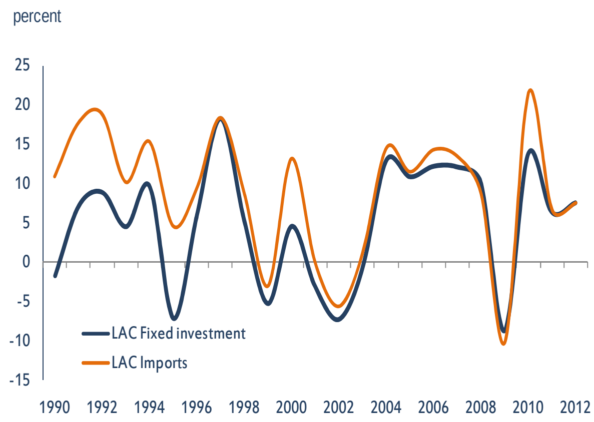
Tourism, an important source of foreign currency in many countries, especially in Central America and the Caribbean, also recovered in 2010. Tourism arrivals rose an estimated 3.3 percent in 2010, underpinned by a 3 and 3.2 percent growth recovery in Brazil and Mexico respectively and a sharp 8 percent increase in the number of visitors to Argentina. High-income islands in the Caribbean experienced a disappointing year, with only small increase in arrivals—in part due to inclement weather

Figure R3.3 Export volumes have recovered to pre-crisis levels, but growth is slowing rapidly



Source: World Bank.

Figure R3.5 Investment spending has been a major driver of imports



Source: World Bank

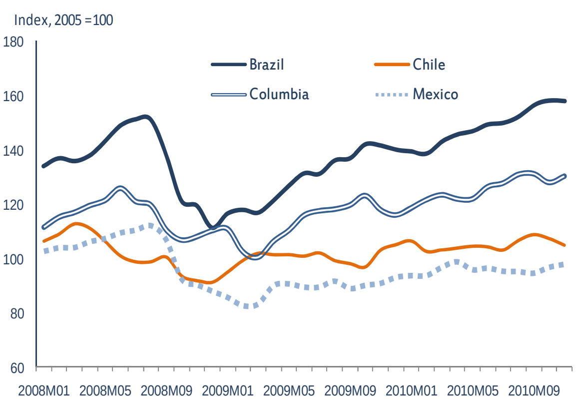
during peak season.

Remittances, also an important source of foreign currency for countries in the region, rebounded by a modest 2 percent in 2010, after falling an estimated 12 percent in 2009 – the second largest regional decline after Europe and Central Asia, where remittances fell 23 percent. Persistent unemployment in the United States and the concentration of joblessness in the construction sector where many regional remitters are or used to be employed underpin this weak performance, which is projected to remain relatively modest in 2011 and 2012.

As indicated earlier, strong capital inflows have put upward pressure on the real exchange rates of some countries in the region (Figure R3.6). This has been particularly evident in Brazil, where the real effective exchange rate has increased by 13.2 percent during 2010, and by 41.5 percent since the 2008 lows. But even in countries such as Colombia, Chile and Mexico, real effective exchange rates have appreciated by 29.9, 14.9 and 18.5 percent respectively since their lows in late-2008/early 2009.

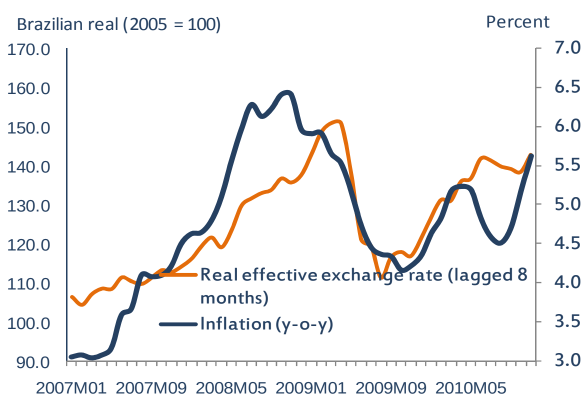
The brisk rebound in economic activity in the region during 2010, combined with the (continued) surge in capital inflows has raised concerns about overheating and the inflation outlook. In Brazil, for instance, the surging capital inflows and appreciation of the Real has coincided with rising inflation (Figure R3.7). Elsewhere in the region, where surging capital inflows has played less of a role, rising commodity prices have raised inflation somewhat, as food prices have a high weighting in the region's price basket. With a more rapid than expected recovery pushing up wage demands, a number of central banks in the region have started to tighten interest rates. Brazil, where first quarter growth came in at 9 percent, first raised its benchmark policy rate in April - Peru and Chile followed later. Although inflationary pressures have been strongest in Argentina, a desire to sustain the consumption boom suggests that policy may not be tightened

Figure R3.6 Upward pressure on real exchange rates



Source: World Bank.

Figure R3.7 Appreciating real is placing upward pressure on inflation



Source: World Bank

unless there is a dramatic reversal in capital flows. Mexico has also not yet tightened rates, reflecting its relative weak recovery.

Medium-term outlook

Aggressive policy stimulus and Chinese demand has enabled the region's commodity exporters (Brazil, Chile and Peru together account for 70 percent of the region's exports to China) to lead the recovery, growing by an estimated 7.6, 5.5 and 8.0 percent respectively in 2010. The region as a whole is estimated to have expanded by 5.7 percent in 2010, and is forecast to grow by around 4 percent per annum over the 2011-2012 period (Table R3.2). Private consumption is forecast to rebound by 5.0 percent after contracting by 1.2 percent during 2009, supported by the lagged effects of expansionary macroeconomic policies, while later in the forecast period, the government spending contribution to growth will wane as policy stimuli are being withdrawn. Stronger demand is also fuelling a cyclical rebound in fixed investment and imports.

As policy makers in the region begin tightening monetary policy and interest rates rise, many currencies will continue to experience appreciation pressures, which will adversely affect external competitiveness. Furthermore higher capital inflows in response to increased interest rate differentials could lead to excess credit expansion, complicating the task of policymakers in combating inflationary pressures, which are already rising in some economies.

Beyond 2010 growth in the region will likely slow as policy stimulus and the inventory cycle's contribution to growth wanes. Also, slower growth in the US in the second half of 2010 and

Table R3.2 Latin America and the Caribbean forecast summary
(annual percent change unless indicated otherwise)

	95-06 [a]	2007	2008	2009	Est. 2010	Forecast 2011	2012
GDP at market prices (2005 US$) [b]	2.9	5.6	4.0	-2.2	5.7	4.0	4.0
GDP per capita (units in US$)	1.4	4.2	2.7	-3.4	4.4	2.7	2.7
PPP GDP [c]	2.9	5.8	4.3	-1.8	5.7	4.0	4.1
Private consumption	3.4	7.1	5.1	-0.7	5.0	3.1	3.5
Public consumption	2.2	5.0	2.4	4.0	6.4	4.3	4.4
Fixed investment	3.5	12.3	8.7	-9.3	13.9	6.4	7.6
Exports, GNFS [d]	6.0	5.6	1.1	-10.3	14.3	5.8	6.4
Imports, GNFS [d]	6.2	13.1	8.3	-15.0	21.0	6.7	7.6
Net exports, contribution to growth	0.1	-1.8	-1.9	1.6	-1.8	-0.4	-0.5
Current account bal/GDP (%)	-1.7	0.3	-0.8	-0.5	-1.2	-1.4	-1.7
GDP deflator (median, LCU)	6.6	5.8	7.2	4.1	6.5	5.6	5.5
Fiscal balance/GDP (%)	-3.6	-1.2	-0.9	-4.0	-2.6	-2.2	-2.1
Memo items: GDP							
LAC excluding Argentina	3.0	5.3	3.8	-2.4	5.5	4.0	4.0
Central America [e]	3.6	3.7	1.8	-5.9	5.0	3.6	3.8
Caribbean [f]	4.2	6.0	3.3	0.6	2.5	3.7	3.8
Brazil	2.4	6.1	5.1	-0.2	7.6	4.4	4.3
Mexico	3.6	3.3	1.5	-6.5	5.2	3.6	3.8
Argentina	2.3	8.7	6.8	0.9	8.0	4.7	4.5

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Central America: Costa Rica, Guatemala, Honduras, Mexico, Nicaragua, Panama, El Salvador.
f. Caribbean: Antigua and Barbuda, Belize, Dominica, Dominican Republic, Haiti, Jamaica, St. Lucia, Trinidad and Tobago, St. Vincent and the Grenadines.

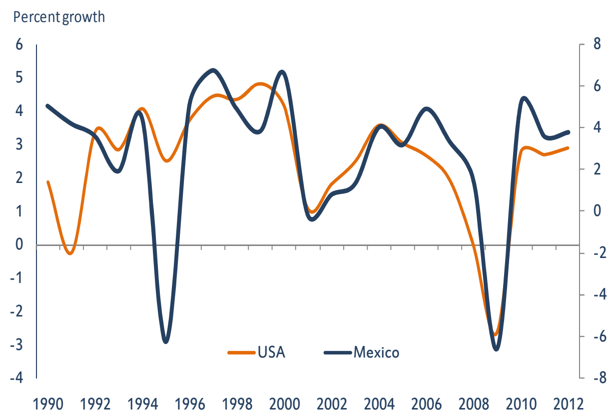
Source: World Bank

lingering high unemployment will undermine growth in Mexico, Central America and the Caribbean, through trade, investment, remittances and tourism linkages.

Brazil has resumed its pre-crisis growth dynamic. GDP is expected to have increased by around 7.6 percent in 2010, on account of strong commodity demand as well as the lagged effects of expansionary demand management policies. Going forward, activity will continue to benefit from an expanding labor force, real wage growth and credit expansion, facilitated by a strong financial sector, a diversified economy and highly diverse trade partners. Over the medium term growth is forecast to slow to, albeit still strong, 4.4 and 4.3 percent pace in 2011 and 2012, respectively. However, renewed global capital market volatility is expected to affect the Real, and Brazil's external competitiveness. Somewhat weaker growth in major trading partners during 2011-12 pose additional downside risks for Brazil's economic outlook. Brazilian policymakers should ensure that growth remains within levels that are sustainable over the long term. Brazil's ability to use monetary policy for this task is limited by the likelihood that higher interest rates will attract further capital inflows, while the long-term consequences of further appreciation for firms' export and import-competing points to a potential drawback of flexible exchange rates. In this context, a further fiscal policy tightening may be required.

Mexico was one of the few countries in region to not have fully recovered from the crisis in 2010, and with US output gaps only slowly unwinding over the forecast period, Mexican growth is projected to remain relatively weak and below potential (Figure R3.8). Mexican domestic demand is not expected to be sufficiently strong to drive internal dynamism, reflecting local structural weaknesses. Although a recovery in real wages and a rapid expansion in the working age population will support demand, the impact will be muted by weak employment prospects in both Mexico and the United States. Remittances are estimated to have declined by 8.7 percent in 2010 - well off the pre-crisis pace of 17.5

Figure R3.8 Mexican growth closely link to US developments

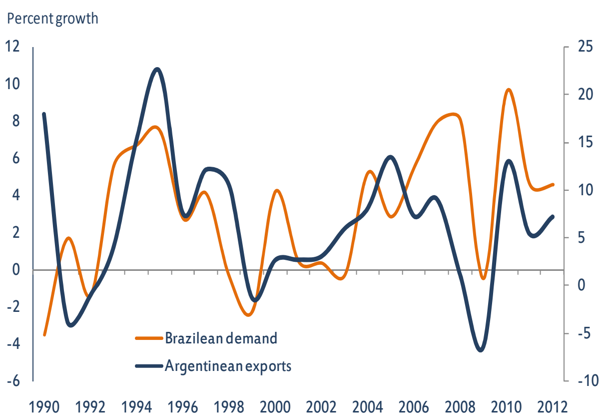


Source: World Bank

percent growth on average over 2004-2006. Trade (both exports and imports), which recovered rapidly during 2010 from very depressed 2009-bases, is expected to slow once more as global (particularly US) growth slows and the base effects dissipate. Overall GDP growth is forecast at 5.2, 3.6 and 3.8 over the 2010 – 2012 period.

GDP growth in **Argentina** is projected to have increased by a robust 8 percent in 2010, but expected to decelerate to 4.7 and 4.5 percent in 2011 and 2012 respectively. During 2010, Argentina and other commodity exporters in the region have benefitted from terms of trade gains, stronger external demand, in particular from Asia, while strong Brazilian demand has supported a sharp recovery in Argentina's industrial sector (Figure R3.9). Although the current lax monetary and fiscal policies are not sustainable over the long term, there are signs that economic policies may move towards a more moderate and "market friendly" approach. Two important steps here were the new negotiations with the Paris Club to restructure the official debt which has remained in default since 2001 and the agreement with the IMF for a technical mission to Argentina to help design a new nationwide CPI index. Also, the government seems keen to establish a social pact with unions and employers to anchor inflation expectations. However, no radical changes in the policy stance prior to the 2011 presidential

Figure R3.9 Argentinean exports benefitting from Brazilian demand



Source: World Bank, Datastream.

elections are expected.

Chile's well deserved status as the most stable and resilient economy in Latin America, owing to many years of sound and consistent economic management, will remain intact as GDP is forecast to grow by an average of 5.4 percent over 2010-12. This projected growth is even slightly faster than during the 2004 – 2007 boom periods, with forecast growth benefitting from the massive reconstruction activity following the earthquake. Around one-half of total exports are accounted for by copper mining, which was unaffected by the earthquake. Although continued export diversification and relatively strong demand from Asia will underpin export growth, import spending will rise as reconstruction gets under way, resulting in a somewhat weaker current-account balance over the forecast period.

Although GDP growth in **Colombia** is forecast to rebound from the 2009 slump and average 4.2 percent over 2010-12, the growth will be more subdued than the average 6.2 percent during the 2004-2007 boom years. Growth will be supported by high levels of investment and strong private demand, but the collapsing trade with Venezuela will prevent faster growth rates.

Given the recovery in commodity prices and activity in the region, the growth outlook for **Venezuela** (-2.3, 0.9 and 1.7 percent) over 2010-12 remains extremely dissatisfactory as government policy is creating severe economic distortions and the sustainability of macroeconomic policy remains under pressure. Notwithstanding the steep currency devaluation in early 2010 and various other measures implemented to avoid further depreciation, the exchange rate remains severely overvalued, while access to foreign currency remains difficult. Despite devaluation and higher oil prices which have boosted the government's revenues, current levels of spending are not sustainable and will only aggravate economic dislocations, hence failing to produce a sustainable recovery.

In **Peru**, real GDP growth is forecast to average 6.2 percent over 2010-12. Growth has been broad based, with household consumption and investment recoding strong growth in 2010 – a trend which is expected to continue over the forecast period.

The prospects for the **Caribbean** economies have been hindered by high unemployment and weak private consumption in the US and other high-income countries that affect the demand for tourism services and remittances inflows. Although the Dominican Republic-Central American Free-Trade Agreement (DR-CAFTA) has boosted growth over the 2004-2008 period, it has also increased the region's reliance on the US economy. With US growth projected to slow, the region's fragile recovery remains vulnerable to adverse trade, investment and remittance flow developments. Haiti's economy is projected to recover over the forecast horizon, after contracting an estimated dramatic 8.5 percent in 2010 due to the earthquake, boosted by reconstruction efforts financed mostly by aid flows.

Central American economies (excluding Mexico) were one of the hardest-hit sub regions in 2009 due to the sub region's close economic ties to the U.S. The recovery has also been hampered by limited fiscal space to implement counter-cyclical policies, while prospects for remittances – the greatest source of foreign exchange and large contributor to income and private consumption – continues to be hindered by still weak job prospects for many Central Americans working in the crisis affected US and Spanish (housing) markets. In countries such as Honduras, El Salvador, Guatemala and Nicaragua, where remittances are equivalent to 10-20 percent of GDP, and consumption heavily relies on remittances inflows, the recovery will be weaker. But in Costa Rica, where the contribution of remittances is relatively small, growth is forecast to have been stronger, at 3.6 percent in 2010. The region's growth prospects also continue to suffer from crime, corruption, weak institutions and a lack of competitiveness, stemming from infrastructure deficiencies. In Panama however, a number of mega-projects should support growth which is forecast to average 5.6 percent over 2010 - 2012.

Risks

Although LAC's improved resilience has passed the test of the global crisis, there is no room for complacency as the continued robustness of countries in the region is not a foregone conclusion. Paramount among the risks facing the region is dealing with the surging capital inflows and the destabilizing impact that this might have on exchange rates, external competitiveness and domestic asset prices. Already, delays in withdrawing domestic stimulus fast enough could be supporting unsustainable growth, and may be contributing to overheating of some economies. For the region's commodity exporting countries, further accommodative monetary policies (quantitative easing) in high-income countries may translate into even larger capital inflows and further commodity price and terms of trade gains adding to the pace of the recovery (and overheating).

Robust commodity prices have boosted export revenues and domestic income, which along with easy financing conditions has supported domestic demand. Should global growth slow more abruptly than projected in the baseline, these gains would be quickly unwounded. Countries such as Mexico, with its deep real and financial links to the US economy, and the commodity importing Central and Caribbean regions, with their dependence on tourism and remittance flows from the US, remain particularly vulnerable to weaker than projected US economic conditions.

The tightening stance of monetary policy in the region, even as interest rates in high-income countries remains very low has led to a surge of capital flows into several countries in the region (see discussion in main text). Attractive interest rate spreads, the region's positive growth outlook, strong commodity prices and the low opportunity cost of borrowing in high-income countries have all contributed to the increase in flows. While for many countries the inflows have been positive and helped support productive investments, in others, notably Brazil they have contributed to a consumer credit boom, rapidly rising imports and asset prices.

At this stage, monetary policy appears overburdened. Despite efforts to control money expansion with higher interest rates and administrative controls (including taxes on short-term capital inflows), many currencies in the region have appreciated sharply, hurting domestic competitiveness in both exporting and import-competing sectors. In this context, further tightening of fiscal policy may be required both to keep demand under control, but also to restore the fiscal space that the effective counter-cyclical policies of the past few years have depleted. This is all the more important, given the potential need to react should today's rapid inflows reverse rapidly as exchange rates deviate ever more from underlying fundamental levels.

The possibility of intensified and prolonged sovereign debt stresses in a number of high-income (European) countries, which subsided during the summer, has increased once again. As discussed in the main text, Latin America retains close financial and trade ties with both Spain and Portugal, and as such could be exposed to significant repercussions should conditions in those countries deteriorate sharply. So far, these risks have not materialized and indeed banks in these countries have expanded business in the region attracted by its strong growth prospects, However, should they be forced to restructure and or deleverage, they could call on the assets of regional subsidiaries —extending a European tightening of credit to Latin America. In a less severe scenario Latin America could benefit if it is seen as a more secure location for investing.

Even though the region's public finances have emerged from the global downturn in relatively good shape, some countries in the region remain vulnerable to a sharp increase in their debt stock, reflecting weak revenue bases, and/or limited financing options. Some of the smaller countries in the region (Jamaica, the Dominican Republic) have already agreed on lending arrangements with the IMF. In Argentina, the financing of the rapid expenditure growth is placing the longer-

Table R3.3 Latin America and the Caribbean country forecasts
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Argentina							
GDP at market prices (2005 US$) [b]	2.3	8.7	6.8	0.9	8.0	4.7	4.5
Current account bal/GDP (%)	-0.2	2.8	2.1	2.8	1.8	1.3	1.2
Antigua and Barbuda							
GDP at market prices (2005 US$) [b]	4.3	9.1	0.2	-8.5	0.0	2.5	3.0
Current account bal/GDP (%)	-10.5	-32.9	-29.4	-23.1	-21.9	-19.2	-17.3
Belize							
GDP at market prices (2005 US$) [b]	5.7	1.2	3.8	0.0	1.5	2.1	2.4
Current account bal/GDP (%)	-12.1	-4.1	-9.7	-7.0	-7.2	-7.8	-7.6
Bolivia							
GDP at market prices (2005 US$) [b]	3.8	0.0	6.1	3.4	4.1	4.0	4.2
Current account bal/GDP (%)	-3.0	12.1	12.0	4.7	8.0	7.7	7.1
Brazil							
GDP at market prices (2005 US$) [b]	2.4	6.1	5.1	-0.2	7.6	4.4	4.3
Current account bal/GDP (%)	-2.0	0.1	-1.7	-1.5	-2.7	-3.0	-3.2
Chile							
GDP at market prices (2005 US$) [b]	4.2	4.6	3.7	-1.5	5.5	5.8	5.0
Current account bal/GDP (%)	-1.5	4.5	-1.5	2.6	0.6	0.3	-0.3
Colombia							
GDP at market prices (2005 US$) [b]	2.4	6.9	2.7	0.8	4.3	4.4	4.0
Current account bal/GDP (%)	-2.2	-2.9	-2.8	-2.2	-2.7	-1.9	-2.2
Costa Rica							
GDP at market prices (2005 US$) [b]	4.5	7.8	2.6	-1.5	3.6	3.4	3.8
Current account bal/GDP (%)	-4.0	-6.3	-9.3	-1.8	-3.2	-2.8	-3.3
Dominica							
GDP at market prices (2005 US$) [b]	1.4	4.9	3.5	-0.8	1.2	2.0	2.8
Current account bal/GDP (%)	-18.7	-25.2	-36.4	-32.6	-30.4	-25.8	-22.8
Dominican Republic							
GDP at market prices (2005 US$) [b]	5.2	8.5	5.3	3.5	4.4	4.2	4.3
Current account bal/GDP (%)	-0.8	-5.2	-9.9	-4.6	-5.9	-5.4	-5.2
Ecuador							
GDP at market prices (2005 US$) [b]	3.2	4.0	7.2	0.4	2.3	2.3	2.0
Current account bal/GDP (%)	-1.4	3.5	2.0	-0.5	-0.8	-1.5	-1.4
El Salvador							
GDP at market prices (2005 US$) [b]	2.7	4.6	2.4	-3.5	1.3	2.5	2.8
Current account bal/GDP (%)	-2.5	-5.8	-7.2	-1.8	-3.1	-3.3	-3.4
Guatemala							
GDP at market prices (2005 US$) [b]	3.5	6.3	3.3	0.6	2.2	2.5	2.8
Current account bal/GDP (%)	-4.9	-5.4	-4.7	-0.7	-2.5	-2.6	-3.1
Guyana							
GDP at market prices (2005 US$) [b]	1.7	5.4	3.0	2.5	2.8	3.2	3.8
Current account bal/GDP (%)	-9.4	-10.4	-16.5	-11.2	-9.0	-10.9	-12.8
Honduras							
GDP at market prices (2005 US$) [b]	3.8	6.3	4.0	-1.9	2.4	3.1	3.3
Current account bal/GDP (%)	-6.6	-9.0	-12.9	-3.1	-4.7	-2.9	-4.1
Haiti							
GDP at market prices (2005 US$) [b]	1.0	3.3	0.8	2.9	-8.5	7.6	7.6
Current account bal/GDP (%)	-24.1	-8.0	-11.9	-9.7	-13.6	-9.6	-10.4

Table R3.3 (continuation)

	95-06 [a]	2007	2008	2009	Est. 2010	Forecast 2011	Forecast 2012
Jamaica							
GDP at market prices (2005 US$) [b]	0.8	1.4	-0.5	-3.0	0.6	2.2	2.5
Current account bal/GDP (%)	-5.5	-15.8	-19.6	-9.3	-7.9	-6.6	-5.9
Mexico							
GDP at market prices (2005 US$) [b]	3.6	3.3	1.5	-6.5	5.2	3.6	3.8
Current account bal/GDP (%)	-1.9	-0.8	-1.5	-0.7	-1.0	-1.2	-1.3
Nicaragua							
GDP at market prices (2005 US$) [b]	4.1	3.2	7.5	-5.6	3.0	3.0	3.3
Current account bal/GDP (%)	-20.1	-17.7	-25.8	-12.9	-13.8	-12.7	-12.6
Panama							
GDP at market prices (2005 US$) [b]	4.5	12.1	10.7	2.4	5.7	5.4	5.8
Current account bal/GDP (%)	-5.3	-7.1	-11.5	0.0	-6.1	-5.5	-5.5
Peru							
GDP at market prices (2005 US$) [b]	3.3	8.9	9.8	0.9	8.0	5.5	5.2
Current account bal/GDP (%)	-3.3	1.3	-3.7	0.2	-1.7	-1.3	-1.6
Paraguay							
GDP at market prices (2005 US$) [b]	1.2	6.8	5.8	-3.8	8.5	4.0	4.2
Current account bal/GDP (%)	-1.5	1.5	-2.5	0.3	-1.8	-1.8	-0.9
St. Lucia							
GDP at market prices (2005 US$) [b]	2.4	2.2	0.8	-3.8	1.2	2.7	2.8
Current account bal/GDP (%)	-13.2	-36.0	-35.2	-19.8	-16.8	-13.8	-12.0
St. Vincent and the Grenadines							
GDP at market prices (2005 US$) [b]	4.3	8.4	1.1	-2.8	-1.0	3.1	3.9
Current account bal/GDP (%)	-18.2	-34.5	-39.2	-34.0	-34.6	-31.0	-28.4
Trinidad and Tobago							
GDP at market prices (2005 US$) [b]	6.5	4.6	2.3	-3.0	2.2	2.8	2.8
Current account bal/GDP (%)	3.9	25.5	32.9	21.8	25.7	26.0	27.1
Uruguay							
GDP at market prices (2005 US$) [b]	1.5	7.5	8.5	2.9	7.9	4.6	4.2
Current account bal/GDP (%)	-0.9	-0.9	-4.8	0.7	-0.6	-0.7	-0.6
Venezuela, RB							
GDP at market prices (2005 US$) [b]	1.6	8.2	4.8	-3.3	-2.3	0.9	1.7
Current account bal/GDP (%)	7.5	8.0	12.0	2.6	5.9	5.2	4.7

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.

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

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

b. GDP measured in constant 2005 U.S. dollars.

Source: World Bank

term health and sustainability of public finances at risk and exposing the economy to a rapid acceleration of inflation. In Venezuela, government policy is creating severe economic distortions and the sustainability of macroeconomic policy remains under pressure. Although the recent steep currency devaluation (along with the introduction of a secondary rate for non-essential imports) should temporary boost the government's fiscal position and help to finance (largely inefficient) government spending, current levels of spending are not sustainable and will only aggravate economic dislocations, and therefore not support a sustainable recovery.

Inflexible labor markets, high non-wage costs, scarce skilled labor and limited infrastructure remain serious challenges that need to be addressed if the region is to achieve the higher longer term growth to which it aspires and required to make more progress against poverty.

Middle East and North Africa

Recent developments

The developing countries of the Middle East and North Africa region were less affected than other developing regions by the global recession, in part because of the region's limited financial integration, but also due to its export mix, which is concentrated in products (oil, materials and light manufactures) that were not as sharply affected by the crisis as capital goods- and, in turn, as the economies which produce them.[1] Reflecting a muted downturn, the region's recovery in 2010 was also more subdued than for other developing regions.

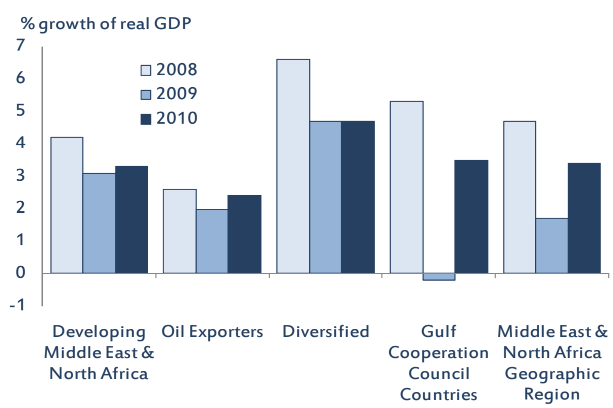
The upturn in 2010 reflected both an improved external environment and the ongoing effect of earlier stimulus measures. Higher oil prices tended to benefit oil exporters, while the growth rebound in the Euro Area and high-income Gulf Cooperation Council (GCC) helped boost remittances and exports in the region, particularly among the diversified economies.

Growth edged higher in 2010. With the rebound in world trade and production, upward pressure on oil prices and recovery of the Euro Area to growth in 2010, GDP gains for developing Middle East and North Africa picked up modestly from 3.1 percent in 2009 to 3.3 percent in 2010.[2] The diversified economies of the region, those with close ties to the GCC and those with tighter linkages to Europe, experienced a pick-up in exports that supported an upturn in growth for most countries. But overall, the GDP of these countries grew somewhat less quickly than in 2009 (4.7 versus 4.8 percent) mainly because agricultural production growth in the Maghreb was weaker than in 2009. This overall stability masks much improved bounce backs in Egypt, Jordan and Tunisia. Oil exporters saw moderate gains ranging between 1.5 to 2.5 percent in 2010, dampened to a degree by self-imposed limits on hydrocarbons output in support of OPEC price targets (Figure R4.1).

Developing oil exporters and the GCC benefited from a substantial 28 percent gain in dollar-denominated oil prices in the year to $79/bbl from $61/bbl in 2009. And for the high-income countries, a gradual process of financial consolidation is underway in the wake of Dubai's crisis of 2008-09. The GCC emerged to growth of 3.5 percent from a decline of 0.2 percent in 2009. A broader measure of GDP performance for the geographic region (including the high-income countries) moved up to 3.4 percent in the year from 1.9 percent at the depth of global recession (Table R4.1).

Sources of growth. Several factors in 2010 helped to shift the principal source of growth for the diversified economies further toward domestic demand (particularly private and government consumption), as the contribution to growth from net trade waned. Stimulus packages were slow to unwind in 2010 and therefore continued to support household spending, public -sector infrastructure projects, and, through spillover effects, private investment in the year.[3] Moreover, worker remittances to developing Middle East and North Africa picked up by 5.3 percent in 2010 to $35.5 billion, much stronger than earlier expected, augmenting household incomes and offering support for consumption

Figure R4.1 Developing Middle East and North Africa region less adversely affected by crisis and recession than many others



Source: World Bank.

growth of 4.6 percent in the year. Private consumption accounted for 3.4 points of 4.7 percent GDP growth in 2010, up from 3.1 points in the year preceding.

For the developing oil exporters, the shift in sources of growth during 2010 was similar to the diversified economies, but amplified by weak overall export volumes (0.7 percent growth). This contrasts with large-scale public-sector infrastructure and consumption support programs that lifted construction, engineering and domestic production activities, in turn supporting household spending and overall non-oil activity. Indeed, imports surged by 14 percent for the group, leading net exports to subtract 2.3 points from GDP growth.[4] The exception to this rule is Yemen, where the coming online of LNG exports in 2010 expanded the hydrocarbons sector by almost 50 percent and underpinned GDP growth of 8 percent in the year.

Turnaround in the external environment. Among the more favorable factors supporting growth in 2010 were the increase in oil price; recovery in the Euro Area; a modest increase in capital flows to the region and stronger recovery in tourism and remittances. On the downside, the U.S. dollar price of internationally-traded food prices jumped, notably for wheat-, maize and other grains. As the developing region most dependent on imported food, these increases are particularly worrisome, especially for those countries where currencies are fixed to the dollar. Financial conditions among the GCC improved fairly slowly across the year, limiting faster growth in remittances and other flows to the developing countries of the region.

Oil prices firmed by $17 per barrel on average during 2010, on the back of stronger demand in emerging markets, expectations of improved future global demand, and continued supply restraint on the part of OPEC. The increase

Table R4.1 Middle East and North Africa forecast summary
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 US$) [b]	4.4	5.9	4.2	3.1	3.3	4.3	4.4
GDP per capita (units in US$)	2.7	4.1	2.4	1.4	1.6	2.6	2.8
PPP GDP [c]	4.4	6.2	4.1	3.1	3.3	4.2	4.4
Private consumption	4.1	7.0	5.3	4.8	4.3	4.7	5.0
Public consumption	3.3	2.0	8.4	19.1	7.1	6.8	6.3
Fixed investment	6.6	11.6	9.7	5.0	5.0	4.8	5.1
Exports, GNFS [d]	4.9	5.6	-0.8	-14.1	3.8	5.3	6.3
Imports, GNFS [d]	5.7	12.3	12.0	-3.1	12.6	6.8	7.9
Net exports, contribution to growth	-0.2	-1.9	-4.4	-3.9	-3.3	-1.0	-1.2
Current account bal/GDP (%)	2.9	10.6	6.5	-1.2	0.3	1.0	0.0
GDP deflator (median, LCU)	5.2	7.3	14.7	2.0	8.6	5.3	5.0
Fiscal balance/GDP (%)	-1.5	0.0	-0.3	-4.2	-4.4	-3.4	-2.4
Memo items: GDP							
MENA Geographic Region [e]	4.0	4.6	4.7	1.9	3.4	4.1	4.4
Resource poor- Labor abundant [6]	4.3	5.9	6.6	4.8	4.7	5.2	5.6
Resource rich- Labor abundant [7]	4.4	5.9	2.6	2.2	2.4	3.6	3.6
Selected GCC Countries [f]	3.6	3.0	5.3	-0.2	3.5	4.3	4.2
Egypt	4.4	7.1	7.2	4.7	5.1	5.5	6.0
Iran	4.8	7.8	2.3	1.4	1.5	3.0	3.0
Algeria	4.0	3.0	2.4	2.4	2.4	4.1	4.1

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Geographic region includes high-income countries: Bahrain, Kuwait, Oman and Saudi Arabia.
f. Selected GCC Countries: Bahrain, Kuwait, Oman and Saudi Arabia.

Source: World Bank

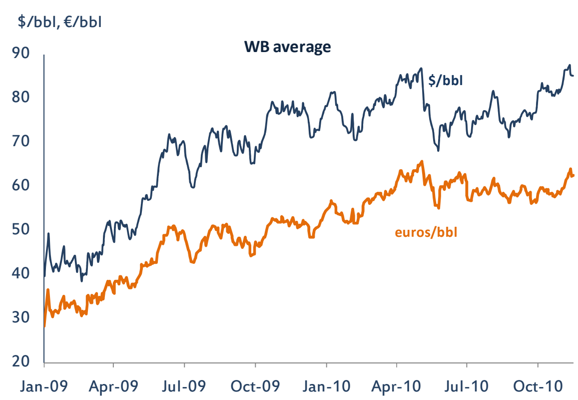
occurred despite more-than sufficient global crude oil and product stocks, and is driven in part by the weaker dollar and a "search for yield" on the part of international investors, treating oil (see discussion in main text) as an "asset class" of interest (Figure R4.2). The oil price rise directly benefits regional oil exporters; and indirectly- (in theory) regional oil importers, in the form of improved remittance flows into the diversified economies. But benefits must be weighed against associated adverse shifts in terms of trade.

Overall the region's oil revenues increased 28 percent from $450 billion in 2009 to $575 billion in 2010. The increase helped push the current account- and fiscal positions of most exporters back into positive territory – though 2010 fell well short of 2008 peaks. The divergent results are tied to the degree of restraint placed on crude oil production and/or difficulties for several exporters in maintaining current output levels against physical-, technology or resource limitations. Saudi Arabia bore the brunt of production cutbacks during 2009-10; currently 35 percent of Saudi oil capacity is idle (Figure R4.3). Oman has been able to boost crude oil output using enhanced recovery techniques, and is not bounded by OPEC quotas. During the year oil production increased by between 1.5 and 2.5 percent across the GCC and developing oil exporters.

For the latter group, the upturn in oil revenues will provide only partial support for GDP growth, as most countries have focused attention on raising domestic demand. In *Algeria*, an expansionary fiscal policy will keep the budget position in deficit for some time (9.5 percent of GDP in 2010), as the second phase of the Public Infrastructure Program comes online. GDP is likely to repeat the moderate 2.4 percent gain of 2009 with technical production difficulties continuing in the oil sector. GDP growth placed at 1.5 percent in *Iran* for 2010 is likely to remain on the weaker side moving forward, in part because of increased economic isolation. In *Syria*, a net oil importer since 2008, growth picked-up from 4 percent to 5 percent in 2010 due to improved agricultural output in the wake of drought. Fiscal stimulus remains in the pipeline—as rising public investment, public sector wages and transfers are compensating for higher fuel prices. And in *Yemen*, the long awaited Liquefied National Gas Production Facility began operation in 2010, now producing at 90 percent capacity. Despite currently depressed international gas prices, the project is expected to yield $20-to $30 billion over its 20-year lifetime, offering needed revenues for the low-income economy.

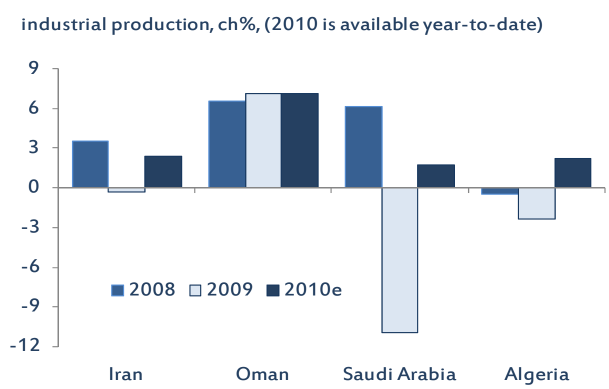
The upturn in GCC oil revenues in 2010 has helped spur demand. In *Saudi Arabia*, government and quasi-government investment spending supported growth of 3.7 percent up from 0.2 percent in the year preceding. *Kuwait* is projected to register positive growth in 2010 (1.9

Figure R4.2 Daily oil price in dollars & euros



Source: World Bank

Figure R4.3 Oil output, largely curtailed in 2009 begins to increase in 2010



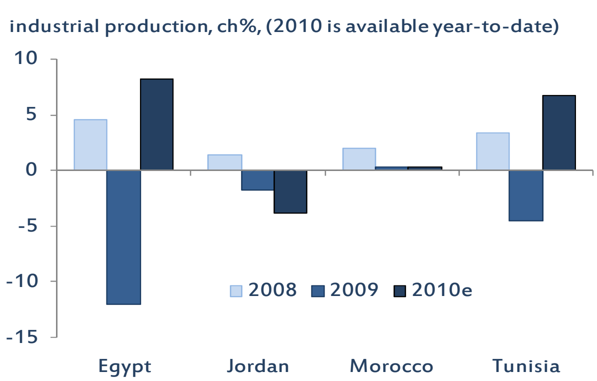
Source: World Bank

percent) after a 4 percent decline in 2009, the sharpest downturn among the GCC. And in the *United Arab Emirates* (UAE), the Dubai crisis dominated the policy agenda. Following a 7 percent GDP advance in 2008, GDP dropped 2.5 percent in 2009 and is expected to pick-up 2.4 percent in 2010.

The moderate easing of growth for the *diversified economies of the region* was in part due to slow growth among their major trading partners— the European Union members and GCC member states. But a number of one-off, or special factors restrained growth from what could have been stronger outturns. In *Egypt*, for example, GDP improved from the 4.7 percent gain of 2009—strong for a period of global recession—to 5.1 percent in 2010; but this contrasts with rates near 7 percent in the immediate pre-crisis period. Industrial production recovered sharply, growing at an annualized pace of 8.5% between January and August 2010. However, industrial production has since decelerated in line with the slow down in global growth in the third and fourth quarter of 2010 (Figure R4.4).[5] *Morocco's* GDP growth is likely to register 3.5 in 2010, a falloff from the 4.9 percent advance of 2009, as the agricultural sector is showing lower output levels following record production in 2009. There have also been adverse terms of trade developments related to the rising cost of oil and wheat imports.

In *Tunisia*, industrial production is moving higher in 2010, up 6.7 percent over the year through September on an upturn in domestic and foreign demand for manufactures. Consumption is underpinned by rising incomes, and policy measures are geared to promote competitiveness and improve the business climate for Tunisian firms. Key public investments are making substantial contributions to economic activity. Growth is expected to reach 3.8 percent in 2010, contrasted with the 3.1 percent advance of 2009. And in *Jordan and Lebanon*, recovery appears to be fairly well on-track. For the former, with tight links to the GCC, growth in these economics is improving—but as remittances, other income flows and FDI will likely take time to recover, growth may remain below potential for a time.

Figure R4.4 For diversified group varied production outturns for 2010



Source: World Bank

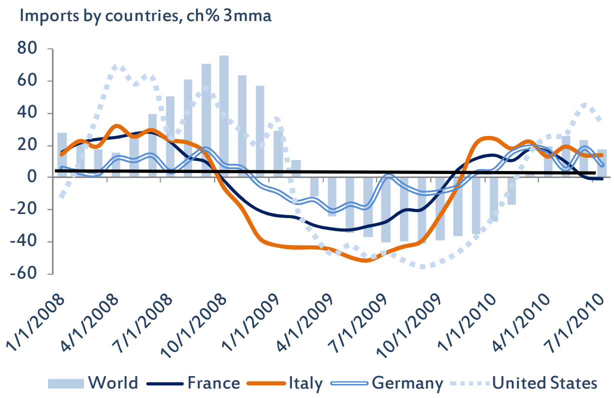
Economic revival in the Euro Zone. Following a record 4.1 percent decline in Euro Area real GDP in 2009, activity is likely to recoup to a 1.7 percent pace in 2010 (see main text), led by strong growth in Germany, and in broader terms, by good export performance—and increasingly in improved domestic demand. Though not a stellar recovery, and one hindered by continuation of substantial sovereign fiscal and debt difficulties among smaller Area members, import demand accelerated over the course of 2010, offering export opportunities for the diversified economies of Middle East and North Africa—notably, Morocco, Tunisia and Egypt.

The rebound of activity in the Euro Area, and recovery in Morocco's exports of specialized products including phosphate acid and fertilizers, up 80 percent in October (y/y), and fish exports (7 percent) has underpinned overall exports from the Maghreb. The Euro Area accounts for between 60-70 percent of goods exports, remittance receipts and tourist arrivals for these countries, with the United States also accounting for a substantial share. In Morocco for example, dollar exports increased 23 percent in October 2010 on a year-on-year basis. Similarly Tunisian total exports were up 17.2 percent as of June, with shipments to Germany gaining momentum (Figure R4.5).

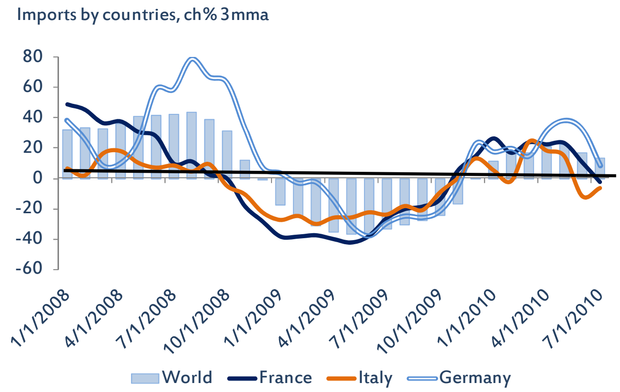
Remittances and tourism. There was a surprising pick-up in worker remittances and tourist

Figure R4.5 Morocco sees export recovery notably to the United States while Tunisia's export rebound appears to be losing steam

Morocco



Tunisia



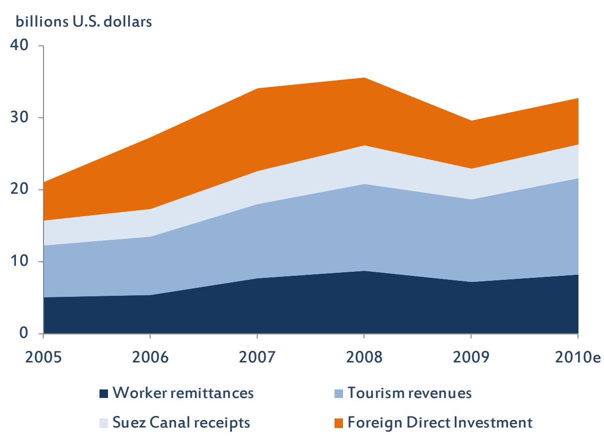
Source: IMF, Direction of Trade Statistics, and Haver Analytics

arrivals in 2010 that provided additional support for growth—particularly for household consumption. The upturn in tourism is offering potential for job creation, incentives for infrastructure improvement and new development. These improved flows have been particularly evident in Egypt in 2010, but most countries of the developing region participated in the upturn. After *remittances* growth in the region peaked at 13.2 percent in 2007 (equivalent to $32.1 billion) receipts fell by 6.3 percent during the 2009 recession. Declines were largest for Morocco (9 percent), Egypt (9 percent) and Jordan (5 percent)—a substantial proportion of Jordanian GDP (Table R4.2, top panel).

World Bank estimates for 2010 suggest that the dollar value of remittances to the region increased 5.3 percent to $35.5 billion, on recovery in Europe and to a lesser degree, the GCC economies. Largest gains were recorded by Egypt (25 percent), Lebanon (8.2 percent) and Jordan (5.3 percent). *Tourism* is another key element in the forces propelling growth in the Middle East and North Africa, representing on average $32 billion or 3.5 percent of the developing region's GDP over the past three years. After falling 4 percent globally in 2009, the United Nation's World Tourism Organization estimates that arrivals will increase by as much as 13 percent for the region—with arrivals to the Middle East rising 20 percent, and up 6 percent for North Africa in the first half of 2010 (Table R4.2 bottom panel).[6]

Egypt offers a prime example of the importance of ancillary external revenues (including FDI) as a financial offset to deficits in the balance of trade, and a support for growth in domestic demand and economic activity across sectors of the economy (Figure R4.6). Trade deficits averaging $20 billion per year are usually fully offset by the aggregate of remittances, tourism, and Suez Canal dues; and FDI, through the financial account, offers further financing

Figure R4.6 Egypt's ancillary revenues more than offset average trade deficits



Source: World Bank, Government of Egypt, UNCTAD

Table R4.2 Middle East and North Africa, remittances and tourism-related revenues, 2000-2010e

	2000	2005	2007	2008	2009	2010e
Remittances inflows ($mn)						
MENA Region	**15,323**	**25,078**	**32,145**	**35,937**	**33,660**	**35,455**
growth per year (%)		**10.4**	**13.2**	**11.8**	**-6.3**	**5.3**
share of GDP (%)	**4.2**	**4.5**	**4.3**	**3.7**	**3.5**	**3.5**
Egypt	3,067	4,330	6,321	8,560	7,806	9,753
Lebanon	1,582	4,924	5,769	7,181	7,558	8,177
Morocco	2,161	4,590	6,730	6,895	6,271	6,447
Jordan	1,845	2,500	3,433	3,794	3,597	3,789
Tunisia	796	1,393	1,716	1,977	1,966	1,960
Yemen	1,228	1,283	1,332	1,411	1,378	1,471
West Bank and Gaza	1,010	705	1,085	1,220	1,261	1,307
Other Middle East and North Africa	3,634	5,353	5,759	4,899	3,823	2,551
Memo items: MNA ex Egypt	12,256	20,748	25,824	27,377	25,854	25,702
growth per year (%)		11.1	11.6	6.0	-5.6	-0.6
MNA share of global remittances (%)	16.1	13.1	11.5	11.1	11.0	10.9
Tourism arrivals and revenues						
MENA Region						
Arrivals - Thousands	**21,155**	**31,831**	**38,308**	**42,982**	**44,034**	**49,777**
Tourism expenditure in the country - US$ Mn	**11,898**	**21,102**	**30,885**	**34,015**	**33,886**	…
growth of arrivals per year (%)		**8.5**	**9.7**	**12.2**	**2.4**	**13.0**
growth of revenues per year (%)		**12.1**	**7.9**	**10.1**	**-0.4**	…
revenue share of GDP (%)	**3.2**	**3.8**	**4.1**	**3.5**	**3.5**	
Tourism arrivals						
Egypt	5,116	8,650	9,788	12,294	12,293	13,758
Morocco	4,278	5,843	7,408	7,879	8,341	9,375
Syria	2,100	3,571	4,158	5,430	6,092	7,615
Tunisia	5,058	6,378	6,762	7,049	6,901	6,970
Jordan	1,580	2,987	3,431	3,729	3,789	4,547
Lebanon	742	1,140	1,017	1,333	1,851	2,221
Other Middle East and North Africa	2,281	3,262	5,744	5,268	4,767	5,291
Memo items: MNA ex Egypt						
Arrivals - Thousands	16,039	23,181	28,520	30,688	31,741	36,019
Tourism expenditure in the country - US$ Mn	7,241	13,896	20,558	21,911	22,401	…
growth of arrivals per year (%)		7.6	10.9	7.6	3.4	13.5
growth of revenues per year (%)		13.9	21.6	6.6	2.2	…

Source: Remittances: World Bank, Tourism: United Nations World Tourism Organization & World Bank estimates

support for possible overruns in trade.

Foreign direct investment. If 2010 outturns for remittances and tourism arrivals are “upside surprises”, then the near-12 percent decline in FDI inflows to the developing countries of Middle East and North Africa has to be considered a “downside” development. FDI established average growth of 32 percent between 2000 and 2005 and reached $35.3 billion, or 3.7 percent of GDP in 2008. Egypt, Lebanon, Iran and Jordan are key recipients (Table R4.3, top panel). The Dubai financial crisis served to disrupt these flows. Outbound FDI from the GCC halved from 2007 levels by 2009 (Table R4.3, bottom panel). Developments among GCC economies suggest that the likelihood of a quick return to the halcyon days of 2007-08 is small, though signs of economic recovery and financial improvement are emerging. Increasingly, flows may begin to take place across developing countries of the region, as trade and production agreements among Middle East and North Africa countries-, and between Middle East and North Africa and the European Union begin to gather momentum. Even at reduced levels, FDI continues to dominate overall financial flows to the region.

Net capital flows to Middle East and North Africa. Private capital flows to the developing Middle East and North Africa region increased modestly (by 1.2 percent, or $320 million) to $25.8 billion during 2010; this in contrast with the sharp pick-up in flows into East- and South Asia (Table R4.4).[7] Moderate gains in portfolio equity and medium-term debt flows were almost wholly offset by the decline in FDI noted for the

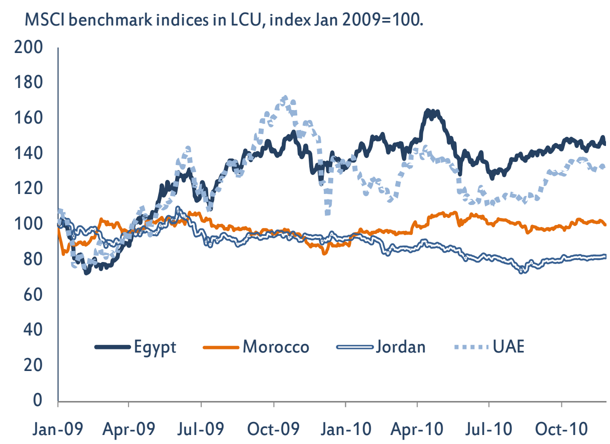
Table R4.3 Middle East and North Africa, foreign direct investment flows, 2000 to 2010e

	2000	2005	2007	2008	2009	2010e
Foreign Direct Investment inflows ($mn)						
Middle East and North Africa Region	**5,628**	**22,523**	**32,646**	**35,248**	**32,170**	**28,350**
growth per year (%)		**32.0**	**20.4**	**8.0**	**-8.7**	**-11.9**
share of GDP (%)	**1.4**	**3.5**	**4.3**	**3.7**	**3.3**	**2.8**
Egypt	1,235	5,376	11,578	9,495	6,712	6,500
Lebanon	964	2,624	3,376	4,333	4,804	4,650
Iran	194	3,136	1,670	1,615	3,016	2,900
Jordan	815	1,774	1,950	1,965	2,382	2,500
Algeria	438	1,081	1,665	2,656	2,390	2,000
Tunisia	752	723	1,532	2,638	1,688	1,700
Morocco	221	1,620	2,825	2,466	1,332	1,500
Other Middle East and North Africa	1,009	6,189	8,050	10,080	9,846	6,600
Memo items: Middle East and North Africa ex Egypt	4,393	17,147	21,068	25,753	25,458	21,850
growth per year (%)		31.3	10.8	22.2	-1.1	-14.2
Middle East & North Africa share of developing country FDI (%)	16.1	13.1	11.5	11.1	11.0	10.9
Foreign Direct Investment outflows ($mn)						
Gulf Cooperation Council (GCC)	**18,888**	**10,690**	**44,247**	**34,342**	**20,382**	**...**
growth per year (%)		**-10.8**	**103.4**	**-22.4**	**-40.6**	**...**
share of GDP (%)						
Kuwait	-303	5,142	10,156	8,858	8,737	...
Saudi Arabia	1,550	78	12,730	1,450	6,526	...
Qatar	17,210	352	5,160	6,029	3,772	...
United Arab Emirates	423	3,750	14,568	15,800	2,732	...
Other GCC	8	1,368	1,633	2,205	-1,385	...
Memo items: GCC ex Kuwait						
FDI outflows ($mn)	19,191	5,548	34,091	25,484	11,645	...
growth per year (%)		-22.0	147.9	-25.2	-54.3	...

Source: Foreign Direct Investment: World Bank, and United Nations, UNCTAD
Note: FDI inflows include those to Iran and Lebanon, not included in developing totals elsewhere.

year. Equity flows increased for a second year in succession favoring the bourses of Egypt and the UAE. For the UAE market, improvements were centered in fall 2010 as the Dubai World restructuring was settled and banking results improved (Figure R4.7). Medium and long-term private debt flows increased by $6.7 billion, with issuance of $2.3 billion in international bonds and the undertaking of syndicated bank borrowing of some $2.7 billion. Net flows from official creditors increased by $620 million to $2.9 billion in the year. But the decline in FDI by 15 percent to $20.8 billion dominates the flow of capital to the region.[8] Looking forward, the World Bank anticipates a resumption of growth in FDI over the period through 2012, with a continued—albeit more moderate—pickup in portfolio equity and private debt.

Figure R4.7 Bourses in Egypt and UAE performing well in 2010



Source: Morgan Stanley, World Bank data.

Medium-term outlook

Global oil markets (see Commodity annex for more detail) remain in excess supply in production and refining, with non-OPEC producers having met almost all increased demand in both 2009 and 2010 (production was

Table R4.4 Net capital flows to Middle East and North Africa
$ billions

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	22.2	37.9	59.8	69.1	81.4	63.0	-8.9	19.6	5.1	-1.0
as % of GDP	5.2	7.8	10.8	10.9	10.7	6.6	-0.9	1.8	0.4	-0.1
Financial flows:										
Net private and official inflows	13.5	13.0	19.4	14.4	29.4	21.1	27.8	28.7		
Net private inflows (equity+debt)	15.6	16.4	22.4	25.7	28.4	22.9	25.5	25.8	32.4	33.1
..Net private inflows (% GDP)	3.7	3.4	4.0	4.0	3.7	2.4	2.7	2.4	2.8	2.6
Net equity inflows	10.2	10.4	19.2	28.2	25.5	29.7	25.6	22.2	25.4	30.1
..Net FDI inflows	10.0	9.7	16.8	27.2	27.6	29.3	24.4	20.8	23.3	27.8
..Net portfolio equity inflows	0.2	0.7	2.4	1.0	-2.1	0.4	1.2	1.4	2.1	2.3
Net debt flows	3.4	2.6	0.2	-13.7	3.9	-8.6	2.2	6.5		
..Official creditors	-2.1	-3.4	-3.0	-11.2	1.1	-1.8	2.3	2.9		
....World Bank	-0.3	-0.6	0.0	-0.8	1.0	-0.3	0.9	1.8		
....IMF	-0.6	-0.5	-0.7	-0.2	-0.1	-0.1	-0.1	-0.1		
....Other official	-1.2	-2.3	-2.3	-10.3	0.2	-1.4	1.4	1.2		
..Private creditors	5.4	5.9	3.2	-2.5	2.8	-6.8	-0.1	3.6	7.0	3.0
....Net M-L term debt flows	0.9	2.7	2.9	-1.7	-0.7	-2.7	-1.7	5.0		
......Bonds	0.7	2.8	2.5	0.8	0.7	-0.8	0.5	2.3		
......Banks	-0.2	0.0	1.3	-1.3	-0.2	-0.5	-1.2	2.7		
......Other private	0.4	0.0	-0.9	-1.2	-1.2	-1.3	-0.9	0.0		
....Net short-term debt flows/a	4.6	3.2	0.3	-0.8	3.5	-4.2	1.6	-1.4		
Balancing item /b	-12.5	-36.2	-40.2	-45.7	-62.8	-40.7	5.3	-37.0		
Change in reserves (- = increase)	-23.2	-14.7	-38.9	-37.8	-48.0	-43.4	-24.2	-11.3		
Memorandum items										
Workers' remittances	19.9	22.6	23.6	25.1	32.0	36.0	34.0	35.0	37.0	40.0

Source: World Bank

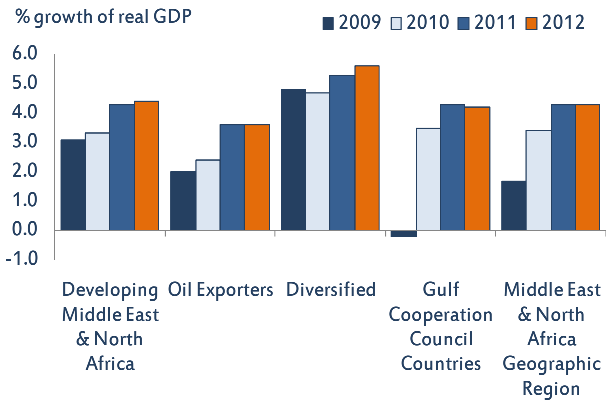
up 0.9mb/d each year) leaving little room for OPEC members to increase output. Growth in global oil demand is expected to remain moderate at 1.5 percent per year in the near term, with non-OPEC oil supplies projected to continue increasing at about the same pace, implying about 0.5mb/d increase for OPEC.

Despite recent upticks in oil price, world prices are projected to remain between $70-90/bbl in the medium term, with OPEC producers stepping up sales from their ample spare capacity to meet any additional demand not supplied by non-OPEC producers. OPEC is not expected to allow prices to rise beyond this point for fear of inducing additional non OPEC supply or demand substitution. Globally there are no medium-to longer run supply constraints (2020); and a long-term upper-range of $80/bbl is consistent with the end-cost of developing additional oil capacity, notably from oil sands in Canada.

As a result, incomes among oil exporting countries are unlikely to benefit from a substantial exogenous boost over the forecast period. *Developing oil exporter* growth is expected to inch-up to 3.6 percent in 2011-12, on continued strength in domestic demand. Net exports should continue to exert drag, given hefty imports related to infrastructure projects (Figure R4.8). The current account surplus of developing exporters is projected to ease from about 5 percent of GDP in 2010-11 toward 3.5 percent in 2012, as large-scale spending and imports offset oil revenue gains. For the high-income *GCC economies* recovery will depend on oil markets, but also on international financial and growth developments, given the increasingly diversified nature of economies such as the UAE, Bahrain, and Kuwait. GDP gains for the group are expected to register 4.3-and 4.2 percent in 2011 and 2012, on stronger government-investment and household spending.

Given a pickup in growth among the GCC and a leveling-out of economic activity in key export

Figure R4.8 Growth in developing Middle East & North Africa region to reach 4.5% by 2012



Source: World Bank

markets by 2012 (in the Euro Area near 2 percent; the United States closer to 3 percent), prospects for the *diversified economies* are fairly buoyant. GDP growth for these countries is anticipated to accelerate to a 5.6 percent pace by 2012. Growth approaches 6 percent in Egypt, 5 percent in Morocco and Tunisia, and averages 5.5 percent in Jordan and Lebanon by 2012. This is grounded in a firming of goods exports; stronger remittance and tourism receipts; return of stronger FDI inflows, and domestic policies oriented toward further opening of trade and domestic service sectors. For the geographical region, projections point to growth picking up to 4.3 percent during 2011-12, fostered in part by a healthier financial and economic environment among the GCC economies.

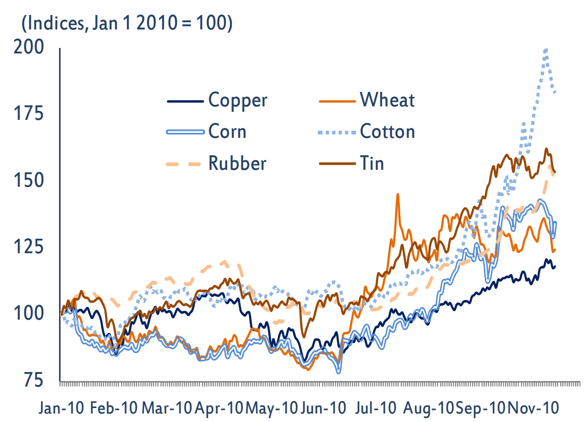
Risks

Though risks to the baseline forecast may be viewed as many, two appear to stand out:

- Risks for recovery in the OECD countries, notably for the Euro Area, have heightened with the onset of sovereign financial difficulties. But risks to European growth linked to coming imposition of austerity measures to rein-in fiscal deficits are also of some concern. For the diversified exporters of the Maghreb, in particular, with tight trade links to the southern tier of the Euro Area (Italy, France and Spain), further disruptions related to fiscal difficulties would put Maghreb exports at risk. And in the United States, quantitative easing monetary policies are raising uncertainties in exchange and commodity markets.

- The ratcheting up of food prices is of exceptional concern for the broader Middle East and North Africa region. Prices for all non-energy commodities have escalated of late, with fundamental pressures on cereals prices due to the loss of Russian and Ukrainian exports to the world market (Figure R4.9). Food imports account for a very large proportion of Middle East and North Africa imports, notably in the Maghreb and Egypt. Such imports range from 17 percent of the import bill in Algeria to 7 percent in Tunisia; cereals account for 7.5 percent of Algeria's bill to 4 percent in Tunisia (Figure R4.10). The region is effectively still in "recovery mode" from the food crisis of 2008.

Figure R4.9 Metals, raw materials and agricultural prices surge—on the weak dollar and other factors



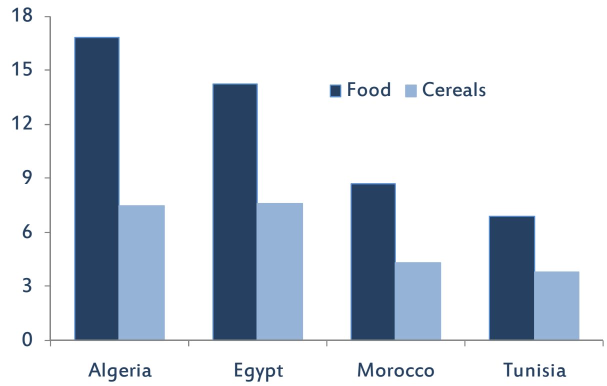
Source: Commodity exchanges through Thomson-Reuters/ Datastream

Notes:

1. See "Sustaining the Recovery in Times of Uncertainty", A Regional Economic Outlook. Middle East and North Africa

Figure R4.10 Food and cereals are a large proportion of the import bill in the Maghreb and Egypt

share of total goods imports, average 2006-09, percent



Source: U.N. Comtrade Database

Region. The World Bank, October 2010.

2. The low-and middle income countries of the region included in this report are Algeria, The Arab Republic of Egypt, The Islamic Republic of Iran, Jordan, Lebanon, Morocco, Syria Arab Republic, Tunisia and Yemen. Data is insufficient for the inclusion of Djibouti, Iraq and the West Bank and Gaza. The high-income economies included here are Bahrain, Kuwait, Oman and Saudi Arabia. Data is insufficient for the inclusion of Libya, Qatar and the United Arab Emirates. The group of developing oil exporters includes Algeria, the Islamic Republic of Iran, the Syrian Arab Republic and Yemen. The diversified economies of the region (oil importers) may be usefully

Table R4.5 Middle East and North Africa country forecasts
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Algeria							
GDP at market prices (2005 US$) [b]	4.0	3.0	2.4	2.4	2.4	4.1	4.1
Current account bal/GDP (%)	8.2	22.5	20.2	0.0	4.6	6.2	3.4
Egypt, Arab Rep.							
GDP at market prices (2005 US$) [b]	4.4	7.1	7.2	4.7	5.1	5.5	6.0
Current account bal/GDP (%)	0.4	0.3	-0.7	-1.7	-4.1	-3.2	-2.7
Iran, Islamic Rep.							
GDP at market prices (2005 US$) [b]	4.8	7.8	2.3	1.4	1.5	3.0	3.0
Current account bal/GDP (%)	7.2	20.1	13.2	3.4	6.1	6.7	4.4
Jordan							
GDP at market prices (2005 US$) [b]	4.8	8.5	7.6	2.3	4.0	5.0	5.5
Current account bal/GDP (%)	-0.2	-16.2	-8.7	-4.3	-4.6	-5.4	-4.5
Lebanon							
GDP at market prices (2005 US$) [b]	2.6	7.6	9.3	9.0	8.0	7.0	6.0
Current account bal/GDP (%)	-19.6	-6.4	-13.7	-21.9	-23.6	-22.6	-21.7
Morocco							
GDP at market prices (2005 US$) [b]	4.4	2.7	5.6	4.9	3.5	4.4	5.1
Current account bal/GDP (%)	0.7	-0.3	-6.4	-5.1	-3.2	-2.9	-1.4
Syrian Arab Republic							
GDP at market prices (2005 US$) [b]	3.2	4.2	5.2	4.0	5.0	5.5	5.6
Current account bal/GDP (%)	2.9	1.1	-3.6	-4.5	-3.9	-3.4	-3.2
Tunisia							
GDP at market prices (2005 US$) [b]	5.0	6.3	4.6	3.1	3.8	4.8	5.0
Current account bal/GDP (%)	-3.0	-2.6	-3.7	-2.8	-4.8	-4.1	-3.0
Yemen, Rep.							
GDP at market prices (2005 US$) [b]	4.9	3.3	3.6	3.9	8.0	4.1	4.2
Current account bal/GDP (%)	3.1	-7.0	-4.6	-9.7	-0.6	1.7	-0.7

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.

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

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

b. GDP measured in constant 2005 U.S. dollars.

Source: World Bank

segmented into two groups: those with strong links to the GCC (Jordan and Lebanon), and those with strong EU links (The Arab Republic of Egypt, Morocco and Tunisia).

3. For example, in Tunisia, government food and fuel subsidies (part of mitigation efforts from the global food price crisis of 2008 which hit the Middle East and North Africa region hard-the largest food importing region in the world) helped to support household consumption to stronger gains. Public infrastructure projects continue, and the 2010 budget carries a cushion of 1.5 percent of GDP for potential fiscal support measures should the external environment (notably growth in Europe) take a turn to the downside.

4. For example, in Algeria, non-oil growth advanced 9.3 percent in 2009, supported by the on-going Public Investment Program (PIP), yielding the first fiscal deficit in more-than a decade. Algeria is continuing with expansionary fiscal policies, with the second phase of PIP slated at $285 billion over 2010 to 2014, focusing on improved access to- and the quality of basic services; upgrading housing, transport and utilities.

5. Industrial production (IP) figures herein are sourced from the World Bank- Development Prospects Group high-frequency database. For IP, manufacturing, mining and utilities share in GDP (factor cost) is used to establish a real dollar value (in 2005 prices) for production. This is moved forward using available industrial production indicators from Thomson-Datastream, Haver Analytics, the International Monetary Fund and other electronic sources. The original series are often sourced from country-specific statistical agencies or central banks.

6. "World Tourism Barometer", Interim Update, August 2010. United Nations World Tourism Organization.

7. Capital flows to the developing MENA region include net flows to: Algeria, Djibuti, the Arab Republic of Egypt, the Islamic Republic of Iran, Jordan, Lebanon, the Syrian Arab Republic, Tunisia and the Republic of Yemen. Table R4.4.

8. Table R4.3 earlier includes FDI inflows for the Islamic Republic of Iran and for Lebanon, which are not part of the overall capital flows Table R4.4.

South Asia

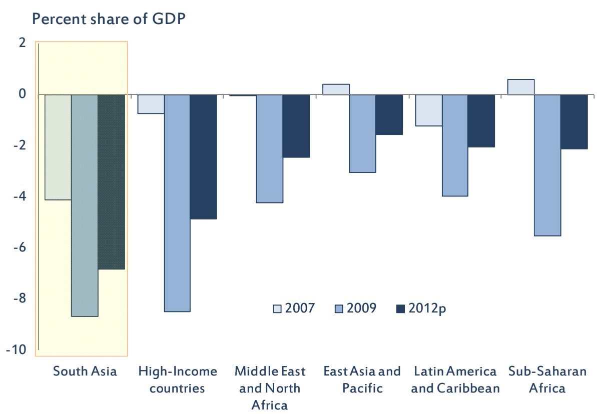
Recent developments

South Asia's real GDP growth accelerated to an estimated 8.7 percent in FY2010-11 from 7.0 percent in FY2009-10, buoyed by very strong growth in India, which represents 80 percent of regional GDP. Excluding India, regional GDP growth (on a fiscal year basis) firmed, but to a more modest 5.1 percent from 4.3 percent the year before. On a calendar year basis, GDP for the region as a whole is estimated to have expanded 8.4 percent in 2010 after 5.3 percent in 2009, and to 4.8 percent in 2010 from 3.8 percent in 2009 if India is excluded.

These strong growth rates mainly reflect robust domestic demand, supported by macroeconomic policy stimulus measures, and a revival in investor and consumer sentiment. Improved external demand and stronger private capital inflows have also played a role. At the country level, local factors—such as a good harvest and strong donor funding in Afghanistan; a favorable monsoon in India; recovery of tourism in the Maldives; rising capital expenditures for ongoing development of hydropower capacity in Bhutan; and the peace dividend in Sri Lanka—have also supported the rebound. In Pakistan, however, a standstill on policy implementation, severe disruption tied to massive flooding and continued security problems have constrained economic activity. Political stalemate has contributed to lackluster growth in Nepal. And, although growth was fairly strong in Bangladesh, continued power-supply bottlenecks have held back the expansion that could have been even stronger. (Table R5.1)

Macroeconomic policy in South Asia is accommodative, given the strength of regional economic activity and relative to other regions (where growth has generally not gained as strong of a footing). While policy interest-rates have been raised (beginning in mid-March 2010 in India, and, more recently, in Bangladesh and Pakistan), monetary policy normalization is incomplete and real interest rates remain negative. Moreover, despite some modest progress toward fiscal consolidation in 2010, South Asia has the largest fiscal deficit among developing countries with the region-wide deficit estimated at 8.2 percent in 2010. At the country-level, fiscal deficits as a share of GDP range significantly. For instance, Bangladesh's overall general government deficit is more manageable at an estimated 2.5 percent compared with the Maldives' deficit of 22.4 percent, and those in India (9.6 percent), Sri Lanka (8 percent), Pakistan (6.3 percent), and Bhutan (6.1 percent). (Figure R5.1)

Figure R5.1 General government deficit in South Asia is highest among developing regions



Source:World Bank Databases and DEC Prospects Group projections

The region's high fiscal deficits reflect a number of longstanding structural factors, with significant pressures emanating from both the revenue and expenditure sides. In particular, tax mobilization in the region is low. South Asia's general government tax revenues averaged 14.3 percent as a share of GDP in 2009—compared with Europe and Central Asia (21.4%), Sub-Saharan Africa (16.5%) and Latin America and Caribbean (16.4%)—and represented less than 12 percent of GDP in Pakistan (10.4 percent), Nepal (11.8 percent) and Afghanistan (7.2 percent). India's tax base is broader at 16.5 percent. On the expenditure side, the region carries a particularly heavy burden in the form of high interest payments. Relative to total expenditures, interest payments averaged 18.2 percent in 2009, by far the highest share among developing regions and at least twice the as high, with the exception of Latin America and the Caribbean (11%) (general government accounts). This reflects elevated interest payments as a share of total outlays in Bangladesh (17.3 percent, as of 2009) India (17.7 percent), Pakistan (25.5 percent), and Sri Lanka (25.8 percent). In comparison, government interest payments in Afghanistan and Nepal are more manageable at 4 percent or lower (as a share of general government outlays).(Figure R5.2)

Other factors have contributed to the region's

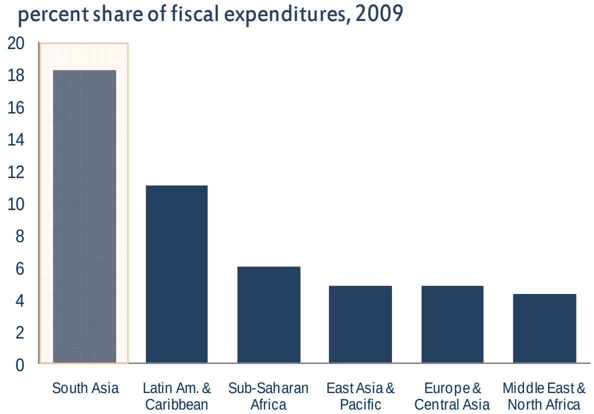
Table R5.1 South Asia forecast summary
(annual percent change unless indicated otherwise)

	95-06 [a]	2007	2008	2009	Est. 2010	Forecast 2011	2012
GDP at market prices (2005 US$) [b,f]	6.0	8.9	4.8	7.0	8.7	7.7	8.1
GDP in Calendar year basis [c]	6.1	9.2	6.1	5.3	8.3	7.8	7.9
GDP per capita (units in US$)	4.1	7.3	3.4	5.6	7.3	6.3	6.7
PPP GDP [d]	6.0	8.9	4.8	7.0	8.7	7.7	8.1
Private consumption	4.8	8.7	5.6	5.1	7.5	5.2	5.7
Public consumption	5.2	7.3	18.1	6.1	9.1	8.4	7.0
Fixed investment	7.8	14.6	4.1	5.7	10.3	13.2	13.3
Exports, GNFS [e]	11.9	5.4	16.0	-6.1	7.4	8.8	10.3
Imports, GNFS [e]	9.8	8.8	19.0	-7.4	6.2	9.4	10.3
Net exports, contribution to growth	-0.2	-1.0	-1.5	0.7	-0.1	-0.5	-0.5
Current account bal/GDP (%)	-0.7	-1.2	-3.3	-1.7	-3.4	-2.9	-2.9
GDP deflator (median, LCU)	6.1	7.7	8.8	6.5	11.5	8.7	6.9
Fiscal balance/GDP (%)	-7.4	-4.2	-7.2	-8.8	-8.3	-7.5	-6.9
Memo items: GDP at market prices [f]							
South Asia excluding India	4.5	5.9	3.7	4.3	5.1	4.3	5.0
India	6.4	9.6	5.1	7.7	9.5	8.4	8.7
at factor cost	-	9.2	6.7	7.7	8.7	9.0	8.5
Pakistan	4.1	5.7	1.6	3.6	4.4	2.6	3.8
Bangladesh	5.3	6.4	6.2	5.7	5.8	6.1	6.3

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. 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.
d. GDP measured at PPP exchange rates.
e. Exports and imports of goods and non-factor services (GNFS).
f. 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.

Source: World Bank.

Figure R5.2 Interest payments weigh on South Asia's fiscal coffers and constrain policy options

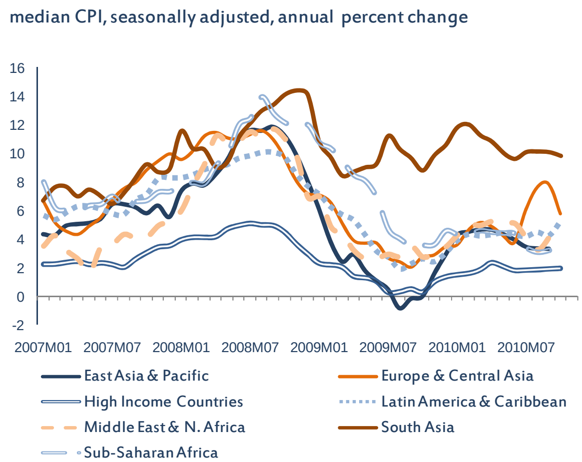


Sources: World Bank and International Monetary Fund, 2010

large deficits, including in the case of India, for example, elevated countercyclical spending that has yet to be fully unwound. Recent efforts at budget consolidation have been missed in Pakistan, because of revenue shortfalls, overrun on power sector subsidies and elevated security expenditures, as well as flood-related expenditures; and in the Maldives and Nepal, due to political stalemates that have undermined progress on budget agreements.

South Asia posted the highest median inflation rate among developing regions in the second-half of 2010. Inflationary pressures were up across most economies in the region in 2010, with the exceptions of Afghanistan and the Maldives, where they remained more stable. In part rising inflationary pressures stem from recent firming in international fuel and food prices. However, domestic drivers also contributed to higher prices, including elevated capacity utilization rates, accommodative macro-policy stances and increased inflationary expectations following several years of rising inflation. The rise in headline prices in Bangladesh, Bhutan and Nepal also partly reflects spillover from India, a key trade partner, through higher imported prices. Temporary price shocks have also been a factor, such as the disruption of flooding in Pakistan and some liberalization of fuel-price subsidies in India. More recently, inflationary pressures have been partly offset by falling local food prices, due to improved harvests following a good 2010 monsoon, particularly in Afghanistan and India. (Figure R5.3)

Figure R5.3 Inflation in South Asia has not eased as much as in other regions

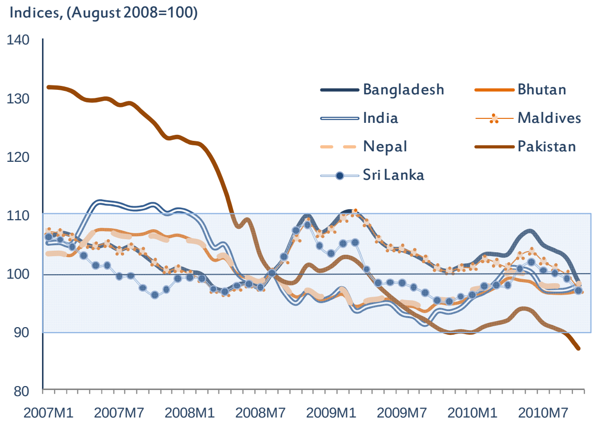


Source: Thomson Datastream and World Bank

The significant inflation differential between many South Asian countries and their trade partners has contributed to a real appreciation of their currencies in 2010. Notably, much of the appreciation during the year represents a reversal of depreciation in the aftermath of the global financial crisis. And, since January 2007 regional currencies have remained broadly stable, trading within a plus/minus 10 percent band—with the exceptions of Afghanistan and Pakistan. Over the same period, Afghanistan’s currency has appreciated by 17 percent, supported by massive foreign aid inflows. In contrast, Pakistan’s currency real effective exchange rate depreciated by 34 percent since January 2007, partly tied to large and persistent structural macroeconomic imbalances. (Figure R5.4)

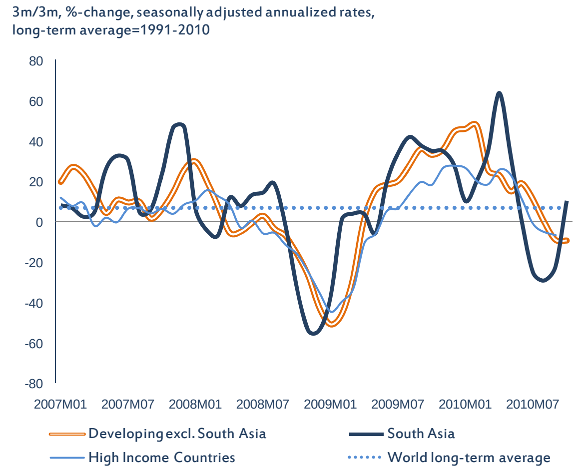
The pace of growth in merchandise exports and imports moderated sharply in mid-2010 following several months of double-digit growth

Figure R5.4 Real effective exchange rates in South Asia generally remain within plus/minus 10 percent band since 2007

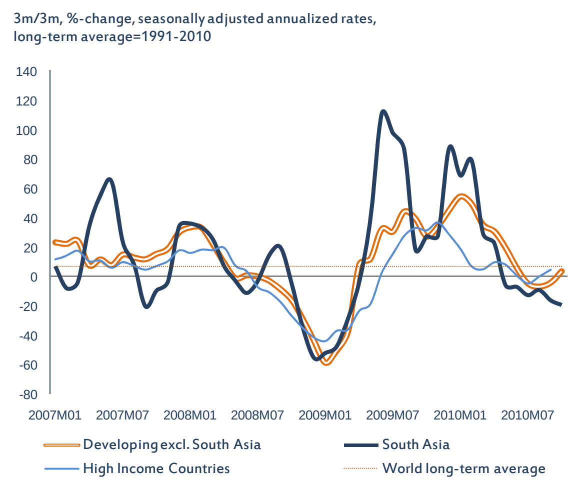


Source: International Monetary Fund and World Bank

Figure R5.5 South Asia's merchandise goods exports recover following sharp deceleration in mid-2010



South Asia's merchandise goods volume imports loose steam from mid-2010



Source: Thomson Datastream and World Bank

(3m/3m, seasonally adjusted, annualized rates). This basic pattern was observed across the world, and coincided with the recovery of pre-crisis trade levels (see main text), and partly reflects an overshooting of activity levels and a coming-to-an-end of the global inventory restocking phase of the global recovery. However, in South Asia, the slowdown in trade activity also stems from country-specific factors. For example, merchandise export volumes have been adversely impacted by power outages in Bangladesh that disrupted ready-made garment production, which represents over 75 percent of merchandise exports. In Pakistan, floods led to an estimated 20 percent reduction in cotton harvest and sharp fall-off in cotton exports and textiles (with the latter representing two-thirds of total merchandise exports). The pace of growth of regional merchandise import volumes has slowed markedly compared with other regions, and could reflect a recent moderation in the pace of growth of remittances inflows—a key driver of regional private consumption. (Figure R5.5)

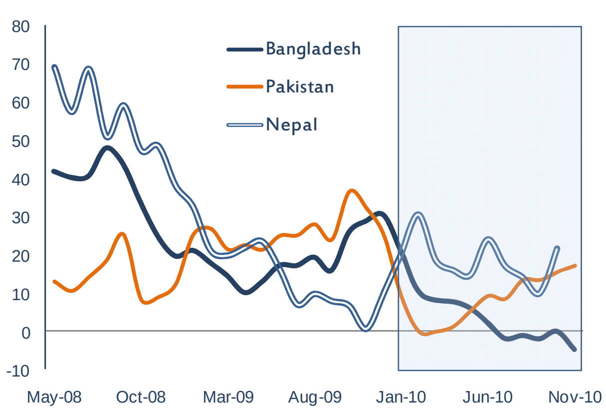
Remittances are a main source of foreign exchange for the region, and are an important driver of regional domestic demand. Official remittances inflows represent a significant share of GDP in Nepal (23 percent), Bangladesh (12 percent), Sri Lanka (9 percent), Pakistan (5.1 percent) and India (4 percent).[1] Remittances inflows to South Asia increased by an estimated 10.3 percent (in US-dollar value terms) in 2010, more than double the 4.5 percent growth rate in 2009—but well below the 19 percent average annual rate recorded between 1999 and 2009. However, because local currencies appreciated against the US-dollar, remittances inflows in real local currency-terms are estimated to have contracted in India (down 8.6 percent), Bangladesh (3.4 percent), Nepal (3.1 percent), Sri Lanka (1.7 percent) and Pakistan (1.4 percent). This compares with vibrant growth in real local currency-terms in the past, which over the previous five years (2004-2009) expanded by an average 17.6 percent (median growth rate across the five countries).

While remittances inflows in US-dollar terms rose for the regional aggregate in 2010, the growth trend varied at the country level, reflecting divergent economic trends in migrant destination countries and shifts in net emigration. In Bangladesh for example, net emigration slowed markedly in 2010, while it surged to the highest level on record in Nepal (reaching 300,000). The annual growth rate of remittances inflows slowed markedly in 2010 in Bangladesh, as the pace of expansion stalled at close to zero growth from June 2010 and shifted into contraction in November (4.6 percent over November 2009). As the stock of Bangladeshi migrants abroad continued to rise (albeit at a slower pace than in the past), the pronounced moderation in inflows (and recent decline in November) could reflect a variety of factors, including a fall in employment, decline in wages, or a decline in the propensity to remit. (Figure R5.6).

The regional current account deficit deteriorated in 2010, reflecting the relative strength of domestic demand, as growth of imports of goods outpaced that of exports and led to a sharp

Figure R5.6 Remittances inflows post tepid growth in some South Asian countries in 2010

3-month moving averages, annual percent growth

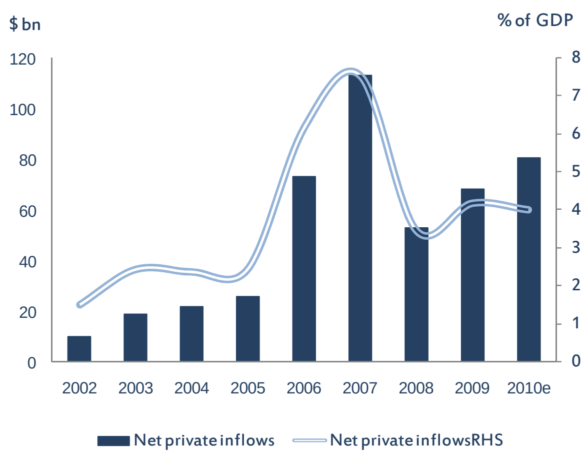


Source: Country central banks and World Bank

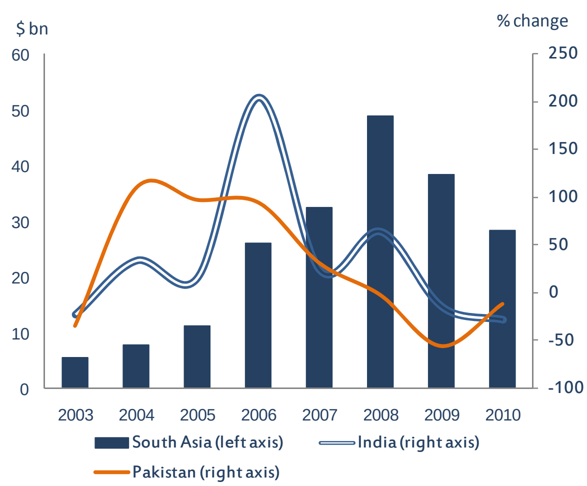
deterioration in merchandise trade balances. Partly as a result, India's current account deficit rose to a projected 3.7 percent of GDP in 2010, up from 2.0 percent in 2009. Current account deficits also rose significantly in Sri Lanka and Nepal. Strengthened remittances inflows (in US-dollar terms) have contained pressures on external balances and significantly offset sizeable trade deficits. Similarly, services receipts helped offset large trade deficits, given a rebound in tourism activity. In particular, the Maldives, Nepal and Sri Lanka witnessed a sharp upswing in tourist arrivals in 2010 of at least 12 percent over 2009. In the Maldives, the total number of arrivals for the first seven months of 2010 increased to a record of nearly 440,000—with arrivals up 29 percent over July 2009 in part due to a strengthening in arrivals from fast-growing emerging economies (with China surpassing the U.K. as the largest number of tourists). Bhutan and India also saw a pick-up in tourism activity, with arrivals for both countries projected to have risen by 6 percent in 2010. In India, the pace of growth of ICT-exports (internet, communication and technology) has decelerated markedly compared with vibrant growth rates posted in the past. This is largely attributed to a tepid recovery in external demand in the key export markets of the United States, United Kingdom and Europe, which comprise about 85 percent of Indian software and services exports.

Net private capital inflows (excluding official inflows) to South Asia strengthened by an estimated 18.4 percent in 2010 to $81 billion from 2009, and held fairly steady as a share of GDP at 4.0 percent in 2010 versus 4.3 percent in 2009. India and Sri Lanka account for the bulk of private capital inflows. While private capital inflows have nearly halved from the pre-crisis boom share of GDP of 7.8 percent recorded in 2007, at 4.0 percent it is roughly double the 2.0 percent share recorded during the period from 2000 through 2005. The recovery of inflows in 2010 over 2009 reflects a firming in portfolio equity and short-term debt flows, which increased to 2.1 percent as a share of GDP in 2010 from 1.2 percent in 2009. Compared with other developing regions, where portfolio inflows averaged 0.8 percent of GDP in 2010, portfolio inflows are relatively high in South Asia—and largely reflect record high foreign portfolio inflows into India during 2010. In contrast, net foreign direct investment inflows in South Asia continued to decline in level terms (and as a share of GDP) in 2010, albeit the pace of decline decelerated markedly compared with the sharp fall-off in 2009. Compared with other developing regions, where FDI inflows averaged 2.2 percent of GDP in 2010, FDI inflows are modestly lower at 1.4 percent of GDP in South Asia. (Figure R5.7).

Figure R5.7 Net private capital inflows to South Asia remains stable as a share of GDP at 4% in 2010



Pace of decline in FDI inflows slows



Source: World Bank

Medium-term outlook

South Asia is projected to continue to post robust growth of 7.7 percent and 8.1 percent over the forecast horizon in FY2011/12 and FY2012-13, respectively—albeit a deceleration from the 8.7 percent growth recorded in FY2010/11. The projected slowdown in growth partly reflects expected further tightening of fiscal and monetary policies, which are aimed at reducing inflationary pressures, bringing fiscal deficits down to sustainable levels, creating fiscal space, and avoiding the buildup of large external imbalances. India is targeting progressive reductions in the central government's fiscal deficit to 3.0 percent of GDP by end-FY2013-14 from 6.7 percent in FY2009-10, which will be supported by proceeds from divestment and reforms to fuel-subsidy programs. The Maldives and Sri Lanka are also pursuing fiscal deficit-reduction programs as part of their IMF stand-by agreements.

In combination with additional normalization of monetary policy in FY2011/12, fiscal consolidation is expected to lead to an easing of regional inflationary pressures over the forecast period. The median GDP deflator is projected to decline to 6.9 percent by the end of the forecast horizon from 11.5 percent in FY2010/2011. (Table R5.2).

Tighter macroeconomic policy conditions should be reflected in a deceleration in public sector consumption, which is expected to grow 7.0 percent in FY2012-13, down from 9.1 percent growth in FY2010-11. Given the expected less accommodative macro-policy environment and projected deceleration in the pace of growth of remittances inflows, private consumption growth is also projected to decelerate from 7.5 percent in 2010 to 5.7 percent over the same period. Regional fixed investment, however, is projected to strengthen over the forecast period to an average of 13.3 percent from 10.3 percent in 2010-11, supported by an expected continued firming of net private capital inflows to the region, buoyed by strong growth fundamentals, particularly in India, as well as continued strong investment growth tied to ongoing post-war reconstruction in Sri Lanka. Reconstruction activity should also support investment in flood-ravaged Pakistan.

A moderation in domestic demand growth—reflecting the impacts of projected fiscal consolidation (through, for example, cuts in government outlays and improved tax collection) and deceleration in the growth rate of remittances inflows—should be reflected in a deceleration of import growth. Nevertheless, the pace of growth of imports is expected to continue to outpace that of exports on average over the forecast period, and net exports are projected to continue to subtract from growth, albeit modestly.

Table R5.2 South Asia country forecasts
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Calendar year basis [b]							
Bangladesh							
GDP at market prices (2005 US$) [c]	5.4	6.5	6.3	6.0	5.8	5.9	6.2
Current account bal/GDP (%)	-0.7	1.2	1.4	3.5	2.4	1.6	0.7
India							
GDP at market prices (2005 US$) [c]	6.5	9.9	6.4	5.7	9.2	8.5	8.7
Memo: Real GDP at factor cost	-	9.5	7.3	6.8	8.8	8.9	8.5
Current account bal/GDP (%)	-0.5	-0.7	-2.5	-2.0	-3.7	-3.1	-3.0
Nepal							
GDP at market prices (2005 US$) [c]	4.0	3.5	4.3	5.0	4.0	3.5	3.8
Current account bal/GDP (%)	-3.5	-1.7	4.2	-2.1	-3.0	-2.9	-2.5
Pakistan							
GDP at market prices (2005 US$) [c]	4.2	5.9	3.6	2.6	2.8	3.5	3.2
Current account bal/GDP (%)	-1.1	-5.8	-9.6	-2.2	-3.1	-3.4	-3.9
Sri Lanka							
GDP at market prices (2005 US$) [c]	4.5	6.8	6.0	3.5	7.1	6.8	6.0
Current account bal/GDP (%)	-3.2	-4.6	-9.8	-0.7	-3.6	-3.3	-3.7
Fiscal year basis [b]							
Bangladesh							
Real GDP at market prices	5.3	6.4	6.2	5.7	5.8	6.1	6.3
Current account bal/GDP (%)	-0.9	1.4	0.9	2.7	3.7	2.0	1.2
India							
Real GDP at market prices	6.4	9.6	5.1	7.7	9.5	8.4	8.7
Memo: Real GDP at factor cost	-	9.2	6.7	7.7	8.7	9.0	8.5
Current account bal/GDP (%)	-0.5	-1.3	-2.4	-2.9	-3.6	-3.1	-3.0
Nepal							
Real GDP at market prices	4.1	3.3	5.3	4.7	3.3	3.7	4.0
Current account bal/GDP (%)	1.4	-0.1	2.9	4.3	-2.6	-3.0	-2.7
Pakistan							
Real GDP at market prices	4.1	5.7	1.6	3.6	4.4	2.6	3.8
Current account bal/GDP (%)	-1.7	-4.8	-8.5	-5.7	-2.0	-3.3	-3.6

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.

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

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

b. 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. 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.

c. GDP measured in constant 2005 U.S. dollars.

Source: World Bank

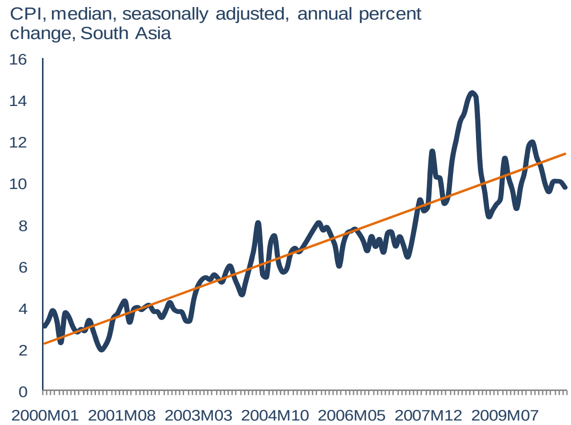
The growth rate of the dollar value of remittances inflows is projected to halve over the forecast horizon, from an estimated 10.3 percent rate of expansion in 2010 to 5.1 percent in 2011—reflecting a lagged impact of the crisis, as migrant deployments from the region have slowed sharply and demand for migrants from oil-rich Arabian Gulf countries (a key migrant destination countries for South Asia) is expected to plateau with the completion of several large construction projects.[2] In 2012, a projected strengthening in high-income country growth is expected to support a modest acceleration to 6.3 percent growth in remittances inflows to South Asia in FY2012-13—well below the 19 percent average annual rate recorded between 1999 and 2009.

Foreign private capital inflows (excluding official inflows) to South Asia are projected to show strong growth over the forecast period and reach $102 billion by 2012. In 2011 and 2012, net private inflows are projected to expand by 13 percent and 11 percent, respectively, largely due to rising net FDI inflows, led by inflows to India. As a share of GDP, net FDI inflows are expected represent 2.1 percent of GDP, firming from an estimated 1.4 percent in 2010. In contrast, net portfolio equity inflows to the region are projected to diminish to $37 billion by 2012 from an estimated $43 billion in 2010, and correspondingly decline as a share of GDP from 2.1 percent to 1.4 percent over the same period, largely led by a projected gradual moderation of portfolio inflows to India (the largest recipient in the region) following record inflows in 2010. This also reflects a projected unwinding of the extraordinary monetary stimulus in high-income countries that is expected to induce an easing of portfolio inflows to developing countries (Table R5.3).

Risks

A major domestic challenge facing policy makers in the region is bringing inflation back down to the low levels observed in the pre-boom period, when regional inflation averaged 3.3 percent from 2000 to 2003 (median CPI). This challenge is complicated by the fact that inflation has risen more or less steadily since 2000, contributing to rising inflation expectations, and because the process of deficit reduction poses real political challenges. Sharply higher than-projected international commodity prices would create additional pressures and challenges (Figure R5.8).

Figure R5.8 Inflationary pressures have trended upward in the last decade



Source: Thomson Datastream and World Bank

On the fiscal expenditure side, risks are tied to sharply higher-than-projected international commodity prices—particularly for hydrocarbons and grains—given large regional fiscal subsidies for food, fuel and fertilizers. Higher oil prices, in particular, would also lead to deterioration of current account positions for the energy-importing region. Further, presenting risks to fiscal consolidation efforts, a long-standing challenge for the region is raising fiscal revenue mobilization. Improving tax administration and enforcement would help diminish pressures on fiscal coffers.

The challenges that high-income European countries with large deficits and large debt-to-GDP ratios are encountering are an important reminder of the importance of maintaining fiscal sustainability. In South Asia, the policy measures that have been proposed will, if met, will help to achieve needed macroeconomic policy tightening. The task is, however, complicated by the desire to maintain the pace of

Table R5.3 Net capital flows to South Asia

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	12.5	-1.2	-15.1	-16.8	-20.6	-55.1	-45.2	-46.9	-44.5	-51.6
as % of GDP	1.6	-0.1	-1.5	-1.5	-1.4	-3.8	-2.9	-2.3	-1.9	-2.0
Financial flows:										
Net private and official inflows	14.5	21.2	28.5	76.6	117.7	61.4	77.7	92.4		
Net private inflows (equity+debt)	18.6	21.5	25.6	73.1	113.3	52.8	68.2	80.7	91.5	101.9
..Net private inflows (% GDP)	2.4	2.4	2.5	6.4	7.8	3.6	4.3	4.0	3.9	3.9
Net equity inflows	13.5	16.8	23.6	36.4	68.4	32.9	58.8	71.3	83.5	93.3
..Net FDI inflows	5.4	7.8	11.2	26.0	32.3	48.7	38.3	28.3	44.5	56.3
..Net portfolio equity inflows	8.0	9.0	12.4	10.4	36.1	-15.8	20.5	43.0	39.0	37.0
Net debt flows	1.0	4.4	4.9	40.2	49.3	28.5	18.8	21.1		
..Official creditors	-4.1	-0.3	2.9	3.5	4.4	8.6	9.5	11.7		
....World Bank	-2.3	2.3	2.3	2.0	2.0	1.4	2.1	3.9		
....IMF	-0.1	-0.3	0.0	-0.1	-0.1	3.2	3.6	3.8		
....Other official	-1.8	-2.4	0.6	1.6	2.4	4.0	3.8	4.0		
..Private creditors	5.1	4.7	2.0	36.7	44.9	19.9	9.3	9.4	8.0	8.6
....Net M-L term debt flows	3.1	4.0	-0.2	19.9	32.0	12.0	10.3	3.2		
......Bonds	-3.7	3.9	-2.8	6.4	10.7	1.7	1.7	-2.6		
......Banks	6.8	0.5	2.8	13.5	21.3	10.3	8.6	5.8		
......Other private	0.0	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0		
....Net short-term debt flows/a	2.0	0.7	2.3	16.8	12.9	7.9	-1.0	6.2		
Balancing item /b	10.0	7.6	-6.6	-18.1	6.7	-32.6	6.2	-37.2		
Change in reserves (- = increase)	-36.9	-27.6	-6.8	-41.7	-103.8	26.3	-38.6	-8.3		
Memorandum items										
Workers' remittances	30.4	28.7	33.9	42.5	54.0	71.6	74.9	83.0	87.0	92.0

Source: World Bank
Note: Countries covered are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka

growth-enhancing infrastructure investments, necessarily forcing a greater share of needed consolidation on other areas of government spending and points to risks of fiscal slippage. The policy challenge is to find politically acceptable areas for deficit cutting, while preserving growth enhancing investments—needed to address structural supply-side constraints and improve medium to long-term growth prospects and poverty reduction. Aside from supporting growth outturns, investment in physical and human capital—for which performance indicators generally lag in South Asia compared with most other developing regions—would also support international competitiveness.

Notes:

1 Remittances are particularly important to South Asia among developing regions, as for example, Nepal is among the top ten recipients in the world of remittances inflows measured as a share of GDP, (fifth), and both India and Bangladesh are among the top ten recipient countries in the world measured in U.S. dollar level-terms (estimated at $55 billion in 2010 for India, placing it as top recipient, and $11 billion for Bangladesh). Ratha, Dilip et al, "Migration and Development Brief (number 13)", November 8, 2010, The World Bank.

2 Ratha, Dilip et al, "Migration and Development Brief (number 13)", November 8, 2010, The World Bank.

Sub-Saharan Africa

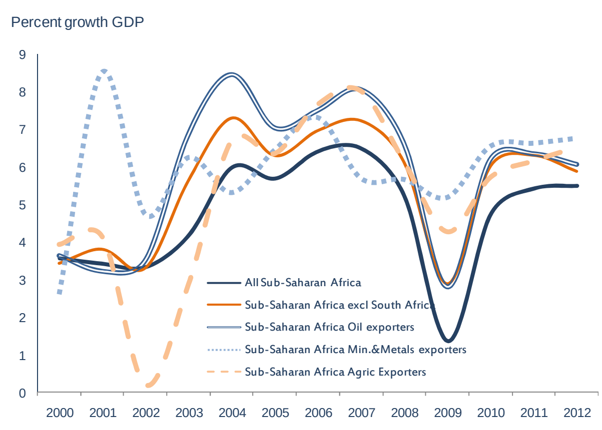
Recent developments

GDP in Sub-Saharan Africa is estimated to have expanded by 4.7 percent in 2010, up from 1.7 percent in 2009. Excluding the region's largest economy, South Africa, growth in the region is estimated at 5.8 percent in 2010, up from 3.8 percent in 2009 (Figure R6.1).

While a resilient demand environment supported growth during 2009, the recovery in 2010 was bolstered by the external sector, through stronger export volumes, rising commodity prices, higher foreign direct investment and a recovery in tourism.

After falling sharply, regional export volumes rebounded during the second half of 2009 and into the first half of 2010, peaking in March 2010 at 13.6 percent above pre-crisis volumes. In line with the global slowing in trade, exports declined toward the middle of the year and as of July 2010, export volumes were only 2.2 percent above their pre-crisis levels. Excluding South Africa, whose exports were affected by the rand appreciation and labor strikes, export volumes in the rest of the region were 10 percent above pre-crisis levels in July.

Figure R6.1 Growth among metal and mineral exporters in Sub-Saharan Africa ahead of oil and agriculture exporters



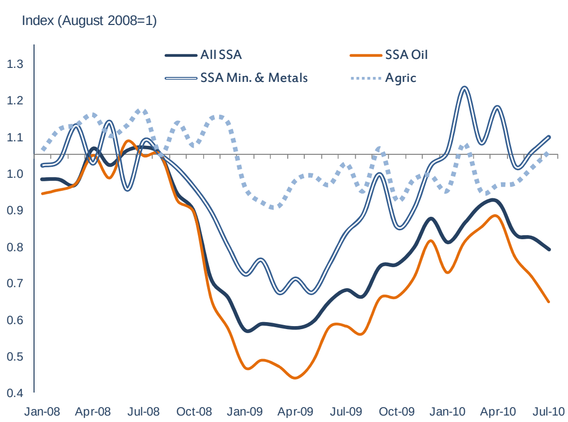
Source: World Bank.

Export volumes rebounded most strongly for metal and mineral exporters (up 34.7 percent, 18.2 percent for oil exporters and only 5.8 percent for agricultural commodity exporters. Partly as a result, growth in 2010 was strongest among mineral and metals exporters (6.5 percent), somewhat less strong among oil exporters (5.9 percent), and a weaker but nevertheless robust 5.7 percent among agricultural exporters (Figure R6.2).

Notwithstanding the rebounding in volumes the value of regional exports remains 26 percent below its August 2008 levels, because as they are yet to regain the extraordinary high levels of 2008. However, this mainly reflects weaker oil prices, as metals and mineral prices have recovered much of the declines endured during the crisis. As a result, while oil exporters revenues are off 40 percent, agricultural exporters were at their August 2008 level, and metal and mineral exporters were 4.8 percent above that benchmark.

Foreign earnings were also boosted by South Africa's hosting of the FIFA World Cup. Partly as a result, Sub-Saharan Africa, the only region to have experienced an increase in tourist arrivals in 2009, sustained that growth trajectory

Figure R6.2 Sub-Saharan metal and mineral exporters experience sharpest rebound



Source: World Bank.

with a 16 percent increase in international arrivals during the first half of 2010 (UN World Tourism Organization, 2010). Tourism revenues were also up in major tourist destinations in the region (Cape Verde, Kenya Mauritius, Seychelles, and Tanzania).

Foreign direct investment is the most important source of private capital flows to sub-Saharan Africa. After declining by 12.3 percent in 2009, FDI recovered by 6 percent to $32bn in 2010 (Table R6.1). Indeed, foreign direct investment to the region has risen in six of the past eight years, reflecting increased investment interest in the region (UNCTAD estimates that the rate of return of FDI in Africa is the highest globally).

The bulk of this investment (40 percent) went to the three largest economies: South Africa, Angola and Nigeria. Nonetheless, over 50 percent of FDI goes to the smaller countries in the region, in marked contrast with portfolio flows, 90 percent of which go to the region's largest economies. Supported by the rise in metal and energy prices in recent years most of these flows went to the extractive industries sector. Beneficiaries of these flows cover a diverse range of countries including middle income (Congo, Ghana), low income (Mozambique, Zambia, Niger), post-conflict (Liberia, Sierra Leone) as well conflict countries (Guinea).

However, although most of the dollar value of FDI goes to the extractive sector, the manufacturing sector accounted for 41 per cent of the total number of greenfield investment projects during 2003–2009, including, for example, metals (9 per cent of the total), transport equipment (7 per cent) and food and beverage (6 per cent) (UNCTAD, 2009). Besides manufacturing the services sector is also another large recipient, particularly telecommunications, transportation and banking services. In June 2010, for instance, Bharti Airtel, an Indian company, completed the acquisition of Zain's mobile operations in Africa for $10.7bn, one of the largest acquisitions in 2010. Even though developed countries are the main source of

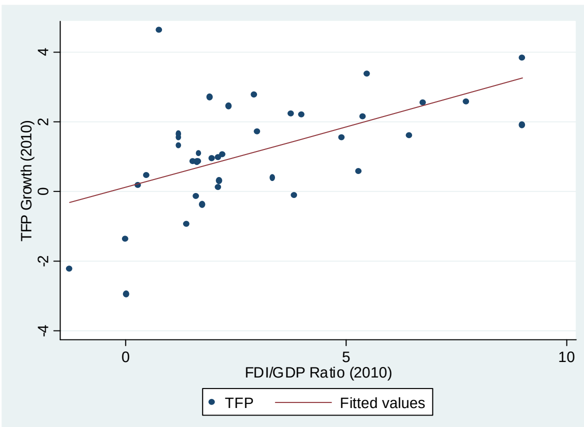
Table R6.1 Net capital flows to Sub-Saharan Africa
$ billions

	2003	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f
Current account balance	-7.1	2.3	20.3	16.0	-5.9	-17.0	-18.5	-14.7	-20.1	-29.2
as % of GDP	-1.6	0.4	3.2	2.2	-0.7	-1.7	-2.0	-1.4	-1.7	-2.3
Financial flows:										
Net private and official inflows	14.6	24.0	33.0	42.4	53.2	38.9	45.3	59.3		
Net private inflows (equity+debt)	13.2	21.7	33.9	44.4	50.7	34.3	35.8	49.3	56.8	64.8
..Net private inflows (% GDP)	3.0	4.0	5.3	6.0	5.9	3.5	3.9	4.6	4.9	5.2
Net equity inflows	14.0	17.7	26.1	37.0	38.7	28.9	40.2	43.0	49.8	60.8
..Net FDI inflows	13.3	11.0	18.0	20.2	28.5	34.5	30.3	32.0	40.8	51.8
..Net portfolio equity inflows	0.7	6.7	8.1	16.8	10.1	-5.6	10.0	11.0	9.0	9.0
Net debt flows	0.6	6.4	6.9	5.4	14.6	10.0	5.1	16.3		
..Official creditors	1.4	2.3	-0.9	-1.9	2.5	4.6	9.5	10.0		
....World Bank	2.2	2.5	2.4	2.2	2.4	1.9	3.1	3.4		
....IMF	0.0	-0.1	-0.4	-0.1	0.1	0.7	2.2	1.8		
....Other official	-0.8	0.0	-2.9	-4.1	0.0	2.0	4.1	4.8		
..Private creditors	-0.8	4.0	7.9	7.4	12.1	5.5	-4.4	6.3	7.0	4.0
....Net M-L term debt flows	0.9	2.7	4.8	-2.0	8.0	0.8	5.6	8.1		
......Bonds	0.4	0.6	1.3	0.3	6.7	-0.7	1.9	3.4		
......Banks	1.2	2.4	3.8	-1.7	2.1	1.7	2.9	4.7		
......Other private	-0.7	-0.3	-0.3	-0.7	-0.8	-0.1	0.8	0.0		
....Net short-term debt flows/a	-1.7	1.4	3.0	9.4	4.0	4.6	-10.0	-1.8		
Balancing item /b	-4.1	-4.6	-33.5	-26.0	-20.4	-11.1	-28.7	-38.5		
Change in reserves (- = increase)	-3.5	-21.7	-19.9	-32.5	-27.0	-10.9	1.9	-6.1		
Memorandum items										
Workers' remittances	6.0	8.0	9.4	12.7	18.6	21.3	20.8	21.0	22.0	24.0

Source: World Bank.

foreign direct investment to the region, developing countries (including from elsewhere within Africa) are increasing their share of foreign direct investment within Africa. These investments are providing critically needed capital, upgrading technologies, creating jobs and contributing to Sub-Saharan Africa's growth (Figure R6.3).

Figure R6.3 Foreign direct investment flows are positively correlated with total factor productivity growth in sub Saharan Africa



Source: World Bank.

In 2010, South Africa was the only Sub-Saharan African country to issue new foreign denominated bonds ($4.7bn) in international capital markets, though a number of countries, including Nigeria, are preparing to issue international bonds and many recently issued bonds (e.g. those of Ghana and Gabon) continued to be actively traded in secondary markets.

So far, the euro area sovereign debt crisis has had little effect on the yields of Sub-Saharan Africa sovereign debt bonds. Though initially rising in May, in the wake of the bail out to Greece, the decline in spreads for bonds issued by Sub-Saharan African countries continued their retreat even amidst the rescue package for Ireland in November (Figure R6.4).

Economic ties between Sub-Sahara Africa and Asia have been strengthening in recent years, and as a result, a number of African countries

Figure R6.4 EMBI stripped spreads fall to pre-crisis levels despite persistence of euro area sovereign debt crisis

Source: JPMorgan

have benefitted from access to loans from Asian countries. Though overall totals are not available, some notable deals include: a September 2010 framework agreement between the Government of Ghana and the Chinese Development Bank and Chinese Exim Bank amounting to over $13bn; a loan between the Democratic Republic of Congo of up to $6bn with China in 2010 (Table R6.2). The majority of these loans were towards the financing of infrastructure-related projects such as roads, railways, power plants and economic zones. The Forum on Chinese and Africa Co-operation reports that since 2000 Chinese companies have built 60,000km of road and 3.5 million kw in generating capacity of power plants in Sub-Saharan Africa.

By the end of October portfolio flows to South Africa, the most liquid market in the region, had more than doubled to $6bn. They have supported a recovery in share prices and with it underpinned household consumption due to the increased wealth effect. The inflows have also accounted for the appreciation of the rand (8 percent against the dollar between January and December 2010, and 30% real effective appreciation since January 2009). The appreciation, while moderating domestic price

Table R6.2 Selected Asia-Africa infrastructure-related financing agreements signed in 2010

Country of origin	Beneficiary country	Value ($ bn)
China	Ghana	13.4
Korea	Ghana	1.5
China	Democratic Republic of Congo	6.0
China	Cameroon	0.7
China	Nigeria	0.9

Source: National Sources and Thomson Reuters

increases has also reduced the competitiveness of South Africa's exports, in particular the manufacturing sector.

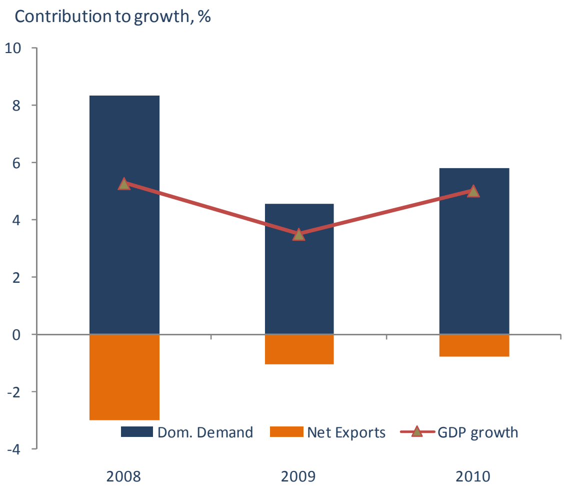
Thanks to the ongoing recovery in the U.S and in Europe, remittance flows to Sub-Saharan Africa, which remained nearly flat during the crisis, registered a modest 1 percent gain in 2010 to reach $21 billion. Remittance flows are important in supporting household consumption in a number of Sub-Saharan African countries, accounting for up to 22 percent of GDP in Lesotho and about 10 percent in Cape Verde, Senegal and Togo.

Improving domestic conditions also supported the rebound.

Despite improved external conditions, strong domestic demand – partly reflecting improved incomes due to higher commodity prices – meant that imports increased faster than exports and the contribution of net exports to GDP growth was negative in most Sub-Saharan countries (Figure R6.5), subtracting some 0.8 percent from aggregate 2010 GDP growth. However, the rebound is not a simple commodity story. Between 2000 and 2008 less than one third of Sub-Saharan African GDP growth was due to natural resources, with the bulk reflecting the rapid expansion of wholesale and retail trade, transportation, telecommunications, and manufacturing.

Part of the recent resilience reflects the implementation of countercyclical domestic demand policies in a number of countries. Many countries with adequate fiscal space (e.g. Kenya,

Figure R6.5 Strong domestic demand helps drive growth in Sub-Saharan Africa



Source: World Bank.

Nigeria and Tanzania) went ahead with infrastructure programs despite the crisis in part because of multilateral and bilateral budgetary support and in part because good macroeconomic management and earlier debt relief meant that they had the fiscal space to pursue these plans despite the global recession. Indeed, though shut out from international capital markets, during the recession, many sub Saharan African governments were able to borrow from their domestic securities market to finance their fiscal plans.

As a result fiscal deficits in the region surged to 5.5 percent of GDP in 2009 from a surplus of 1 percent in 2008. Since then, the ongoing recovery is helping to bring down fiscal deficits. In 2010 fiscal deficits are estimated to have declined to 4.3 percent of GDP, with the decline being most marked among oil exporting countries (a fall from 6.8 percent in 2009 to 3.0 percent in 2010).

Favorable weather conditions in Eastern and Southern Africa supported bumper harvest in a number of countries in the region, thereby providing support to household incomes as the agricultural sector remains the largest employer in most countries. For a number of countries in the region (e.g. Malawi and Zambia) the extension in farmer coverage of government input support programs contributed to favorable maize harvests. In West Africa, floods destroyed agricultural output in Benin, Togo and parts of Nigeria. On the other hand, a severe drought across the Sahel left many households in Niger insecure as crop yields failed.

While these forces were at play throughout the region, low-income countries were more successful in translating them into growth. These countries averaged 5.6 percent in 2010, versus 4.7 percent for middle-income countries (6.0 percent excluding South Africa).

With over 40 countries in the region it is a challenge to categorize growth performances within income groupings, regional blocks, and resource content of exports since performances remain heterogeneous even across each of these sub groupings. The following section will focus on recent growth performances among the largest and the fastest growing economies in the region.

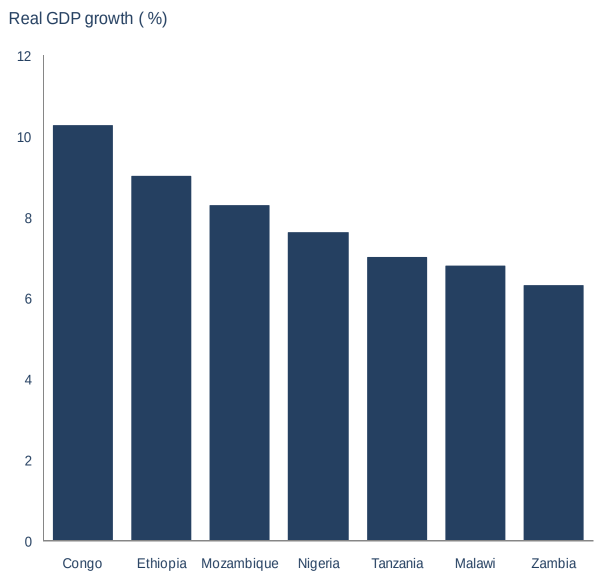
In South Africa, the largest economy in the region, output in first, second and third quarters expanded at seasonally adjusted annualized rates of 1.7 percent and 3.1 percent and 2.6 percent respectively. Growth for 2010 is forecast at 2.7 percent, supported by a firming in domestic demand, reflected in the pick-up in wholesale and retail trade, and the recovery in house prices. Household consumption has benefitted from increases in real wages and lower interest rates and the wealth effects of higher equity prices. Households increased their borrowing by 4.6 percent (y/y) in July while the corporate sector increased borrowing by 6 percent (y/y). Though private sector investment was sluggish, investment by the public sector was strong. Indeed, construction services were some 10 percent higher than the pre-crisis level. South Africa also received a fillip from hosting the World Cup. GDP growth in South Africa would have been even higher were it not for a number of industrial strikes. In Q2 for instance, the industrial strike contributed to the 20.8 percent fall in mining output. Overall by October 2010, some 1.25 million work days had already been lost compared to 526,000 in 2009.

Nigeria's economy has continued on its robust growth path. This strong performance continued into 2010, with the first and second quarters registering 7.4 percent and 7.7 percent annualized growth. Growth in 2010 is expected at 7.6%. Though the rebound in the global economy helped, domestic developments were major factors. The relative peace in the Niger Delta region has boosted crude oil and natural gas production, while the non-oil sector has continued to grow strongly (contributing 70 percent of growth in 2009 for example). The agriculture sector benefited from favorable weather, and the increasing commercialization of the sector. And robust activity in services particularly, telecommunications and public and private construction activity supported growth. The contribution from the banking sector was more subdued, due to restructuring following the clean-up in 2009.

Angola's GDP is estimated to have increased 3.0 percent in 2010, up from the 0.7 percent growth recorded in 2009. With oil accounting for over 50 percent of the Angolan economy, increased incomes from the stronger oil prices has underpinned the acceleration. However, large government payment arrears to the private sector had strong negative spillover effects in the non-oil economy, limiting economic growth in 2010. According to the government, from May to August 2010 it paid $1.3 billion out of an estimated $6.8 billion in accumulated arrears. Despite the tight fiscal and monetary policies inflation picked up speed in 2010 to 14.5% from 13.7% in 2009.

The Kenyan economy returned to higher growth, thanks to a rebound in the agricultural and industrial sectors. The Kenyan economy is estimated to have grown 5.0 percent in 2010. The rebound in the agriculture sector has been supported by favorable weather conditions and an increase in the area under irrigation. Agriculture exports, particularly tea (up 50 percent in volume terms), has supported the upturn – although horticultural exports were hampered by the weak recovery in Europe and the Iceland volcanic ash crisis in April 2010 – which cut into time-sensitive deliveries. Counter cyclical fiscal policy helped firm domestic demand in 2010, with government investing heavily in domestic infrastructure. The passing of the new constitution and the strengthening of regional integration efforts in East Africa has created new opportunities for businesses in Kenya. Remittance flows rose to $1.8bn in 2010. This amount was higher than each of the traditional foreign exchange earners: tourism, tea and horticulture. Kenya continues to benefit from the productivity gains that growth in its dynamic information and communications technology sector brings to its economy (e.g. banking, trade and health services etc). The ICT sector alone is estimated to have accounted for 13 percent of growth in Kenya's economy over the past decade.

Figure R6.6 Fast growing Sub-Saharan Economies in 2010



Source: World Bank.

Boosted by increased oil production and recovery in international oil prices, GDP growth for 2010 in the **Republic of Congo** is estimated at 10.3 percent, making it the fastest growing economy in sub-Saharan Africa in 2010 (Figure R6.6). Oil production increased to an average of 340,000 barrels per day (bpd) up from 274,000 in 2009. Indeed, Congo was one of the few economies that recorded robust growth (7.5 percent) in 2009, thanks to the coming on stream of recent oil discoveries. Congo reached the heavily indebted poor countries (HIPC) completion point in January and received debt relief from multilateral creditors. In November the Paris club creditor nations also cancelled more than half of Congo's debt ($7.35bn). As a result, the country's debt-servicing bill is expected to decline by $1.9bn annually. In spite of its high growth rates, Congo's non-oil sector economy remains severely constrained by poor infrastructure and a weak business environment. The debt relief should provide some fiscal space to increase growth-enhancing spending, particularly in the transport, power, and key social sectors. However, this fiscal space needs to be used with caution and with proper planning to ensure public investments are productive.

Unlike other fast growing Sub-Saharan African economies, where growth has been supported by the minerals sector, **Ethiopia's** robust growth performance over the past couple of years, including a 9 percent increase in GDP during 2010, has been driven by the agricultural sector. The sector has benefitted from continuing government investment in roads, power projects and marketing networks, which has helped bring more small-holder farmers into the market. Generous incentives have also supported large scale commercial agriculture ventures, including in agro-processing. The peaceful elections conducted in May supported the return of investors. In 2010, exports rebounded on modest increases in international commodity prices and the depreciation of the Birr. Further, for the first 10 months of 2010, remittances were up 9 percent, yoy. In recent years, the government has been enacting policies to support remittance inflows, including allowing Ethiopian's in the diaspora to open foreign currency accounts in local banks.

Thanks to the recovery in exports, increased inflows of foreign direct investment and continuing donor support **Mozambique's** economy is estimated to have grown 7.8 percent in 2010. Export proceeds for the first six months of 2010 were up by 11 percent compared with the same period in 2009. This was mostly due to an increase in world market prices for aluminum, which accounts for 56 percent of Mozambique's exports. Other exports to register significant increases were natural gas, ilmenite and electricity exports to South Africa. Foreign interest in Mozambique continues to grow. The state-run investment promotion agency approved $601.2m worth of projects in the first half of 2010 (up 400 percent from the low-base in 2009). However, high-inflation has cut into private consumption spending, as has currency depreciation viz-a-viz the rand (South Africa being a major source of imports (particularly food imports). In September the government reversed an earlier decision to increase the price of bread, other basic goods and utilities due to riots.

Botswana was one of the middle income countries in sub Saharan Africa that was severely hit by the crisis in 2009, due to the fall in diamond prices, its principal exports. The recovery in diamond prices has spurred a strong rebound in mining activity, which accounts for some 36% of GDP. Growth in 2010 is estimated at 7.8% in 2010. Contributions from the non-mining sector also supported growth in 2010. By the third quarter of 2010, contributions from the agriculture sector and tourism-related services were 0.7 and 1.2 percentage points respectively.

A rebound in copper prices, bumper harvests, inflows of foreign direct investment and a strengthening services sector contributed to the robust 6.4 percent growth in **Zambia** for 2010. With the dollar price of copper rising 54 percent during the period January-November 2010 versus the same period in 2009, copper output increased to 720,000 metric tons the highest level recorded since the 1970's. Overall exports values increased by 28 percent for the first half of 2010. Further, thanks to a government fertilizer and seed subsidy program and favorable weather, maize harvest increased 42.1 percent in the 2009/10 season. The favorable supply-side conditions contributed to a moderation of inflation in 2010, falling from an average annual rate of 14.2 percent for the first nine months in 2009 to 8.9 percent for the same period in 2010. Foreign direct investment pledges reached a record $2.4bn in the first half of 2010, with the bulk of this from China and going into the manufacturing, mining and energy sectors. The services sector was buoyed by sharp increases in public infrastructure spending, and the launch of third-generation services helped boost activity in the telecoms sector.

In spite of the slowdown in tobacco production, the main foreign exchange earner, the **Malawian** economy is estimated to have grown by 6.8 percent in 2010 on account of bumper maize harvests, aid inflows and rising uranium exports. Subsidies on fertilizers and hybrid seeds to farmers supported the boost in maize harvests. Prudent macroeconomic policies have also kept a lid on inflation, despite depreciation pressures.

Tanzania is expected to record a solid 7.0 percent growth in 2010, thanks to favorable developments in the services and minerals sector. With the recovery in the global economy, merchandise trade and tourism rebounded. Supported by developments in the gold sector, by August 2010, merchandise exports had reached $3.4bn up from the $2.5bn recorded in the same period in 2009. With the completion of the Buzwagi Gold Mine in June 2009, export volumes in gold increased to 37.4 tons by August 2010. With gold prices soaring in 2010, this contributed to the 33.9 percent (y/y) increase in exports values by August 2010. Travel receipts from tourism also increased to $1,3bn by August 2010 compared to $1.2bn for same period in 2009. Further, given Tanzania's position as a transit country, the recovery in trade led to increased activity in the transportation sector.

Medium-term outlook

Sub-Saharan Africa is projected to grow at 5.3 percent and 5.5 percent in 2011 and 2012 respectively. Excluding South Africa, growth is projected at 6.4 percent and 6.2 percent for 2011 and 2012 respectively, making sit one of the fastest growing developing regions (Figures R6.3 and R6.4). Growth is expected to be driven by continued recovery in the global economy. Developments in domestic demand will continue to play a dominant role in supporting the growth process particularly through productivity spillovers from ongoing investments in telecommunications, banking, energy and transportation services. These projects are being financed through foreign and domestic sources. Over the forecast horizon an increasing number of Sub-Saharan African countries are likely to raise finance in international capital markets. Countries that have indicated an interest in doing so over the forecast horizon include Nigeria, Angola, Kenya, Senegal, Tanzania, and Zambia.

Short-term prospects in the agriculture sector, which is the region's largest employer, continues to hinge on weather conditions. For those countries, where agriculture provided a big fillip to growth in 2010, its contribution can be expected to decline next year. Over the longer term, the sector should continue to benefit from the stepping up in government input support programs and the commercial activity.

The dollar value of remittances into Africa are expected to grow by 4.5 percent and 6.7 percent in 2011 and 2012 supporting the strengthening of household consumption.

Individual growth performances will vary across countries. **Among the larger economies, South Africa should benefit from** an improving global economy, ongoing public investment and firming up in consumer demand. South Africa's economy is projected to expand by 3.5 percent

Table R6.3 Sub-Saharan Africa forecast summary
(annual percent change unless indicated otherwise)

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
GDP at market prices (2005 US$) [b]	4.0	6.5	5.2	1.7	4.7	5.3	5.5
GDP per capita (units in US$)	1.4	4.1	3.1	-0.3	2.7	3.3	3.4
PPP GDP [c]	4.2	6.8	5.5	2.2	5.0	5.6	5.7
Private consumption	2.0	9.1	3.7	1.4	4.9	5.0	5.0
Public consumption	5.1	5.9	7.8	4.4	5.5	5.2	5.0
Fixed investment	6.7	17.7	11.7	4.6	6.7	8.3	7.6
Exports, GNFS [d]	4.7	5.0	4.3	-5.7	7.5	6.9	6.9
Imports, GNFS [d]	5.9	12.5	6.7	-3.7	9.1	7.9	7.2
Net exports, contribution to growth	-0.1	-2.7	-1.1	-0.5	-0.9	-0.8	-0.5
Current account bal/GDP (%)	-1.6	-0.2	-1.2	-2.7	-2.0	-2.3	-2.7
GDP deflator (median, LCU)	7.3	7.4	11.0	3.8	6.1	5.6	5.4
Fiscal balance/GDP (%)	-1.7	0.5	0.9	-5.1	-4.0	-3.0	-1.9
Memo items: GDP							
SSA excluding South Africa	4.5	7.2	6.1	3.8	5.8	6.4	6.2
Oil exporters [e]	4.6	8.0	6.6	3.9	5.9	6.3	6.0
CFA countries [f]	4.4	4.6	4.2	1.7	4.1	4.7	4.5
South Africa	3.3	5.5	3.7	-1.8	2.7	3.5	4.1
Nigeria	4.6	6.4	6.0	5.6	7.6	7.1	6.2
Kenya	2.9	7.0	1.6	2.6	5.0	5.2	5.5

a. Growth rates over intervals are compound average; growth contributions, ratios and the GDP deflator are averages.
b. GDP measured in constant 2005 U.S. dollars.
c. GDP measured at PPP exchange rates.
d. Exports and imports of goods and non-factor services (GNFS).
e. Oil Exporters: Angola, Cote d Ivoire, Cameroon, Congo, Rep., Gabon, Nigeria, Sudan, Chad, Congo, Dem. Rep.
f. 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

and 4.1 percent in 2011 and 2012 respectively. With R811bn (rands) targeted to improve infrastructure over the next three years, public investment is likely to provide support to the economy, including employment. However, higher growth levels would likely be needed to significantly reduce the high levels of unemployment (25.3 percent).

Nigeria is expected to continue its strong growth performance in 2011, with GDP expanding 7.1 percent before moderating in 2012 to 6.2 percent closer to its medium term trend growth rate. The non-oil sector should be a major driver of growth, benefitting from new offshore developments and an improved security situation in the Niger Delta area. The scaling-up of government spending on infrastructure will also reinforce growth prospects. However, the upcoming elections may however lead investors to hold-off investments until a peaceful transition is in place.

Notwithstanding efforts to diversify the economy from the oil sector, growth prospects over the forecast horizon in **Angola** will continue to be tied to developments in the oil sector. With oil prices projected to be broadly stable over the forecast horizon, the fiscal policy should cease to be a drag on growth. As a result, GDP is expected to expand by 6.7 and 7.5 percent in 2011 and 2012, respectively – potentially resulting in increased inflationary pressures.

Supported by increasing intra-regional trade and productivity benefits of ongoing infrastructure investments, **Kenya's** outlook remains favorable, with growth projected above trend at 5.2 and 5.5 percent in 2011 and 2012. However, droughts could hinder growth in the agriculture sector and private investment spending may also slow in the run-up to the 2012 election.

As oil production begins, **Ghana** is projected to be the fastest growing economy in sub-Sahara Africa, with a growth rate of 13.4 percent in 2011 and 10 percent in 2012. A recent revision to Ghanaian GDP data has raised estimates of its income 60 percent, suggesting that it is now a lower-middle-income country. Outside the oil sector Ghana's economy will still register strong growth, particularly in construction services as large infrastructure projects are carried out. The inflows from the oil sector, if not managed prudently, could discourage the incentive structure for agricultural exports.

Risks to the outlook

The main downside risk to the growth prospects of Sub-Saharan African countries stems from a possible faltering in the global economic recovery. Most countries have depleted the fiscal space they had created during the pre-crisis period, and have not had time to rebuild it. As a result, few would be able to conduct the kind of counter-cyclical policies that helped limit disruption during the past crisis should there be an early faltering of the recovery process.

The fiscal austerity measures in the EU, many of which will be carried out during the forecast horizon could dampen growth prospects in the region, especially so as Europe remains the largest trading partner for several Sub-Saharan Africa countries. Further, though contagion from the EU debt crisis to Sub Saharan Africa has been limited thus far, a further round or intensification of European banking-sector consolidation could both reduce the supply and raise the cost of international capital for Sub Saharan African borrowers. This is all the more important since a record number of Sub-Saharan sovereigns are planning to issue international bonds over the forecast horizon. Among Asian countries, developments in China will be important for sub Saharan Africa, given the burgeoning trade and investment links between the two regions. A significant slowdown in China could reduce growth propects in sub Saharan Africa, particularly for metal, mineral and oil exporters.

With the agriculture sector being the largest employer in the region and contributing a large share of GDP in many countries in the region, unfavorable weather conditions, such as wide spread droughts, could threaten growth prospects by reducing output as well as dampening domestic demand, as food prices rise. A related risk is a spike in the prices of agricultural food products on international markets. Though many staples in the region are non-traded and their markets are mainly domestic in nature, some key commodities such as rice, flour, sugar and vegetable oil are imported in large quantities. As a result, a significant rise in the local currency cost of these internationally traded commodities could have a significant effect on the incidence of poverty and on growth prospects. Similarly, for oil importing countries, a spike in oil prices could lead to macroeconomic instability with its deleterious consequences on economic growth.

Over the forecast horizon, elections are scheduled to be carried out in at least a third of Sub-Saharan African countries. Though the past decade has seen an increase in the smooth transition of power in many countries in the region, there still remain a number of instances where the political developments leading to the elections and in its aftermath have been a deterrent to economic activity. In 2010 for instance, growth prospects in Madagascar, Comoros, Cote d'Ivoire and Guinea were severely dented by political unrest. Hence the evolution of the political cycle over the forecast horizon will be consequential to individual country growth outcomes.

The appreciation pressures associated with the rising inflows of hot money in emerging economies is unlikely to be a direct growth risk to many Sub-Saharan African countries. However, South Africa has and is likely to continue to be affected by the appreciation of the rand. Its manufacturing sector, which accounts for 16.4 percent of the economy, has become increasingly less competitive because of rand appreciation. Rand appreciation has indirect effects for other countries in the region, particularly in the Southern Africa region. For countries whose local currencies are not pegged to the rand (e.g. Mozambique), the strengthening of the rand implies a depreciation in their local currencies against the rand, better export prospects and higher imported inflation. The opposite effect however occurs for countries in the sub-region whose currencies are effectively pegged to the rand (e.g. Lesotho). Like South Africa, rand appreciation implies reduced international competitiveness, reduced inflationary pressures and potentially increased joblessness. Outside Southern Africa, fluctuations in euro could affect external competitiveness in the CFA member states.

Table R6.4 Sub-Saharan Africa country forecasts
(annual percent change unless indicated otherwise)

	95-06 [a]	2007	2008	2009	Est. 2010	Forecast 2011	Forecast 2012
Angola							
GDP at market prices (2005 US$) [b]	8.3	20.3	13.3	0.7	3.0	6.7	7.5
Current account bal/GDP (%)	-2.2	17.9	8.5	-10.0	-5.1	-4.0	-3.3
Benin							
GDP at market prices (2005 US$) [b]	4.6	4.6	5.1	3.8	2.8	4.9	4.2
Current account bal/GDP (%)	-7.2	-11.8	-9.0	-9.5	-9.1	-8.6	-8.5
Botswana							
GDP at market prices (2005 US$) [b]	6.3	4.8	3.1	-3.7	7.8	6.5	5.9
Current account bal/GDP (%)	8.3	14.5	3.5	-4.4	-2.1	-1.5	0.9
Burkina Faso							
GDP at market prices (2005 US$) [b]	6.4	3.6	5.0	3.5	5.0	5.7	5.2
Current account bal/GDP (%)	-12.8	-20.1	-24.4	-19.4	-23.1	-23.7	-24.0
Burundi							
GDP at market prices (2005 US$) [b]	0.4	3.6	4.5	3.5	3.7	4.1	4.6
Current account bal/GDP (%)	-13.7	-27.4	-30.2	-12.3	-9.6	-10.0	-8.9
Cape Verde							
GDP at market prices (2005 US$) [b]	5.7	8.6	6.5	2.8	4.3	5.8	6.6
Current account bal/GDP (%)	-10.1	-14.9	-8.6	-9.6	-6.7	-5.4	-12.1
Cameroon							
GDP at market prices (2005 US$) [b]	4.2	3.5	2.9	2.0	3.0	3.8	4.3
Current account bal/GDP (%)	-3.2	1.4	-1.9	-5.1	-2.7	-2.6	-2.6
Central African Republic							
GDP at market prices (2005 US$) [b]	0.7	3.7	2.2	2.4	3.0	3.3	3.3
Current account bal/GDP (%)	-4.4	-6.7	-9.5	-7.9	-8.1	-7.4	-6.7
Chad							
GDP at market prices (2005 US$) [b]	9.5	0.2	-0.4	-1.6	3.7	4.0	4.0
Current account bal/GDP (%)	-36.6	-14.7	-19.8	-28.7	-26.0	-23.0	-20.8
Comoros							
GDP at market prices (2005 US$) [b]	2.1	0.5	1.0	12.3	2.1	2.3	2.3
Current account bal/GDP (%)	-6.3	-2.5	-15.2	-9.3	-10.5	-11.0	-10.9
Congo, Dem. Rep.							
GDP at market prices (2005 US$) [b]	0.0	6.3	6.2	2.7	5.2	6.9	6.9
Current account bal/GDP (%)	-1.5	-2.7	-13.8	-13.7	-17.2	-18.5	-18.6
Congo, Rep.							
GDP at market prices (2005 US$) [b]	3.2	-1.6	5.6	7.6	10.3	10.4	5.4
Current account bal/GDP (%)	-2.3	-26.1	-2.2	-11.1	-1.2	3.5	-0.4
Cote d Ivoire							
GDP at market prices (2005 US$) [b]	1.6	1.7	2.2	3.6	3.0	4.1	4.3
Current account bal/GDP (%)	-0.2	-0.7	1.2	7.1	4.1	0.8	-1.1
Equatorial Guinea							
GDP at market prices (2000 USD) [2]	30.6	21.4	11.3	-5.4	3.0	2.8	4.0
Current account bal/GDP (%)	-16.7	4.7	10.1	-20.0	-6.2	-10.0	-8.0
Eritrea							
GDP at market prices (2005 US$) [b]	1.7	1.3	-11.3	4.2	2.7	3.4	3.5
Current account bal/GDP (%)	-14.1	-6.4	-5.2	-6.5	-7.1	-6.7	-6.5
Ethiopia							
GDP at market prices (2005 US$) [b]	5.5	11.5	10.8	8.7	9.0	9.0	8.1
Current account bal/GDP (%)	-3.3	-4.3	-7.0	-7.7	-8.5	-9.4	-11.5
Gabon							
GDP at market prices (2005 US$) [b]	1.0	5.6	2.3	-1.0	5.1	4.1	4.1
Current account bal/GDP (%)	10.6	12.2	22.2	13.3	12.7	10.6	12.0

Table R6.4 continuation

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Gambia, The							
GDP at market prices (2005 US$) [b]	4.4	6.3	6.1	4.6	5.0	5.1	5.4
Current account bal/GDP (%)	-8.2	-10.6	-6.1	4.0	5.2	6.1	6.1
Ghana							
GDP at market prices (2005 US$) [b]	4.7	6.5	8.4	4.7	6.6	13.4	10.0
Current account bal/GDP (%)	-5.7	-8.6	-12.2	-3.3	-3.6	-3.1	-2.9
Guinea							
GDP at market prices (2005 US$) [b]	3.9	1.8	4.9	-0.3	2.6	3.6	3.6
Current account bal/GDP (%)	-5.1	-9.3	-31.9	-10.4	-7.3	-8.5	-9.6
Guinea-Bissau							
GDP at market prices (2005 US$) [b]	-0.3	0.3	3.5	3.0	2.3	3.9	3.8
Current account bal/GDP (%)	-8.3	-9.5	-10.1	-8.6	-9.4	-9.9	-11.1
Kenya							
GDP at market prices (2005 US$) [b]	2.9	7.0	1.6	2.6	5.0	5.2	5.5
Current account bal/GDP (%)	-7.5	-3.8	-6.6	-5.7	-5.7	-4.5	-4.3
Lesotho							
GDP at market prices (2005 US$) [b]	3.2	2.4	4.5	2.5	3.3	3.5	3.8
Current account bal/GDP (%)	-23.4	13.9	12.6	-2.0	-25.5	-25.5	-23.8
Madagascar							
GDP at market prices (2005 US$) [b]	3.1	6.2	7.3	0.4	0.6	2.6	3.9
Current account bal/GDP (%)	-8.6	-14.4	-18.4	-21.9	-16.7	-15.8	-14.6
Malawi							
GDP at market prices (2005 US$) [b]	2.4	8.6	9.7	7.7	6.8	7.0	7.2
Current account bal/GDP (%)	-5.7	-1.7	-6.8	-7.1	-5.4	-6.4	-6.4
Mali							
GDP at market prices (2005 US$) [b]	5.8	4.3	4.9	4.3	5.0	5.8	5.9
Current account bal/GDP (%)	-8.7	-8.1	-12.1	-14.1	-9.0	-8.7	-9.2
Mauritania							
GDP at market prices (2005 US$) [b]	3.3	1.9	3.7	-1.1	4.9	5.4	5.4
Current account bal/GDP (%)	-3.2	-9.7	-12.8	-13.1	-11.2	-12.2	-12.8
Mauritius							
GDP at market prices (2005 US$) [b]	4.4	5.5	5.1	3.1	4.2	4.3	4.4
Current account bal/GDP (%)	0.1	-5.8	-10.5	-7.8	-9.4	-8.8	-8.4
Mozambique							
GDP at market prices (2005 US$) [b]	8.0	7.3	6.7	6.3	7.8	7.6	7.7
Current account bal/GDP (%)	-15.1	-9.8	-12.0	-12.0	-11.6	-10.5	-9.6
Namibia							
GDP at market prices (2005 US$) [b]	4.2	5.4	4.3	-0.8	4.2	4.2	4.8
Current account bal/GDP (%)	2.8	7.9	0.5	-1.7	-1.6	4.1	4.1
Niger							
GDP at market prices (2005 US$) [b]	3.5	3.3	9.5	1.0	3.6	6.0	6.8
Current account bal/GDP (%)	-7.1	-8.3	-12.1	-21.2	-20.3	-20.7	-20.1
Nigeria							
GDP at market prices (2005 US$) [b]	4.6	6.4	6.0	5.6	7.6	7.1	6.2
Current account bal/GDP (%)	6.4	16.7	13.8	12.5	10.7	9.2	8.2
Rwanda							
GDP at market prices (2005 US$) [b]	8.3	7.9	11.2	4.1	6.5	6.5	7.0
Current account bal/GDP (%)	-4.7	-4.3	-4.9	-8.5	-6.7	-9.0	-6.4
Senegal							
GDP at market prices (2005 US$) [b]	4.4	4.9	3.3	2.2	4.0	4.2	4.4
Current account bal/GDP (%)	-5.7	-11.6	-13.7	-13.6	-14.3	-14.2	-15.3

Table R6.4 continuation

					Est.	Forecast	
	95-06 [a]	2007	2008	2009	2010	2011	2012
Seychelles							
GDP at market prices (2005 US$) [b]	2.8	9.7	-0.9	-7.6	6.2	4.0	5.0
Current account bal/GDP (%)	-13.4	-26.8	-44.0	-37.2	-45.3	-26.5	-19.1
Sierra Leone							
GDP at market prices (2005 US$) [b]	4.6	6.4	5.5	4.0	4.7	5.2	5.9
Current account bal/GDP (%)	-12.3	-13.0	-15.3	-14.9	-11.6	-11.1	-10.5
South Africa							
GDP at market prices (2005 US$) [b]	3.3	5.5	3.7	-1.8	2.7	3.5	4.1
Current account bal/GDP (%)	-1.2	-7.2	-7.1	-4.1	-4.1	-4.8	-5.2
Sudan							
GDP at market prices (2005 US$) [b]	6.2	10.2	6.8	4.5	5.9	5.3	5.8
Current account bal/GDP (%)	-6.3	-7.4	-2.3	-7.1	-1.9	-1.4	-2.1
Swaziland							
GDP at market prices (2005 US$) [b]	3.5	3.5	2.4	1.2	1.9	2.8	2.0
Current account bal/GDP (%)	-0.8	-2.2	-8.1	-13.8	-12.4	-12.5	-13.0
Tanzania							
GDP at market prices (2005 US$) [b]	5.4	7.1	7.4	6.0	7.0	7.2	6.9
Current account bal/GDP (%)	-6.4	-10.8	-13.0	-8.4	-8.3	-9.3	-9.7
Togo							
GDP at market prices (2005 US$) [b]	3.2	1.9	1.8	2.5	3.3	3.5	3.4
Current account bal/GDP (%)	-9.6	-8.6	-7.4	-8.1	-8.5	-7.0	-7.1
Uganda							
GDP at market prices (2005 US$) [b]	7.0	8.4	8.7	7.1	6.3	6.5	8.6
Current account bal/GDP (%)	-5.3	-4.0	-5.5	-2.8	-3.6	-3.8	-1.3
Zambia							
GDP at market prices (2005 US$) [b]	3.8	6.2	5.7	6.3	6.4	6.5	6.7
Current account bal/GDP (%)	-12.9	-8.4	-9.2	-5.5	-4.5	-6.0	-6.7
Zimbabwe							
GDP at market prices (2005 US$) [b]	-2.2	-6.9	-14.1	4.0	5.7	5.7	6.0
Current account bal/GDP (%)	-11.5	-0.5	-1.5	-1.8	-1.3	-1.1	-0.9

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.

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

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

b. GDP measured in constant 2005 U.S. dollars.

Source: World Bank